PROFESSIONAL PROGRAMME

GROUP 1
PAPER 3

COMPLIANCE MANAGEMENT, AUDIT & DUE DILIGENCE

PART I – COMPLIANCE MANAGEMENT

PART II – AUDIT & DUE DILIGENCE

THE INSTITUTE OF
Company Secretaries of India
भारतीय कम्पनी सचिव संस्थान
IN PURSUIT OF PROFESSIONAL EXCELLENCE
Statutory body under an Act of Parliament
(Under the jurisdiction of Ministry of Corporate Affairs)

STUDY MATERIAL

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Timing of Headquarters :

Monday to Friday
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Public Dealing Timings :

Without financial transactions – 9.30 A.M. to 5.00 P.M.
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Laser Typesetting by :

Druck Media Private Limited, Greater Noida, Uttar Pradesh

PROFESSIONAL PROGRAMME

COMPLIANCE MANAGEMENT, AUDIT & DUE DILIGENCE

Compliance management is the method by which corporate manage the entire compliance process with the help of check list of compliance calendar. It includes compliance program, compliance audit, compliance report etc. In other words it is called compliance solution. Secretarial Audit and Compliance Management are the routine tools for effective governance. Compliance Management is into a corporate system to avoid non-compliances and the Secretarial Audit is carried out on periodical basis by an independent professional.

Secretarial Audit is a process to check compliance under the provisions of various laws and rules/ regulations/ procedures applicable to organization. It is conducted by an independent professional to ensure that the company has complied with the appealable legal and procedural requirements and has also followed the due process. It is essentially a mechanism to monitor compliance with the requirements of stated laws.

Due diligence is a pre-emptive tool to assess a business transaction. Due diligence is an investigative process for providing the desired comfort level about the potential investment and to minimize the risks such as hidden uncovered liabilities, poor growth prospects, price claimed for proposed investment being on higher side etc., In general, due diligence process is based on transaction.

This study material is published to aid the students in preparing for the paper on Compliance Management, Audit & Due Diligence of Professional Programme. It is part of the educational kit and guide the students step by step through each phase of preparation while emphasizing on key concepts, principles, comprehending, integrating and advising to resolve complex issues case studies and decision making.

Company Secretaryship being a professional course, requires the examination standards to be set very high, with emphasis as expert of concepts, applications, procedures and case laws, for which sole reliance on the contents of the study material may not be enough. Besides Company Secretaries Regulations, 1982 it requires the students to be conversant with the amendments in the laws made upto six months preceding the date of examination. This study material may therefore be regarded as basic material and must be read along with the respective amendments in the Act, Rules, Regulations, Order, Circulars, Clarification notified by the Central Government or issued by the respective Regulators.

The coverage of subject is "Hybrid" in nature which requires integrated application of several Core / Ancillary areas or references of the other subjects included in the ICSI Syllabus. This study material has covered such topics to a limited context. The students are advised to refer the relevant topics from the Bare Acts, Rules &regulations and study material of the respective subjects or from the publications such as ICSI Auditing Standards, guidance note on Secretarial Audit, Annual Secretarial Compliance Audit, Peer Review, Quality review etc., referencer published by the ICSI.

The Study Material is divided in two parts covers in the details the concepts of Compliance Management in Part I and Audit & Due Diligence in detail under Part II.

The legislative changes made upto May 31, 2024 have been incorporated in the study material. In addition to study material students are advised to refer to the updations at the Regulator's website, supplements relevant for the subject issued by ICSI and ICSI Journal Chartered Secretary and Other publications. Specifically, students are advised to read "Student Company Secretary" e-Journal which covers regulatory and other relevant developments relating to the subject, which is available at academic portal *https://www.icsi.edu/student-n/academic-portal*. In the event of any doubt, students may contact the Directorate of Academics at **academics@icsi.edu**.

The amendments to law made upto 31st May of the Calendar Year for December Examinations and upto 30th November of the previous Calendar Year for June Examinations shall be applicable.

Although due care has been taken in publishing this study material, the possibility of errors, missions and / ordiscrepancies cannot be rules out. This publication is released with an understanding that the Institute shall not be responsible for any errors, omissions and/or discrepancies or any action taken in that behalf.

PROFESSIONAL PROGRAMME

Group 1

Paper 3

COMPLIANCE MANAGEMENT, AUDIT & DUE DILIGENCE

SYLLABUS

OBJECTIVES

Part I : To develop expertise to monitor compliance with the requirements of laws.

Part II : To equip with the process involved in conducting Audits and to impart knowledge on the process for conducting Due Diligence of various business transactions.

Level of Knowledge: Expert Knowledge

Detailed Contents

PART I : COMPLIANCE MANAGEMENT (40 MARKS)

1. **Compliance Framework**: ● Identification of applicable laws, rules, regulations ● Risk Assessment ● Responsibility center mapping/ allocation ● Escalation & reporting ● Creation of Compliance framework and reporting system ● Review & Updation ● Training &Implementation ● Need/benefit/ scope of Compliance Management ● Directors' Responsibility Statement ● Compliances under Companies Act ● Compliance Management Tool ● Importance of Compliance Management Tool ● Difference types of Compliance Management Tools ● Case Laws and Case Studies
2. **Documentation & Maintenance of Records:** ● General principles of good documentation, coding, storage, preservation, safety & retrieval Privacy & Control ● Case Laws and Case Studies
3. **Signing and Certification:** ● Various Certification(s) by Company Secretary in Practice ● Pre-certification of Forms Signing & Certification of Annual Return ● Corporate Governance Certification ● Signing of Financial Statement ● Obligations and Penal provisions ● Case Laws and Case Studies
4. **Legal Framework Governing Company Secretaries:** ● Power and functions of Company Secretary ● The Company Secretaries Act, 1980 along with Rules and Regulations ● Disciplinary Mechanism and Penalties for Professional Misconduct Professional Liabilities
5. **Values, Ethics and Professional Conduct:** ● Ethical Practices ● ICSI Code of Conduct ● Fundamental duties of Professional ● Ethical Dilemma ● Recent Disciplinary case studies on Values, Ethics and Professional conduct
6. **Non-Compliances, Penalties and Adjudications:** ● Non-Compliances under Companies Act, 2013 ● Penalties and Adjudications ● Prosecution procedures ● Compliant by Registrar and Serious Fraud Investigation Office ● Tribunals Case Laws and Case Studies

7. **Relief and Remedies:** ● What is Compounding ● Which Offences can be Compounded ● Which Offences cannot be Compounded ● When Compounding can be done ● Who are the Compounding Authorities/ who can Compound the Offence? ● Mediation and Conciliation ● Case Laws and Case Studies

PART II: AUDIT & DUE DILIGENCE (60 MARKS)

8. **Concepts of Various Audits:** ● Corporate Governance Audit ● Secretarial Audit ● Internal Audit ● CSR Audit ● Takeover Audit ● Insider Trading Audit ● Industrial and Labour Laws Audit ● Cyber Audit ● Environment Audit ● Systems Audit ● Forensic Audit ● Social Audit

9. **Audit Engagement:** ● Auditing Standard on Audit Engagement (CSAS-1) ● Audit Engagement Process ● Audit Fee Limit on Audit Engagements ● Conflict of interest ● Confidentiality ● Changes in terms of Engagement ● Case Laws and Case Studies

10. **Audit Principles and Techniques:** ● Audit Techniques, Examination and its Process ● Enquiry ● Confirmation ● Sampling Compliance test of Internal Control System ● Substantive Checking ● Verification of documents/ records ● Creation of Audit Trails ● Analysis of Audit findings ● Case Laws and Case Studies

11. **Audit Process and Documentation :** ● Auditing Standard on Audit Process and Documentation (CSAS-2) ● Audit Planning ● Risk Assessment ● Information about the Auditee ● Audit Check-lists ● Collection and Verification of Audit Evidence ● Third Party Confirmation ● Analysis of Audit Evidence ● Documentation Record Keeping and Retention ● Case Laws and Case Studies

12. **Forming an Opinion & Reporting:** ● Auditing Standard on Forming of Opinion (CSAS-3) ● Process of Forming of Opinion ● Precedence and Practice ● Third Party Report or Opinion ● Form of an Opinion ● Limitation ● Auditor's Responsibility ● Management Representation Letter ● Discussion with Management Format of Report ● Audit Report and drafting of qualification ● Sharing of draft report with Management ● Signing of Audit Report and Submission ● Case Laws and Case Studies

13. **Secretarial Audit:** ● Auditing Standard on Secretarial Audit (CSAS-4) ● Concept & Advantages ● Legal Provisions ● Risk of Secretarial Auditor ● Code of Conduct ● Scope of Secretarial Audit ● Identification and Segregation of applicable Laws ● Verification of corporate conduct and compliance of Laws ● Board Composition ● Board Processes ● System and Process ● Detection of Fraud Reporting of Fraud ● Identification and Reporting of the events/actions having major bearing on Auditee's affairs ● Impact of Audit Report ● Case Laws and Case Studies

14. **Internal Audit & Performance Audit:** ● Objective & Scope ● Internal Audit Techniques ● Appraisal of Management Decisions ● Performance Assessment ● Internal Control Mechanism ● Case Laws and Case Studies

15. **Peer Review and Quality Review:** ● Peer Review ● Monitoring of Certification and Audit Work by Quality Review Board ● Case Laws and Case Studies

16. **Due Diligence:** ● Overview and Introduction to Due Diligence ● Scope of Due Deligence ● Stages and Process of Due Diligence ● Techniques of Due Diligence and Risk Assessment ● Types of Due Diligence : Legal Due Diligence; Financial Due Diligence; Bank Due Diligence ● Case Laws and Case Studies

ARRANGEMENT OF STUDY LESSONS

COMPLIANCE MANAGEMENT, AUDIT & DUE DILIGENCE

GROUP 1 • PAPER 3

PART I: COMPLIANCE MANAGEMENT (40 MARKS)

PART II: AUDIT & DUE DILIGENCE (60 MARKS)

LESSON WISE SUMMARY

COMPLIANCE MANAGEMENT, AUDIT & DUE DILIGENCE

PART I : COMPLIANCE MANAGEMENT

Lesson 1 - Compliance Framework

A compliance management system manages the entire compliance process of the company. It includes the compliance program, compliance audit, compliance reporting etc. The compliance program consists of the policies and procedures which guide in adherence of the applicable laws and regulations on the company. Further, the compliance audit is an independent testing of level of compliance with applicable laws and regulations on an Organisation.

The core function of the company secretary is to formation of the compliance framework in association with the other functional heads of the company. The lesson covers process of formation of the compliance frame work and point to be considered while dealing with the corporate compliances.

Lesson 2 - Documentation & Maintenance of Records

The good documentation promotes good corporate governance practices and improves the compliance level of the company. Also the documentation provides a detailed knowledge of the historical records of the company. The effective documentation provides easy access to the required information on time for the effective and timely utilization of the information. The primary responsibly of a company secretary to prepare and maintain the secretarial and other records, which are required to be kept by the company under the various regulatory requirements.

The lesson covers the various method of documents and the principles to be followed by the professional while preparation of records as well as at the time of preserving the records in the record room.

Lesson 3 - Signing and Certification

Pre-certification means certification of correctness of any document by a professional including Company Secretary in Practice before the same is filed with the respective authority or with the Registrar in terms of the requirements of the Companies Act, 2013 and certification under SEBI Laws. The signing professional should check the correctness of the particulars stated in form or supporting documents after due consideration of the provisions of the Act and the rules made thereunder. The professional should also ensure that the particulars stated in the form/ disclosure/ certificates are in agreement with the books and records of the company. The lesson covers the prerequisite for the signing and certification by the professionals and the requirement for various forms, annual return, corporate governance certification.

Lesson 4 - Legal Framework Governing Company Secretaries

Professionals are expected to conduct themselves in such a manner so as to uphold the grace, dignity and professional standing of their respective Institutes. Any commitment to complete a particular assignment as agreed by the person himself should be completed in a professional manner.

The purpose of this Lesson is to explain to the students, expectation as a member with respect to various aspects of the ethical conduct. This lesson has been designed to assist in defining appropriate personal and professional conduct, to provide guidance in the identification and resolution of ethical issues, and to help the

students (the future members) of the Institute to maintain the culture of honesty, integrity, transparency and accountability.

Lesson 5 - Values, Ethics and Professional Conduct

India with its inherent spiritual strength, rich traditions and strong value systems- which drive from the core of family run businesses to large corporate houses become the role model for other countries in corporate governance. The company secretaries being practitioners of corporate governance should play a leading role in making India a global leader in their field.

Further, the company secretary is not only the conscience keeper of an enterprise, but he also has a larger social responsibility represent internal and external stakeholders of the company and to play a pivotal role in ensuring compliances and implementing principles of good governance.

Accordingly, every professional should inculcate highest standards of professional ethics and moral values and adherence to professional code of conduct in its true letter and spirit while working in the various capacities. The lesson covers the various ethical principles, issues, practical aspects and the recent case laws in the Indian corporate sectors.

Lesson 6 - Non-Compliances, Penalties and Adjudications

Corporate compliance involves adhering to various rules, regulations, laws, and standards which are designed to protect business, employees, and all others stake holders involved in the organization. The impact of the noncompliance of such rules and regulations on a business could be in the form of monetary fines, disqualification of directors, prohibition of doing business, regulatory enforcement, and court cases or even extended to the closure of the business entity.

In the recent years the instances of the non-compliances have been continuously increased and the business owners are getting impatient as these consequences would affect their eligibility and affect the business in many ways.

The lesson covers the various non-compliances under the Companies Act, 2013, SEBI Act, 1992 & RBI Act, etc. and the manner of adjudication and compounding of such offences.

Lesson 7 - Relief and Remedies

The NCLT consolidates the corporate jurisdiction of: i. Company Law Board, ii. Board of Industrial and Financial Reconstruction, iii. Appellate Authority for Industrial and Financial Reconstruction and iv. jurisdiction and powers relating to winding up, restructuring and other provisions as vested with the High Courts resulting the Reduction of the burden on courts and will help companies facing issues related to winding up, mismanagement and insolvency of businesses and to Eliminates the overlap the conflicting rulings and minimize the delays in the resolution of disputes.

The proceedings before the NCLT or NCLAT are deemed to be judicial proceedings within the meaning of sections 193 and 228, and for the purposes of section 196 of the Indian Penal Code, and the Tribunal and the Appellate Tribunal shall be deemed to be civil court for the purposes of section 195 and Chapter XXVI of the Code of Criminal Procedure, 1973. The lesson cover the various aspects under Code of Criminal Procedures relevant for dealing with the various judicial authorities.

PART II: AUDIT & DUE DILIGENCE

Lesson 8 - Concepts of Various Audits

Audit is an independent and systematic examination of statutory records, books of accounts, documents and vouchers of an organization. This mainly performed or conducted to ascertain how far the financial statements as well as non-financial disclosures present a true and fair view of the affairs of the company. Audit provides a significant assurance to the management and other stakeholders on the affairs of the company. The Auditor

while conducting audit obtains evidence and formulates an opinion on the basis of his judgement which is communicated through his audit report.

As an independent professional, auditor provide third party assurance on every subject matter for which he has been engaged. The lesson covers the areas which are commonly audited by the company secretaries such as Corporate Governance Audit, CSR Audit, Takeover Audit, Insider Trading Audit, Industrial and Labour Laws Audit, Cyber Audit, Environment Audit, Systems Audit, Forensic Audit, Social Audit etc.

Lesson 9 - Audit Engagement

The Companies Act, 2013 provides that the statutory auditors of the company shall be appointed by the members of the company, through a resolution passed at the annual general meeting. However In case of other audit the auditors are appointed by the board of the company or by the person authorized by the board of the company, by the tribunal/ courts, company liquidators etc.

In any auditing assignment, the engagement letter is the governing documents for whole audit process, as it covers the scope of audit, terms & conditions of audit, responsibility of auditor and the management etc.

The lesson covers the various requirements of laws and the points to be considered while taking up the audit engagement by any professional.

Lesson 10 - Audit Principles and Techniques

The Auditing principles are the generally accepted rules, which are commonly applicable for the every type of Audit, whereas the audit techniques stand for the methods that are adopted by an auditor to obtain audit evidence and performance of the audit as per the scope of the audit. An auditor can apply various techniques of auditing which may be applied by the auditor under different circumstances of audit.

The purpose of an audit is to enhance the degree of confidence in the secretarial records/non-financial statements, of intended users. An auditor expresses his opinion as to whether the significant reporting aspects of an enterprise are duly covered within the prescribed framework. The auditor is required to conduct the audit and express his opinion based on these principles and techniques for conducting audit.

The lesson covers the various auditing principles and techniques which are useful for undertaking the audit.

Lesson 11 - Audit Process and Documentation

The auditing process is a way to ensure that the affairs of the company were in accordance with the applicable laws, rules, regulations and principles and that they are free of material misstatement. The audit process include the phase like Pre-Planning, Planning, Fieldwork, Reporting, Corrective Action etc.

The audit documentation is the written record of the basis for the auditor's conclusions. The audit documentation also facilitates the planning, performance, and supervision of the engagement, and is the basis for the review of the quality of the work because it provides the reviewer with written documentation of the evidence supporting the auditor's significant conclusions. Among other things, audit documentation includes records of the planning and performance of the work, the procedures performed, evidence obtained, and conclusions reached by the auditor. Audit documentation also may be referred to as work papers or working papers.

The lesson covers designing the auditing program, procedures and documentation procedures relating to the performance of the audit.

Lesson 12 - Forming an Opinion & Reporting

On the completion of each audit assignment, the auditor need to prepare a written report setting out the audit observations and conclusions in an appropriate form; the content of the audit report should be easy to understand, free from ambiguity and supported by sufficient, competent and relevant audit evidence and be independent, objective, fair, complete, accurate, constructive and concise.

The content of the opinion will need to indicate unambiguously whether it is unqualified or qualified and, if the same is qualified, whether it is qualified in certain respects or is adverse or a disclaimer of opinion.

The lesson covers process of forming opinion and the process to the followed by the auditor before submitting the final reports to the management.

Lesson 13 - Secretarial Audit

Secretarial Audit is a mechanism which gives necessary comfort to the management, regulators and the stakeholders, as to the compliance by the company of applicable laws and the existence of proper and adequate systems and processes in the company. Submission of Secretarial Audit Reports for the prescribed companies was mandated from financial year 2014-15 under section 204 of the Companies Act, 2013.

Further, Regulation 24A of the SEBI (LODR) Regulations, 2015, every listed entity and its material unlisted subsidiaries incorporated in India is required to undertake secretarial audit and shall annex with its annual report, a secretarial audit report, given by a company secretary in practice, in From No. MR-3 from the year ended March 31, 2019.

The secretarial auditors should detect the instances of non-compliances and in result facilitate taking corrective-measures. The professional should perform an effective due diligence exercise before the issuance of Secretarial Audit Report.

The lesson covers the various requirements under the scope of secretarial audit and process to be followed by the company secretaries while conducting secretarial audit.

Lesson 14 - Internal Audit & Performance Audit

The internal audit is an Independent review and appraisal of financial and operational control systems across the organization. The internal audit also includes the ascertainment of the extent of compliance of policies, procedures, regulations and legislations and facilitate in risk management.

The internal auditor is also involved in structuring programs and activities that safeguard company assets, it also provide internal check systems which minimize the possibility of fraud / early warning signals for identifying fraud.

The provisions of Companies Act, 2013 provides that an internal auditor appointed under section 138 shall either be a chartered accountant or a cost accountant, or such other professional (including company secretaries) as may be decided by the board to conduct internal audit of the functions and activities of the company. The lesson cover the objective& scope of internal audit, manner of engagement, internal audit techniques and the process for reviewing the internal control mechanism in the company.

Lesson 15 - Peer Review and Quality Review

The Professional Codes of Conduct are one of the most important characteristics of a profession. Such Codes of Conduct illustrate the high ethical and professional standards to reassure stakeholders of two conditions, namely, that any particular set of professional services is being rendered not only by (i) properly qualified or technically expert persons but also (ii) by persons whose professional standards merit the high degrees of trustworthiness, typically required of professionals.

The Peer Review mechanisms used in working groups for many professional occupations only to strengthen systems and infrastructure to enhance the quality of professional services. Whereas the Quality Review Board (QRB) has been set up to review and enhance the quality of the services rendered by the members of the ICSI. The Board aims to standardize the practices followed by the Company Secretaries and enhance the quality of the services rendered by the members of ICSI on continuous basis.

The lesson covers the various aspects relating to the peer review of the company secretaries in practice and the highlights relating to the Quality of Audit & Attestation Services by the company secretaries.

Lesson 16 - Due Diligence

Due diligence is an analysis and risk assessment of an impending business transaction. It is the careful and methodological investigation of a business or persons, or the performance of an act with a certain standard of care to ensure that information is accurate, and to uncover information that may affect the outcome of the transaction.

For any strategic business transactions the detailed analysis of both financial and non-financial information requires careful and methodological investigation of business processes and the parties involved. Due diligence of business transaction includes methodical investigation of information relating to the financial, human resources, tax, environmental, legal matters, intellectual property matters etc. The lesson covers the various types of the due diligence, due diligence process and the points need to be considered while performing due diligence.

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PART I

COMPLIANCE MANAGEMENT

Compliance Framework

Lesson 1

KEY CONCEPTS

■ Compliance Management ■ Risk Assessment ■ Risk Mitigation ■ Risk Escalation ■ Compliance Ownership ■ Cyclical Reporting ■ Incident Reporting

Learning Objectives

To understand:

- The need of timely compliance and how it reduces risks as well as potential cost of non-compliance and also builds better corporate image.
- Compliance framework as a system designed to assist an organisation to meet its obligations and to reduce the risk of non- compliance.
- How a systematic compliance framework establishes better compliance platform by timely compliances with the provisions of various statutes including, laws, rules & regulations, procedures therein.
- The importance of the compliance framework in an organization.
- Systematic approach in identifying, responding, implementing, reporting of compliances and changes in it.

Lesson Outline

- Corporate Compliance Framework
- Preparation of Compliance Chart
- Contents of Compliance Chart
- Compliance Risk– Review and Updation
- Training and Implementation
- Need for Compliance Management
- Process of Corporate Compliance Reporting
- Compliance Management tools
- Lesson Round-Up
- Glossary
- Test Yourself
- List of Further Readings
- Other References (Including Websites / Video Links)

CORPORATE COMPLIANCE FRAMEWORK

Compliance with laws and regulations must be an integral part of any corporate strategy. It is the responsibility of the board of directors of the company to recognize scope and implications of applicable laws and regulations on the company. While framing and setting the corporate strategies for achieving their target goals and objectives, they must duly consider the compliance of applicable laws and regulations on the company. The board of directors of the company need to establish the compliance framework. It serves as a supporting system of risk management system as it reduces risk associated with non- compliance. However, to ensure an effective approach to compliance, the following steps are to be undertaken by the Board of Directors:

- The participation of senior management in the development and maintenance of a compliance program.
- Reviewing the effectiveness of compliance management system at periodic intervals.
- To ensure that it remains updated and relevant in terms of modifications/ changes in regulatory regime including acts, rules, regulations etc. and business environment.

Effective Corporate Compliance Framework enables the organization to achieve its objectives and goals with compliance of applicable laws and regulations, mitigating the risks associated with and making continuous improvements as required.

Compliance Framework is to be in built into the corporate system to avoid non-compliances and the secretarial audit is carried out on periodical basis by an independent professional to check the effectiveness of the controls within the organization and report that how the organization is complying with the statutory requirements. Company Secretaries plays a vital role and hold the responsibility for the compliance being the compliance officer and KMP of the entity.

Corporate compliance management involves a full process of research and analysis as well as investigation and evaluation. Such an exercise is undertaken in order to determine the potential issues and get a realistic view about how the entity is performing and how it is likely to perform in the future. Corporates which ensure compliance are rewarded with positive public image and customer trust. Company Secretaries with core competence in compliance and corporate governance play a crucial role in the corporate compliance management in an organisation.

Compliance Management -Maruti Suzuki Limited

To ensure compliance with increasing regulatory requirements and enforcement, the Company has established systems and controls to continually ensure zero non-compliance with the law. A compliance certificate is submitted to the Board on a quarterly basis. During the reporting period, over 3,500 applicable compliances were monitored through an electronic system and 78 compliance health checks were done covering all facilities. The tracking mechanism was enhanced to manage compliances more efficiently and productively. There was no significant non-compliance with applicable laws and regulations during the year. The Company observes an annual 'Compliance Month' reinforcing its commitment to doing business

with compliance and integrity. Over the years, the Company has continued to enhance its compliance programme - from meeting statutory obligations to now being determined to excel through compliance and leveraging it as a competitive advantage for the business. In FY 2020-21, Compliance Month was organised virtually on the theme 'Being Compliant in the New Normal'. The event comprised panel discussions, training programmes and external speaker series covering topics such as increased relevance of privacy and cyber security, changing face of enterprise risk, compliance, corporate governance and learnings from the pandemic. As a first, the Company's Board members participated in the event along with senior leadership and shared their valuable thoughts on managing enterprise risk and compliance, especially in the face of the unprecedented pandemic situation. These sessions benefitted over 4,000 attendees.

(Source: Annual Report 21-22)

Compliance Management – Hindustan Unilever Limited – Annual Report 2022-23

The Company is committed to complying with the laws and regulations of the country. In specialist areas, the relevant teams are responsible for setting detailed standards and ensuring that all employees are aware of and comply with regulations and laws specific and relevant to their roles. Our legal and regulatory teams are involved in monitoring and reviewing our regulatory practices to provide reasonable assurance that we remain aware of and are in line with all relevant laws and legal obligations. The teams also work with the Industry and Trade Associations in making recommendations on newer and evolving regulations keeping the multistakeholder model in mind.

The Company has Received the Certificate of Recognition at the 22nd ICSI National Awards for Excellence in Corporate Governance, for adopting and promoting exemplary corporate governance practices

(Source: https://www.hul.co.in/files/92ui5egz/production/6a9122377e0712e70bfb04f0336bf84f84b518ef.pdf)

Emerging concept of 21st century: The GRC

The Governance, Risk Management, and Compliance (GRC) is a relatively new corporate management system that integrates these three crucial functions into the processes of every department within an organization. The overall purpose of GRC is to reduce risks and costs as well as duplication of effort. It is a strategy that requires company-wide cooperation to achieve results that meet internal guidelines and processes established for each of the three key functions.

The three elements of GRC are:

Governance, or Corporate Governance, is the overall system of rules, practices, and standards that guide a business. Governance is the combination of processes established and executed by the directors (or the board of directors) that are reflected in the organization's structure and how it is managed and led toward achieving goals. Governance describes the overall management approach through which senior executives direct and control the entire organization, using a combination of management information and hierarchical management control structures. Governance activities ensure that critical management information reaching the executive team is sufficiently complete, accurate and timely to enable appropriate management decision making, and provide the control mechanisms to ensure that strategies, directions and instructions from management are carried out systematically and effectively.

Risk, or Enterprise Risk Management, is the process of identifying potential hazards to the business and acting to reduce or eliminate their financial impact.

Risk Management is predicting and managing risks that could hinder the organization from reliably achieving its objectives under uncertainty. Risk management is the set of processes through which management identifies, analyzes, and, where necessary, responds appropriately to risks that might adversely affect realization of the organization's business objectives. The response to risks typically depends on their

perceived gravity, and involves controlling, avoiding, accepting or transferring them to a third party, whereas organizations routinely manage a wide range of risks (e.g. technological risks, commercial/financial risks, information security risks etc.)

Compliance, or Corporate Compliance, is the set of processes and procedures that a company has in place in order to make certain that the company and its employees are conducting business in a legal and ethical manner.

Compliance refers to adhering with the mandated boundaries (laws and regulations) and voluntary boundaries (company's policies, procedures, etc.). Compliance means conforming to the stated requirements. At an organizational level, it is achieved through management processes which identify the applicable requirements (defined for example in laws, regulations, contracts, strategies and policies), assess the state of compliance, assess the risks and potential costs of non-compliance against the projected expenses to achieve compliance, and hence prioritize, fund and initiate any corrective actions deemed necessary.

CASE STUDIES

Tata Motors has implemented a comprehensive GRC program that covers all aspects of its operations, including legal compliance, risk management, and ethical practices. The company has established a risk management framework that enables it to identify and mitigate potential risks and ensure compliance with all applicable laws and regulations.

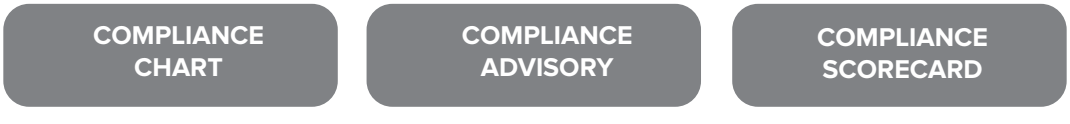
Mahindra & Mahindra has implemented a GRC framework that encompasses all aspects of its operations, including risk management, compliance, and ethical practices. The company has established a risk management committee that oversees the identification and mitigation of potential risks and ensures compliance with all applicable laws and regulations.

COMPONENTS OF CORPORATE COMPLIANCE FRAMEWORK

Organizations in every industry face a growing array of compliance obligations. In addition to anti-money laundering regulations, there are an increasing number of environmental, social and governance (ESG) requirements covering everything from board composition to data privacy. Furthermore, economic and trade sanctions pose a constantly shifting challenge given the global nature of supply chains, subsidiary holdings, and customer and banking relationships.

Fulfilling these compliance requirements requires a complex mechanism that includes policies and procedures, training, whistleblowing channels, internal audit, escalation, response and disclosure. Complicating matters further, the mechanism must comply with regulations that differ across jurisdictions, and that may even be at odds with one another.

The corporate compliance framework consists of three key components:



- **Compliance Chart:** The Chart provides an overview of the applicable local, state, central and international laws, regulations and standards relating to a business' operations. The compliance chart also outlines how compliance risk mitigation activities are embedded in business processes. In other words, how compliance with the laws, regulations and standards is embedded and ensured. The compliance chart help business in meeting its compliance obligations towards the customers,

regulators, shareholders and employees because it provides a centralize compliance information of the company on a single chart. The compliance chart also reflects the key activities and compliance calendar which is to be followed and performed by a business unit to manage its compliance risks.

- **Compliance Advisory:** It advices on compliances of applicable laws and effect of non-compliances. Compliance advisory helps organisation to evaluate their compliance finctions, prevent compliance breaches and respond quickly and effectively when a breach occured.
- **Compliance Scorecard:** It is a tool to analyse the position of an organisation in compliance.

A compliance scorecard must be set up by organizations. The scorecard is not to be used as a mere reporting but as a compliance management tool. It enables the reported compliance breaches' immediate remediation by informing a predefined responsible person in the case of a violation. Thus, this employee can directly start remediation activities. The tracking of the remediation activities' status is again included into the scorecard. An integrated escalation structure, predefined by organizational hierarchies ensures timely remediation. Also the possibility of classifying a rule breach according to its level of risk must be included into the scorecard. So a risk-prioritized remediation of violations can be ensured.

COMPLIANCE CHART

As discussed in above paragraphs, the corporate compliance framework consists of three key components Compliance Chart, Compliance Advisory and Compliance Scorecard. The Compliance Chart is a vital part of the Framework and every organization shall give more focus on the preparation of the compliance chart. The compliance chart of a company is prepared after considering the operations and the structure of the company as the compliance requirements for an organization is based on the type of organization, activity of the organization, industry, sector in which the company operates and laws which are specifically applicable to the company.

Broadly, the compliance chart is prepared by considering the following activities:

- Identification of compliances under applicable Laws, Rules and Regulations;
- Risk Assessment;
- Risk Mitigation (includes Training);
- Compliance Monitoring (includes Action Tracking);
- Compliance Reporting (includes Incident Management).

Test Yourself:

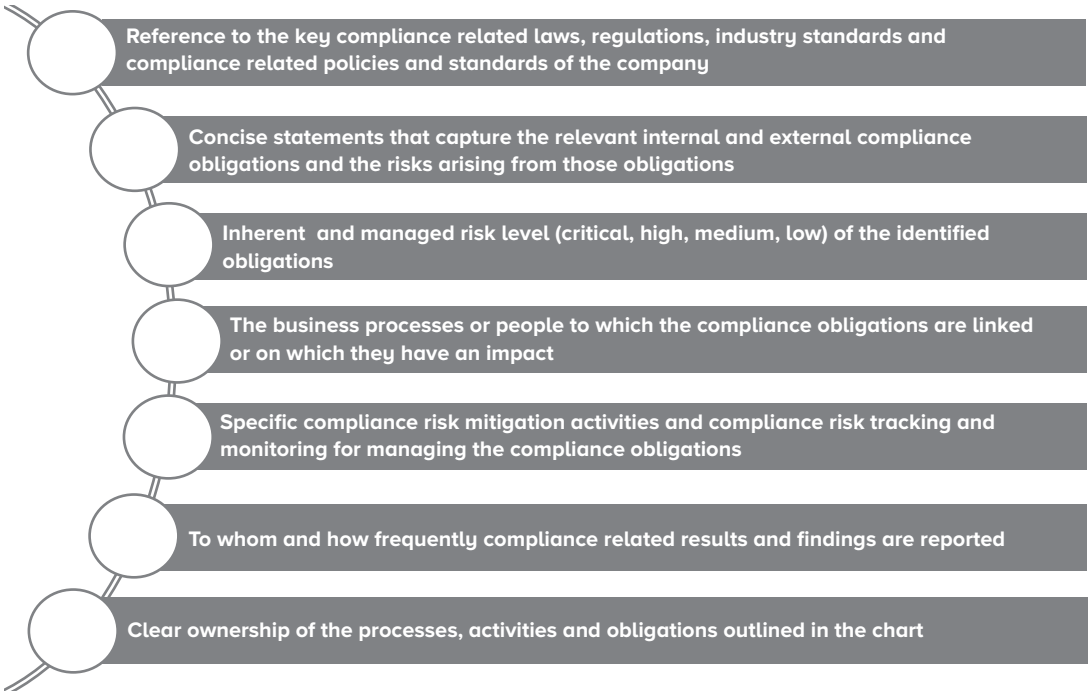
Question : Which of the following activity is not required to be considered while preparing compliance chart?

Options: (A) Risk Assessment (B) Risk Mitigation (C) Compliances reported in previous years (D) Compliance monitoring

Answer: (C)

CONTENTS OF COMPLIANCE CHART

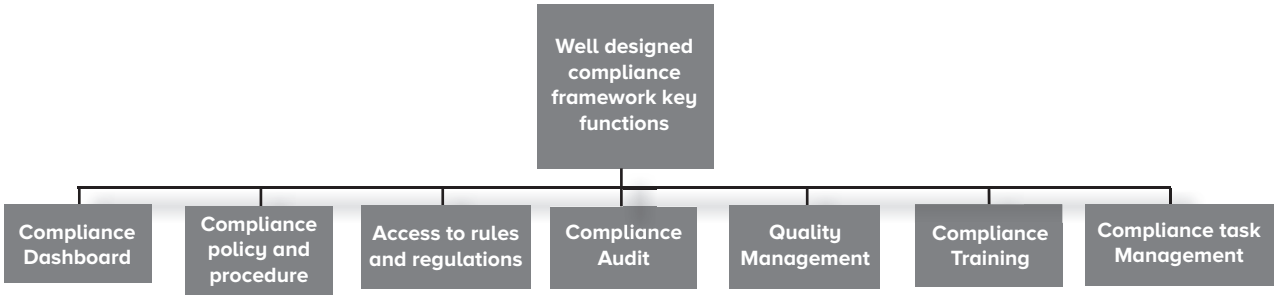
The Compliance Chart of any company must contain the complete information on compliance dashboard, which provide a detailed compliance procedure to the compliance executor, this information includes:



The role of Company Secretary as a compliance manager in a company is now extended to create a compliance framework for translating the regulatory requirements into management actions.

Role of Company Secretary in creation of Compliance Chart:

A well-designed compliance framework has abilities to perform the following key functions across every type of business organisation:



Compliance Dashboard: The compliance program must provide a single enterprise-wide dashboard for all users to track and trend compliance events. All compliance events should be easily viewed interactively through the enterprise compliance dashboard. Statutory auditors, internal auditors, compliance officers can use the dashboards to make decisions on the compliance status of the organization.

Illustration

A financial institution should generally establish a formal, written compliance program. In addition to being a planned and organized effort to guide the institution's compliance activities, a written program represents an essential source document that will serve as a training and reference tool for all employees. A well planned, implemented, and maintained compliance program will prevent or reduce regulatory violations, provide cost efficiencies, and is a sound business step.

Compliance Policy and Procedure: A well-designed document management system forms the basis of managing the entire lifecycle of policies and procedures within an enterprise. Ensuring that these policies and procedures are in conformity with the ever-changing rules and regulations is a critical requirement. The creation, review, approval and release process of the policy documents and SOPs (Standard Operating Procedures) should be driven by collaborative tools that provide core document management functionality.

Access to Rules and Regulations: A well-designed compliance management solution must offer capabilities for organization to continuously stay in sync with changing rules and regulations. As soon as there are regulatory changes, various departments should be notified proactively through "email based" collaboration. This process critically enables the organization to dynamically change their policies and procedures in adherence to the revised rules and regulations. While tracking a single regulation may be manually feasible, it becomes an error-prone task to track all local, state, and central regulations including those taking place across the globe. A well-designed compliance management program offers up-to-date regulatory alerts across the enterprise.

Compliance Audit: Audits have now become part of the enterprise core infrastructure. Internal audits, financial audits, external audits, vendor audits must be facilitated through a real-time system. Audits are no more an annual activity and corporations offer appropriate audit capabilities. Appropriate evidence of internal audits becomes critical in defending compliance to regulations.

Quality Management: Most organizations have internal operational, plant-level or departmental quality initiatives to industry mandates like Six-sigma or ISO 9000. A well-designed compliance management program incorporates and supports ongoing quality initiatives. Most quality practitioners agree that compliance and quality are two sides of the same coin. Therefore, it is critical to ensure that compliance management solution offers support for enterprise-wide quality initiatives.

Compliance Training: Most compliance programs often require evidence of employee training. Sometimes lack of knowledge and in complete procedure lead to fines and penalties to the director and officers of the

company. The compliance office has to work closely with the legal team of the organization to facilitate employee training. Well-designed compliance program requires a well-integrated approach to training management.

Compliance Task Management: The company must create plan to manage and report status of all compliance related activities from a centralized data base. Automated updates from the various compliance modules should provide for up-to-the-date status reporting that could be viewed by the Board, compliance officer, entity compliance coordinators, quality offices and others as designated.

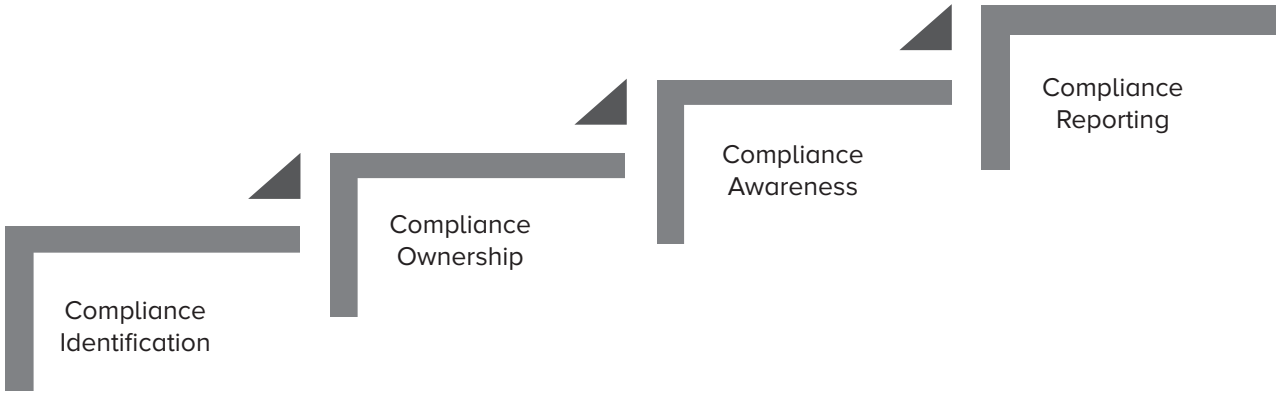
Accordingly, for creating a compliance management framework an organization need to perform activities relating to the compliance identification, compliance ownership, compliance awareness, compliance reporting and periodical compliance MIS.

However, the compliance framework in summary form consists of the following:

Process for Setting up of Compliance Framework				
Stage-1	**Stage-2**	**Stage-3**	**Stage-4**	**Stage-5**
Identification of Compliance Obligations	**Preparation of Compliance Chart**	**Assessment of Historical Compliance Status**	**Assessment of Compliance Risk**	**Compliance/ Action Reporting**
Applicability of the various Act, Rules, Regulations, Policies and Procedures covering Industry Specific Sector Specific, Specific Activity, Specific Entity, Specific State Law, Local Laws	Setting-up role and responsibilities of senior Management, Legal Department, and Compliance Executor	Assessment of File/ Report/ Return Statements/ Internal Auditor/ Independent agency/ Regulator	Identification of possible situations of non-compliance and development of strategy for Risk Mitigation/Risk Monitoring/Risk Reporting	Report of Internal Auditor/ Independent agency/Regulator with the possible consequence such as disqualification/ suspension/ lock out/ license cancellation

Process of Corporate Compliance Framework

Various steps are involved in the process of Corporate Compliance Framework which are as follows:



Step 1: Compliance Identification:

It includes the process to identify various acts and legislations applicable to the company in consultation with the functional heads. The legal team has to identify the legislations applicable to the company and identify the compliances that are required under each legislation or rules and regulations made there under.

Step 2: Compliance Ownership:

Definition: ***Compliance owner is the person who is responsible for the compliances.***

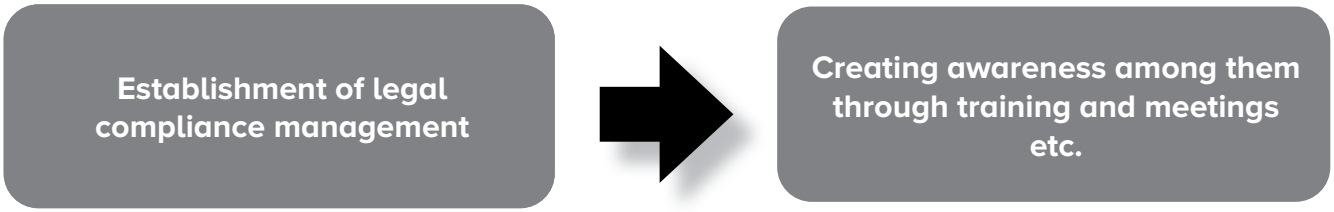
Compliance Ownership of the various compliances identified has to be described function wise and individual wise. Clear description of primary and secondary ownership is also very important. While the primary owner is mainly responsible for the compliance the secondary owner (usually the supervisor of the primary owner) has to supervise the compliance.

Illustration

In a Company ABC Private Limited, Mr. S, Company Secretary, is the person primarily responsible for all the compliances made under various laws applicable to ABC Pvt. Ltd.

Step 3: Compliance Awareness:

The Compliance Awareness covers the establishment of the legal compliance management and creation of awareness of the various Legal Compliances amongst those responsible. Sometimes the compliances are handled by persons who are not fully aware of the requirements of the legislations and hence creating appropriate awareness amongst the owners is very important. This could be done in the form of meetings/ trainings explaining various compliances or some manual containing the details of compliances.

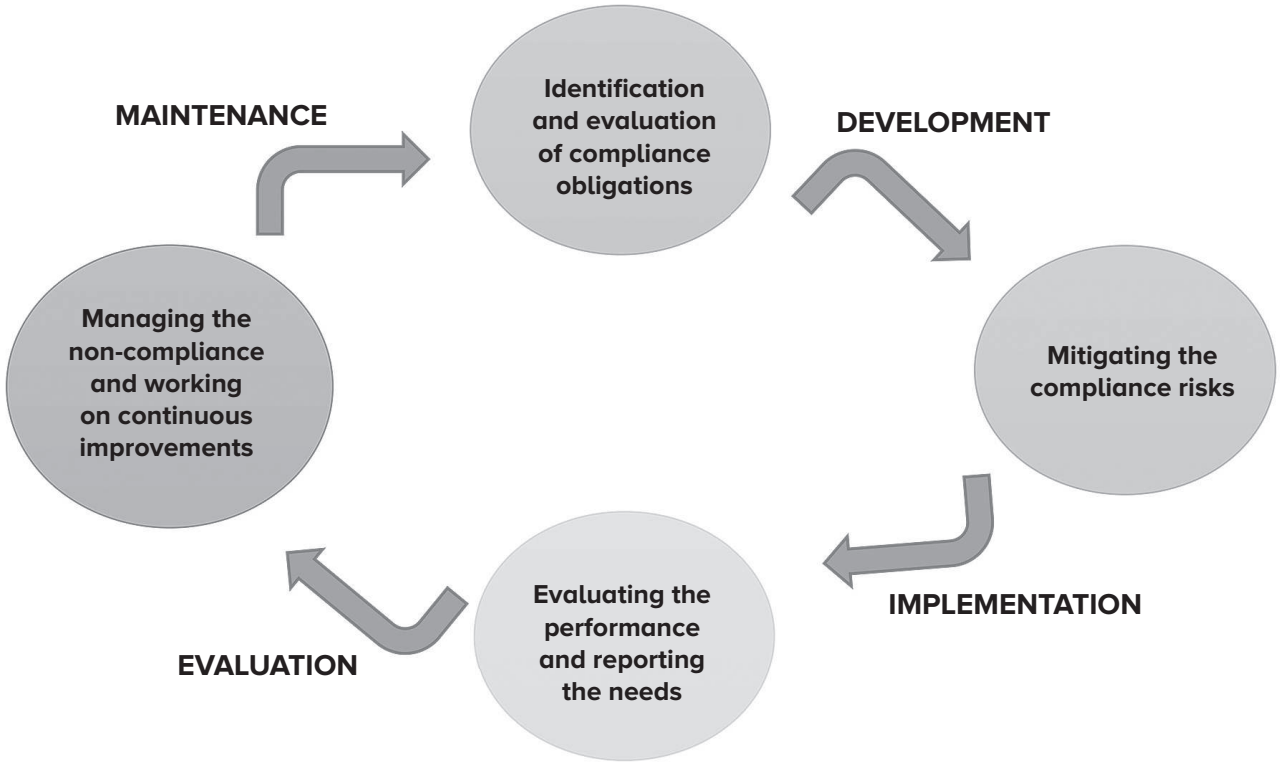


Step 4: Compliance Reporting:

In the process of the Compliance Reporting status of compliances or non-compliances should be communicated to the concerned. This is done annually by the compliance officer. Reporting of non-compliances ensures that appropriate corrective action is being taken by the responsible person in case of the failure in doing compliances.

Such compliance should be reported periodically in MIS (Management information system).

The Compliance management process revolves around the following steps:



How Compliance Management Works in Legal Department

- It monitors compliances across all entities, locations & various departments.
- It tracks the expiry dates of all executed contracts which needs to be renewed.
- Easy management of Litigation dates, documents and orders.
- Complying with documents policies and processes.

IDENTIFICATION OF APPLICABLE LAWS AND REGULATIONS

The identification of compliance requirements involves the compliances under various applicable laws and regulations to the organisation. There must be as systematic process of identifying compliance obligations of the organisation and their implications for its activities and services. It includes the identification and implementation of such changed in managing the compliances with amended laws and regulations.

For preparation of compliance framework by a company secretary and to identify the compliances & other requirements, it is necessary for him to get familiar with the business model of the company along with the environmental, health and safety aspects, and data security requirements. Further, a periodically review of the compliance requirements in the light of the regulatory updates is also necessary for the effective compliance management.

The compliance chart covering above applicable laws must be kept up to date and should also reflect the compliance obligations and associated risks that may arise. Such obligations may be based on company

compliance policies and / or international and local laws, regulations and standards that apply to a business' activities. As a good practice the company should communicate to the compliance executor that what he should or should not do for performing any compliance requirement.

CASE LAW

In Re *Siddarth Gupta (Appellant) v. The Delhi Golf Club Limited & Anr (Respondent) [DEL] I.A. No. 19355/2015 in C.S (OS) No. 2805/2015*, in this matter the Appellant had acquired membership in the Delhi Golf Club Ltd after paying the requisite fees and was enjoying the rights and privileges guaranteed to the members of the Club. Meanwhile, the Appellant got to know that a resolution had been passed in the AGM of the Club wherein the Appellant's membership was cancelled. Consequently, the Appellant filed a Petition against the said resolution in the Delhi High Court.

The honourable court observed that the membership of a person can be cancelled only after following the related provisions of the Memorandum of Association and Articles of Association of the Club and also the Principles of Natural justice. In this scenario neither any notice was given to the appellant nor any opportunity of being heard was provided to Appellant. Further, the provisions related to expulsion of members as mentioned in the Memorandum of Association and Articles of Association were not followed. Therefore, the resolution could not be sustained. The Court directed the club to reverse the Resolutions and refrained from cancelling the membership of the appellant.

In case where there is a policy issued by a company, research must be conducted to identify whether additional or different local laws exist. If a conflict between policies issued by company, local law and/ or international law arises, the conflict must be resolved and the appropriate obligation must be identified. Where the obligations of local laws or regulations impose greater or more stringent requirements than those included in a policy issued by company (or if the opposite situation exists), the more stringent obligations shall prevail.

The sources for the identification of compliance obligations include:

- Engagement with management and other key staff in Divisions.
- Laws and regulations.
- Permits, licences or other forms of authorisation.
- Orders, rules or guidance issues by regulatory agencies.
- Judgements of courts or administrative tribunals.
- Treaties, conventions and protocols.
- Internal policies and procedures.
- Voluntary principals or codes of practice.
- Commentary sourced from the public domain.
- Membership of professional groups.
- Subscriptions to relevant information services.
- Attending industry forums and seminars.
- Monitoring regulators (websites, mailing lists, meetings, media).

Depending on the nature of the business of the organisation, it is required to comply with following laws and regulations:

- Labour Laws;
- Fiscal/ Tax Laws;
- Pollution/Environment related Laws;
- Securities Laws;
- Commercial Laws including Intellectual Property Rights Laws;
- Industry Specified Laws;
- Corporate and Economic Laws;
- Cyber Laws which is also known as 'The Information Technology Laws';
- All other laws affecting the company concerned depending upon the type of industry/activity.

CASE STUDIES

Non Compliance of mandatory standards prescribed as per the Domestic Pressure Cooker (Quality Control) Order, 2020

CCPA fines Cloudtail with Rs 1 Lakh for not complying with BIS standards

The Central Consumer Protection Authority (CCPA) has imposed a fine of Rs 1 Lakh on Cloudtail India for violating the Quality Control Orders and consumer rights.

The company has also been asked for the price reimbursement of 1,033 pressure cookers to the consumers and is directed to submit the compliance report within 45 days.

Cloudtail, a retail company selling pressure cookers on an e-commerce platform, was issued an order for unfair trade practice by selling domestic pressure cookers in violation of mandatory standards prescribed as per the Domestic Pressure Cooker (Quality Control) Order, 2020.

The company was also directed to pay a penalty of Rs 100,000 for selling domestic pressure cookers to consumers in violation of mandatory standards prescribed under the QCO and violating the rights of consumers

In the matter of: ***M/s. Assam Timber Products Pvt. Ltd. (ATPPL) (Transferee Company) AND M/s. Ravi Marketing and Services Pvt. Ltd. (RMSPL)*** (Transferor Company)

The NCLT held that since publishing an advertisement in widely circulated newspapers in both States was required in the interest of all stakeholders, the statutory requirement of sections 230 and 232 of the Companies Act, 2013 had not been complied with.

Therefore, the proposed scheme of amalgamation of companies was not to be sanctioned in the interest of all shareholders. Hence, the petition was to be dismissed.

Source: https://nclt.gov.in/gen_pdf.php?filepath=/Efile_Document/ncltdoc/casedoc/180612002202021/04/Order-Challenge/04_order-Challange_004_168182609759487402464 3ea1315115e.pdf

COMPLIANCE RISK ASSESSMENT: BASIS FOR COMPLIANCE MANAGEMENT

The compliance chart of the company oversees and objectively challenges execution, management, control and reporting of risk, however the management of the company has ultimate accountability for the effective

control of risks affecting their business and the management should take ownership and responsibility for execution of risk assessments.

Risk assessments should be done according to the changes in the business' profile. Such changes may result because of new laws or regulations, new interpretations of existing laws or regulations, new theories of liability, a new activity of the business or changing social standards.

Risk assessments includes:

- **Identification areas of potential non Compliances**
- **Rating the risks**
- **Assessing the outcomes to find the need for training, monitoring, internal controls, detailed reviews and corrective steps**

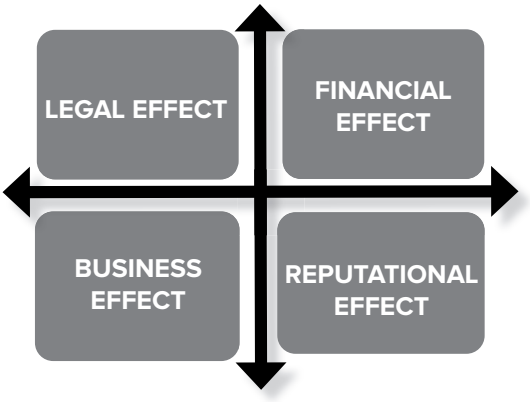
An organisation assesses risks for identification of different types of organisation risks. While identifying inherent risks it need to consider the following risks drivers which can be categorised in the following:

Legal Effect: Non compliances by the organisation can leads to various penalties, fines, imprisonment, debarment, and seizing the products etc. against the organisation and its officers.

Financial Effect: Low share prices of the securities of the organisation, financial losses and low revenues and lowering the trust of the investors are some of its negative effects.

Business Effect: Shutdown of the factories can affect the business operations of the organisation.

Reputational Effect: Loss in customers' confidence in the brand of the organisation, bad media or social discussion can tarnish the reputation of the organisation.



In the risk assessment process, the company identifies the inherent risk of each obligation as critical, high, medium or low. The outcome determines the type of risk mitigation strategy. However, the systems and procedure at the first line tracking and second line monitoring needed to effectively utilize to manage the risk. Thereafter the business assesses its managed risk levels for the identified compliance obligations.

There are two types of risk assessments that can be performed by the company, i.e.,

- High Level Risk Assessment
- Detailed Risk Assessments

In the High Level Risk Assessment, the risk identification procedures and its assessment and the detailed risk assessment results are required as inputs for high level risk assessment which are facilitated by representatives of Risk Management team. The current and anticipated critical and high compliance risks must be included in the high level risk assessment process. The outcome of the risk assessment is the high level risk assessment report.

Reports from the detailed and high level risk assessments must include key compliance risks, with existing and approved risk mitigation activities. Assessment Reports must be discussed and signed off in accordance with the risk management procedure of the company. Risk assessment techniques can be a combination of desk assessments, interviews and/or workshops; however they should be aligned with risk management standards of the company.

To ensure that risk is properly assessed and mitigated, a detailed risk assessment should be undertaken, particularly when further input is needed from support functions (i.e. outside experts) and/or to manage certain current and anticipated critical and high risk areas.

Illustrations:

Below mentioned companies are observing certain best practices for Risk Assessment (2022):

1. **Future Generali India Insurance Company Limited**

   Risk Identification and management process includes Top-down approach with Risk Surveys followed by Top Risk Workshop and Bottom-Up approach which includes Risk Registers and Scenario Analysis, Strategic Risk Assessment, Risk Appetite Framework including risk metrics and tolerance limits.

   The company conducts vendor risk assessment for material vendors at the time of on boarding and at the time of renewal.

   The company has in place a Remote Monitoring System (RMS) for safety of Branches.

2. **Bharti Airtel Limited**

   Identified risks are mapped to the Key Responsibility Area (KRA) of senior executives.

3. **Hindustan Unilever Limited**

   Management Committee led discussions across 14+ Cross Functional Leadership teams for identification of Functional & Company Level Risk Registers involving quantitative and qualitative risk assessment based on impact, Likelihood and velocity scales.

   The company has adopted digital transformation in Risk Management areas across the business.

   Ownership of risks and mitigation action is clearly defined for the entire risk repository along with detailed KPIs to assess the same.

4. **Wipro Limited**

   The company has an Enterprise Risk Management (ERM) Framework based on globally recognised standards. The ERM framework is administered by the Risk and Governance Committee and is supported by a multi-layered risk governance structure across the enterprise.

   'DigiQ' is used as a central tracker for all CAT audit, customer audits and the associated findings closure.

5. **Enterprise Risk Management (ERM) at Reliance**

   Ever-changing dynamics of risk environment has made it inevitable for every organisation to have a robust risk management process in place to address multi-dimensional risks proactively in holistic manner.

   The Company's Risk Management Framework follows the below mentioned risk assessment process and thus allows the management to:

   - Identify specific risks and assess the overall potential exposure
   - Decide how best to deal with those risks to manage overall exposure
   - Allocate resources and actively manage those risks
   - Obtain assurance over effectiveness of the management of risks and reporting

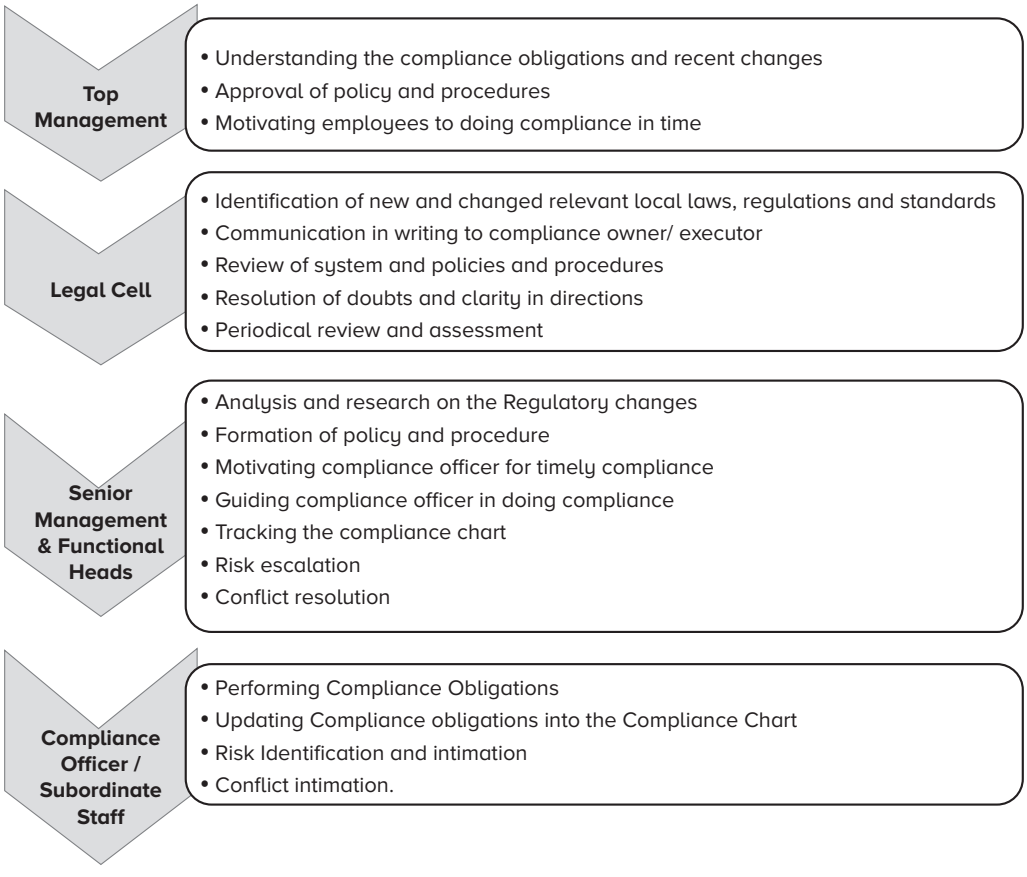
   (Source: https://www.ril.com/ar2022-23/risk-and-governance.html)

COMPLIANCE MONITORING AND RESPONSIBILITY CENTRE MAPPING /ALLOCATION

Compliance monitoring is the most essential mechanism of corporate compliance framework because it enables companies to recognize whether their compliance framework has been implemented in practice and whether it is practicable, responsive, and suitable for the characteristics of the company.

Further, Compliance monitoring, as the most effective tool of compliance framework, concisely means the "oversight" of the company's operations and activities, both in light of local and binding cross-border regulations and the company's local and global policies, procedures, and ethical rules. However, a one-off regulatory compliance check will not be enough as companies typically operate within a dynamic business environment. Business activities and services may rapidly change; for instance, companies may make mergers and acquisitions, enter into new business with state-owned entities, and/or cooperate with new private business partners. For this reason, the effectiveness of risk assessment and monitoring should be reviewed periodically to ensure compliance framework remain relevant in changing business conditions.

The next important aspect of designing compliance framework is the compliance ownership. The ownership of the various compliances has to be described function wise and individual wise. Clear description of primary and secondary ownership is also very important. While the primary owner is mainly responsible for the compliance, secondary owner (usually the supervisor of the primary owner) has to supervise the compliance. Ex: Secretarial Officer /Asst. Company Secretary may be primarily responsible and Group Company Secretary's responsibility is secondary. The role of the various level of management for compliance ownership is illustrated as under:



The management of the company should develop and update the chart by clearly identifying the principle business activities and relevant processes affected by the obligation(s) and should identify the individuals having accountability for executing the activities outlined in the chart including those individuals with managerial responsibility. The management should formally approves the compliance chart and they should notify any changes in the policies, products, activities, strategy or governance structures of the company immediately.

ESCLATION AND COMPLIANCE REPORTING

Compliance reporting allows Management and the Compliance function to assess whether Compliance Risks exceed the risk appetite of Company. Compliance Reporting also allows for communication and discussion of potential Compliance Risks. Management and the Compliance officer is responsible for gathering information, and the analysing and communicating the results so that informed, timely decisions can be made. At least quarterly, reports should be discussed at the risk management committee meeting.

Broadly, there can be two primary types of reporting: **Cyclical Reporting and Incident Reporting.**

CYCLICAL REPORTING — At least quarterly basis, the Compliance officer works with management and other risk functions to provide non-financial risk reporting.

INCIDENT REPORTING — The material compliance incidents are reported, which need to be handled through the risk management process.

Material compliance incidents are defined as events that have effect on the company's integrity, damaging company reputation, legal or regulatory sanctions, or financial loss, as a result of a failure (or perceived failure) to comply with applicable compliance related laws, regulations and standards.

CASE STUDY

ABC Limited, A BSE limited company has made following cyclical reporting arrangements for compliance activities which includes:

Audit & Risk Management Committee:

Quarterly reports on the performance of the compliance programme will be submitted to the Audit and Risk Management Committee. These reports will include a high-level summary of activities by all functions undertaking significant compliance related activities.

Separate reports will also be submitted to the Audit and Risk Committee for major noncompliance incidents or emerging compliance issues.

Annual Certifications:

At the end of each financial year Responsible Officers will be required to provide an assurance that to the best of their knowledge, the ABC Limited has complied with the obligations relevant to their area of responsibility.

Assurance Maps:

To facilitate quarterly and annual reporting requirements an assurance mapping approach that is consistent with the model.

Regulatory Reporting:

The regulatory reporting arrangements for compliance activities shall be accounted. The reporting of significant compliance issues which are required by law must be undertaken in accordance with the procedures.

CREATION OF COMPLIANCE REPORTING SYSTEM

Compliances or non-compliances should be communicated to the concerned person. Reporting of non-compliances ensures that appropriate corrective action is taken by the responsible person to reduce the compliance risk. For example, Automated escalation emails in case of non-compliance, Pop-ups for the Compliance Due dates etc. Although, the actual process of compliance reporting under the various laws may vary from company to company and is dependent on various factors such as the number of units and scale of operations, a brief process of the Compliance reporting is as follows:

A. Reporting by the functional heads for which they have the compliance ownership. For instance, the Chief Financial Officer (CFO) will report on the various finance, accounting and taxation laws, the head of the personnel department could report the compliance of labour and industrial laws.

B. Each of the functional heads may collect and classify the relevant information from the various units/ locations pertaining to their department and consolidate them in the form of a report.

EFFECTIVE COMPLIANCE REPORTING REQUIREMENTS

- Language must be cleared
- Language to be concise
- Must contain an executive summary
- Listing actions to be taken
- Timelines for improving non compliance
- Necessary actions to be taken by the management of the organization

C. The report shall carry an affirmation from the functional heads that the said report has been prepared based on the inputs received from the various units/offices and then list out the specific compliances/ non-compliances, as already circulated to the functional heads.

D. Each of the functional heads will forward their respective compliance reports to the company secretary/ managing director.

E. The company secretary would then brief the managing director. Upon receipt of suitable inputs from the company secretary, the Managing Director would consolidate and present, under his signature, a comprehensive compliance report to the Board for its information, advice and noting.

F. The whole process of compliance reporting is contingent on the creation and implementation of comprehensive legal Management Information System (MIS).

Periodical compliance MIS is a type of reporting that occurs at a pre decided period, at least quarterly, if not monthly. This report contain status of the various compliances need to be done by the company and any gap in compliance and other incidents which are needed to be reported to Board, Senior Management of the company.

COMPLIANCE RISK - REVIEW AND UPDATION

Compliance risk monitoring makes it possible for the business to test if risk mitigation activities are working properly and to identify new or changed risks. The plan for monitoring must be documented and reviewed and, if necessary, updated annually and more frequently based on other framework activities and monitoring results.

The purpose of the review is to determine:

- **if the plan is still necessary and accurate**
- **if the plan should be combined with another plan or if it should be rescinded**
- **if the plan is up to date with current laws and regulations**
- **if changes are required to improve the effectiveness or clarity of the plan**

Contents of compliance risk monitoring plan :

- Critical and high Compliance Risks, focusing on inherent and managed risk levels;
- Key Compliance Risk mitigation activities;
- Routine business transactions to which compliance obligations or risks are associated;
- The implementation/embedding of the Framework and all policies issued by the corporate compliance department;
- Compliance with the laws, regulations and standards included in the chart, including the company values; and
- The obligations that have been delegated to the compliance function (e.g. complaints handling, privacy related obligations).

The plan for monitoring must include:

1. Concise statements that capture the relevant internal and external compliance obligations and the risks arising from those obligations;
2. The business processes to which the compliance obligations are linked or on which they have an impact;
3. Specific Compliance Risk mitigation activities for managing the compliance obligations;
4. The first line tracking (ongoing tracking as part of the normal course of business activities), second line monitoring (health check performed by the Compliance Function) and third line assurance (independent review performed by internal audit) for efficiency and / or effectiveness of first and second line activities);
5. Brief description of how tracking and monitoring activities are performed;
6. Frequency of tracking and monitoring activities;
7. Recipient(s) of the tracking and monitoring reports.

The following methodology may be adopted for accessing the compliance mechanism of the company:

Risk/Cultural Assessment: Through employee surveys, interviews, and document reviews, a company's culture of ethics and compliance at all levels of the organization is validated. The basis of this assessment is to identify gaps between company's current practices and the regulatory requirements.

Test Yourself

Question: What is purpose of cultural assessment?

Options: (A) To identify gaps between current practices and regulatory requirements (B) To understand the culture of particular place (C) To find out, how many CSR activities are done by an organization (D) None of the above

Answer: (A)

Program Design/Update: In this approach the review of the guideline documents that outline the reporting structure, communications methods, and other key components of the code of ethics and compliance program is accessed. This encompasses review of all aspects of the compliance program, from grass root policies to structuring board committees that oversee the program.

Policies and Procedures: In this approach of compliance assessment, the company should review, develop or enhance the detailed policies of the program, including issues of financial reporting, anti-trust, conflicts of interest, gifts and entertainment, records accuracy and retention, employment, the environment, global business, fraud, political activities, securities, and sexual harassment etc.

Communication, Training, and Implementation: In this stage of compliance assessment, the Company focuses on the articulation, communication and reinforcement of the various policies and procedure of the company along with the philosophy behind such policies. Further training program on such policies help in the adoption of such policies in day-to-day realities and helps inculcation the same incorporate it into the attitudes and behaviors of the employees of the company.

Ongoing self-Assessment, Monitoring, and Reporting: The true test of a company's ethics and compliance program comes over time. How does one know in one year or five years that both the intent and letter of the law are still being observed throughout organization? How does the program and the organization adapt to

changing legislation and business conditions? As the organization evolves for example, through mergers and acquisitions will the program remain relevant? The cultural assessment, mechanisms, and processes put in place including employee surveys, internal controls, and monitoring and auditing programs, help organisations achieve sustained success.

TRAINING AND IMPLEMENTATION

In compliance framework, it is most important to create awareness of the various compliances requirements amongst the individuals responsible for such compliances. Many a times compliances are handled by persons who are not fully aware of the requirements of the law and hence creating appropriate awareness amongst the owners is very important. This could be done in the form of meetings/trainings/ communications explaining the various compliances or some manual containing the details of compliances.

A strong Compliance training and education programme reinforces the company compliance culture. It builds awareness and understanding of compliance standards, procedures, guidelines and issues. Specifically, it should build awareness and understanding of:

- Company Framework, including the four conduct-related integrity risk areas;
- Roles and responsibilities outlined in the policies and framework;
- Critical and high compliance obligations identified in the Compliance Chart;
- The process for addressing compliance issues and reporting concerns; and
- Consequences of failing to meet compliance obligations.

FIVE ESSENTIAL THINGS TO CREATE COMPLIANCE TRAINING PROGRAM:

An annual plan for Compliance Risk related training and education must be developed and updated, as necessary, and should indicate the target audience and training delivery method. Compliance Risk related training program should, to the extent possible, be integrated into the training plans.

Plans for Compliance Training and Education Program may include:

1. Concise statements that capture the relevant internal and external compliance obligations and the risks arising from those obligations;
2. The business processes to which the compliance obligations are linked or on which they have an impact;
3. Brief description of the training or education activity;
4. Target audience (refresher for existing Employees, induction for new Employees, or Adhoc when required);

5. Frequency of training or education activity.

Test Yourself

Question: Training and Implementation can be done in the form of ..... explaining various compliances or some manual containing the details of compliances.

Options: (A) Meetings (B) Trainings (C) Communications (D) All of the above

Answer: (D)

COMPLIANCE AUDIT

Compliance audits may be planned, performed and reported separately to the Board, senior management or Regulators. The compliance audit is completely different from the audit of financial statements and from performance audits. The compliance audits may be conducted separately on a regular basis, as distinct and clearly-defined audits each related to a specific subject matter.

As per CAG Auditing Standards, the Compliance audit is the independent assessment of whether a given subject matter is in compliance with applicable authorities identified as criteria. Compliance audits are carried out by assessing whether activities, financial transactions and information comply in all material respects, with the authorities who govern the audited entity. Compliance auditing may be concerned with:

- Regulatory - adherence of the subject matter to the formal criteria emanating from relevant laws, regulations and agreements applicable to the entity.
- Propriety - observance of the general principles governing sound financial management and the ethical conduct of public officials.

Objectives of Compliance Audit

- To verify whether procurement was carried out as per extant rules and in accordance with delegated financial powers.
- To verify whether financial propriety was ensured during the stages of tendering, evaluation and award of contract.
- **In case of Plant efficiency:**
  - T**o v**erify whether the usage of power, fuel are as per approved norms.
  - To verify whether plant shutdowns are as per approved norms.
  - To verify whether the production is as per the prescribed scale.
  - To verify whether the installed capacity of the plant is designed as per regulatory approvals.
  - To verify whether the operation of plant complies with environmental norms.
- **Corporate social responsibility**
  - To verify whether corporate social responsibility framework is as per regulatory approvals.
  - To verify whether activities of corporate social responsibility are as per corporate policy.
  - To verify whether the corporate policy is in consonance with relevant regulations and DPE guidelines.

(Source: https://cag.gov.in/uploads/guidelines/Compliance-Guidelines-approved-final-preface-05de4efef9159d0-85033036.pdf)

BENEFITS OF CORPORATE COMPLIANCE MANAGEMENT

Compliance management program can produce positive results at several levels:

- Better compliance of the law;
- Real time status of legal/statutory compliances;
- Improved operations and higher productivity;
- Go to the extra mile and lays the foundation for the control environment;
- Real time status on the progress of pending litigation before the judicial/quasi-judicial authority;
- Likely to avoid stiff personal penalties, both monetary and imprisonment;
- Companies that embed positive ethics and effective compliance management program deep within their culture often enjoy healthy returns through employees and customers loyalty and public respect for their brand, both of which can translate into stronger market capitalization and shareholder returns;
- Safety valve against unintended non compliances/ prosecutions, etc.;
- Cost savings by avoiding penalties/fines and minimizing litigation;
- Better employee engagement and retained talent;
- Better brand image and positioning of the company in the market;
- Enhanced credibility/creditworthiness that only a law abiding company can command;
- Goodwill among the shareholders, investors, and stakeholders and regulators;
- Recognition as Good corporate citizen.

Clearly, the benefits of implementing and maintaining an effective compliance program far outweigh its costs. Not only does the compliance management protect investor's wealth but also helps the business in running successfully with any potential risk being addressed in a timely and accurate manner.

SECRETARIAL AUDIT AND COMPLIANCE MANAGEMENT SYSTEM

The compliance system and processes in a company are dependent mainly on the following factors:

A. Nature of business(es).

B. Geographical domain of its area of operation(s).

C. Size of the company both in terms of operations as well as investments, technology, multiplicity of business activities and manpower employed.

D. Jurisdictions in which it operates.

E. Whether the company is a listed company or not.

F. Regulatory authority(ies) in respect of its business operations.

G. Nature of the company viz., private, public, government company, etc.

Based on the above the Secretarial Auditor can constitute a broad idea about the desired system and process to be adopted by a company. For example, a multi product / multi operation company is supposed to comply all the applicable corporate laws in addition to regulatory framework applicable at products/ operations.

Now-a-days most of the large companies have adopted Enterprise Resource Planning (ERP) Systems to cater to their complex operations. In many a cases, compliance system becomes a part of these modules.

Auditing in such systems requires the Auditor to enter and to have access within the system. While taking up the audit assignment, the Auditor needs to ensure that access would be given so that assessment of proper system and process of compliance is made.

Auditing of compliance system and process is not a fault finding exercise, rather a device to scale up compliance mechanism of a company commensurate to its size and operations. It is desired that the Secretarial Auditor as an expert in corporate compliance would advise the companies to build up strong corporate compliance system in case the system appears to be insufficient during the audit process.

ROLE OF COMPANY SECRETARIES IN COMPLIANCE MANAGEMENT

Compliance Management can add substantial business value only if compliance is done with due diligence. A company secretary is the 'Compliance Manager' of the company. It is he, who ensures that the company is in compliance with all regulatory provisions. Corporate disclosures, which play a vital role in enhancing corporate valuation, is the forte of a company secretary. These disclosures can be classified into statutory disclosures, no statutory disclosures, specifies disclosures and continuous disclosures. Companies Act, 2013 and SEBI (Listing Obligations and Disclosure Requirements) Regulation, 2015 spells out elaborately on various aspects of disclosures which are to be made by the company such as contingent liabilities, related party transactions, proceeds from initial public offerings, remuneration of directors and various details giving the threats, risks and opportunities under management discussion and analysis in the corporate governance report which is published in the annual accounts duly certified by the professional like company secretaries. A company secretary has to ensure that these disclosures are made to shareholders and other stakeholders in true letter and spirit.

The advisory services of the company secretaries impacts to all components and activities of the compliance framework, as the business receives one point specialized support and advice to help manage its compliance risks more effectively. The company secretary play a proactive advisory role as he advises management, Boards and committees, the compliance executor, and the employees. The company secretary provide advice on compliance risk, responsibilities, obligations, concerns and other compliance issues that are suitable for the business' practices and operational constraints of the company.

In nutshell, the company secretary is the professional who guides the Board and the company in all matters, renders advice in terms of compliance and ensures that the Board procedures are duly followed, best global practices are brought in and the organisation is taken forward towards good corporate citizenship.

DIRECTORS RESPONSIBILITY STATEMENT

Section 134(5) of the Companies Act, 2013 casts responsibility on each and every director to apply their judgment in preparation of annual accounts according to applicable accounting standards and accounting policies, preparing accounting records on going concern basis. The directors are responsible to devise a proper system to ensure compliance with all applicable laws.

The Directors' Responsibility Statement is required under Section 134(5) of the Act to state as under:

i. In preparing the annual accounts, the applicable accounting standards and proper explanations relating to material departures were followed.

ii. The directors had selected such accounting policies and applied them consistently and made judgments and estimates that were reasonable and prudent to give a true and fair view of the state of affairs of the Company at the end of the financial year and of the profit and loss of the Company for that period.

iii. The directors had taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the Act's provisions for safeguarding the Company's assets and for preventing and detecting fraud and other irregularities.

iv. The directors had prepared the annual accounts on a going concern basis.

v. In the case of a listed company, the directors had laid down internal financial controls to be followed by the Company and that such internal financial controls are adequate and operating effectively.

vi. The directors had devised a proper system to ensure compliance with all applicable laws and that such systems are adequate and operating effectively.

CASE LAW

Director carrying competing business breaches fiduciary duty, imposes restriction, interprets Section 166 of the Companies Act, 2013

In the matter of *Rajeev Saumitra Vs Neetu Singh (I.A. NO. 17545 OF 2015. CS (OS) NO. 2528 OF 2015 JANUARY 27, 2016,* the honourable Court held that director has breached fiduciary duty u/s 166 of Companies Act, 2013 by initiating competing business as the director was involved in the situation in which there was a direct interest that conflicted with company's interest, in order to gain advantage by director and its relatives. In case a Director violates the duties prescribed in Section 166, the cause of action accrues in favour of Company.

CERTAIN IMPORTANT COMPLIANCE REQUIREMENTS UNDER COMPANIES ACT, 2013

1. Disclosures by a Director of his interest: Form MBP-1

Every director shall at the first meeting of the Board in which he participates as a director and thereafter at the first meeting in every financial year or whenever there is any change in the disclosures already made, then at the first Board meeting held after such change, should disclose his concern or interest in any entity which shall include the shareholding.

2. Disqualification of Directors: Form DIR-8

No person who is or has been a director of a company which:

(a has not filed financial statements/ annual returns for any continuous period of three financial years; or

(b) has failed to repay the deposits accepted by it or pay interest thereon or to redeem any debentures on the due date or pay interest due thereon or pay any dividend declared and such failure to pay or redeem continues for one year or more,

shall be eligible to be re-appointed as a director of that company or appointed in other company for a period of five years from the date on which the said company fails to do so.

Every director shall inform to the company concerned about his disqualification under sub-section (2) of section 164, if any, before he is appointed or re- appointed.

However, where a person is appointed as a director of a company which is in default of clause (a) or clause (b) of section 164(2) , he shall not incur the disqualification for a period of six months from the date of his appointment.

3. Annual Return: Form MGT-7

Every Company shall file its Annual Return within 60 days of holding the AGM or where no AGM is held in any year within 60 days from the date on which the AGM should have been held together with the statement specifying the reasons for not holding the AGM with such fees or additional fees as may be prescribed.

Annual Return of every Private Company shall be signed by a director and the company secretary, or where there is no company secretary, by a company secretary in practice.

4. Filing Financial Statements: Form AOC-4 & AOC-4 CFS

Company is required to file its financial statements, including consolidated financial statements, if any, along with all the documents required to be or attached to such financial statements, duly adopted at the AGM of the company, shall be filed with the Registrar within 30 days of the date of AGM in such manner, with such fees or additional fees as may be prescribed. In case financial statements are not adopted in the AGM or adjourned AGM, such unadopted financial statements along with the required documents shall be filed with the ROC within 30 days of the date of AGM and the Registrar shall take them in his records as provisional till the financial statements are filed with him after their adoption in the adjourned annual general meeting for that purpose: with such fees or such additional fees.

If annual general meeting is not held for any year, the financial statements along with the documents required to be attached under section 137(1) duly signed along with the statement of facts and reasons for not holding the annual general meeting shall be with the Registrar within 30 days of the last date before which the annual general meeting should have been held in such manner, with such fees or additional fees as may be prescribed.

Illustration:

The Company ABC Pvt. Ltd. has not filed annual returns for the year 2019-2020, 2020-2021 & 2021-2022 yet. What can be consequences of such non filing?

If Company does not file annual returns for any continuous period of three financial years; then directors of said company shall become disqualified for continuous period of 5 years, and they would not be eligible to be appointed, re-appointed as directors in other company.

5. Certification of Return: Form MGT -8

The annual return filed by a listed company or a company having paid up share capital of Rs. 10 Crores or more or turnover of Rs. 50 crores or more shall be certified by a Company Secretary in Practice.

6. Circulation of Financial Statement & other relevant Documents

Company shall send to all the members of the Company, all trustees for the debenture holders and to all persons being the persons so entitled, copy of the approved financial statements (including consolidated financial statements, if any, auditor's report and every other document required by law to be annexed/ attached to the financial statements) at least 21 clear days before the AGM.

7. Notice of AGM

Every Notice of Annual General Meeting shall be prepared as per Section 101 of Companies Act, 2013 and Secretarial Standard - 2. In case of private company - Section 101 shall apply, unless otherwise specified in such section or the articles of the company provide otherwise. - Notification No. G.S.R.464 (E) dated 5th June, 2015.

8. Board Meetings

Every Company shall hold a minimum of 4 meetings of its Board of Directors every year in such a manner that

If a company is incorporated on 15th June, the first Meeting should be held within thirty days i.e. latest by 14th July. if the meeting is held say on 10th July, then the next Meeting should be held within 120 days from 10th July.

maximum gap between two meetings should not exceed 120 days. In case of Specified IFSC Private Company–The Company shall hold the first meeting of the Board of Directors within sixty days of its incorporation and thereafter atleast one meeting of the Board of Directors in each half of a calendar year.

A One Person Company, small company and dormant company shall be deemed to have complied with the provisions of this section if at least one meeting of the Board of Directors has been conducted in each half of a calendar year and the gap between the two meetings is not less than ninety days

9. Notice of Board Meeting

Board meeting shall be called by giving not less than 7 days notice in writing to every director at his address registered with the company and such notice shall be sent by hand delivery or by post or by electronic means. However, meeting may be called at shorter notice to transact urgent business subject to the presence of one independent director, if any and in his absence decision shall be circulated to all directors and shall be final on ratification by atleast one independent director, if any.

Illustration:

What if the company secretary is not appointed in ABC Pvt. Ltd., where required under Companies Act, 2013?

Solution: *Such company shall be liable to a penalty of five lakh rupees and every director and key managerial personnel of the company who is in default shall be liable to a penalty of fifty thousand rupees and where the default is a continuing one, with a further penalty of one thousand rupees for each day after the first during which such default continues but not exceeding five lakh rupees.*

10. Appointment of Auditor: Form ADT-1

Auditor shall be appointed for 5 years in the AGM. Company shall inform the auditor concerned of its appointment and also file a notice of such appointment with the Registrar within 15 days of the meeting in which the auditor is appointed in E-form ADT-1.

In case of Specified IFSC Private Company- notice of auditor's appointment shall be filed with the Registrar within 30 days of the meeting in which the auditor is appointed.

[Vide Notification No. G.S.R. 9 (E) Dated 4th January, 2017].

11. Appointment of Company Secretary

Private Company having paid up share capital of Rs. 10 crores or more is required to appoint a whole time Company Secretary (Vide notification dated January 03, 2019**)**

12. Register of members

Company shall keep & maintain the following mandatory Registers viz:

1. Register of Members residing in or outside India,
2. Register of debenture-holders, and
3. Register of any other security holders

Illustration: *ABC Pvt. Ltd. Has not maintained register of members. What can be penalty under Companies Act, 2013?*

Solution: *If a company does not maintain a register of members or debenture-holders.or other security holders or fails to maintain them in accordance with the provisions of sub-section (1) or sub-section (2), the company shall be liable to a penalty of three lakh rupees and every officer of the company who is in default shall be liable to a penalty of fifty thousand rupees.*

ABC Pvt. Ltd. Shall be liable to a penalty of three lakh rupees and directors liable to a penalty of ₹50000/-.

CASE LAW

In this matter of *Economy Hotels India Services (Appellant) Private Limited Vs. Registrar of Companies & Anr. (Respondent) (NCLAT) Company Appeal (AT) No. 97 of 2020*, the Appellant Company had filed a petition under Section 66 of the Companies Act praying for confirming the reduction of share capital against the NCLT order for rejection of application for reduction of share capital because in the extract of the minutes submitted to NCLT, the case is, it was written that the 'unanimous ordinary resolution' required for reduction has been obtained. The case is it was a mere typographical error in the minutes characterising the 'special resolution' as 'unanimous ordinary resolution' and the Appellant had filed the special resolution with ROC and fulfilled all the statutory requirements prescribed in the Companies Act, 2013.

The honourable NCLAT observed that 'Reduction of Capital' under Section 66 of the Companies Act, 2013 is a 'Domestic Affair' of a particular Company in which, ordinarily, a Tribunal will not interfere because of the reason that it is a 'majority decision' which prevails. As the Appellant has admitted its typographical error

in the extract of the Minutes of the Meeting characterizing the 'special resolution' as 'unanimous ordinary resolution' and also taking into consideration of the fact that the Appellant had filed the special resolution with ROC, which satisfies the requirement of Section 66 of the Companies Act, 2013. NCLAT allowed the Appeal, thereby confirming the reduction of share capital of the Appellant Company.

The Registrar Of Companies, West Bengal (Appellant) V. Karan Kishore Samtani (Respondent)(NCLAT) Company Appeal (AT) No. 13 of 2019, in this matter the Respondent was the Director, for more than 20 Companies till 31.03.2015. On 27.01.2016 the Registrar of Companies, West Bengal sent show cause notice on the ground that he was the Director of more than 20.Companies at once. The Respondent admitted the guilty and sent representation to the Registrar with a request to compound the offence under Section.441(1) of the Companies Act, 2013. After hearing the parties the NCLT Kolkata Bench (Tribunal) allowed the compounding application subject to payment of compounding fees of Rs. 50,000/-.

Being aggrieved with this order ROC has filed this Appeal saying that the minimum fine prescribed for the offence is more than 50,000,.Hence the compounding fees of 50,000 is not appropriate. The issue for consideration is, whether Tribunal can impose the compounding fees, less than minimum fine prescribed for the offence under the Act.

Provision Involved: Section 165(6) of Companies Act, 2013 states - If a person accepts an appointment as a director in contravention of sub-section (1), he shall be punishable with fine which shall not be less than five thousand rupees but which may extend to twenty-five thousand rupees for every day after the first during which the contravention continues.

The NCLAT held that the NCLT, Kolkata Bench has failed to notice the minimum fine prescribed under Section 165 of the Companies Act, 2013 which was applicable at relevant time. Accordingly, NCLAT imposed minimum fine at the rate of 5000 rupees for every day for the period 01.04.2015 to 21.02.2016 i.e. 272 days, which came to Rs. 13,60,000. Further, the court held that the compounding fees has to be more than or equal to the minimum fine prescribed under the Act.

REGISTERS TO BE MAINTAINED UNDER COMPANIES ACT 2013

S.NO.	FORM NO. /FORMATS UNDER COMPANIES ACT 2013	PARTICULARS
1.	PAS-5	Maintenance of complete record of Private Placement Offers
2.	SH-2	Register of Renewed and Duplicate Share Certificates

S.NO.	FORM NO. /FORMATS UNDER COMPANIES ACT 2013	PARTICULARS
3.	SH-3	Register of Sweat Equity Shares
4.	SH-6	Register of Employees Stock Options
5.	SH-10	Register of Shares or other Securities bought back
6.	CHG- 7	Register of Charges
7.	MGT- 1 MGT- 2	Register of Members Register of debenture holder and other security holders
8.	MGT- 1	Foreign Register of Members
9.	MGT- 2	Foreign Register of Debenture holders/other security holders with index of names
10.	BEN-3	Register of significant beneficial owners
11.	No format specified	Attendance Register – Board & Committee Meetings
12.	No format specified	Minutes (General Meeting, Class of Shareholders, Creditors or Resolution passed by Postal Ballot)
13.	Schedule III	Books of Account (together with the vouchers to any entry in such books of account)
14.	MBP-1	Notice of interest by Director
15.	MBP-2	Register of Loans, Guarantee, Security and in respect of Acquisition made by the company
16.	MBP-3	Register of Investment not held in its own name by the company
17.	MBP-4	Register of Contracts or arrangements with related party and with Bodies corporate etc. in which directors are interested

COMPLIANCE MANAGEMENT TOOL

Compliance Management tool is generally required in large organisations where many risks are involved. These organisations required to adhere to a wide variety of laws and regulations applicable. Now a day's not only big companies but also smaller companies are required to comply with applicable laws and regulations to them. Compliance Management Tool handles and controls their business processes and enables them in scaling their operations without increasing their risk of non-compliance. A manual approach to tracking and monitoring compliance activities drives up costs and is more prone to error.

Compliance Management tools are software products that automate or facilitate processes and procedures that businesses must have in place to be compliant with industry, legal, security and regulatory requirements. Compliance Management tool is a software which facilitates your compliance management by bundling all important workflows on a digital platform.

Illustration:

NSE has introduced NEAPS (NSE Electronic Application Processing System) which is a web based application facilitates online filing of SEBI Disclosures, Clarifications and Compliance Filings, Corporate Governance Report, the Shareholding Pattern by companies, Results and other disclosures.

The objectives of Compliance Management Tool with respect to digitization, automation and compliances are:

Digitization

1. Robust compliance tool replaces spreadsheets and manual processes
2.Enhances visibility & accountability
3. Reduces the information & knowledge gap

Automation

1. Provides automated legal updates
2. Helps in automated compliance tracker with reminders and escalations
3. Showcase automated workflows, dashboards & reports

Compliances

1. Monitor the activities of the organisation
2. Ensures compliance with all applicable laws
3. Helps to avoid penalties, prosecutions & litigation
4. Helps implement better processes and controls enabled by technology
5. Helps in Audit Management
6. Helps in Audit Documentation

Cloud computing is becoming increasingly popular for delivering IT services, thanks to its scalability, ease of deployment, and lower maintenance costs. However, it also introduces new cyber security risks and challenges that businesses need to be aware of.

To help Regulated Entities (REs) navigate these risks, SEBI vide circular no. SEBI/HO/ITD/ITD_VAPT/P/CIR/2023/033, dated March 6, 2023 has introduced a cloud framework that sets baseline standards for security and regulatory compliances. This framework is a crucial addition to SEBI's existing guidelines on cloud computing and is designed to help regulated entities (Res) implement secure and compliant cloud adoption practices.

By following the guidelines outlined in the.framework, REs can establish a robust risk management approach for cloud adoption, which includes assessing risks, implementing appropriate controls, monitoring compliance, and ensuring regulatory.compliance.

CASE STUDIES

1. Compliance Management at Bharti Airtel Limited

The Company has in place a robust automated Compliance Framework based on the global inventory of all applicable laws and compliance obligations, which are regularly monitored and updated basis the changing requirements of law. Proactive automated alerts are sent to compliance owners to ensure compliance within stipulated timelines. The compliance owners certify the compliance status which is reviewed by compliance approvers and a consolidated dashboard is presented to the respective Business Leaders and the Managing Director & CEO. A certificate of compliance of all applicable laws and regulations along with exceptions report and mitigation plan, if any, is placed before the Audit Committee and Board of Directors on a quarterly basis. Additionally, the Company has centralised automated tool in place viz. Notice Management System to regularly monitor and update the legal notices and court cases.

Source: Annual Report 21-22

2. Compliance Management at BCL India

Compliance Management Services is a set of complex legal acquiescence required to be adhered to by organizations. The legal obligations differ with Central or State specific laws depending upon the industry, locations and jurisdictions and they are updated from time to time. Organizations irrespective of their size must adhere to statutory laws and regulations to keep the businesses out of any legal

trouble and avoid penalties. Keeping track of changing government norms and regulations is not always easy and is a challenge for most companies.

The experts at BCL India stay updated with recent legislation and provide end-to-end proficient service regarding registrations, renewals, filing, auditing, reporting, and collation of documents.

(Source: https://bclindia.in/)

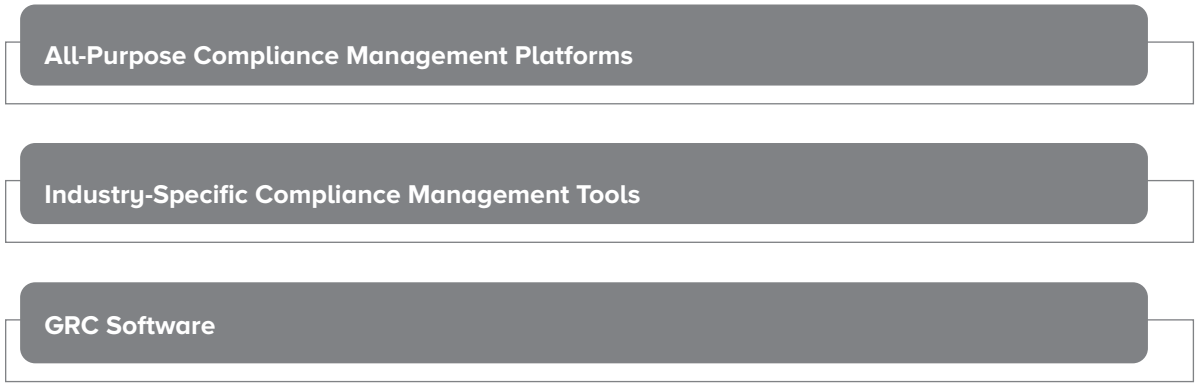
3. Compliance Management at ORACLE

Governance Guidelines and Committee Charters

Oracle's Board of Directors has adopted Corporate Governance Guidelines and committee charters to help ensure it has the necessary authority and procedures in place to oversee the work of management and to exercise independence in evaluating Oracle's business operations. These guidelines allow the Board to align the interests of directors and management with those of Oracle's shareholders.

Source: https://www.oracle.com/in/corporate/corporate-governance/

KINDS OF COMPLIANCE MANAGEMENT TOOL



I All-Purpose Compliance Management Platforms

These compliance Management Platforms can be used in any kind of the organisation but with low level of organisation focused at providing:

- Risk remedy
- Solving Technical issues
- Corporate Governance

II Industry-Specific Compliance Management Tools

These tools focus on the compliance of laws and regulations applicable to specific industry like health care industry, manufacturing, financial, etc. It is structured in specialised frameworks that complies with particular regulations and laws.

III GRC Software

This software is a general compliance tool which focuses on the following:

- Managing the risks
- Monitoring the compliance risks
- Handling corporate governance tasks

- Streamline the compliance workflows and initiatives

Illustrations:

Below mentioned companies are have adopted compliance management tools (2022):

1. ***Bharti Airtel Limited***

   The company has implemented in-house rule based data analytics tool and oracle Governance Risk and Compliance (GRC).

2. ***Reliance BP Mobility Limited***

   Governance, Risk, Compliance and Audit (GRCA 2.0) Platform which is an in-house developed platform on open source technology, has enabled real-time actionable dashboards and real-time monitoring of risks and controls.

   The company has integrated Reliance Compliance Managements System (iRCMS), an online compliance monitoring system which maps and tracks compliances applicable to the company and its units state wise and legislation wise, ensuring "Zero non-compliance' and 'Zero Pendency'.

BENEFITS OF COMPLAINCE MANAGEMETN TOOLS

Compliance Management Tools help to work more efficiently so that it can work upon more compliance initiatives with following:

- **Reduction in Manual Work**: The management of compliances and requirement in spreadsheet is time consuming and tedious work. Compliance management tools helps in the growth of the business and highlights where the improvements are required. It helps in easy task management and documenting the corrective steps.
- **Streamlining implementation**: With streamlining the implementation of various relevant frameworks, it reduces the compliance efforts. It facilitates the compliance audits and corrective steps.
- **Simplification in Monitoring and reporting**: It auto populates the compliances dates and give alerts pertaining to compliance issues. It helps the responsible persons to ask their subordinates to update the metrics in compliance with regulations and laws.
- **Risk in human errors reduced**: It helps in improving the compliance programs performance and it reduces the risk in human errors. It generates the reports quickly with detection of compliance failures.
- **Builds Organisation Reputation:** The more organisation can maintain compliance, the better its reputation is going to be. This includes both organisational reputation with its customer base and with its employees. The Customers only want to work with trustworthy organizations, which is why a record of compliance will boost its reputation.
- **Creates a Roadmap for Business:** One of the biggest benefits of a compliance management tool is that it shows you where to go. Compliance management tool maps out organisations regulatory requirements and tells where it need to improve. It tells everything Essentially, this "compliance calendar" helps you prioritize what needs to be fixed/resolved and when. This way, it can effectively map out your compliance activities to best drive compliance in the organization.

CASE STUDY

Project Eagle: Infosys Regulatory Compliance Program

Infosys compliance program, known as Project Eagle, is intended to track, detect, prevent and remediate any violations of applicable laws and regulations and to encourage a culture of compliance to protect our organizations value and guides our interactions with governments, regulators, shareholders, employees.

Infosys regularly assesses and enhances the compliance mechanisms to meet its evolving compliance needs and obligations, in collaboration with Functional Heads and external consultants. Project Eagle covers the applicable regulations emanating from, for example, Global Immigration, Health, Safety, HR & Employment Law, Tax, Anti Bribery, Export Control, Information Security, Intellectual Property etc.

Project Eagle is supported by the implementation of software tool-based systems ("Compliance Manager Tool") to effectively track and monitor such applicable compliances under various regulations and enable compliance with the same. Infosys use the Compliance Manager Tool to implement an enterprise-wide regulatory compliance management to oversee and track regulatory compliance for applicable regulations globally. The company also have a contractual arrangement with external consultant to add more countries in the tool as and when required.

Any changes in applicable regulations are also being updated on the tool on a regular basis, in collaboration with external consultant. An inter-functional team of designated users and checkers oversee implementation and its functioning. Further, respective Functional Heads also supervise and certify continued adherence of applicable regulations as well as any risk of non-compliance with mitigation plan to the Board on a quarterly basis. Infosys culture of compliance and the compliance tracking tools are reviewed by Audit Committee of the Board and Management at regular intervals. It further undergoes independent assessment internally and with the help of external auditors.

LESSON ROUND-UP

- Effective Corporate Compliance Framework enables the organization to achieve its objectives and goals with compliance of applicable laws and regulations, mitigating the risks associated with and making continuous improvements as required.
- Corporate compliance management involves a full process of research and analysis as well as investigation and evaluation.
- The role of company secretaries in a company is to create such framework which can translate the regulatory requirements into management actions of the company.
- The compliances requirement under various laws applicable to the company should be prepared in consultation with the respective functional heads.
- The risk monitoring plan must include critical and high compliance risks and should focus on inherent and managed risk levels.
- The material compliance incidents are the events having effect on the company's integrity, damaging company reputation, legal or regulatory sanctions, or financial loss, as a result of a failure (or perceived failure) to comply with applicable compliance related laws, regulations and standards.
- The compliance audit is the independent assessment of whether a given subject matter is in compliance with applicable laws and criteria defined by the authorities.
- The corporate compliance framework consists of three key components Compliance Chart, Compliance Advisory and Compliance Scorecard.
- The compliance chart of a company is prepared after considering the operations and the structure of the company as the compliance requirements for an organization is based on the type of organization, activity of the organization, industry, sector in which the company operates and laws which are specifically applicable to the company.
- The Compliance Chart of any company must contain the complete information on compliance dashboard, which provide a detailed compliance procedure to the compliance executor.

- The identification of compliance requirements involves the compliances under various applicable laws and regulations to the organisation. There must be as systematic process of identifying compliance obligations of the organisation and their implications for its activities and services.
- Risk assessments should be done according to the changes in the business' profile. Such changes may result because of new laws or regulations, new interpretations of existing laws or regulations, new theories of liability, a new activity of the business or changing social standards.
- Compliance monitoring, as the most effective tool of compliance framework, concisely means the "oversight" of the company's operations and activities, both in light of local and binding cross-border regulations and the company's local and global policies, procedures, and ethical rules.
- A strong Compliance training and education programme reinforces the company compliance culture. It builds awareness and understanding of compliance standards, procedures, guidelines and issues.

GLOSSARY

Compliance Chart : The Chart that provides an overview of the applicable local, state, central and international laws, regulations and standards relating to a business' operations.

Compliance Advisory : Advice on compliances of applicable laws and effect of non-compliances.

Compliance Scorecard : A tool to analyse the position of an organisation in compliances.

Compliance Dashboard : a single enterprise-wide dashboard for all users to track and trend compliance events.

Action Reporting : Report of Internal Auditor/Independent agency/Regulator with the possible consequence such as disqualification/ suspension/ lock out/ license cancellation.

Monitoring : Determining the status of a system, a process or an activity.

Non-compliance : Non-fulfilment of a compliance obligation, either deliberately or inadvertently. It involves circumstances where a compliance obligation has not been met or has only partially been met.

TEST YOURSELF

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. You are the Company Secretary of the newly formed company Sun Moon Ltd. Your chairman has asked you to prepare a compliance chart. What are the various points you would mention in the compliance chart?
2. Define the point which should be kept in mind while developing a compliance framework.
3. ''The Compliance Chart of any company must contain the complete information on compliance dashboard. Which provide a detailed compliance procedure to the compliance executor''. As a Company Secretary, list out the various content of the Compliance Chart.
4. Describe the importance of the compliance chart in the managing compliances of the company.
5. What are the various risks a company may face for non-compliance of law?
6. "A strong compliance training and education program reinforces company compliance culture" Comment.
7. ABC Ltd., a listed company has appointed two independent directors. As part of its familiarization policy it provides key updates and background about the company to the newly appointed directors. The directors have requested you as the Company Secretary of the company to explain the process of Corporate Compliance Reporting. Explain the process.

8. Why does compliance management crucial to any business? Elucidate.

LIST OF FURTHER READINGS

- Companies Act, 2013 and Rules made thereunder
- SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015
- ICSI Publication on "CS: A Preferred Professional"

OTHER REFERENCES (Including Websites / Video Links)

- https://static.mygov.in/rest/s3fs-public/mygov_160975438978977151.pdf
- https://prsindia.org/policy/report-summaries/revised-draft-non-personal-data-governance-framework
- https://www.business-standard.com/article/companies/ccpa-fines-cloudtail-with-rs-1-lakh-for-not-complying-with-bis-standards-122110501204_1.html
- https://www.otago.ac.nz/risk/otago701770.pdf
- https://www.investopedia.com/terms/g/grc.asp

Documentation & Maintenance of Records

Lesson 2

KEY CONCEPTS

■ Document ■ Record ■ Repository ■ Coding ■ Archive ■ Privacy Control ■ Record Room

Learning Objectives

To understand:

- Effective documentation provides easy access to the required information on time for the effective and timely utilization of the Information.
- What are the statutory provisions with respect to preservation of records.
- The importance of the documentation and record maintenance and the principles of the good documentations.
- The document management system.

Lesson Outline

REGULATORY FRAMEWORK

- The Companies Act, 2013
- The Companies (Management and Administration) Rules, 2014
- SEBI (LODR) Regulations, 2015

INTRODUCTION

Document means:

A document is a part and parcel of written, printed, or electronic matter that provides certain information. The information may be in a structured or unstructured format. Documents may usually be changed and revised as per requirement. In our daily lives, we all create, receive and use documents. The emails we send and receive, reports, shopping lists, etc. are all examples of documents.

Record means:

A record is a matter of evidence about the past. Many records initially start out as documents and later become records when they are used as evidence. Records can be used as proof in legal obligations or in the transaction of business. It is also important to keep in mind that not every record is a document. For instance, a taped conversation between two persons may be used as a record to conclude that they were framing a conspiracy. Some examples of records may include final reports, emails confirming actions or decisions, photographs, spreadsheets, business contracts, etc.

The primary responsibility of a Company Secretary is to prepare and maintain the secretarial and other records, which are required to be kept by the company and in many cases the role is extended towards creating & execution of the critical corporate records. This require a good understanding of what documents need to be created, what is the purpose of such documentation, how much details are required to be disclosed in any documents etc.

At the next level of the documentation, it is the duty of the Company Secretary to ensure the confidentiality of the documents and check whether or not the document requires any further action, also to check whether it is consistent with prior records (in both substance and form), or if it conflicts with corporate policies, may create concerns under existing agreements, may results in a violation of law, or may have tax implications etc.

CASE LAW

Consequences of non-maintenance of record (updated Register of Members)

In the matter of *M/s. SDU Holdings Private Limited, the Registrar of Companies, Bangalore*, has passed an adjudication order by imposing of penalty, for violation of provisions of section 88 of the Companies Act, 2013. As per the provisions of the Companies Act, 2013, every company limited by shares shall from the date of its registration, maintain a register of its members in form no. MGT-1.

During the course of enquiry pursuant to section 206 of the Companies Act 2013, the inspection officer persuaded the statutory registers maintained by the company and noticed that the register Form No. MGT-1 maintained by the company is incomplete. Taking on account of default, the adjudication officer gave reasonable opportunity to being heard to the company and every officer in default by way of giving personal hearing notice.

Consequently, the Adjudicating Officer, after having considered the facts and circumstances of the case and also the submissions made by the company and its director during the personal hearing, decided to impose the penalty on the company and its directors for non-compliance of section 88 of the Companies Act, 2013.

Source: https://www.mca.gov.in/content/mca/global/en/data-and-reports/rd-roc-info/roc-adjudication-orders.html

The Company Secretary is also responsible for storing, maintaining, retrieving, certifying, and explaining corporate documents. Many issues are implicated relating to document storage, including the span of time the records need to be retained, ensuring the documents are stored in a safe place, whether documents are backed up, either in hard copy or electronically, and their timely access. A Company Secretary is often responsible for documents relating to subsidiaries, joint ventures, consortiums, and other entities also, many of which may be at locations other than corporate headquarters, including locations around the world. In such cases, the Company Secretary must consider whether and to what extent, he should rely on local partners in maintaining and creating corporate records, as well as to what extent he or she must exercise oversight. The Company Secretary may also execute documents on behalf of the company and may be involved in maintaining or advising with respect to the corporate website and social media.

CASE LAW

In the matter of *Welspun Project Ltd. V. National Company Law Tribunal, Ahmedabad Bench (T.P. NO. 149/621A/NCLT/AHM/2016)*, it was observed that the Register of directors' shareholding of the petitioner company did not disclose the complete particulars as required under section 307 of the Companies Act, 1956 (now section 170 of the Companies Act, 2013). ROC's report observed that this violation was committed for about 8 years. Petitioners admitted such violation and filed petition under section 621A (now section 441) for compounding violation. The offence committed was compounded on payment of fine.

PURPOSE OF DOCUMENTATION

Client Service: Documentation is a tool for professionals to serve better to their clients in a timely and effective manner.

Communication: Documentation is the base for better communication between professionals. Clear, complete, accurate and factual documentation provides a reliable permanent record of client.

Accountability: Documentation demonstrates professional accountability and records the work of the professional. It may be used in relation to performance management, internal inquiries, regulatory proceedings and/or legal proceedings.

Professional Responsibility: Documentation is an integral part of professional practice and forms the basis for evidence of professional conduct.

Legal Requirement: Professionals are required to make and keep records of their professional work in accordance with practice standards followed and organisational policy. However, the laws mandate specific information to be recorded and maintained.

Quality: Documentation may be used to evaluate professional practice in terms of Peer reviews, Quality reviews, audits and accreditation processes, Regulatory inspections or critical incident reviews.

Research: Documentation is a valuable source of data for researchers. It provides information to professional, evaluates client outcomes and is a concise record, essential for accurate research data and evidence based practice.

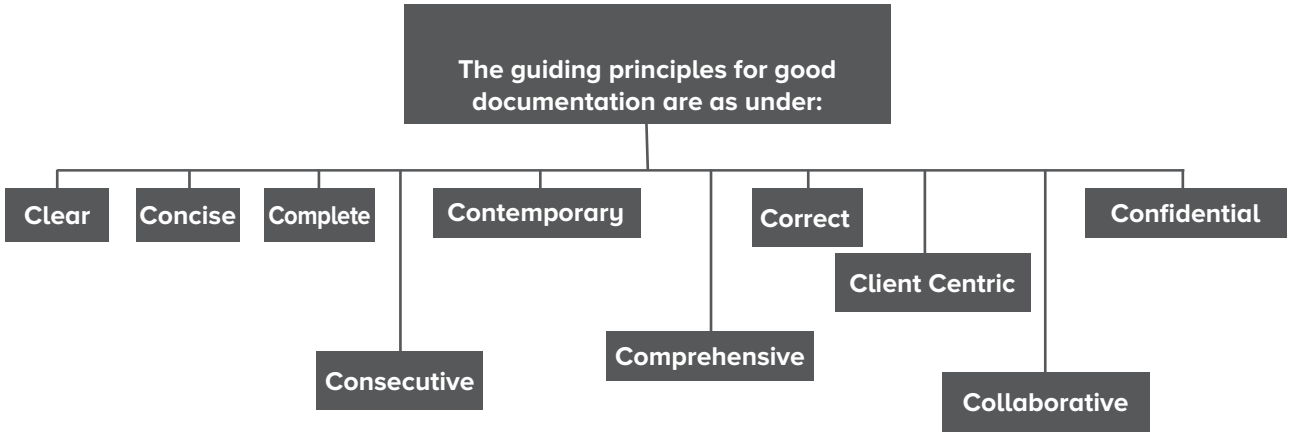
Resource Management: Accurate and comprehensive documentation is a valuable source of evidence and provide basis for resource management.

Illustration:

A multinational company conducts operations across the globe and employ millions of people and on every day basis millions of transactions are carried out. To maintain the company's interest, ensure the proper compliance of statutes, and retain the confidence of the stakeholders, proper documentation must be carried out.

Guiding Principles of Good Documentation

The term documentation includes any and all forms of documentation recorded by a person in professional capacity in relation to his professional duties and includes written and electronic records, audio and video tapes, emails, facsimiles, images (photographs and diagrams), charts, check lists, communication books, management reports, incident reports and working notes or any other type or form of documentation. The good documentation promotes good corporate governance practices and compliance level of the company and also improves communication and dissemination of information between and across various stakeholders. These guiding principles support professionals, employers, policy makers and managers in assessment, planning, execution and evaluation. Also, the good documentation practices and policies demonstrate the professional obligation, accountability and legal requirement to communicate and record client information and good secretarial practice.



What is Good Documentation Practice?

Good documentation practices is a set of best practices for documentation and recordkeeping. It aims to preserve the data integrity of important documents and records and can also serve as guidelines for how to record information and store data appropriately.

Examples of Poor Documentation Practices

The following are the some of the examples of poor documentations practices:

- Document with errors, correction, not signed/dated, and didn't include a reason for the correction;
- Write-overs, multiple line-through and use of "White-out" or other masking device;
- Recording of events is not in sequence & tabled;
- The delegation of work is not recorded/documented;
- Standards operating procedures as adopted by the professional is not authorised;
- Out-of-specification procedure not detailed enough; flow chart and/or check list not available.

Examples of Good Documentation Practices

The following are the some of the examples of good documentations practices:

- Records should be completed at time of activity or when any action is taken;
- Superseded documents should be retained for a specific period of time;
- Concise, legible, accurate and traceable;
- Picture is worth a thousand words;
- Clear examples;
- Don't assume knowledge/information.

Situation Based Example:-

A regulatory authority has some follow-up questions for a business that has recently submitted evidence of its compliance.

Scenario 1- If Documentation Followed: Since the business immediately knows the person who recorded the compliance data, they are able to fetch more information and even able to answer the follow-up questions of the regulatory authority spontaneously. Consequently, the regulatory authority is able to confirm that the business is compliant.

Scenario 2- If Documentation Not Followed: Since the records submitted as evidence of compliance don't identify the person who is responsible for creating them, the business is having difficulty finding more information on their compliance data. They are unable to answer the regulatory authority's follow-up questions and consequently are in danger of being deemed as non-compliant by the regulatory authority.

CASE LAW

In the matter of *M/s Indiabulls Real Estate Limited, the Registrar of Companies, NCT of Delhi & Haryana*, has passed an Adjudication order for non-compliance of the provisions of sub-section (10) of section 118 (mandatory observance of Secretarial Standards with respect of general and board meetings) of the Companies Act 2013 read with Secretarial Standards – 1 & 2.

As per section 206(5) of the Companies Act 2013, the Central Government carried out the inspection of the books of accounts of the company and after going through the records / documents of the company, the inspector, upon completion of the inspection observed that the company has not complied with the provisions of section 118 (10) read with Secretarial Standards. The inspector while submitting the report pointed out that the company has not serially numbered their "Attendance Register" of board meetings and other meetings and also the "Attendance Register" maintained in loose-leaf form, not bound periodically, which is not in compliance with section 118 of the Companies Act 2013 read with Secretarial Standards issued by the Institute of Company Secretaries of India.

The Registrar of Companies, based on the report submitted by the inspector, issued a show cause notice to the company. The company in a reply to show cause notice stated that the company and its directors / officers accept that there has been an inadvertent mistakes and these have been rectified subsequent to the issue of the show cause notice. The company stated that there was no deliberate intention and no *mens-rea* with read to the offences and therefore the company, its directors / officers deserve to be excused.

The Registrar of Companies / Adjudicating Officer came to the conclusion after going through the application and also based on the oral and written submission made by the company at the time of the personal hearing and imposed penalty on the company and its officers.

Good Documentation Do's and Don'ts	
Do's	**Don'ts**
Do record the data/document as soon as it is generated	Don't delay in data/document recording
Do add the reference notes (if possible) to provide the context	Don't make the data confusing, vague and unreadable
Do validate your computerised system or document software	Don't encourage handwritten documentation

Good Documentation Do's and Don'ts	
Do's	**Don'ts**
Do limit document access to authorised personnel	Don't intentionally falsify the record/document
Do specify when the data/document was recorded, reviewed and approved	Don't pre-date or back-date the data/document
Do keep data back-up, either automatically or by storing the true copy in separate location	Don't archive data/documents unless explicitly authorised to do so

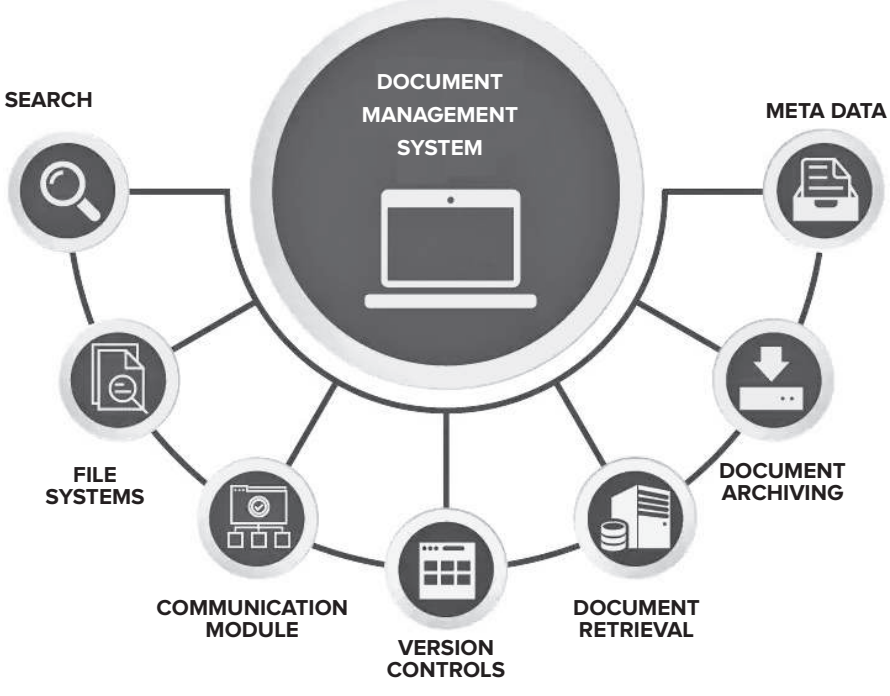
ELECTRONIC REPOSITORY OF DOCUMENTS

Document management refer the process of managing and tracking of the documents and records through an electronic or physical source of documents.

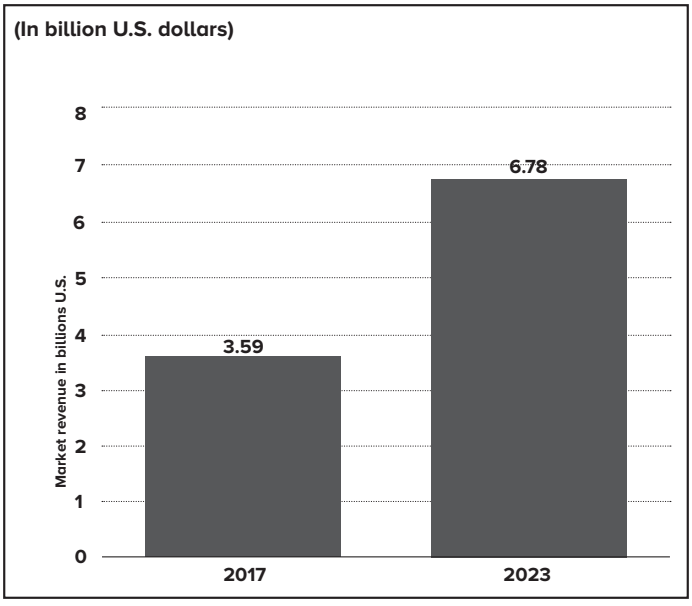
In an electronic repository, Document Management Systems (DMS) works by using a computer system and software to store, manage and track electronic documents and electronic images of paper based information captured through the use of a scanner.

The term document management system can be defined as the software that controls and organizes documents of an organization. It incorporates document and content capture, workflow, document repositories and output systems, and information retrieval systems. Also, the processes used to track, store and control documents.

Now a days many business houses are adopting maintenance of records efficiently through document scanning, cloud document management and secure archive storage services. In Cloud Document Management – Digitised records can be uploaded, together with relevant data to secure cloud document management solution. This allows maintenance records to be accessed from any location using a web browser. The system provides a full electronic audit trail and restricts access to records by user, group or role, providing improved compliance. Documents can be tagged by any required data, which allows information to be found quickly and easily using a keyword search functionality.



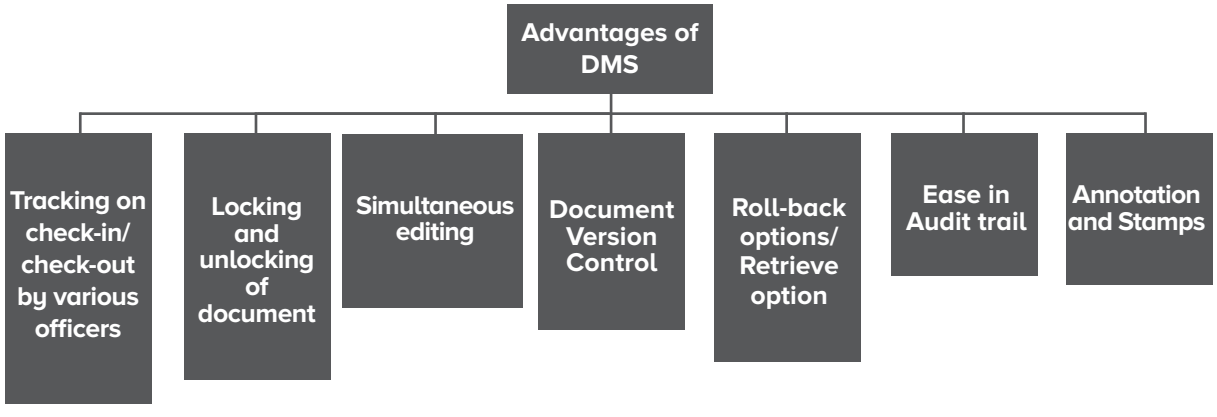
The below statistics showcase the volume of Document Management Systems and its market revenue forecast worldwide in 2017 and 2023*



CASE STUDY

Health Care Provider Moves to Electronic Records

Top of minds for a North American Regional Health Care Provider (RHCP) had made the decision to move to electronic records. They wanted one organization (Electronic Record Keeping Service Provider) that could handle every aspect of implementing their electronic health record strategy, while simultaneously standardizing records management practices across the four major hospitals and numerous clinics they managed. Team of the Electronic Record Keeping Service Provider met with the senior management of RHCP and showcased the implementation plan for a new electronic health record strategy. The Electronic Record Keeping Service Provider recommended an automated, streamlined end tab labelling system that would standardize all files. The service provider completed the RHCP project in a tight timeline and with the integrity of every file intact, its ability to provide a "one stop" methodology for organizations moving to electronic records was proven successful. Approximately 500,000 records were converted during the project, an impressive feat.



Source: https://www.statista.com/statistics/884083/worldwide-documents-management-market-value/

Advantages of the Electronic Records

- **Cost Effective:** Storing and maintaining records in digital form is much cheaper than in any other format. With the increase in the technology advancement, the Digital media costs drop every day. Today, digital storage costs a 1000th of what it cost just a few decades ago, so the storage costs are continually dropping for electronic images.
- **Ease of use:** It's very easy to locate and share electronic documents through Computers aid searching now a days the process of filing doesn't exist anymore. The Document management system take care for finding and maintaining Records consistent locations.
- **Labor savings:** The labor required to locate, manage and dispose of electronic documents is almost nil and minimum. With electronic documents, all the steps like filing collating, stapling etc. can be automated and that labor completely disappears.
- **Search ability:** Electronic documents can be made searchable by doing OCR of a document and make the whole text keyword searchable. That is not possible with paper documents.
- **Portability:** It's very easy to transport electronic documents. No more boxes of records and trucks and semi-trucks to haul records archives. They can easily be stored on a removable hard drive or thumb drive and taken to the courthouse or to the field office.
- **Version tracking:** In case of the version tracking it is very easy with electronic documents, making it easy to see who has made changes to a document, when they made those and what the document looked like before the change. Version tracking and document management in the hard copy world is much more complex and much more costly.

Question: Which of the following is not an advantage of DMS?

Options: (A) Tracking on check-in/check-out by various officers

(B) Locking and unlocking of Document

(C) Simultaneous editing

(D) Difficult Audit Trials

Answer: (D)

CASE LAW

A Case Regarding Admissibility of Electronic Evidence

In the matter of Arjun Panditrao Khotkar vs. Kailash Kushanrao Gorantayal and Ors. civil appl no. 20825-20826 of 2017, Civil Appeals were referred to a Bench of Judges of Supreme Court by a Division Bench, dealing with the interpretation of Section 65B of the Indian Evidence Act, 1872 by two judgments. It was found by the court that a Division Bench judgment in *Shafhi Mohammad v. State of Himachal Pradesh (2018) 2 SCC 801* may need reconsideration by a Supreme Court Bench of a larger strength. In the case of *Shafhi Mohammad (supra)*. it was observed by Supreme Court that it can be safely held that electronic evidence is admissible and provisions under Sections 65-A and 65-B of the Evidence Act are by way of a clarification and are procedural provisions. If the electronic evidence is authentic and relevant the same can certainly be admitted subject to the Court being satisfied about its authenticity and procedure for its admissibility may depend on fact situation such as whether the person producing such evidence is in a position to furnish certificate under Section 65-B(4).

The Supreme Court observed that the major premise of *Shafhi Mohammad (supra)* that the certificate under section 65-B(4) cannot be secured by persons who are not in possession of an electronic device is incorrect. An application can always be made to a Judge for production of such a certificate from the requisite person under Section 65B(4) in cases in which such person refuses to give it.

Disadvantage of Electronic records

- **Software risk:** Storing records in an electronic document management system, have a risk that the system being no longer supported by the software company; that the company will cease to exist; and that the documents will be locked in an unsupported system and have to pay conversion costs to recover them. So, the person is somewhat at risk to the software vendor that manages the records.
- **Format risk:** When storing the records in electronic format, a person run the risk of not being able to read them at some point. For example, some of the software are become the standard storage format now a days like PDF, JPEG, etc., but there is a risk that such software will cease to exist, be purchased or no longer support PDF format, and then it will be difficult in the future to read those PDF documents. Though such software provides to address this with their PDF or archive PDF format, which is supported by software code escrow and other measures that should make it forward and backwards compatible for years and years to come, but it is a risk.
- **Reliability:** Paper is an agnostic format. All person needs to have is a light source and some eyes to be able to read paper. It's a good idea to have most vital documents imaged, but keeping a paper copy assures that the person have access to them anytime. A person should keep a paper copy of vital documents - deeds, corporate documents-stored in a safe off-site location.
- **Portability:** The portability is an advantage for digital images. It's very easy to misplace or accidentally delete large amounts of data. It's very easy mode for data to duplicated and transported outside of any organization without permission or knowledge. It's very easy for it to be misplaced or corrupted as well. The very properties that make it easy to use, also make it easy to steal and easy to delete if the proper safeguards aren't in place but those safeguards are expensive.

MAINTENANCE AND INSPECTION OF DOCUMENTS IN ELECTRONIC FORM UNDER COMPANIES ACT, 2013

Section 120 of the Companies Act, 2013 (the Act) read with Rule 27 & 28 of the Companies (Management and Administration) Rule, 2014 provides for maintenance of documents in electronic form. The provisions also provide for inspection of documents maintained in electronic form. It states that any document, record, register, minutes, etc. that are required to be kept by a company or allowed to be inspected or copies to be given to any person by a company under the Act, may be kept or inspected or copies given, as the case may be, in electronic form. Rule 27 provides that every listed company or a company having not less than one thousand shareholders, debenture holders and other security holders, may maintain its records in electronic form.

> Section 2(36) of the said Act relates to the definition of "document" which includes summons, notice, requisition, order, declaration, form and register, whether issued, sent or kept in pursuance of Companies Act or under any other law for the time being in force or otherwise, maintained on paper or in electronic form.
>
> The term "records" means any register, index, agreement, memorandum, minutes or any other document required by the Act or the Rules made thereunder to be kept by a company. Therefore, such documents and records can also be maintained in electronic form.

However, the records in electronic form shall be maintained in such manner as the Board of directors of the company may think fit, provided that -

(a) the records are maintained in the same formats and in accordance with all other requirements as provided in the Act or the rules made there under;

(b the information as required under the provisions of the Act or the rules made there under should be adequately recorded for future reference;

(c) the records must be capable of being readable, retrievable and reproducible in printed form;

(d) the records are capable of being dated and signed digitally wherever it is required under the provisions of the Act or the rules made there under;

(e) the records, once dated and signed digitally, shall not be capable of being edited or altered;

(f) the records shall be capable of being updated, according to the provisions of the Act or the rules made there under, and the date of updating shall be capable of being recorded on every updating.

Security of Records Maintained in Electronic Form- Rule 28

(1) The Managing Director, Company Secretary or any other director or officer of the company as the Board may decide shall be responsible for the maintenance and security of electronic records.

(2) The person who is responsible for the maintenance and security of electronic records shall-

(a) provide adequate protection against unauthorized access, alteration or tampering of records;

(b) ensure against loss of the records as a result of damage to, or failure of the media on which the records are maintained;

(c) ensure that the signatory of electronic records does not repudiate the signed record as not genuine;

(d) ensure that computer systems, software and hardware are adequately secured and validated to ensure their accuracy, reliability and consistent intended performance;

(e) ensure that the computer systems can discern invalid and altered records;

(f) ensure that records are accurate, accessible, and capable of being reproduced for reference later;

(g) ensure that the records are at all times capable of being retrieved to a readable and printable form;

(h) ensure that records are kept in a non-rewriteable and non-erasable format like pdf. version or some other version which cannot be altered or tampered;

(i) ensure that at least one backup, taken at a periodicity of not exceeding one day, are kept of the updated records kept in electronic form, every backup is authenticated and dated and such backups shall be securely kept at such places as may be decided by the Board;

(j) limit the access to the records to the managing director, company secretary or any other director or officer or persons performing work of the company as may be authorized by the Board in this behalf;

(k) ensure that any reproduction of non-electronic original records in electronic form is complete, authentic, true and legible when retrieved;

(l) arrange and index the records in a way that permits easy location, access and retrieval of any particular record; and

(m) take necessary steps to ensure security, integrity and confidentiality of records.

CASE LAW

In the matter of *M/s. Michelin India Pvt Ltd, the Registrar of Companies, Tamil Nadu on 18th October, 2022*, has passed an adjudication order by imposing of penalty for violation of provisions of section 134(3)(f) of the Companies Act, 2013. Pursuant to Section 134(3)(f) of the Companies Act, 20l3, there shall be attached to statements laid before a company in general meeting, a report by its Board of Directors, Which shall include explanations or comments by the Board on every qualification, reservation or adverse remark or disclaimer made by the auditor in auditors report or by company secretary in his secretarial audit report.

The Regional Director, Southern Region Chennai has observed that while examining, that the statutory Auditor's in their audit report have reported deficiencies in the internal financial control and they were unable to obtain sufficient and appropriate audit evidence. It is clearly evident from the said statement that the company did not have proper internal financial control and also did not maintain appropriate records. Further, auditors report also mentioned non-maintenance of back up of books of accounts maintained in electronic mode in servers physically located in India. However, the Board of Director in their Boards report have not offered any explanation for the observations of auditors.

The Regional Director, Ministry of Corporate Affairs, had issued directions to take action against the company, every director and key managerial personnel of the company who is in default and to penalize the defaulter(s) *ibid* adjudication order.

CASE LAW

In Re *Anil Kumar Poddar V. Bonanza Industries Ltd. Co. application no. 20 of 2014 CLB Mumbai*, in this case the applicant filed application seeking to pass an order directing the respondent company to allow inspection of statutory register and record of the Respondent Company by stating that he had a statutory right to seek inspection of the documents in the capacity of he being a shareholder of the company and obtain copies thereof upon payment of the requisite charges.

The Respondent Company submitted that the applicant acquired had 10 shares only and started harassing the company and its management by frequently demanding the copies of statutory register required to be maintained under the Companies Act, minutes of the general meeting of the members of the company and the copies of the annual accounts and other documents.

The Court held that It appears that the applicant is in the habit of making such application. It is a matter of common knowledge that presently all the statutory records of any company are available on the MCA portal. It is open for inspection to all concerned. The certified copies can be obtained from the department of the ROC concerned. Yet, the Applicant keeps on filing such frivolous applications and it is, therefore, apparent that he is not a bona fide applicant. The application deserves to be dismissed.

PHYSICAL REPOSITORY

The term Physical repository refers to a central place where data is stored and maintained. A repository can be a place where multiple databases or files are located for distribution over a network, or a repository can be a location that is directly accessible to the user without having to travel across a network. The comparison between the virtual and Physical data room is illustrated as under:

VIRTUAL AND PHYSICAL DATA ROOM - A COMPARISON

Sl.No.	Particulars	Physical Data Room	Virtual Data Room
1	Form of documents	Papers, files, boxes or other tangible thing	Electronic/Digital/soft copies of documents including video/audio documents
2	Security of documents	Lies with the integrity of person who is in-charge of the data room	More secured through specific log-in id and pass word. In addition facilities like internet fire walls are there.
3	Time required for creation of data room	Longer time required	Can be created within 48 hours once demands of prospective bidders are identified

Sl.No.	Particulars	Physical Data Room	Virtual Data Room
4	Cost	Cost is high because of reasons like- Requirement of one person to take care of data room. Requires bidders to travel from their place to the place of location of data room, etc.	Cost is Low as the documents can be viewed from any location with internet security
5	Convenience	Searching the documents is time consuming	More convenient as it enables multiple bidders to review documents at the same time with search facility also.
6	Accessibility to data room	Timings to access data may be restricted	Data may be accessed nearly any time
7	Facility to restrict access of specific document	Difficult to implement any Restriction	Access can be restricted
8	Facility to check who has reviewed what documents and how many times	Available with high cost	Available with negotiable cost
9	Facility to highlight new information	To be conveyed manually to all bidders	A highlight can be made in the website created as data room
10	Ability to copy documents	Possible	Not possible always
11	One to one communication with the seller or his representatives	Available	Not available

CODING AND NOMENCLATURE

For naming of any documents adopting good file naming conventions can help ensure that files will work with different operating systems. Further, the file names can be either self-descriptive or non-descriptive.

The **Descriptive file** names are useful for small, well-defined projects with existing identification schemes that link the digital object to the source material. However, inconsistent application of terms or typos will increase to indexing and sorting errors.

Non-descriptive file names are usually system-generated sequential numerical string or the system based, such as a digital ID number, combination of Date and time, name of original file and are often linked to meta data stored elsewhere. Non-descriptive file names are often created for large scale digitization projects and may employ a digital ID number and numerical sequences to indicate batch or parent-child relationships. The advantage of non-descriptive names is that there is less chance of repeated or non-unique file names within a data structure.

Some applications and computer scripts could not recognize spaces or process files differently when using spaces. A best practice is to replace spaces in file names with an underline (_) or hyphen (-).

However, the punctuation, symbols, or special characters (periods, commas, parentheses, ampersands, asterisks, etc.) should be avoided. The following are best practices for file naming.

The File names should:

- Be unique and consistently structured;
- Be persistent and not tied to anything that changes over time or location;
- Limit the character length to no more than 25-35 characters;

- Use leading 0s to facilitate sorting in numerical order if following a numeric scheme "001, 002, 010, 011 ... 100, 101, etc." instead of "1, 2, ...10, 11 ... 100, 101, etc.";
- Contain a file format extension;
- Use a period followed by a file extension (for example, .tif, .jpg, .gif, .pdf, .wav, .mpg);
- Use lowercase letters. However, when a name has more than one word, start each word with an uppercase letter for example, "File_Name_Convention_001.doc";
- Use numbers and/or letters but not characters such as symbols or spaces that could cause complications across operating platforms;
- Use hyphens or underscores instead of spaces;
- Use standard date notation (YYYY-MM-DD or YYYYMMDD);
- Avoid blank spaces anywhere within the character string; and
- Not use an overly complex or lengthy naming scheme that is susceptible to human error during manual input, such as "filenameconventionjoesfinalversioneditedfinal.doc".

The strength of a folder and file naming convention is dependent on the proposed naming structure and the quality and quantity of the data elements chosen to build it. It should be of no surprise that for any business activity there is always an ideal naming structure. However, any structured naming convention that attempts to be all encompassing may result in overkill and unwieldiness.

The ten basic rules that could serve as a general guideline in structuring folder and file naming are:

S.No.	Particulars	Do's	Don'ts	Reason
1	Avoid extra-long folder names and complex hierarchical structures but use information-rich filenames instead.	D:\ABC\FY\16-17\ AR\ MGT-7.doc	D:/ Alfa Botanicals Private\Financial Year\2016-2017\ Annual Return\ Form MGT-7.doc	Complex hierarchical folder structures require extra browsing at time of storage and at the time of file retrieval. By having all the essential information concisely in the file name itself, both the search and identification of the file is streamlined and more precise.
2	Put sufficient elements in the structure for easy retrieval and identification but do not overdo it.	ABC_SearchReport_ Invoice 20.07.2018. pdf	ABC_Report_ Invoice.pdf	Precision targeted retrieval requires sufficient elements to avoid ambiguous search results but too much information adds undue effort at file naming time with little or no returns at retrieval time.
3	Use the underscore (_) as element delimiter. Do not use spaces or other characters such as: ! # $ % & ' @ ^ ` ~ + , . ; =) (	SMITH-J_ AXA_7654-6_ POLICY_20120915. pdf || FUJITSU_ S1500_SPEC_ Scanner.pdf	SMITH-J AXA 7654-6 POLICY 20120915.pdf || FUJITSU $S1500$ SPEC$Scanner.pdf	The underscore (_) is a quasi standard for field delimiting and is the most visually ergonomic character. Some search tools do not work with spaces and should be especially avoided for internet files. Other characters may be interesting but visually confusing and awkward.

S.No.	Particulars	Do's	Don'ts	Reason
4	Use the hyphen (-) to delimit words within an element or capitalize the first letter of each word within an element.	Smith-John_AIG _7654-6_POLICY_2009-09-15.pdf || WhitePaper_ Structured File Naming Strategy.doc	Smith John AIG 7654 6 POLICY 2009 09 15.pdf || White Paper Structured file naming strategy.doc	Spaces are poor visual delimiters and some search tools do not work with spaces. The hyphen (-) is a common word delimiter. Alternatively, capitalizing the words within an element is an efficient method of differentiating words but is harder to read.
5	Elements should be ordered from general to specific detail of importance as much as possible.	FY2009_Acme-Corp _Q3_ TrialBal_20091015_ V02.xls || Production_ Paint-Shop_ WorkOrder_775-2.xls	TrialBal _ Q3_20091015_ Acme-Corp_V02_ FY2009.xls || Paint-Shop_775-2_ WorkOrder_ Production.xls	In general the elements should be ordered logically, in the same sequence that you would normally search for a targeted file.
6	The order of importance rule holds true when elements include date and time stamps. Dates should be ordered: YEAR, MONTH, DAY. (e.g. YYYYMMDD, Y Y Y Y M M D D , YYYYMM). Time should be ordered: HOUR, MINUTES, SECONDS (HHMMSS).	RFQ375_Cables-Unlimited _BID_20091015-1655.pdf || 2009-11-20_AMATProj_ Phase1_Report.doc	RFQ375_Cables-Unlimited _ BID_10152009-1655.pdf || Nov-20-2009_ AMATProj_ Phase1_ Report.doc	To ensure that files are sorted in proper chronological order the most significant date and time components should appear first followed with the least significant components.
7	Personal names within an element should have family name first followed by first names or initials.	Tate-Peter_SunLife _1-7566-2_ POLICY_10YrTerm.pdf || SmithJ_ ID3567_ADMIN_ WageReview.xls	Peter-Tate_SunLife _1-7566-2_POLICY_10 Year Term.pdf || JSmith_ ID3567_ ADMIN_Wage Review.xls	The family name is the standard reference for retrieving records. Having the family name first will ensure that files are sorted in proper alphabetical order.
8	Abbreviate the content of elements whenever possible.	RevQC _QST_2009-Q2.xls || MCIM_ 27643 _POD. doc	Minister of Revenue Quebec _Quebec-Sales-Tax_2009-2ndQuarter.xls || MultiCIM-Technologies-Inc_27643_Proof-Of-Delivery.pdf	Abbreviating helps create concise file names that are easier to read and recognize.

S.No.	Particulars	Do's	Don'ts	Reason
9	An element for version control should start with V followed by at least 2 digits and should be placed as the last most element. To distinguish between working drafts (i.e. minor revisions) use Vx-01->Vx-99 range and for final draft (i.e. major version release) use V1-00-> V9-xx. (where x =0-9)	MCIM_Proposal_ V09.doc || eXadox_ UserManual_V1-02. doc	MCIM_Proposal_9. doc || eXadox_ UserManual_ V2FinalDraft.doc	The "V" helps denote that the element pertains to a version number. A minimum of 2 digits with a leading zero is required to ensure that search results are properly sorted. The intent is to avoid the situation where for example, a filename with a "V1-13" will wrongly appear before an identical filename with a "V1-2" version number when sorted in ascending alphabetical/numerical order. To distinguish between working, review and final draft a single digit prefix followed by hyphen "-" is preferred to facilitate proper sorting; using words in the file name such Final, Draft or Review in the filename affect the order and should be avoided.
10	Prefix the names of the pertinent sub-folders to the file name of files that are being shared via email or portable storage devices.	Prod_PS_AssL7_ W O _ Suzuki _ J3688-20090725. xls || FY2009_ Acme-Corp _Q3_ TrialBal_20091015_ V02.xls	WO_Suzuki_J3688-20090725.xls || Q3_ TrialBal_20091015_ V02.xls	Attached files and files shared through portable devices include only the file name and can be totally devoid of the context that is generally provided by the folder structure of origin. To compensate and avoid confusion it is sometimes essential to prefix the name of the subfolder(s) to such file names.

CIRCULATION OF DOCUMENTS

In a company efforts shall be established to control the issuance of documents, such as instructions, procedures, and drawings, including changes thereto, which prescribe all activities affecting quality of the document & record. These measures shall assure that documents, including changes, are reviewed for adequacy and approved for release by authorized personnel and are distributed to and used at the location where the prescribed activity is performed. Changes to documents shall be reviewed and approved by the same authority that performed the original review and approval unless the organization designates another responsible Authority.

SAFETY AND RETRIEVAL OF RECORDS

To assure the best quality of documents, it is to be assured that sufficient records are maintained to furnish evidence of the activities affecting quality. The records should incorporate the following:

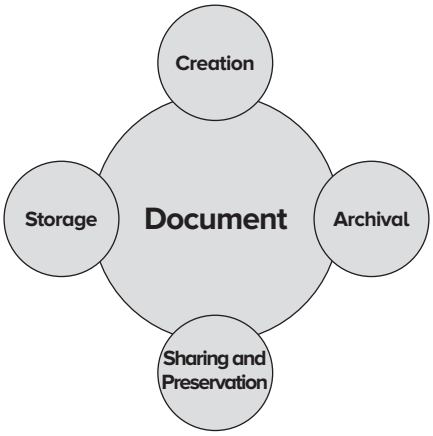
- **Operating logs:** the names of the individuals who all have worked on the same documents;
- **Results of reviews:** the recording of the changes suggested by each reviewer and basis of the rejection on Non agreement;

- **Inspections:** list of individuals who have access of the records and have inspection rights of the same;
- **Monitoring of work performance:** will ease in the monitoring of work performed by the person to whom the file is shared;
- **Information analyses:** Provide ease in the Information system of the organization and tracking of files.

Records should be identifiable and retrievable and should consistent with applicable regulatory requirements. The company should comply with requirements concerning record retention, such as duration, location, and assigned responsibility. Every record must be well managed in order to ensure that they are protected for both administrative purposes and to serve as evidence of the organization's work. Records management provides a professional approach to caring for records. The care of records and archives is governed by three key concepts.

(i) Keeping together

The records must be kept together according to the department / Section responsible for their creation or accumulation, in the original order established at the time of their creation. This gives them their 'evidential' nature and distinguishes them from other kinds of information. It is the basis for retrieving information from records. Knowing who created or used a record, and where, when and why, is the key to retrieval rather than their format, subject matter or content. This is true for paper-based records as well as the electronic records.



(ii) Ensure life cycle

Every records follow a 'life-cycle', in that they are created, used for so long as they have continuing value and then disposed of by destruction or by transfer to an archival institution. Every record pass through three main phases, i.e. current phase, semi-current phase and non-current phase.

In the **current phase**, they are used regularly in the conduct of current business and maintained in their place of origin or in the file store of an associated records office or registry.

In the **semi-current phase**, they are used infrequently in the conduct of current business and are maintained in a records center.

In the **non-current phase** they are destroyed unless they have a continuing value which merits their preservation as archives in an archival institution. The effective management of records throughout this life-cycle is a key issue in civil service reform.

(iii) Record Preservation

The care of records and archives is that the care should be managed through a coherent and consistent range of actions from the development of record-keeping systems, through the creation and preservation of records to their use as archives.

The concept suggests that four actions continue or reappear throughout the life of a record: i.e., identification of records; intellectual control; provision of access; and physical control. The management of this continuum basis for a strategic approach to records management.

CASE STUDY

U.S. Food & Drug Administration (FDA) has issued series of warning letters to pharmaceutical companies for Good Manufacturing Practices (GMP) violations particularly for data integrity. The different companies who fail to ensure the data integrity are as under:

Ranbaxy Laboratories, a multinational pharmaceutical company has received a warning letter by US FDA for its two facilities that are Dewas and Poanta Sahib facility. In Dewas facility, the company failed to maintain batch production and control records. And in Poanta Sahib facility, incomplete batch and production records were followed for the review and approval of production and control records for drug products.

Canton Laboratories, a manufacturer of chemical and bulk drugs has received a warning letter by US FDA for its Vadodara plant for reporting results for the tests that were never performed. Significant Good Manufacturing Practices (GMP) violations related to record maintenance were observed in the industry. The company was accused for serious documentation practices and reported missing data.

Wockhardt Limited, a Mumbai based pharmaceutical company received a warning letter by US FDA for Aurangabad plants for data integrity issues. The company failed to exercise appropriate controls over computer or related systems to assure that only authorised personnel institute changes in master production and control records or other records.

Source: https://www.igmpiindia.org/DocumentationandMaintenance.pdf

PRESERVATION OF RECORDS

Preservation of records refers to the implementation of strategies that enhance and prolong the useable life of records and archives. Preservation encompasses storage and handling. Responsibility for the preservation of records is vested in the creating office during the active and semi-active phases of the records life-cycle. The other offices are charged with ensuring accessibility in the short and medium terms. However, where it is evident that records will be required as archives, and to assist the organization in long-term preservation, standards in the storage and handling of records should refer to the long term rather than short or medium terms. The provisions of Regulation 9 and 30(8) of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 state the provisions of preservations of records as under:

Preservation of Documents

Regulation 9 provides that the listed entity shall have a policy for preservation of documents, approved by its board of directors, classifying them in at least two categories as follows-

(a) documents whose preservation shall be permanent in nature ;

(b) documents with preservation period of not less than eight years after completion of the relevant transactions:

Provided that the listed entity may keep documents specified in clauses (a) and (b) in electronic mode.

Regulation 30(8) provides that the listed entity shall disclose on its website all such events or information which has been disclosed to stock exchange(s) under-regulation 30(Disclosure of events or information by listed entities), and such disclosures shall be hosted on the website of the listed entity for a minimum period of five years and thereafter as per the archival policy of the listed entity, as disclosed on its website.

Accordingly, the companies are required to prepare a policy statement relating to the preservation of its documents and archival of documents in the website. The following factors need to be considered in the preparation of the preservation and archival policy of the company.

- Analysis and Restructuring Existing Systems
  - reviewing and revising legislation and policies
  - reviewing and revising organizational policies and structures
  - determining resource requirements, such as facilities and staffing
  - developing strategic and business plans.

- Organizing and Controlling Records
  - building sound record-keeping systems
  - managing the creation, maintenance, and use of files.
- Providing Physical Protection for Records
  - implementing and maintaining preservation measures
  - developing emergency plans to protect records
  - identifying and protecting vital records.
- Managing Records in Records Centers
  - developing and maintaining records center facilities
  - transferring, storing and retrieving records according to disposal schedules
  - disposing of records as indicated by the schedules.
- Managing Archives
  - acquiring and receiving archives
  - arranging and describing archives according to archival principles
  - providing public access to the archives.
- Supporting and Sustaining the Program
  - promoting records services to the government and the public
  - promoting education for records and archives personnel
  - developing and expanding the records and archives professions.

Question : Which of the following regulation of SEBI (LODR) Regulations, 2015 provides for disclosures to be hosted on the website of the listed entity for a minimum period of five years and thereafter as per the archival policy of the listed entity, as disclosed on its website.

Options: (A) Regulation 9(8) (B) Regulation 30(8)

(C) Regulation 19 (D) Regulation 91

Answer: (B)

Preservation of Litigation Documents

Documents arising out of various litigation wherein a company is a party in any manner, shall need to be preserved as per the directions/orders of the court(s)/tribunal(s)/judicial/other authority(ies) as may be applicable, in absence of which the documents shall be preserved for a period of not less than eight consecutive calendar years after conclusion of the litigation.

Deviation from the Policy

Any court(s)/tribunal(s)/judicial/other authority(ies) shall have the power to direct a company to produce / preserve and/or destroy any document(s), however, if any document(s) has/have been destroyed pursuant to the Policy followed as per the SEBI Regulations, herein, it may not be possible for the company to produce such

document(s), therefore, necessary permission to that effect has to be taken by the company and/or a statement to that effect shall be given by the company from/to the relevant authorities. Any other action(s) shall need to be taken as may be advised by these authorities.

Model Policy

The model policy on preservation of Documents and archival of documents is as under:

Policy on Preservation of Documents and Archival of Documents in the Website
[Under Regulation 9 and 30(8) of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015]

1. Purpose and Scope

The purpose of this document is to present a policy statement for (Company) regarding preservation of its documents and archival of documents on the website in accordance with the provisions of the Companies Act, 2013 and Regulation 9 and 30(8) of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("LODR").

The policy is framed for the purpose of systematic identification, categorization, maintenance, review, retention and destruction of documents received or created in the course of business. The policy gives guidelines on how to identify documents that need to be maintained, how long certain documents should be retained, how and when those documents should be disposed of, if no longer needed and how the documents should be accessed and retrieved when they are needed.

2. Classification of Documents to be Preserved / Retained

The Company's physical and electronic documents shall be classified for the purpose of preservation as follows:

A. Documents whose preservation shall be permanent in nature;

B. Documents whose preservation period shall not be less than eight years after completion of the relevant transactions;

C. Documents whose preservation shall be for a minimum period of three years after completion of the event.

The details of documents for the above three categories are given in the Annexure.

3. Principle of Responsibility of Employees for Preservation of Documents

All the Employees in the permanent rolls of the Company are responsible for taking into account the potential impacts on preservation of the documents in their work area and their decision to retain/ preserve or destroy documents pertaining to their area.

4. Periodical Review of the Policy

The Chief Executive Officer/ Managing Director/ Whole-time Director of the Company is authorised to periodically review the policy and make such changes as considered necessary.

5. Suspension of Record Disposal in the Event of Litigation or Claims

In case the Company is served with any notice for request of documents or any employee becomes aware of a governmental investigation or audit concerning the Company or commencement of any litigation against the Company, any further disposal of documents connected with the matter shall be suspended until such time the investigation / litigation ends.

6. Statutory Requirements

If as per any other law of land including Information Technology Act, a physical or electronic record should be preserved for a longer period than what has been stipulated in this policy, then the document shall be preserved as per the applicable statutory stipulations.

7. Web Archival Policy

The Company shall disclose on its website all events or information which has been disclosed to stock exchange(s). <<Not required>> We should be specific.

Such disclosures shall be retained on the website of the Company for a minimum period of five years.

Place:.....

Date:.....

ANNEXURE

A. Documents whose preservation shall be permanent in nature:

1. Property records including purchase and sale deeds, licences, copyrights, patents & trademarks;
2. Corporate Records including Certificate of Incorporation, Common Seal, Minutes of Board, Committee and Shareholders' Meetings, Register of Members and other Statutory Records;
3. Personal files of all live employees;
4. Any other record as may be decided by the Chief Executive Officer/ Managing Director/ Whole-time Director of the Company from time to time.

B. Documents whose preservation period shall not be less than eight years after completion of the relevant transactions:

1. Books of Account, Bank Statements and vouchers;
2. Filings with Stock Exchanges, Registrar of Companies and other statutory authorities;
3. Payroll Records, Employee deduction authorisations, attendance records, employee medical records, leave records, Pension and retiral related Records, etc.
4. Corporate Social Responsibility Records;
5. Sponsorship Projects Records;
6. Correspondence and Internal Memoranda;
7. Any other record as may be decided by the Chief Executive Officer of the Company from time to time.

C. Documents whose preservation shall be for a minimum period of three years after completion of the event:

1. Tender Documents;
2. Lease Deeds and Contracts
3. Legal files;
4. Insurance Records including policies and claims;
5. All e-mail correspondence, internal & external <<Where it is coming from>>
6. Documents under Secretarial Standards:

   Proof of sending Notice of the meetings of the Board / Committee and General meetings and its delivery. Proof of sending Agenda and Notes on Agenda and their delivery.

   Proof of sending and delivery of the draft of the Resolution.

   Proof of sending draft Minutes of the Board / Committee and its delivery. Proof of sending signed Minutes of the Board / Committee and its delivery.

7. Any other record as may be decided by the Chief Executive Officer/ Managing Director/ Whole-time Director of the Company from time to time.

SETTING UP OF A RECORD ROOM

The Records room must be located at convenient location to the accesses of the record. The record room should be kept separate from other administrative units and should be large enough to house the relevant files. The accommodation must be secure and well maintained, and it must be of strong construction so that it can bear the weight of the records.

Sometimes the Due to the absence of the proper record room, the documents were stored for years in a basement or in an attic which are the worst places to preserve them. The best conditions for conservation of Physical Records are a neat environment, free of dust, with controlled light, humidity and temperature. The following factors should be considered while setting up the Data Room:

Humidity: It's a very important factor. An excess of humidity creates fungus and produces a proliferation of corrosive insects. The lack of humidity, on the other hand, produces brittle and fragile sheets of paper. A controlled humidity between 30% and 40% is the best standard for preservation. With the less possible variation, and the maximum of stability, because variations of humidity provoke more damages than a stable low or medium range.

Temperature: The lower is the temperature, the better is for preservation of Records. However, it is suggested to maintain normal temperature in the record room, which is required for comfortable standard for human beings in public places.

Light: Light has a considerable impact on document's preservation. Not only the visible light to the human eye, but the infrared or ultraviolet radiation, could cause damages. At the environments exposed to the daylight, should be installed curtains with UV filters. Documents exposed to more luminance, should be stored in dark places until its public exposition.

Fire extinguisher, particular paint to be used in the room, security checks etc. need to be mentioned here.

The Public Records Act, 1993: An Act to regulate the management, administration and preservation of public records of the Central Government, Union territory Administrations, public sector undertakings, statutory bodies and corporations, commissions and committees constituted by the Central Government or a Union territory Administration and matters connected therewith or incidental thereto.

PRIVACY OF RECORD AND ITS CONTROL

The most official communication now a days done electronically and most corporate documents are kept in digital form yet there are plenty of physical data which cannot be circulated electronically and are need to be circulated around various branches and other offices in the form of documents, thumb drives, hard disks or log books. Such physical data needs to be protected and handled responsibly; especially if the data contains personal or confidential information. Just like companies have protocols, firewalls, passwords and other security measures to protect their digital data, they need to put in place the right processes and procedures to ensure their data is secure.

For the managing the confidential and privacy, the first step in the process is to identify what constitutes confidential documents at the workplace, and what to share securely. For any business house the following documents are primarily considered as confidential and need complete privacy:

(i) Customer's & Employees' Information

Safe guarding of the personal data is information about an individual that can be used to identify him/her. Information like Aadhar number, Mobile numbers, Residential addresses, Name, credit card numbers, etc. can all be considered personal information.

In India, by the majority of the business, the strong mechanism for safe guarding the personal information is not yet adopted. Even when the documents or data cease to be useful to the organisation, this doesn't mean that the information is no longer confidential. In such cases the data needs to be disposed of securely and cannot be placed freely on the public platform or mixed with other kinds

of data in the office. In such cases the business should work with a trusted information destruction agency to physically destroy both electronic and physical data.

The Customer's & Employees Confidential Information includes discussions about employee relations issues, disciplinary actions, impending layoffs/reductions-in-force, terminations, workplace investigations of employee misconduct, etc.

(ii) Office Plans, Office IDs and Internal Procedure Manuals

For every organisation internal planning & procedures is the key aspect for controlling business and the organisation should ensure the protection of the same. It is important to place the documents with detailed office layouts throughout offices to identify key exits in case of emergency but the other documents and forms related to internal processes and procedures should be kept electronically on secure network drives and encourage employees to limit print-outs.

(iii) Contracts and Commercial Documents and Trade Secretes

In case of the business contracts, every detail of the arrangement should be treated with the utmost confidentiality for both organization itself and the third party's benefit. If the contract has a confidentiality agreement, it could be rendered obsolete if an unauthorised person got their hands on the physical copy of the contract. The contracts are full of commercially sensitive information such as the nature of the arrangement, the value of the services offered/received in the agreement, the names of the main contracting parties, etc.

The business should avoid sharing contracts broadly unless strictly required, and limit physical copies; consider using tools to sign contracts electronically in order to reduce unnecessary print-outs. While these documents are some of the most important to securely store and shared, the easiest and safest way to reduce the risk of a data breach is to implement a secure document retention policy specific to organisation's needs.

The confidential business information as "proprietary information" or "trade secrets." Which is not generally known to the public and would not ordinarily be available to competitors except via illegal or improper means. Common examples of "trade secrets" include manufacturing processes and methods, business plans, financial data, budgets and forecasts, computer programs and data compilation, client/customer lists, ingredient formulas and recipes, membership or employee lists, supplier lists, etc. "Trade secrets" does not include information that a company voluntarily gives to potential customers, posts on its website, or otherwise freely provides to others outside of the company. If such Confidential information is available in the wrong hands, confidential information can be misused to commit illegal activity (e.g., fraud or discrimination), which can in turn result in costly lawsuits for the Company. The disclosure of sensitive employee and management information can lead to a loss of employee trust, confidence and loyalty. This will almost always result in a loss of productivity.

SUGGESTIVE STEPS FOR PROTECTING CONFIDENTIAL INFORMATION

For every business/organization it is important to have a written confidentiality describing both the type of information considered confidential and the procedures employees must follow for protecting confidential information and dealing with the confidential information's. However, the company may adopt the following procedures for protecting confidential information:

- All confidential documents should be stored in locked file cabinets or rooms accessible only to those who are authorized.
- All electronic confidential information should be protected via firewalls, encryption and passwords.
- Employees should clear their desks of any confidential information before going home at the end of the day.
- Employees should refrain from leaving confidential information visible on their computer monitors when they leave their work stations.

- All confidential information, whether contained on written documents or electronically, should be marked as "confidential."
- All confidential information should be disposed of properly (e.g., employees should not print out a confidential document and then throw it away without shredding it first.)
- Employees should refrain from discussing confidential information in public places.
- Employees should avoid using e-mail to transmit certain sensitive or controversial information.
- Limit the acquisition of confidential client data (e.g., social security numbers, bank accounts, or driver's license numbers) unless it is integral to the business transaction and restrict access on a "need-to-know' basis.
- Before disposing of an old computer, use software programs to wipe out the data contained on the computer or have the hard drive destroyed.

LESSON ROUND-UP

- The good documentation promotes good corporate governance practices and compliance level of the company and also improves communication and dissemination of information between and across various stakeholders.
- The General principles for documentation provide that the document should Clear, Concise, Complete, Contemporary, Consecutive, Correct, Comprehensive, Collaborative, Client Centric and should maintain Confidentiality.
- Section 120 of the Companies Act, 2013 read with Rule 27 & 28 of the Companies (Management and Administration) Rule, 2014 provides for maintenance of documents in electronic form.
- Document management refer the process of managing and tracking of the documents and records through an electronic or physical source of documents.
- Disadvantages of the electronic records are software risk, format risk, chances of misplacing or accidentally deletion of large amounts of data.
- Responsibility for the preservation of records is vested with the creator of the document during the active and semi-active phases of the records life-cycle.
- For any business house the following documents are primarily considered as confidential and need complete privacy i.e. Customer's & Employees' Information; Office Plans, Office IDs and Internal Procedure Manuals; Contracts and Commercial Documents and Trade Secretes.
- The confidential policy should describe the type of information considered confidential and the procedures employees must follow for protecting confidential information and dealing with the confidential information's.

GLOSSARY

Document Management System : The process of managing and tracking of the documents and records through an electronic or physical source of documents.

Version tracking : It is a way of finding out who has made the changes.

Format risk : When storing the records in electronic format, a person has the risk of not being able to read them at some point due to the format.

Media compatibility : When a document saved in a hard drive is compatible with the available technologies.

Physical repository : Physical repository is a central place where data is stored and maintained.

Descriptive file names : Small, well-defined projects with existing identification schemes that link the digital object to the source material.

Non-descriptive file names : System-generated sequential numerical string or the system based, such as a digital ID number, combination of Date and time, name of original file and are often linked to meta data stored elsewhere.

TEST YOURSELF

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation)

1. Before drafting any document, it is the most essential to familiar with the purpose of document. Comment?
2. Briefly explain the advantage and disadvantage of the electronic records.
3. In naming of a document, briefly explain the concept of Descriptive file and Non-Descriptive file.
4. To assure the best quality of documents, the records should maintained of the activities affecting quality of the records. Comment.
5. Media compatibility is one of the biggest challenge in saving the documents electronically. Comment.
6. Briefly explain the provisions relating to maintenance of documents in electronic form under Companies Act, 2013 and rules made thereunder.
7. Draft a policy on preservation of Documents and archival of Documents in the website under SEBI (LODR) Regulations, 2015
8. What does the term documentation connote ? Name the 10'Cs which form the guiding principles of good documentation.
9. Records Management provides a professional approach to caring for the records and archives which is governed by certain key concepts. Explain the concepts that govern the care of records and archives.
10. The Board of directors of ABC Ltd. was of the view that as the company was diversifying its operations, it should evaluate digitizing the books of accounts and other records. The Board sought views from the Company Secretary about the same and asked him to appraise them about the Document Management System including good documentation practices. Advise the Board as the Company Secretary.

LIST OF FURTHER READINGS

- The Companies Act, 2013 and Rules made thereunder
- SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015
- The Public Recordes Act, 1993

OTHER REFERENCES (Including Websites / Video Links)

- https://www.igmpiindia.org/DocumentationandMaintenance.pdf
- https://www.sebi.gov.in/web/?file=https://www.sebi.gov.in/sebi_data/attachdocs/dec-2022/1670327592458.pdf#page=41&zoom=page-width,-19,609
- https://www.cleardatagroup.co.uk/maintenance-records-management/
- https://tab.com/wp-content/uploads/2021/09/tab-case-study-health-care-provider.pdf
- https://www.statista.com/statistics/884083/worldwide-documents-management-market-value/

Signing and Certification

Lesson 3

KEY CONCEPTS

■ Certification ■ Authentication ■ Scrutiny ■ E-forms ■ Digital signatures ■ Professional misconduct ■ Peer review

Learning Objectives

To understand:

- Certification
- Pre-certification & its importance
- Impact of false certification
- Key considerations for certifications
- The list of certifications by PCS
- Peer review
- Professional misconduct

Lesson Outline

- Various Certifications by Company Secretary in Practice
- Pre-certification of forms
- Signing & Certification of Annual Return
- Corporate Governance Certification
- Signing of Financial Statement
- Obligations and Penal provisions
- Case Laws & Case Studies
- Lesson Round-Up
- Glossary
- Test Yourself
- List of Further Readings
- Other References (Including Websites/Video Links)

REGULATORY FRAMEWORK

- The Companies Act, 2013
- SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015
- The Company Secretaries Act, 1980
- The SEBI (Depositories and Participants) Regulations, 2018

INTRODUCTION

The Companies Act, 2013 requires filing of various e-forms by the companies which may be event based or annually. Hence all the e-forms are required to be authenticated by authorized signatories of the company filing the same, using digital signatures. MCA has entrusted practicing professionals like members of the Institute of Company Secretaries of India (ICSI) with the responsibility of certifying the compliances and ensuring reliability of documents filed by companies with MCA in electronic mode and also ensuring proper due diligence for the same.

The authorized signatory and the professionals, who certify e-form, are responsible for the correctness of the contents of e-forms and enclosures attached with the e-form. They are expected to verify/certify, whether all the requirements as per the provisions of the Act and the rules made thereunder have been complied with and all the attachments to the forms have been duly scanned and attached completely and legibly.

Once an e-form has been pre-certified by a professional towards its authenticity based on the contained in the books of accounts and records of the company, the Registrar takes on record such e-form. If a professional gives a false certificate or omits any material information knowingly, he is liable for punishment under the provisions of Companies Act, 2013 as well as liable for professional or other misconduct.

PRE- CERTIFICATION

What is Certification?

As per Cambridge dictionary, 'Certification' means the process of earning an official document, or the act of providing an official document, as proof that something has happened or been done. In ordinary parlance, certification means authentication of the document by an independent professional. Such a certification provides more reliability about the genuineness and contents of the document. In India, the certified documents are essential part of filings with various regulators.

Pre-certification means certification of correctness of any document by a professional including Company Secretary in Practice, before the same is filed with the Registrar in terms of the requirements of the Companies Act, 2013 (hereinafter referred to as "the Act"). Company Secretaries are recognized to pre-certify the e-forms which are required to be filed with the Registrar. Initially, pre-certification was introduced to avoid registration delays and eventually evolved to check correctness of documents filed by professionals.

Further, Pre-certification means certification of correctness of any document by a professional including Company Secretary in Practice, before the same is filed with the Registrar in terms of the requirements of the Companies Act, 2013.

The introduction of pre-certification by an independent professional in the e-form is aimed at self-regulations of companies and reduce the involvement of government machinery, i.e. the Registrar of Companies.

Ministry of Corporate Affairs have introduced pre-certification of e-forms by practicing professionals to reduce the workload of registrar of companies. Once a professional pre-certifies an e-form, based on examination of forms & documents attached thereto, ROC is entitled to take on record such e-form. Professionals are also responsible for certifying documents, if professional certifies false information to be true or knowingly omits any material information, he shall be liable to punishment under companies Act. Besides this he is also subject to disciplinary action by respective institute which has issued certificate of practice.

The requirement of authentication of documents prescribed under Rule 8 (Authentication of Documents) of the Companies (Registration Offices and Fees) Rules, 2014 elaborates on the responsibility of professionals certifying the forms. The professional certifying the form must verify whether all the requirements as per the provisions of the Act and the rules made thereunder have been complied with and all the attachment to the forms have been duly scanned and attached completely and legibly.

Authentication of Documents

As per the Rule 8(1), (2) & (5) of the Companies (Registration Office and fee) Rules, 2014 provides that all electronic forms are required to be authenticated by authorised signatories using digital signatures. The e-forms are required to be authenticated on behalf of the company by the Managing Director or Director or Company Secretary or other key managerial personnel. In case of any change in directors or Company Secretary, the form relating to appointment of such directors or Company Secretary is required to be filed by continuing director or Secretary of the company or other Key Managerial Personnel.

As per Rule 8(6), scanned image of documents must be of the original signed documents relevant to the e-forms and the scanned document image shall not be left blank without bearing actual signature of authorised person.

As per rule 8(7), the person signing the form and the professional certifying the form are responsible to ensure that all the required attachments relevant to the form have been attached completely and legibly to the forms or applications or returns filed as per the Act and the rules.

Rule 8A regarding signing of forms were inserted w.e.f 23rd January 2023. It states that E-forms wherever applicable shall be signed by Insolvency resolution professional or resolution professional or liquidator of companies under insolvency or liquidation, as the case may be, and filed with the Registrar along with the fee as mentioned in Table annexed these rules.

A Practicing Company Secretary (PCS) while exercising due diligence need to be keen and alert while certifying the forms with their eyes wide open. They should not merely restrict themselves to the content of the form and along with mandatory attachments they need to focus whether substantial laws were complied or not. They should exercise vigilance in circumstances such as management disputes, Regulatory complaints, investor complaints etc.

While certification of e-form the declaration is given by the certifying professional which is as follow:

"I declare that I have been duly engaged for the purpose of certification of this form. It is hereby certified that I have gone through the provisions of the Companies Act, 2013 and Rules thereunder for the subject matter of this form and matters incidental thereto and I have verified the above particulars (including attachment(s)) from the original/certified records maintained by the Company/applicant which is subject matter of this form and found them to be true, correct and complete and no information material to this form has been suppressed.

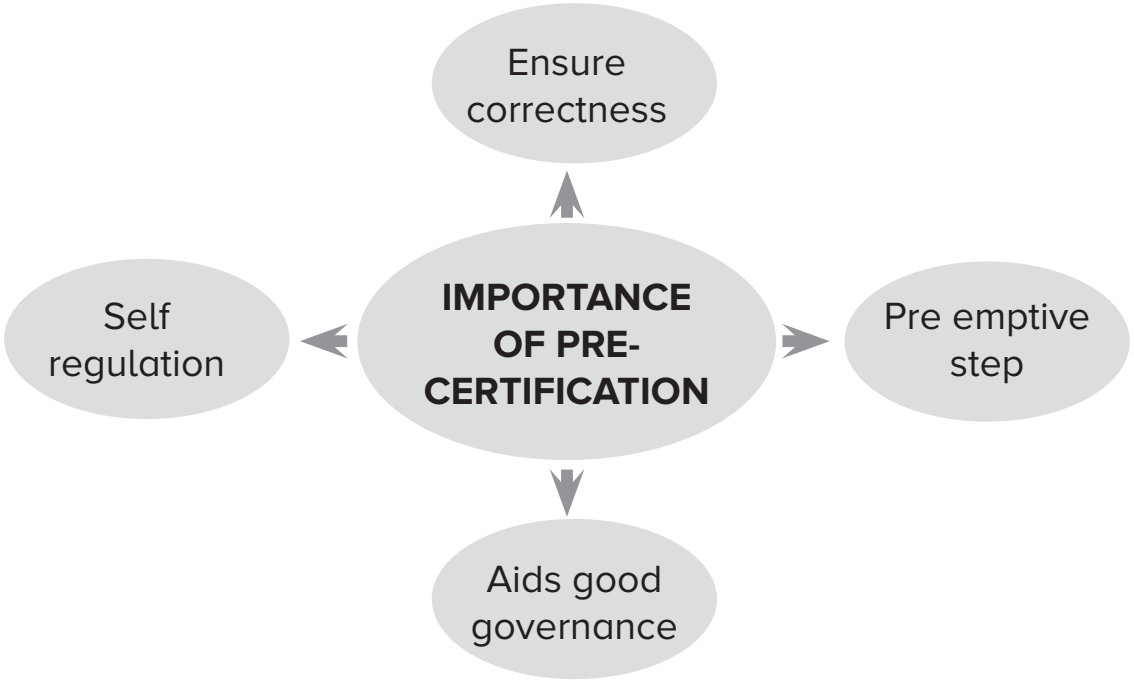
I further certify that:

1. ***The said records have been properly prepared, signed by the required officers of the Company and maintained as per the relevant provisions of the Companies Act, 2013 and were found to be in order.***
2. ***All the required attachments have been completely and legibly attached to this form."***
3. ***It is understood that I shall be liable for action under Section 448 of the Companies Act, 2013 for wrong certification, if any found at any stage.***

Therefore, Pre-certification of forms is, not a routine or mechanical exercise but is a serious and involved work calling for sound application of mind in verifying the averments made in the respective forms after due consideration of the provisions of the Act read with the relevant rules.

IMPORTANCE OF PRE-CERTIFICATION

From a Company's perspective and also from regulators standpoint, pre-certification is important to:



Ensure correctness:

The professional checks the correctness of the particulars stated in the prescribed forms after due consideration of the provisions of the Act and the Rules made thereunder. He also ensures that the particulars stated in the Forms are in agreement with the books and records of the company. If he notices any defect or finds that the information provided in the form is incomplete or defective, he appropriately advices/provides guidance for completion of document/ rectification of defect and makes pre-certification only after completion of documents/ rectification of such defects.

Pre-emptive step:

Pre-certification acts as a pre-emptive check to ensure that the particulars stated in the form or return are as per the books and records of the company and are true and correct. This would mean that the Registrar can rely on the certification of the Company Secretary in Practice and may take the document on record without further examination. Thus, Pre-certification by a Company Secretary in Practice ensures that no form or return filed with the Registrar of Companies is defective or incomplete.

Aids good governance:

Disclosure of information to shareholders is a critical requirement of good governance mechanism with a view to protect the interests of the shareholders and other stakeholders and to ensure better governance. Accordingly, the Act has stipulated stringent measures and requirements for disclosure, included in financial statements, Board's report and annual return. The Act has also prescribed onerous duties and responsibilities on the Director of a company as well as the Company Secretaries. The punishment for violation of provisions of the Act has also been enhanced under the Act, to ensure the correctness of information filed by the corporates.

Self-regulation:

The introduction of pre-certification by an independent professional in the e-form was aimed at self-regulations of companies and to reduce the involvement of government machinery, i.e. the Registrar of Companies. Once any form has been pre-certified by a professional based on the particulars contained in the books of accounts and records of the company, same can be taken on record without further examination.

If a professional gives a false certificate or omits any material information knowingly, he is liable to punishment under the provisions of the Act as well as liable for professional or other misconduct under Company Secretaries Act, 1980.

HISTORICAL BACKGROUND

Pre-certification was introduced after detailed deliberations and it has been refined over time. Though it initially aimed at avoiding delays in Registration of charge and other Documents, its scope was expanded to authentication and verification of documents being filed with the MCA, in view of the benefits arising out of it.

With a view to avoid delay in the Registration of documents, MCA (the then Department of Company Affairs) on the initiative taken by the Institute of Company Secretaries of India issued two circulars advising the Registrars of Companies to take on record documents that are filed by companies or the creditors concerned, duly certified as correct by a Company secretary/ Chartered accountant/ Cost Accountant in practice. The circulars read as under: -

Delay in Registration of Charges (Issued by the Ministry of Industry, Department of Company Affairs, vide No. 1/1/90 CL.V. dated 5-9-1990; Circular No. 14/90)	'I am directed to say that with a view to taking on record the documents relating to charges/ modification of charges/satisfaction of charges, it has been decided that as and when the aforesaid documents are filed by the companies or the creditors concerned, duly certified as correct by a Chartered Accountant/Cost Accountant/ Company Secretary in practice, the same may be taken on record within a reasonable period of say, ten (10) days. You are also advised that in case the relevant certificate of charge, etc. is not collected by the company's representative concerned within seven (7) days thereafter, the same may be sent by post. A copy of this circular is being endorsed to all the three professional Institutes with a request to suitably advise their members to ensure that the documents certified by them have been completely and correctly filled in.'
Delay in Registration of Documents (Issued by the Ministry of Industry, Department of Company Affairs, vide Nos.1/3/ 91-CL.V; Circular No.5/91 dated 26-2-1991)	'This has reference to this Department's Circular No. 14/90 dated 5-9-1990 on the above-mentioned subject. It has been decided that all documents required to be filled with you by companies be taken on record within a reasonable period, say, ten days, if the same are duly certified as correct by a Company Secretary/ Chartered Accountant/ Cost Accountant, in practice.'

The Department Related Parliamentary Standing Committee, which examined the Companies (Second Amendment) Bill, 1999, while endorsing the pre-certification in its 64 Report in 2000, had observed that verification of compliances with the provisions of the Companies Act, 1956 by a Company Secretary in practice was necessary.

The High Level Committee on Corporate Audit and Governance (Naresh Chandra Committee) in its report in 2002, while observing wide gap between prescription and practice, recommended a system of pre-certification by Company Secretaries to remove defect in documents so that these could be taken on record immediately and to reduce workload on Ministry.

It was also recommended that the system should provide for monetary and other penalties on Company Secretaries who certify the forms incorrectly, even though error or oversight.

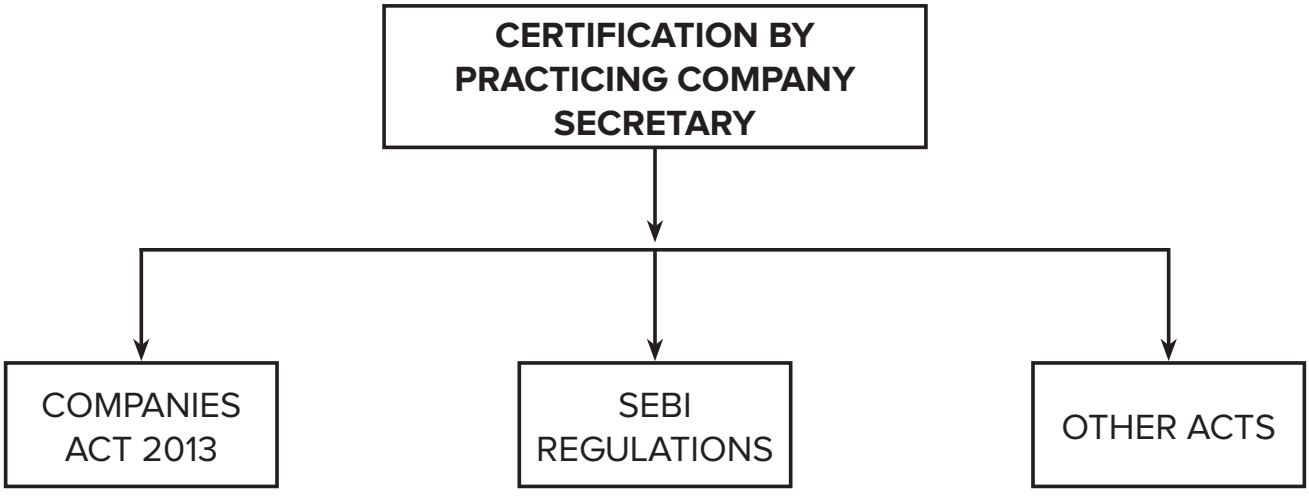
Accordingly, the Companies (Amendment) Bill, 2003 introduced in the Rajya Sabha sought to add a new Section 383C to provide that all documents, returns, forms required to be filed with the Registrar or any statutory authority shall be pre-certified by a Company Secretary in Practice.

In the meantime, the Government issued a Concept Paper for revamping of Company Law in the year 2004, containing a model codified company law which incorporated the provisions of section 383C of the Companies (Amendment) Bill, 2003.

After enactment of the Companies Act, 2013, the provision of Pre-certification was introduced in the Companies (Registration Offices and Fees) Amendment Rules, 2014 [Sub-rule (12) of Rule 8, inserted by Notification No. G.S.R. 297(E) dated 28th April, 2014].

The requirement of authentication of documents prescribed under Rule 8 of the Companies (Registration Offices and Fees) Rules, 2014, elaborates on the responsibility of professionals certifying the forms. The professional certifying the form must verify whether all the requirements as per the provisions of the Act and the rules made thereunder have been complied with and all the attachment to the forms have been duly signed/authenticated, scanned and attached completely and legibly in the PDF Format.

VARIOUS CERTIFICATIONS BY COMPANY SECRETARY IN PRACTICE



FORMS & RETURNS WHICH REQUIRED PRE-CERTIFICATION UNDER THE COMPANIES ACT, 2013

S. No.	e-Form/ web Form	Purpose
1.	INC 20A	Application for Declaration prior to the commencement of business or exercising borrowing powers
2.	INC-22	Notice of situation or change of situation of registered office
3.	INC-28	Notice of Order of the Court or any other competent authority
4.	PAS-3	Return of Allotment
5.	SH-7	Notice of Registrar of any alteration of share capital
6.	CHG-1	Application for registration of creation, modification of charge (other than those related to debentures)
7.	CHG-4	Particulars for satisfaction of Charge
8.	CHG-9	Application for registration of creation or modification of charge for debentures or rectification of particulars filed in respect of creation or modification of charge for debentures
9.	MGT-14	Filing of Resolutions and agreements to the Registrar
10.	DIR-6	Intimation of change in particulars of Director to be given to the Central Government
11.	DIR-12	Particulars of appointment of Directors and the key managerial personnel and the changes among them
12.	MR-1	Return of appointment of MD/WTD/Manager
13.	MR-2	Form of application to the Central PCMA Government for approval of appointment or reappointment and remuneration or increase in remuneration or waiver for excess or over payment to managing director or whole time director or manager and commission or remuneration to directors.
14.	MSC-3	Return of Dormant Company
15.	MSC-1	Application to Registrar for obtaining the status of Dormant Company
16.	MSC-4	Application for seeking status of active company
17.	GNL-1	Applications made to Registrar of Companies
18.	GNL-3	Details of persons/directors/charged/specified “officer who is in default”
19.	ADT-1	Information to the Registrar by Company for appointment of Auditor
20.	NDH-1	Return of Statutory Compliance
21.	NDH-2	Application for Not available extension of Time
22.	NDH-3	Half yearly Return
23.	MGT-7	Annual Return
24.	AOC-4	Form for filing financial statement and other documents with the Registrar
25.	DIR-3 KYC	KYC of Director Form AOC 4 CFS Form for filing consolidated financial statements and other documents with the Registrar Form AOC-4 XBRL Form for filing XBRL document in respect of financial statement and other documents with the Registrar

Other declarations, attestations and certifications under the Companies Act:

Rules	Certifications
Companies (Incorporation) Rules, 2014	To make declaration that all the requirements of the Companies Act, 2013 and the rules made thereunder in respect of registration and matters precedent or incidental thereto have been complied with. {Section 7(1)(b) & (b) Rule 14 of the Companies (Incorporation) Rules, 2014}
	To make declaration that the draft memorandum and articles of association have been drawn up in conformity with the provisions of Section 8 of the Companies Act, 2013 and rules made thereunder and that all the requirements of the Act and the rules made thereunder relating to registration of the company under section 8 and matters incidental or supplemental thereto have been complied with. [Section 8 read with Rule 19 of the Companies (Incorporation) Rules, 2014]
Companies (Prospectus and Allotment of Securities) Rules, 2014	Every unlisted public company governed by this rule shall submit Form PAS-6 to the Registrar with such fee as provided in Companies (the Registration Office and Fees) Rules, 2014 within sixty days from the conclusion of each half year. [rule 9A]
Companies (Share Capital and Debenture) Rules, 2014	To certify that the buyback of securities has been made in compliance with the provisions of the Act and rules made thereunder. [Sub rule (14) of rule 17 of Companies (Share Capital and Debenture) Rules, 2014.
Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014	To issue Secretarial Audit Report to every listed company and 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. {Section 204 & Rule 9 of Companies (Appointment and Remuneration Personnel) Rules, 2014}
Companies (Management and Administration) Rules, 2014	To certify annual return of a listed company or a company having paid up share capital of ten crore rupees or more or turnover of fifty crore rupees or more (Form MGT-8). {Section 92(2) read with Rule 11 of the Companies (Management and Administration) Rules, 2014}
	To be appointed as a scrutinizer in every listed company or a company having not less than one thousand shareholders to scrutinize the Administration) Rules, e-voting process in a fair and transparent manner [Rule 20 of Companies (Management and Administration) Rules, 2014]

PRE-CERTIFICATION UNDER SEBI REGULATIONS

S. No.	Regulation	Purpose
1.	Regulation 40(9) (Listing Obligations and Disclosure Requirements) Regulations, 2015	The listed entity shall ensure that the Share transfer agent and/or the in-house share transfer facility, as the case may be, produces a certificate from a practicing company secretary within thirty days from the end of the financial year, certifying that all certificates have been issued within thirty days of the date of lodgement for transfer, sub-division, consolidation, renewal, exchange or endorsement of calls/allotment monies.

2.	Regulation 24A (Listing Obligations and Disclosure Requirements) Regulations, 2015	Secretarial audit report given by a company secretary in practice.
3.	Regulation 55A SEBI (Depositories and Participants) Regulations, 2018	Every issuer shall submit to the Stock Exchanges, audit report by a practicing company secretary on a quarterly basis, for the purposes of reconciliation of the total issued capital.
4.	Regulation on 76 SEBI (Depositories and Participants) Regulations, 2018.	Reconciliation of Share Capital Audit Report.
5.	SEBI's Circular SEBI/110/DDHS/ CIR/P/2018/ 144	The SEBI guidelines for fund raising by issuance of debt securities by Large Corporate (LC) mandates that the disclosures made by the LC to the Stock Exchange with respect to issuance of debt securities, shall be certified both by the Company Secretary and the Chief Financial Officer of the LC.
6.	SEBI Circular No. SEBI/HO/DDHS/ DDHSRACPOD1/P/CIR/2022/156 read along with Regulation 59A of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015	A detailed Compliance Report is to be certified by the Company Secretary of the Company along with other senior management, in the format specified by the SEBI which is to be submitted to Stock Exchanges.
7.	SEBI (Buy-Back of Securities) Regulations, 2018 [Regulation 5 (ix)]	For the purpose of these regulations, all the filings to the Board shall be made only in electronic mode after being digitally signed by the company secretary or the person authorized by the board of the company.

Other Certifications:

- Certificate regarding Compliance of Conditions of Corporate Governance (Schedule V, Clause E).
- Certificate under Schedule V (10)(i) pertaining to directors' disqualification. [Regulation 34(3)].
- Certification by PCS in case of Offer/allotment of securities to more than 49 to up to 200 investors (SEBI Circular No. CFD/DIL3/CIR/P/2016/53 dated May 03, 2016).
- To issue certificate of compliance to an investment adviser under SEBI (Investment Advisers) Regulations, 2013.
- To conduct annual audit of Research analyst or research entity in respect of Compliance with SEBI (Research Analysts) Regulations, 2014.
- Certification of shareholding pattern for registration as authorised person & Board Resolution in case the applicant is a Corporate body/ Sharing Pattern of Profit/loss in case the applicant is Partnership Firm / LLP.
- Certifications required during IPO's - certifying basis of allotment, allotment of shares from employees quota, etc.
- Certifying that the SEBI (ICDR) Regulations, 2018 for bonus issue has been complied with.
- Certificate for receipt of money specifically certifying that the company has received the application/ allotment monies from the applicants of these shares.
- Quarterly certificate specifically certifying that the company has received the application/ allotment monies from the applicants of these shares.

– Certifying that the floor price for the proposed placement to QIBs is based on the pricing formula prescribed under Chapter VI of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018.

– Certifying that debenture holders have provided their consent for changing the terms of the Debentures whereby mentioning the existing as well as revised terms.

– Listing of units of REITs-Certifying that:

  • Allotment of units has been made as per the basis of allotment approved by designated Stock Exchange.

  • All the funds have been received before the allotment of units of REITs.

– The certificates corresponding to Securities under lock in have been enfaced with non-transferability condition.

CASE LAW

In Re Securities and Exchange Board of India Vs. Shankar Civil Appeal No. 527 OF 2023, Supreme Court of India dated 08.02.2023, in this matter the SAT came to conclusion that role of compliance officer, was limited to redressing grievances of investors and he was nowhere responsible for false or misleading open offer made by company. The Apex court held that, crucial point which had been missed by SAT was that compliance officer was also required to ensure compliance with Buyback Regulations as expressly stipulated by regulation 19(3) of SEBI (Buyback of Securities) Regulations, 1998, decision of SAT was to be set aside and proceeding were to be remitted back.

PRE-CERTIFICATION UNDER LIMITED LIABILITY PARTNERSHIP ACT, 2008

S. No.	Form/Web Form	Purpose
1.	Form- 3	Information with regard to Limited Liability Partnership Agreement and changes, if any, made therein
2.	Form- 4	In case of change in designated partners or partners in the LLP (i.e. appointment or cessation)
3.	Form- 11	Annual Return of Limited Liability Partnership
4.	Form- 15	Shifting of registered office of Limited Liability Partnership

Apart from the above the Company Secretaries also provide various other reports and certification services including the Valuations report, Corporate Governance certificate, Search Reports, Due diligence Report, etc.

PREPARATIONS BEFORE PRE CERTIFICATION

Professional in Practice before undertaking the work relating to Pre-certification should thoroughly read the:

- requirements of the provisions of the Companies Act 2013 and Rules made thereunder; and
- Familiarize himself with the actual practices that are followed in this regard.

Further he should particularly ensure the following:

➤ Ensure that letter of engagement/Board Resolution authorizing the professional for the assignment by the company to be obtained.

- Maintain a physical/scanned of all documents verified (subject to confidentiality requirement).
- Ensure that all relevant documents and attachments are legible & visible.
- Verification of the documents from the original records of the company.
- Correctness of the records and the material departure from the facts.
- the form is signed by the authorised person of the company.
- Before certification of any form, the person should be aware about the relevant provisions under the Act and Rules made thereunder, Process to be followed by the company, approval if any required etc.

For the purpose of maintaining quality of attestation /certification services provided by Company Secretaries in Practice, every Practicing Company Secretary/Firm of Practicing Company Secretaries shall maintain a register regarding attestation /certification services provided by him/her/it, which shall be open for inspection by such person as may be authorised.

As per clause 11 of Part I of the First Schedule of Company Secretaries Act 1980 if a PCS allows a person not being a member of the Institute in practice, or a member not being his partner to sign on his behalf or on behalf of his firm, anything which he is required to certify as a Company Secretary, or any other statements relating thereto it is considered as Professional misconduct.

COMMON ERRORS NOTICED IN E-FILING

- Digital signature is not registered / expired;
- Payment of challan not done before the expiry date;
- Duplicate Payments have been made;
- The size of the form is in excess of the size requirements;
- The e-forms are not verified before filing;
- Incorrect particulars in the e-form;
- Using older versions of Adobe and Java;
- Windows 2000 or later;
- Internet Explorer 10+/ Chrome 49+ or Firefox 45+;
- Adobe Reader from Version XI or later;
- JDK/JRE - Java version 8 Update 92 is suggested;

CONSIDERATIONS IN FILLING E-FORMS

- Before filling of e-forms, the professional should go through the instruction kit of the respective e-form provided by the MCA on MCA-21 portal;
- DIN is mandatory for e-filing of documents. Therefore, the professional should ensure that the details related to DIN of the Directors has been updated on the MCA Portal;
- Digital Signature (DSC) is mandatory and same shall be registered on the MCA Portal before it first use;
- Check Master Data of the company before filing any documents;

- The attachments to the e-forms should be complete and all pages of the attachment should be page numbers and shall be attached in order;
- It would be advisable to file the forms early, without waiting for the last days or the due date of the filing of e-forms;
- Adequate care shall be taken in filing the forms, ensure that the all the entries in the forms are correct and as per the supporting documents to be attached;
- Option for revision/cancellation of e-forms is not available on MCA Portal once it is taken on Record;
- If the pay later option is selected, ensure that the filing fees is paid before the expiry date of the challan as non-payment of fees liable for cancellation of transaction;
- As a trusted advisor of the Company, keep track of various reportable events and advise the Company regularly to file requisite forms to avoid penalties and regulatory actions;
- Attach the required documents duly scanned or converted into PDF with minimum size as possible;
- Use various inbuilt utilities like "PREFILL" and complete the form by clicking on "CHECK" and "PRE-SCRUTINY" options;
- Check the date of resolution and minute book, which authorizes the Director/Secretary before filling the date of resolution in the form;
- DSC used by Director/ Secretary/Signatory should be same as per authority delegation by the Board etc., as the case may be.

REGISTER OF CERTIFICATION

For the purpose of maintaining quality of attestation /certification services provided by Company Secretaries in Practice, every PCS should maintain a register regarding attestation/certification services provided by him including:

1. Signing of Annual Return (MGT-7);
2. Certification of Annual Return (MGT-8);
3. Issue of Secretarial Audit Report (MR-3);
4. Certification of E forms of MCA under Companies Act, 2013 / LLP Act, 2008;
5. Internal Audit of Depository Participants/ portfolio Manager/ Stock Broker;
6. Annual Compliance auditor under SEBI (Research Analyst) Regulations, 2014;
7. Issue of certificate of Securities Transfers in compliance with the Listing Agreement with Stock Exchanges;
8. Certificate of reconciliation of capital, updation of Register of Members, etc. as per the SEBI Circular D&CC/ FITTC/Cir-16/2002 dated December 31, 2002;
9. Conduct of Internal Audit of Operations of the Depository Participants;
10. Corporate Governance Certification under SEBI (LODR) Regulations, 2015;
11. Information relation to E-forms certified and signed; 12. Register of various reports issued.

CERTIFICATION OF ANNUAL RETURN

The Companies Act, 2013 provides a new and significant area of practice for Company Secretaries, it also casts immense responsibility on the Company Secretaries. As they are the professionals certifying the critical documents line Annual Return, Company Secretaries must exercise adequate diligence and care in certification. Any failure or lapse on the part of PCS may attract penalty both under the Companies Act, 2013 as well as under the Company Secretaries Act, 1980 for professional or other misconduct.

Under sub-section (2) of section 92 of the Act read with rule 11(1) of the Companies (Management and Administration) Rules, 2014, every company shall file its annual return in Form MGT- 7, except One Person Company (OPC) & Small Company. OPC & Small Company shall file annual return from the financial year 2020-2021 onwards in Form MGT-7A.

The Annual Return of a listed company or of a company having a paid up share capital of Rs. 10 Crore or more or turnover of Rs. 50 Crore or more shall be certified by a company secretary in whole time practice in the Form No. MGT-8.

Return certification-threshold:

Under sub-section (2) of section 92 of the Act read with rule 11(2) of the Companies (Management and Administration) Rules, 2014 Annual Return certification by Company Secretary in practice:

- Every listed company ;
- Every company having paid-up capital of Rs. 10 crore or more;
- Every company having turnover of 50 crore rupees or more.

While certifying the Form No. MGT 8, the PCS shall certify that:

A. the Annual Return discloses the facts as at the close of the financial year correctly and adequately; and

B. the Company has complied with the provisions of the Act & Rules made there under during the financial year in respect of:

   1. Its status under the Act;
   2. Maintenance of registers/records & making entries therein within the time prescribed therefore;
   3. Filing of forms and returns as stated in the Annual Return, with the Registrar of Companies, Regional Director, Central Government, the Tribunal, Court or other authorities within / beyond the prescribed time;
   4. Calling/ convening/ holding meetings of Board of directors or its committees if any, and the meetings of the members of the company on due dates as stated in the annual return in respect of which meetings, proper notices were given and the proceedings including the circular resolutions and resolutions passed by postal ballot, if any, have been properly recorded in the Minute Book / registers maintained for the purpose and the same have been signed;
   5. Closure of Register of Members / Security holders, as the case may be;
   6. Advances/loans to its directors and/or persons or firms or companies referred in section 185 of the Act;
   7. Contracts/arrangements with related parties as specified in section 188 of the Act;

8. Issue or allotment or transfer or transmission or buy back of securities/ redemption of preference shares or debentures/ alteration or reduction of share capital/ conversion of shares/ securities and issue of security certificates in all instances;

9. Keeping in abeyance the rights to dividend, rights shares and bonus shares pending registration of transfer in compliance with the provisions of the Act;

10. Declaration/ payment of dividend; transfer of unpaid/ unclaimed dividend/ other amounts as applicable to the IEPF in accordance with section 125 of the Act;

11. Signing of audited financial statement and report of directors is as per section 134 of the Act;

12. Constitution/ appointment/ re-appointments/ retirement/ filling up casual vacancies/ disclosures of the Directors, Key Managerial Personnel and the remuneration paid to them;

13. Appointment/ reappointment/ filling up casual vacancies of auditors as per the provisions of section 139 of the Act;

14. Approvals required to be taken from the Central Government, Tribunal, Regional Director, Registrar, Court or such other authorities under the various provisions of the Act;

15. Acceptance/ renewal/ repayment of deposits;

16. Borrowings from its director, members, public financial institutions, banks and others and creation / modification /satisfaction of charges in that respect, wherever applicable;

17. Loans and investments or guarantees given or providing of securities to other bodies corporate or persons falling under the provisions of section 186 of the Act;

18. Alteration of the provisions of the memorandum and / or articles of association of the Company.

While granting certificate under Form MGT-8 iCS must examine following:

1. Statutory registers, such as the register of members, shareholders, debenture holders, securities, charges etc.

2 Incorporation documents, i.e, Memorandum & Articles of association.

3. E-forms filed with MCA.

4. Latest Financial statements of the company.

5. List of Promoters.

6. Shareholding patteren/ ownership structure of the company.

7. Minutes of board, committee & general meetings. Resolution passed, notices & agenda of meetings.

Note: The qualifications, reservation or adverse remarks; if any, may be statial at the relevant places.

SIGNING OF THE ANNUAL RETURN - SECTION 92 (1)

Annual Return is required to be signed by a Director and the Company Secretary, or where there is no company secretary, by a Company Secretary in Practice.

As per the proviso to section 92(1), the Annual Return of One Person Company and Small Company and private company (if such private company is a start-up) shall be signed by the Company Secretary or where there is no Company Secretary, by the Director of the company.

CASE LAW

In Re *Deep Himanshu Desai (petitioners) Vs. Union of Indian (Respondents) Civil Writ Petition No.9564 of 2020 High Court of Rajasthan dated 02.09.2020*, in this matter it was held that the petitioners who were treated as disqualified directors under section 164(2)(a) sought direction to use their Director Identification Number (DIN) and Digital Signature Certificate for purpose of filing annual return. As per the decision of court the respondents were directed to reactivate Director Identification Number (DIN) of petitioner(s) and Digital Signature Certificate to enable petitioner(s) to file necessary annual return and also to discharge their statutory obligations.

While signing the Form MGT-7 (Annual Return) Company Secretary/ Company Secretary in Practice and Director certifies that:

1. The return state the facts, as they stood on the date of the closure of the financial year aforesaid correctly and adequately.
2. Unless otherwise expressly stated to the contrary elsewhere in this return, the company has complied with applicable provisions of the Act during the financial year.

In Case of the Private Company, the Company Secretary/Company Secretary in Practice and Director also certifies that:

3. The company has not, since the date of the closure of the last financial year with reference to which the last return was submitted or in the case of a first return since the date of the Incorporation of the company, issued any invitation to the public to subscribe for any securities of the company.
4. Where the annual return discloses the fact that the number of members, (except in case of a one person company) of the company exceed two hundred, the excess consists of wholly of persons who under second proviso to clause (ii) of sub - section (68) of section 2 of the Act are not to be included in reckoning the number of two hundred.

Further, Company Secretary/Company Secretary in Practice and Authorised Director declares that -

i. Whatever is stated in this form and in the attachments thereto is true, correct and complete and no information material to the subject matter of this form has been suppressed or concealed and is as per the original records maintained by the company.

ii. All the required attachments have been completely and legibly attached to this form.

When a Company Secretary or Company Secretary in practice signs the annual return, he certifies that the facts stated and the material furnished as attachment to the form are duly and fully (correctly and adequately) stated and given.

Further, he has to state that the company has made compliances as well as disclosures in respect of applicable provisions of the Companies Act during the year, also he should give reasons or observations in respect of non-compliances.

Time and Mode of Appointment of Practicing Company Secretary (PCS)

With a view to carry out the voluminous work involved in certifying the Annual Return and considering the fact that an extract of annual return is also required to be prepared before the annual general meeting which forms part of Board's report, it will be advisable that the PCS is appointed by the Board, at the beginning of the respective financial year. The contents to be verified are quite exhaustive and the facts and figures in the Annual Return should match with the financial statements and other statutory registers, records and documents maintained by the Company.

Scope and extent of work for PCS:

For the purpose of certification, PCS should carry out a scrutiny of the data available and check the correctness of the same. Since almost all the events happened between closure of two financial years i.e, between 01 April – 31 March or as approved by Tribunal are captured in the Annual Return, the PCS should be prudent in understanding the events and its impact and consequences, while certifying the same.

PCS should carry out a detailed scrutiny and cross verification of documents. For ensuring the correctness of information contained in the Annual Return, the primary source documents should be looked into. While doing the detailed scrutiny, he may rely on certified copies of the resolutions, forms, agreements as also certificates from the management.

Documents to be Obtained/Verified before Certification of Annual Return by Company Secretary in Practice

1. Memorandum and Articles of Association;
2. Forms & receipts filed with the Registrar of Companies;
3. Statutory Registers;
    - Record of Private Placement PAS-5 (Section 42)
    - Register of Members MGT-1 (Section 88)
    - Register of Debenture holder MGT-2
    - Register of Directors & their Shareholding (Section 170)
    - Register of Key Managerial Personnel (Section 170)
    - Register of Related Party Contracts MBP-4 (Section 188)
    - Register of Loan and Investment SH-12 (Section 186)
    - Register of deposit- Section 73 and 76 read with rule 14
    - Register of Charge CHG-10 (Section 85)
    - Register of Securities
    - Register of Employee Stock Option Under SH-6 (Section 62)
    - Register of Buyback under SH-10 (Section 68)
    - Register of Sweat Equity shares under SH-3 (Section 62).
4. Minutes of the Meetings;
    - Board Meeting
    - General Meeting
    - Committee Meeting
    - Creditors Meeting
    - Debenture holders Meeting
    - Court convened Meetings for the purpose of restructuring and amalgamation
    - Postal ballot minutes.
5. Notices and agenda papers for convening meetings of the Board and Committees thereof;

6. Attendance Registers of all Meetings;
7. Copy of Latest Financial Statements along with the Board's Report and Auditors Reports;
8. Copy of Notice of Annual General Meeting/Extraordinary General Meetings/Postal Ballots/Court convened meetings/Creditors meetings and debenture holders meeting;
9. Shareholder List in Compact Disc (CD) in PDF Format, details of Share Transfers taken place between close of the previous financial year and close of the financial year to which Annual Return relates, Controls of the Data as on the Date of Annual General Meeting of the company or the Beneficial Positions as on close of financial year downloaded from the records of the Depository participants by Registrar Transfer Agent (RTA) of the company on record/book closure date prior to AGM;
10. Certificate from RTA stating the number of shareholders as on the close of the financial year;
11. Indebtedness Certificate signed by Company Secretary/CFO/ Statutory Auditors of the company;
12. Change of name of the company, change in the face value of the shares of the company, new ISIN No of the company in respect of the allotment or as a result of any change in capital structure due to any corporate action taken by the company during the Financial year;
13. Board Resolution for any type of corporate actions taken by the company;
14. Corporate Action Forms filed by the company with Depositories;
15. Shareholding pattern and its break up;
16. Any orders received by the company, Director or officer from the High court or from any other regulatory body under any act;
17. Other Statutory Registers and Records;
18. List of Promoters;
19. Listing and Trading Approval(s) from Stock Exchanges, Credit Confirmation from Depositories namely NSDL and CDSL respectively/confirmation from both depositories in respect of allotment of equity shares of the company during the period between the previous AGM date and current AGM date. Intimation to Stock Exchanges, Confirmation from National Securities Depository Limited (NSDL) and Central Depository Services (India) Limited (CDSL) for change of the name of the company, change in the face value of equity shares, change in ISIN of the company and the Scrip Code/Symbol of the company, etc.

As a good practice, it is advisable to have the Annual Return reviewed/verified by a different professional before it is certified, as part of maker and checker concept for independent verification of the Returns being certified. These two different signing mechanisms include one for the purpose of signing under section 92(1) and the other for certification under section 92(2) of the Companies Act, 2013.

However, where a company is having a Company Secretary then signing of the annual return as per section 92(1) shall be done by the Company Secretary in employment only, but not by the Company Secretary in Practice.

Time limit for filing Annual Return

As per Section 92(4) every company shall file with the Registrar a copy of the annual return, within 60 days from the date on which the annual general meeting is held or where no annual general meeting is held in any year within 60 days from the date on which the annual general meeting should have been held together with

the statement specifying the reasons for not holding the annual general meeting, with such fees or additional fees as may be prescribed.

Consequences of not filing Annual Return

Under Section 92 (5) If a company fails to file its annual return under sub section (4), such company and its officer who is default shall be liable to a penalty of 10,000 rupees and in case of continuing failure with further penalty of 100 rupees for each day after the first day during which such failure continues, subject to a maximum of 2,00,000 rupees in case of company and 50,000 rupees in case of an officer who is in default.

Consequences of Non-Filing Annual Return:

For the Director:

- **Penalty for default:** If the company has not filed its Annual Return from the date by which it should have been filed with fee and additional fees, every officer who is in default shall be liable to a penalty of Rs.10,000 and in case of continuing failure, with further penalty of Rs.100 for each day during which such failure continues, subject to a maximum of Rs.2 lakh incase of a company and Rs.50,000 incase of officer in default. (Section 92)
- **Disqualification:** If the company has not filed its financial statement or Annual Return for continuous period of three financial years, then every person who is or has been director of that company shall not be eligible for re-appointment as Director of that company or appointed in any other company for a period of five years from the date on which the said company fails to do so. [Section 164(2)]

CASE LAW

1. In *Re Abbas Maru Vs. Union of India, High Court of Madhya Pradesh writ petition No. 15683 of 2020 dated 09.06.2022,* it was held that Section 164(2), which had come into force from 1-1-2014 would have prospective and not retrospective effect and defaults contemplated under section 164(2)(a) with regard to non-filing of financial statements or annual returns for any continuous period of three financial years to be counted from financial year 2014-15 only.
2. In *Re Gautam Mehra Vs. Union of India W.P.A. NO. 22790 OF 2019, High Court of Calcutta dated 15.10.2020,* in this matter it was held that the Section 164(2)(a) has not limited disqualification to a person who has been a director of a company for entire period of three continuous years for which company was in default of non filing of annual returns but also to a person who has been a director of defaulting company for any period of time of relevant continuous period of three years and DIN of such person stands cancelled immediately upon such person being visited with a disqualification under section 164.

- **Penalty for Misstatement:** If in Annual Return, any Director or any Person makes a statement (a) which is false in any material particulars, knowing it to be false; or (b) which omits any material fact, knowing it to be material, he shall be punishable with imprisonment for a term which shall not be less than 6 months but which may extend to 10 years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud. (Section 448)
- **Class action suits:** Under section 245, the class of shareholders or depositors may file an application with the Tribunal alleging that the management or conduct of the affairs of any company are being conducted in a manner prejudicial to the interest of the company, its members or depositors. Such class action may include suite against the company, its directors, officers, experts or any other person for wrongful or fraudulent act. The order passed by the Tribunal shall be binding on the Company, its directors and officers.

For the Company:

- **Penalty:** If the company has not filed its Annual Return from the date by which it should have been filed with fee and additional fees, every officer who is in default shall be liable to a penalty of Rs.10,000 and in case of continuing failure, with further penalty of Rs.100 for each day during which such failure continues, subject to a maximum of Rs.2 lakh in case of a company and Rs.50,000 incase of officer in default. (Section 92)
- **Winding up:** If the Company has defaulted in filing Annual Returns for the immediately preceding five financial years, the Company may be wound up by the Tribunal. (Section 271)
- **Inactive status**: If the Company has not filed its Annual Return for last two financial years, it will be termed as "inactive company" [Section 455(1)].

CASE LAW

In *Re AVS Enterprises (P.) Ltd. Vs. Registrar of Companies, Delhi, Company Appeal (AT) no. 47 of 2021, NCLAT New Delhi dated 05.04.2022,* in this matter the appellant company had not filed annual returns with Registrar of Companies from year 2006-07 onwards and, its name was 'struck-off' from Register of Companies. Further, in view of fact that company was carrying on business operation and right to seek restoration of name of company was not extinguished, name of company was to be restored in register of companies subject to filing of all pending statutory documents along with late fee.

- **Dormant status:** If the Company has not filed its Annual Return for two financial years consecutively, the Registrar shall issue notice to the Company and enter its name in the Register of Dormant Companies. [Section 455(4)]
- **Compounding of Offences:** Provisions and procedure for compounding of offences, which are punishable under Companies Act, 2013 are stipulated under Section 441.

Test Yourself:

Question: Whether non-filing of Annual Return is a compoundable?

Answer: Offence in respect of default in filing Annual Return is compoundable (section 441), in accordance with the procedure laid down in this section for compounding of offences. If any company fails to file its annual return under section 92 (4), before the expiry of the period specified therein, such company and its every officer who is in default shall be liable to penalty of ten thousand rupees and in case of continuing failure, with further penalty of Rs.100 for each day during which such failure continues, subject to a maximum of Rs.2 lakh incase of a company and Rs.50,000 incase of officer in default.

Consequences of Wrong Certification of Annual Return

Under Section 92 (6) of the Companies Act, 2013 if a company secretary in practice certifies the annual return otherwise than in conformity with the requirements of this section or the rules made thereunder, he shall be liable to a penalty of Rs. 2,00,000.

A Practicing Company Secretary will be liable for disciplinary actions by the Disciplinary Committee of the ICSI under the provisions of the Company Secretaries Act, 1980. Further, Section 448 of Companies Act, 2013 also imposes a penalty if any return, report, certificate, financial statement, prospectus, statement or any other document makes a false statement or omits any material fact.

Further, Company Secretary in practice may also attract the provisions of Section 447, sections 448 and 449 of Companies Act, 2013.

Authority to initiate action against Professionals

MCA vide its circular no. 10/2014 dated 07.05.2014 has clarified that Regional director/ ROC would initiate action under section 448 and 449 of the Act in the cases of submitting false or misleading or incorrect information. Further, the cases u/s 448 and 449 may also be referred to the concerned Institute for conducting disciplinary proceedings against the errant member and the MCA may debar the concerned professional from filing any document on the MCA portal in future.

Filing Annual Return when Annual General Meeting is not held

Where no AGM is held in a particular year, the Annual Return has to be filed within 60 days from the last day on which the meeting should have been held together with the statement specifying the reasons for not holding the annual general meeting, with such fees or additional fees as may be prescribed, within the time as specified, under section 403. [Section 92(4)]

Consequently, the company cannot excuse itself from the obligation on the plea that AGM was not held. As per Section 403, if the Annual return under section 92 is not filed within the due date the same can be filed on payment of additional fee as may be prescribed, which shall not be less than one hundred rupees per day and different amounts may be prescribed for different classes of companies:

Where the document, fact or information, as the case may be, in cases other than referred to in the first proviso, is not submitted, filed, registered or recorded, as the case may be, within the period provided in the relevant section, it may, without prejudice to any other legal action or liability under this Act, be submitted, filed, registered or recorded as the case may be, on payment of such additional fee as may be prescribed and different fees may be prescribed for different classes of companies.

Further, where there is default on two or more occasions in submitting, filing, registering or recording of such document, fact or information, as may be prescribed, it may, without prejudice to any other legal action or liability under this Act, be submitted, filed, registered or recorded, as the case may be, on payment of such higher additional fee, as may be prescribed.

In case a company fails or commits any default to submit, file, register or record any document, fact or information under Section 92 (1) before the expiry of the period specified, the company and the officers of the company who are in default, shall, without prejudice to the liability for the payment of fee and additional fee, be liable for the penalty or punishment provided under this Act for such failure or default.

Thus, the management of the company cannot escape from the responsibility of filing the return, even if the AGM is not held or the company is inoperative. This section casts an important obligation on the part of management to file the returns and can be relinquished only when the company is wound-up or its name is struck-off from the Register maintained by the Registrar of Companies.

Detailed Scrutiny of Annual Return

The PCS is required to exercise due caution and care, since he/she is bound by the certification in the Annual Return. A very pertinent question which arises for consideration is the extent of detailed verification that has to be performed for certifying the Annual Return.

It is a well-established principle in any auditing practice that an auditor is not expected to carry out a 100% checking of company's documents, in arriving at the final facts and figures represented in the certified document. In financial audit, for instance, the auditor is not expected do vouching of each and every invoice raised / voucher created by the company before accepting the sales figure given in the Financial Statements. Similarly, while certifying the list of past and present shareholders given in the Annual Return, a PCS cannot be expected to check every folio of the Registrar of Members, whose number could run into lakhs. Similarly, the number of share transfers registered in a year could run into thousands. If one is expected to check every transaction in these matters, it could be well almost impossible to meet the statutory time limits for filing the documents.

Therefore, certain techniques of sampling and test checks should be applied for forming a reasonable opinion that the document being certified reflects a true and correct view of the state of affairs. There are no specific modalities or stringent test practices applicable for certification of Annual Return. However, the following guiding principles can be adopted while deciding about the extent of checking that is required.

(i) **Internal Controls**: The PCS shall perform a detailed review of the internal controls, checks and balances built into the systems and procedures of the Company. If appropriate internal controls exist, and operate effectively, the need for detailed checking is reduced to a large extent. For instance, the procedure for registration of share transfers could be so designed that the mistakes and errors committed at one stage are automatically detected and corrected by another before the whole process is complete. The system could also provide for inherent checks, particularly in cases where the process is automated/computerized.

(ii) **Materiality:** Similar to any audits, the principle of materiality is another important and relevant concept. The sample chosen for detailed checking should be representative of the whole, or the 'population', in statistical parlance. For example, in share transfers, instances of transfer of large blocks of shares could be chosen for detailed scrutiny. Or, the 'busy' period for transfer of shares in the year could be identified and selected for sample checking.

(iii) **Risk Assessment**: The PCS shall have an overall understanding of the Company, the industry in which the it operates, corporate governance practices, etc., and perform risk assessment to identify the 'high risk' areas. These 'High risk' areas shall be subjected to more extensive verifications. For instance, in the case of shares on which there are restrictions on transfer statutory or otherwise, a more extensive examination is warranted.

In conclusion, it may be noted that the ultimate responsibility of the document certified will rest with the professional. While the extent of checking is a matter of professional judgment, he should safeguard himself against any possible charge of negligence in respect of inaccurate or incomplete statements certified by him, by adequately documenting the procedures performed and conclusions drawn.

Certification With Reservation /Qualification /Observations /Adverse Remarks

A PCS may certify the Annual Return subject to certain reservations /qualifications/ observations/adverse remarks by way of an annexure to his certificate. However, this course of action can only be resorted to in case where material facts are not stated correctly and completely in the Annual Return or where the company has not complied with the applicable provisions of the Companies Act.

While signing of the Annual Return of a company by a Company Secretary or a Company Secretary in practice shall ensure compliance with the guidance note on the Certification of the Annual Return as published by the ICSI and make appropriate professional judgments, wherever necessary.

It is the duty of the certifying professional to take the copy of the relevant documents and record such facts, based on which he has certified the Returns.

While the certification of Annual Return in Form No. MGT-8, the certifying professional should observe all the statements in a true and fair manner. It is the duty of the professional to give the observation, limitation and disclaimer as may be required and appropriate for the certification.

CORPORATE GOVERNANCE CERTIFICATION BY PRACTICING COMPANY SECRETARY

This certificate on the compliance of conditions of Corporate Governance by the Company, is issued under the regulations 17 to 27 and clauses (b) to (i) of regulation 46(2) and para C and D of Schedule V of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ['SEBI(LODR)']. The certificate can be issued either by the statutory auditors or PCS and shall be annexed to the director's report.

Clause E of Schedule V of the Regulations prescribes that a Compliance Certificate from either the auditors or Practicing Company Secretary regarding compliance of conditions of corporate governance shall be annexed to the directors' report. Besides listed entities are required to submit a quarterly compliance report on corporate governance in the specified format to the stock exchange within fifteen days from the close of each quarter. The listed entities are further required to file a half yearly compliance report and an annual compliance report with the stock exchanges in the prescribed format.

Further, Regulation 27(2) of SEBI(LODR), specifies that the listed entity shall submit quarterly compliance report on corporate governance in the format specified by the Board from time to time to recognized Stock Exchange(s) within twenty one days from close of the quarter.

Accordingly, different formats for Compliance Report on Corporate Governance have been prescribed for Quarterly reporting, and the report to be submitted at the end of the financial year (for the whole of financial year) and also for reports which are to be submitted within six months from end of financial year.

In order to bring about transparency and to strengthen the disclosures around loans/ guarantees/comfort letters/ security provided by the listed entity, directly or indirectly to promoter/ promoter group entities or any other entity controlled by them, SEBI has decided to mandate such disclosures on a half yearly basis, in the Compliance Report on Corporate Governance. The format of disclosure in this regard is specified vide Annex - IV of the said report and shall be effective from financial year 2021-22.

The format for compliance report on Corporate Governance shall be as under:

I. Annex - I - on quarterly basis;

II. Annex - II - at the end of a financial year;

III. Annex - III - at the end of 6 months from the close of financial year;

IV. Annex - IV - on a half yearly basis (w.e.f. first half year of the FY 21-22).

Students are advised to refer format of compliance report on Corporate Governance by Listed Entities issued by SEBI Circular SEBI/HO/CFD/CMD-2/P/CIR/2021/567 dated May 31, 2021.

(Link: https://www.sebi.gov.in/web/?file=/sebi_data/attachdocs/jun-2021/1622538932011.pdf#page=1&zoom=page-width,-20,792)

Regulation 17(3) of the SEBI (LODR) provide that the Board of Directors shall periodically review compliance reports pertaining to all laws applicable to the listed entity, as prepared by the company as well as steps taken by the company to rectify instances of non-compliance, if any.

However, the compliance with the corporate governance provisions as specified in Regulations 17 to 27 and clauses (b) to (i) of Regulation 46(2) and para C , D and E of Schedule V shall not apply, in respect of following –

1. The listed entity having:
   - paid up equity share capital not exceeding rupees 10 crore; and
   - net worth not exceeding rupees 25 crore, as on the last day of the previous financial year.
2. The listed entity which has listed its specified securities on the SME Exchange.

IMPORTANT POINTS RELATING TO CORPORATE GOVERNANCE COMPLIANCE CERTIFICATE (CGCC)

- In order that the PCS can carry out the necessary verification for the purpose of issuing Corporate Governance Compliance Certificate (CGCC), the Company should provide the PCS access to

the registers, books of accounts, papers, documents, reports and records of the Company wherever kept.

- The CGCC from the PCS should relate to the financial year of the listed Company under Report.
- When a PCS is assigned the compliance certification work of the Company for the first time, he should communicate his appointment to the earlier incumbent, if a PCS, by registered post.
- The PCS who has issued the CGCC should make himself available at the Annual General Meeting to provide clarifications, on CGCC, if required.
- Any failure or lapse on the part of a PCS in issuing a CGCC, may not only attract disciplinary action for professional or other misconduct under the provisions of the Company Secretaries Act, 1980, but also make him liable for any injury caused to any person due to his negligence in issuing the CGCC.

MODE OF ISSUING CORPORATE GOVERNANCE COMPLIANCE CERTIFICATE (CGCC)

For issuing CGCC a three-step procedure needs to be followed:

(i) The PCS would first obtain from the listed entity its draft report on Corporate Governance.

(ii) PCS would examine relevant records relating to Corporate Governance and obtain necessary information and explanation from the management. An illustrative list of compliance inputs and checklists has been indicated in each paragraph in this Guidance Note. The list is however, not exhaustive.

(iii) PCS on the basis of the report and verification of such other records as well as information and explanation so obtained, would certify the compliance of the conditions of Corporate Governance and give his certification to the Board to be annexed to the Board's Report.

(iv) Where a Company has adopted the Voluntary Guidelines, the PCS would also certify the compliance thereof.

TYPES OF CERTIFICATION

The certification may be unqualified or qualified:

(a) **Unqualified Certificate:** An unqualified certificate should be issued when the PCS forms the opinion that the conditions of Corporate Governance have been duly complied with by the Company.

(b) **Qualified Certificate:** A qualified certificate should be issued when the PCS concludes that there are certain specific non-compliances or inadequacies. A qualified certificate should contain a brief description of non-compliances or inadequacies in compliances and the extent thereof.

- It is recommended that the qualifications, if any, should be stated in bold type or in italics in the CGCC.
- If the PCS is unable to form any opinion with regard to any specific matter, the PCS shall state clearly the fact that he is unable to form an opinion with regard to that matter and the reasons therefor.
- If the scope of work required to be performed is restricted on account of limitations imposed by the client, or on account of other limitations (such as certain books or papers being in custody of another person or Government Authority), the certificate may indicate such limitations.
- If such limitations are so material that the PCS is unable to express any opinion, the PCS should state that "in the absence of necessary information and records, he is unable to certify compliance or otherwise of the conditions of Corporate Governance by the Company".

PENALTY FOR FALSE CGCC

In certifying the compliance of conditions of Corporate Governance, the PCS should comply with the code of conduct issued by the Institute of Company Secretaries of India. Failure to comply with the code of conduct would render the PCS liable to charge of professional misconduct and the consequences thereof.

Section 448 of the Companies Act provides that if, in any return, report, certificate, balance sheet, prospectus, statement or other document required by or for the purposes of any of the provisions of the Act, any person makes a statement which is false in any material particular, knowing it to be false or which omits material fact, knowing it to be material, he shall be punishable under section 447 (Punishment for Fraud).

Section 449 of the Companies Act further provides penalty of imprisonment for a minimum period of 3 years and a term which may extend to seven years, and fine which may extend to ten lakhs rupees, if any person intentionally gives false evidence upon any examination on oath or solemn affirmation, authorized under the Act or in any affidavit, deposition or solemn affirmation, in or about the winding up of any company under the Act, or otherwise in or about any matter arising under the Act.

Section 23H of the Securities Contracts (Regulation) Act, 1956 ("SCRA"), provides that, whoever fails to comply with any provision of SCRA, the rules or articles or bye-laws or the regulations of a recognized stock exchange or directions issued by the Securities and Exchange Board of India for which no separate penalty has been provided, shall be liable to a penalty which may extend to one crore rupees.

Further Section 23M of the SCRA provides that, without prejudice to any award of penalty by the adjudicating officer under SCRA, if any person contravenes or attempts to contravene or abets the contravention of, the provisions of SCRA or of any rules or regulations or bye-laws made there under, for which no punishment is provided elsewhere in SCRA, he shall be punishable with imprisonment for a term which may extend to ten years, or with fine, which may extend to twenty-five crore rupees or with both. If any person fails to pay the penalty imposed by the adjudicating officer or fails to comply with any of his directions or orders, he shall be punishable with imprisonment for a term, which shall not be less than one month, but which may extend to ten years, or with fine, which may extend to twenty-five crore rupees, or with both.

CORPORATE GOVERNANCE AND SEBI (LISTING OBLIGATIONS AND DISCLOSURE REQUIREMENTS) REGULATIONS, 2015

CORPORATE GOVERNANCE PRINCIPLES UNDER LISTING REGULATIONS :

The listed entity which has listed its specified securities shall comply with the corporate governance principles under following broad headings as specified in Regulation 4 :

(a) The rights of shareholders: The listed entity shall seek to protect and facilitate the exercise of the following rights of shareholders:

(i) right to participate in, and to be sufficiently informed of, decisions concerning fundamental corporate changes.

(ii) opportunity to participate effectively and vote in general shareholder meetings.

(iii) being informed of the rules, including voting procedures that govern general shareholder meetings.

(iv) opportunity to ask questions to the board of directors, to place items on the agenda of general meetings, and to propose resolutions, subject to reasonable limitations.

(v) Effective shareholder participation in key corporate governance decisions, such as the nomination and election of members of board of directors.

(vi) exercise of ownership rights by all shareholders, including institutional investors.

(vii) adequate mechanism to address the grievances of the shareholders.

(viii) protection of minority shareholders from abusive actions by, or in the interest of, controlling shareholders acting either directly or indirectly, and effective means of redress.

(b) Timely information: The listed entity shall provide adequate and timely information to shareholders, including but not limited to the following:

(i) sufficient and timely information concerning the date, location and agenda of general meetings, as well as full and timely information regarding the issues to be discussed at the meeting.

(ii) Capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership.

(iii) rights attached to all series and classes of shares, which shall be disclosed to investors before they acquire shares.

(c) Equitable treatment: The listed entity shall ensure equitable treatment of all shareholders, including minority and foreign shareholders, in the following manner:

(i) All shareholders of the same series of a class shall be treated equally.

(ii) Effective shareholder participation in key corporate governance decisions, such as the nomination and election of members of board of directors, shall be facilitated.

(iii) Exercise of voting rights by foreign shareholders shall be facilitated.

(iv) The listed entity shall devise a framework to avoid insider trading and abusive self-dealing.

(v) Processes and procedures for general shareholder meetings shall allow for equitable treatment of all shareholders.

(vi) Procedures of listed entity shall not make it unduly difficult or expensive to cast votes.

(d) Role of stakeholders in corporate governance: The listed entity shall recognise the rights of its stakeholders and encourage co-operation between listed entity and the stakeholders, in the following manner:

(i) The listed entity shall respect the rights of stakeholders that are established by law or through mutual agreements.

(ii) Stakeholders shall have the opportunity to obtain effective redress for violation of their rights.

(iii) Stakeholders shall have access to relevant, sufficient and reliable information on a timely and regular basis to enable them to participate in corporate governance process.

(iv) The listed entity shall devise an effective vigil mechanism/whistle blower policy enabling stakeholders, including individual employees and their representative bodies, to freely communicate their concerns about illegal or unethical practices.

(e) Disclosure and transparency:

The listed entity shall ensure timely and accurate disclosure on all material matters including the financial situation, performance, ownership, and governance of the listed entity, in the following manner:

(i) Information shall be prepared and disclosed in accordance with the prescribed standards of accounting, financial and non-financial disclosure.

(ii) Channels for disseminating information shall provide for equal, timely and cost efficient access to relevant information by users.

(iii) Minutes of the meeting shall be maintained explicitly recording dissenting opinions, if any.

(f) Responsibilities of the board of directors:

The board of directors of the listed entity shall have the following responsibilities:

(i) Disclosure of information:

1) Members of board of directors and key managerial personnel shall disclose to the board of directors whether they, directly, indirectly, or on behalf of third parties, have a material interest in any transaction or matter directly affecting the listed entity.

2) The board of directors and senior management shall conduct themselves so as to meet the expectations of operational transparency to stakeholders while at the same time maintaining confidentiality of information in order to foster a culture of good decision-making.

(ii) Key functions of the board of directors:

(1) Reviewing and guiding corporate strategy, major plans of action, risk policy, annual budgets and business plans, setting performance objectives, monitoring implementation and corporate performance, and overseeing major capital expenditures, acquisitions and divestments.

(2) Monitoring the effectiveness of the listed entity's governance practices and making changes as needed.

(3) Selecting, compensating, monitoring and, when necessary, replacing key managerial personnel and overseeing succession planning.

(4) Aligning key managerial personnel and remuneration of board of directors with the longer term interests of the listed entity and its shareholders.

(5) Ensuring a transparent nomination process to the board of directors with the diversity of thought, experience, knowledge, perspective and gender in the board of directors.

(6) Monitoring and managing potential conflicts of interest of management, members of the board of directors and shareholders, including misuse of corporate assets and abuse in related party transactions.

(7) Ensuring the integrity of the listed entity's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for risk management, financial and operational control, and compliance with the law and relevant standards.

(8) Overseeing the process of disclosure and communications.

(9) Monitoring and reviewing board of director's evaluation framework.

(iii) Other responsibilities:

(1) The board of directors shall provide strategic guidance to the listed entity, ensure effective monitoring of the management and shall be accountable to the listed entity and the shareholders.

(2) The board of directors shall set a corporate culture and the values by which executives throughout a group shall behave.

(3) Members of the board of directors shall act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the listed entity and the shareholders.

(4) The board of directors shall encourage continuing directors training to ensure that the members of board of directors are kept up to date.

(5) Where decisions of the board of directors may affect different shareholder groups differently, the board of directors shall treat all shareholders fairly.

(6) The board of directors shall maintain high ethical standards and shall take into account the interests of stakeholders.

(7) The board of directors shall exercise objective independent judgement on corporate affairs.

(8) The board of directors shall consider assigning a sufficient number of non-executive members of the board of directors capable of exercising independent judgement to tasks where there is a potential for conflict of interest.

(9) The board of directors shall ensure that, while rightly encouraging positive thinking, these do not result in over optimism that either leads to significant risks not being recognised or exposes the listed entity to excessive risk.

(10) The board of directors shall have ability to 'step back' to assist bexecutive management by challenging the assumptions underlying: strategy, strategic initiatives (such as acquisitions), risk appetite, exposures and the key areas of the listed entity's focus.

(11) When committees of the board of directors are established, their mandate, composition and working procedures shall be well defined and disclosed by the board of directors.

(12) Members of the board of directors shall be able to commit themselves effectively to their responsibilities.

(13) In order to fulfil their responsibilities, members of the board of directors shall have access to accurate, relevant and timely information.

(14) The board of directors and senior management shall facilitate the independent directors to perform their role effectively as a member of the board of directors and also a member of a committee of board of directors.

SIGNING OF FINANCIAL STATEMENTS

The financial statements of a company shall be prepared in accordance with Section 129 and schedule III of Companies Act, 2013 and such financial statements shall be laid before the shareholders at the Annual General Meeting of the Company.

Section 2 (40) of the Companies Act, 2013 states that "financial statement" in relation to a company, includes-

(i) a balance sheet as at the end of the financial year;

(ii) a profit and loss account, or in the case of a company carrying on any activity not for profit, an income and expenditure account for the financial year;

(iii) cash flow statement for the financial year;

(iv) a statement of changes in equity, if applicable; and

(v) any explanatory note annexed to, or forming part of, any document referred to in sub-clause (i) to sub-clause (iv).

As per the provisions of Section 134(1) of Companies Act, 2013, the financial statement, including consolidated financial statement, if any, shall be approved by the Board of Directors before they are signed on behalf of the Board and the Financial Statement will be signed by the following:

(i) Chairperson of the Company (if he is authorized by the board of directors); OR

(ii) Two Directors (out of which one shall be Managing Director); AND

(iii) Chief Executive Officer/ Company Secretary/ Chief Financial Officer of the Company (on the basis of their appointment in the Company.

Test Yourself:

Question: Is it mandatory to sign financial statement from the company secretary?

Answer: As per Section 134(1), the company in which the Whole-time Company Secretary is appointed, then it is mandatory that the Financial Statement is signed from the Whole-time Company Secretary. Further if the company appointed Chief Executive Officer or Chief Financial Officer then the financial statement shall also be signed from them.

The signed financial statement submitted to the auditor then the auditor shall prepare an Auditors' report and the same shall be attached to the financial statement.

Where the company does not have a CFO and CS then only chairman can sign the financial statement. Where the company does not have a chairperson or not authorized by the board, signing of financial statements by two directors one of which shall be managing director and the CFO, if he is a director.

However, Financial Statement of One Person Company shall be signed by only one director.

CASE LAW

In Re *Sourajit Ghosh Vs. Union of India W.P. NO. 5774(W) OF 2020, High Court of Calcutta dated 30.07.2020,* it was held that if a director of a company who has failed to file financial statements incurs disqualification for appointment of a director in another company or re-appointment as a director, as the case may be, his right to continue as director in all companies which may have filed financial statements of annual returns as required under Companies Act would immediately be forfeited.

Adoption and Circulation of Signed Financial Statement

The company is required to adopt the Financial Statement in the Annual General meeting. The Annual General Meeting of the company can be held within 6 months from the end of the financial year i.e. 30 September. As per section 134(7) of the Companies Act, 2013, after signing the financial statement, including consolidated financial statement, if any, shall be circulated along with a copy each of—

(i) any notes or annexure;

(ii) the auditor's report; and

(iii) the Board's report.

Penal Provisions:

If a company is in default in complying with the provisions of section 134 of the Companies Act, 2013, the company shall be liable to a penalty of three lakh rupees and every officer of the company who is in default shall be liable to a penalty of fifty thousand rupees.

CASE LAW

In Re *HIFFCO Farming Ltd. Vs. Registrar of Companies, NCLAT New Delhi, Company Appeal (AT) no. 51 of 2022, dated 21.04.2022,* in this matter the appellant company had not filed financial statement with Registrar of Companies from year 2006-07 onwards and its name was 'struck-off' from Register of Companies, in view of fact that company was carrying on business operation and right to seek restoration of name of company was not extinguished, name of company was to be restored in register of companies subject to filing of all pending statutory documents along with late fees.

PEER REVIEW

The Institute of Company Secretaries of India provides a mechanism of Peer Review of their Members in Practice to enhance the quality of attestation services, to enhance credibility and provide competitive advantage and provide a forum for Guidance and knowledge sharing.

It is a process for examining the work performed by one's equals (peers) and to understand the systems, practices and procedures followed by the Practice Unit and to give suggestions, if any, for further improvement. Each Practice Unit would be required to be peer reviewed at least once in a block of five years. The Practicing Company Secretary/ Firm may apply voluntarily to be peer reviewed or it may be done through random selection by the Peer Review Board.

Peer Review is directed towards maintenance as well as enhancement of quality of attestation services and to provide guidance to members to improve their performance and adhere to various statutory and other regulatory requirements. Essentially, through a review of attestation services engagement records, peer review identifies the areas where a practising member may require guidance in improving the quality of his performance and adherence to various requirements as per applicable Technical Standard.

The main objectives of Peer Review is to ensure that while rendering Professional Services, the members in practice would:

(a) comply with the ICSI Guidance on Office Administration and Systems in the Office of PCS, ICSI Auditing Standards, Guidance Notes, Manuals, Referencers and advisories issued by the Institute; and

(b) have in place proper systems (including documentation systems) for maintaining the quality of professional assignments undertaken by them. Peer Review is directed towards enhancement of quality of professional services by providing guidance to members to improve their performance and adhere to various statutory and other regulatory requirements

Students are advised to refer Lesson 15 (Peer Review Audit and quality Review Audit) for more details.

OBLIGATION & PENAL PROVISIONS

A wrong signing/pre-certification leads to the following threat to the company, its authorised person and to the certifying professional.

To the company:

- The provisions of the Companies Act, 2013 provides for the actions/ fine/ penalty to be imposed on the companies in case of the default made by the company/its officers.

CASE LAW

In Re *Registrar of Companies, CP. NO. 338/441/ND/18, NCLT Delhi dated 19.03.2019*, in this case default was committed in compliance with provisions of sections 159 and 220 of Companies Act, 1956 for not filing its annual return and balance sheet and profit and loss account for F.Y. 2013-14 due to inadvertent mistake with no mala fide intentions and applicant had put an end to offence by filing its annual return and annual accounts, the offence was compounded.

- Further the action may be taken up by Central Government up to the order of the compulsory winding up of the company.

CASE LAW

In Re D3R Gateway Logistics (P.) Ltd. Vs. Registrar of Companies, Tamil Nadu C.P. 85/(252)/2017 dated 09.11.2017, in this matter the applicant-company failed to file annual returns for last four years with Registrar of Companies and its name was 'struck off' from Register of Companies under section 248(5), its name was to be restored to register of companies upon filing all pending financial statements and annual returns.

To the authorised representative of the company:

- The provisions of the Companies Act, 2013 provides for the actions/ fine/ penalty to be imposed on the companies in case of the default made by the company/its officers.
- Further the action may be taken up by Central Government under section 447,447 and 449 of the companies Act, 2013

To the Certifying professional:

i. Risk on Reputation:

- Wrong certifications will not only lead to penal provisions but also will affect the reputation of a Company Secretary's firm and also in his individual capacity.
- It may lead to possibility to lose the practice also. Apart from this there is bad rift to ICSI. So, a PCS has to keep this in mind while certifying or attesting the forms.

ii. Under the Company Secretaries Act 1980:

- The Second Schedule to the Company Secretaries Act, 1980 in clause 2 provides that "where a Company Secretary in Practice certifies or submits in his name, or in the name of his firm, a report of an examination of the matters relating to company secretarial practice and related statements unless the examination of such statements has been made by him or by a partner or an employee in his firm or by another Company Secretary in Practice," he shall be deemed to be guilty of professional misconduct.
- Further, clauses 5, 6, 7 and 8 provide that "where a Company Secretary in Practice while pre-certifying any e-Form or document fails to disclose a material fact known to him in his report or statement but the disclosure of which is necessary in making such report or statement, or fails to report a material mis-statement known to him or does not exercise due diligence, or is grossly negligent in the conduct of his professional duties or fails to obtain sufficient information which is necessary for expression of an opinion or its exceptions are sufficiently material to negate the expression of an opinion," he would be deemed to be guilty of professional or other misconduct under the provisions of the Company Secretaries Act, 1980.
- In case there is any false statement in any material particular or omission of any material fact in the form certified as correct by a Practicing Company Secretary, he would be liable for disciplinary action for professional or other misconduct under the provisions of the Company Secretaries Act, 1980.
- In view of section 21B(3) of the Company Secretaries Act, 1980, in case he is found guilty of professional or other misconduct mentioned in the second schedule to the Company Secretaries Act, 1980, he will be liable for the following actions

  (a) Reprimand,

  (b) Removal of name from the registrar of members permanently or for such period as may be thought fit by the disciplinary committee,

  (c) Fine which may extend to five lakh rupees.

iii. Under the Companies Act 2013

- With a view to ensure that the Company Secretary in practice carries out his work with due diligence, the Registrar may carry out scrutiny of Forms on random basis. As per rule 8(9) of the Companies (Registration Officers and Fees) Rules, 2014, where any instance of filing document, application or return etc. containing a false or misleading information or omission of material fact, requiring action under section 448 or section 449 is observed, the person shall be liable under section 448 and 449 of the Act. Section 448 of Companies Act, 2013 deals with penalty for false statements.
- The section provide that if in any return, report, certificate, financial statement, prospectus, statement or other document required by, or for the purposes of any of the provisions of this Act or the rules made thereunder, any person makes a statement, –

  - which is false in any material particulars, knowing it to be false; or
  - which omits any material fact, knowing it to be material, he shall be liable under section 447.
- Section 447 deals with punishment for fraud which provides that any person who is found to be guilty of fraud, shall be punishable with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud. In case, the fraud in question involves public interest, the term of imprisonment shall not be less than three years.

- In view of this, a Company Secretary in Practice will be attracting the penal provisions of section 448, for any false statement in any material particular or omission of any material fact in the e forms. However, a person will be penalized under section 448 in case he makes a statement, which is false in any material particular, knowing it to be false, or which omits any material fact knowing it to be material.

- It is pertinent to note that section 448 applies to "any person". In view of this, a company secretary in practice, who is an independent professional, will be attracting the penalty, as prescribed in section 448 in case his observations in the secretarial audit report turns out to be false or he omits any material fact, knowing it to be false or material.

iv. Action by Regulator

Further as per rule 8(10) The Companies (Registration Offices and Fees) Rules, 2014, without prejudice to any other liability, in the case of certification of any form, document, application or return under the act containing wrong or false or misleading information or omission of material fact or attachments by the person, the Digital Signature Certificate shall be de-activated by the central government till a final decision is taken in this regard. As per MCA circular no. 10/2014 dated 07.05.2014, where any instance of filing of documents, application or return or form etc, containing false or misleading information or omission of material fact or incomplete information is observed, the Regional Director or the Registrar as the case may be, shall conduct a quick inquiry against the professionals who certified the form and signatory thereof including an officer in default who appears prima facie responsible for submitting false or misleading or incorrect information pursuant to requirement of above said Rules, 15 days' notice may be given for the purpose. The Regional Director or the Registrar will submit his/her report in respect of the inquiry initiated, irrespective of the outcome, to the E-Governance cell of the Ministry within 15 days of the expiry of period given for submission of an explanation with recommendation in initiating action under section 447 and 448 of the Act wherever applicable and also regarding referral of the matter to the concerned professional Institute for initiating disciplinary proceedings.

The E-Governance cell of the Ministry shall process each case so referred and issue necessary instructions to the Regional Director/ Registrar of Companies for initiating action under section 448 and 449 of the Act wherever prima facie cases have been made out. The E-Governance cell will thereafter refer such cases to the concerned Institute for conducting disciplinary proceedings against the errant member as well as debar the concerned professional from filing any document on the MCA portal in future.

The Registrar shall forward a fortnightly report to the concerned Regional Director as well as to the E-Governance Division. Thereafter, the Regional Director shall forward a consolidated report to the Joint Secretary E-Governance Division on or before 7thof every month.

CASE STUDY

1. The disciplinary Committee of the institute of Company Secretaries of India (ICSI) has imposed penalty on a Company secretary for committing professional misconduct by making mistakes in the Compliance Certificate issued by him for a Company. The respondent, a Company Secretary, is a member of the ICSI. A complaint was lodged in the year 2014 alleging that the respondent, in a Compliance Certificate issued by him for a Company wrongly indicated that:

   (i) the company has not issued any equity shares in the relevant year,

   (ii) wrong statement on the conducting of meeting of the Board of Directors,

   (iii) wrongly stated that the Provident Fund is applicable to the company.

The respondent denied all the allegations. After the enquiry, the Director of Discipline observed that the Form 23AC has been filed by the company for filing the balance sheet and other documents with the Registrar of Companies through Chartered Accountant showing increase of Share Capital. However, the fact of increase of share capital is not reflected in the Compliance Certificate. It was observed that the Respondent has stated that the Board of Directors has duly met 4 times during the period under review but it appears that the Board was not constituted as two directors had resigned for which the Respondent has stated that they had written to the ROC, but failed. With regard to the applicability of PF scheme, it was observed that the respondent merely relied on the information provided by the Company instead of the relevant documents.

After considering the rival submissions, the disciplinary Committee found that the respondent is guilty of Professional Misconduct and imposed a fine of Rs. 15,000/-, on failure of remitting the same within the stipulated time, the respondent will be removed from the register for 60 days.

2. The Disciplinary Committee of the Institute of Company Secretaries of India (ICSI) has punished a Company Secretary for committing professional misconduct for filing Compliance Certificate without due diligence. A complaint was filed against the respondent, a Company secretary alleging that several acts of Professional and Other Misconduct was committed by him while certifying the Compliance Certificates of a company for the years 2009-10 and 2010-11. It was noted in the complaint that in the Compliance Certificate, it was wrongly stated that proper notices for Board meetings were given by the Company held during the year 2009-10. The Respondent has admitted that out of eight meetings held in the year, the Respondent has admitted that he had verified the proof of only three meetings. In regard to the other five meetings, the Respondent relied on the letter of the management confirming dispatch of notices.

   It was alleged that the Respondent failed to disclose in his Certificate that the allotment of 72,660 equity shares of Rs. 10/- each on 31st March 2009, by the Company, was illegal and beyond the authority of the Company as its Authorised Capital was only Rs. 5,00,000 as on that date. It was further alleged that the Respondent failed to report that the 1st AGM held by the Company on 1st January 2010, was illegal and void as it was held in complete disregard of Section 166 read with Section 210 of the Companies Act, 1956.

   The Director (Discipline) recorded a prima facie opinion that there was laxity on the part of the Respondent as he failed to verify the proofs of dispatch of notices of all the eight meetings of the Board of Directors. Also, the Board of Directors of the Company in its meeting held on 10.12.2009 had authorized any Director to sign Form 23AC, Form 23ACA, and Form 20B. However, while preparing e-form 20B, the date was inadvertently mentioned as 20.12.2009 instead of 10.12.2009. Further, the Respondent has failed to notice the variation in the paid-up capital and authorized capital wherein the Authorised Capital was lesser than the Paid-up Capital.

   Before the Disciplinary Committee, the Respondent pleaded guilty for non-exercising due diligence in the issuance of Compliance Certificate for the year 2009-2010 with reference to the issue of proper notices to the Directors for Board Meetings of the company.

   After considering the submissions, the disciplinary Committee found that the respondent is guilty of Professional Misconduct and imposed a fine.

LESSON ROUND-UP

- MCA has entrusted practicing professionals like members of the Institute of Company Secretaries of India (ICSI) with the responsibility of certifying the compliances and ensuring reliability of documents filed by companies with MCA in electronic mode and also ensuring proper due diligence for the same.

- Pre-certification means certification of correctness of any document by a professional including Company Secretary in Practice, before the same is filed with the Registrar in terms of the requirements of the Companies Act, 2013.
- Under sub-section (2) of section 92 of the Act read with rule 11(1) of the Companies (Management and Administration) Rules, 2014, every company shall file its annual return in Form MGT- 7, except One Person Company (OPC) & Small Company.
- Annual Return is required to be signed by a Director and the Company Secretary, or where there is no Company Secretary, by a Company Secretary in Practice (PCS).
- For the purpose of certification, PCS should carry out a scrutiny of the data available and check the correctness of the same.
- Practicing Company Secretaries (PCS) have been given a role to contribute towards improvement of standards of good Corporate Governance among listed companies, The SEBI (Listing Obligations and Disclosure Requirements) Regulations,2015 (Listing Regulations) prescribes that a Compliance Certificate from either the auditors or Practicing Company Secretary regarding compliance of conditions of corporate governance shall be annexed to the directors' report.
- The financial statement of a company shall be prepared in accordance with Section 129 and schedule III of Companies Act 2013 and such financial statement shall be laid before the shareholders at the Annual General Meeting of the Company.
- For the purpose of maintaining quality of attestation /certification services provided by Company Secretaries in Practice, every Practicing Company Secretary/Firm of Practicing Company Secretaries shall maintain a register regarding attestation /certification services provided by him/her/it, which shall be open for inspection by such person as may be authorised.

GLOSSARY

Certification : Certification means the process of giving official or legal approval to a document, that has complied with the required standards, legislative or regulatory requirements.

Pre-certification : Pre-certification refers to examination and authentication of various forms required to be filled with Authorities governed under various laws. In other words, Pre-certification means to check the form by the Independent Professional before filling it with the Ministry of Corporate Affairs.

Professional misconduct : Professional misconduct is the behavior outside the bounds of what is considered acceptable or worthy of its membership by the governing body of a profession. Professional misconduct refers to disgraceful or dishonorable conduct not befitting a professional.

Disciplinary Proceedings : Disciplinary proceedings means the institution of formal discipline procedures against a member by way of the laying of a written charge or allegation for any misconduct.

TEST YOURSELF

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation).

1. Describe the various forms which are exclusively certified by the company secretary in practice under the Companies Act, 2013.
2. How the scrutiny of the annual retune take place and what are the guiding principles for scrutiny of annual return?
3. Describe the points covered in the from MGT- 8 which are need to be certified?
4. Azra Limited has not been compliant in filing the Annual Returns for more than two years. Explain in brief the penal provisions which will apply to the directors of the Company for not filing the annual returns.
5. Nixal Limited has a paid-up equity share capital of Rs.8 Crores and for the year ended March 31, 2021 the Company reported a turnover of Rs.55 crores. The Managing Director is of the view that the Company does not require a Company Secretary to sign its annual return. Is the MD's view correct?

LIST OF FURTHER READINGS

ICSI Publications:

- Referencer on Pre-certification of e-forms
- Guidance Note on the Annual Return
- Corporate Governance Certification under Listing Regulations - A Referencer

OTHER REFERENCES (Including Websites/Video Links)

- www.mca.gov.in
- www.sebi.gov.in
- www.icsi.edu
- www.ebook.mca.

Legal Framework Governing Company Secretaries

Lesson 4

KEY CONCEPTS

■ Company Secretary ■ Transparency ■ Accountability ■ Disciplinary Mechanism ■ Associate Member ■ Fellow Member ■ UDIN ■ eCSIN

Learning Objectives

To understand:

- Expectation from a member with respect to various aspects of the ethical conduct
- Functions and Duties of Company Secretaries
- Board of Discipline and Disciplinary Committee
- Provisions relating to misconduct under the Company Secretaries Act, 1980

Lesson Outline

REGULATORY FRAMEWORK

- The Company Secretaries Act, 1980
- The Company Secretaries Regulations, 1982
- ICSI (Guidelines for Advertisement by Company Secretaries), 2020
- The Companies Act, 2013

INTRODUCTION

The need to have a profession of Company Secretaries was first felt in early 50's, when the business environment had started changing, that had necessitated the services of a professional to bring Corporate Discipline.

The Government set up an Advisory Board on a non-statutory basis, to help it in standardizing the basic qualifications needed for manning the position of Company Secretaries and to hold the qualifying examination.

Subsequently, the Department of Company Affairs conducting examination leading to Government Diploma in Company Secretaryship (GDCS), marked the beginning of the profession of Company Secretaries in an organized manner. Later in the wake of substantial increase in the number of candidates for GDCS, the Institute of Company Secretaries of India was set up and registered as a company on 4th October, 1968 under Section 25 of the Companies Act, 1956 (i.e. not for profit company) with its registered office at New Delhi. The work relating to Company Secretaries' Examination and all allied matters were taken over by the Institute with effect from 1st January 1969.

In 1980, the Government moved the Company Secretaries Bill, 1980 to convert the Institute into a statutory body.

While moving the Company Secretaries Bill, 1980 for consideration by the Lok Sabha on 16th June, 1980, the then Minister of Law, Justice and Company Affairs, Shri P. Shiv Shankar had said, "An essential ingredient in the healthy growth of the corporate sector is the induction of professional management. The Government attaches special importance to the development of professional management, so that the corporate sector can evolve and function in tune with the changing needs of the times, and the social responsibilities that this important segment of the economy has to shoulder. The profession of Company Secretaries has an important part to play in the introduction of professionalism in the area of corporate management."

Company Secretary (CS) professionals are recognized as Key Managerial Personnel (KMP) under the Companies Act, 2013, wherein they are entrusted with a senior-level position in the management and are an intrinsic part of the Board of corporate entity. Since past five decades, Professionals have witnessed a substantial and spectacular growth and development made by Institute of Company Secretaries of India (ICSI) especially in the areas of recognitions obtained from various Agencies/ Government for the benefit of its members.

Recognition of Company Secretary Profession-A fascinating journey

In 1887, Lord Justice Esher made the remarks on the duties of the Company Secretary while writing out his judgment in The Court of Appeal in *Barnett Hoares & Co. v South London Tramways Co. (18 QBD 1887)* that, company secretaries could not be assumed to have authority for anything. A Secretary is a mere servant, his position is that he is to do what he is told.

It took 90 years for the Judiciary to take note of the emergence of the Company Secretary in the Corporate World. The remarks made by the celebrated Lord Denning, in *Panorama Developments (Gilford) Ltd v. Fidelis Furnishing Fabrics Limited (1971) (3 All ER 16) (CA)* observed as under:

"..... times have changed. A Company Secretary is a much more important person nowadays than he was in 1887. He is an Officer of the company with extensive duties and responsibilities. This appears not only in

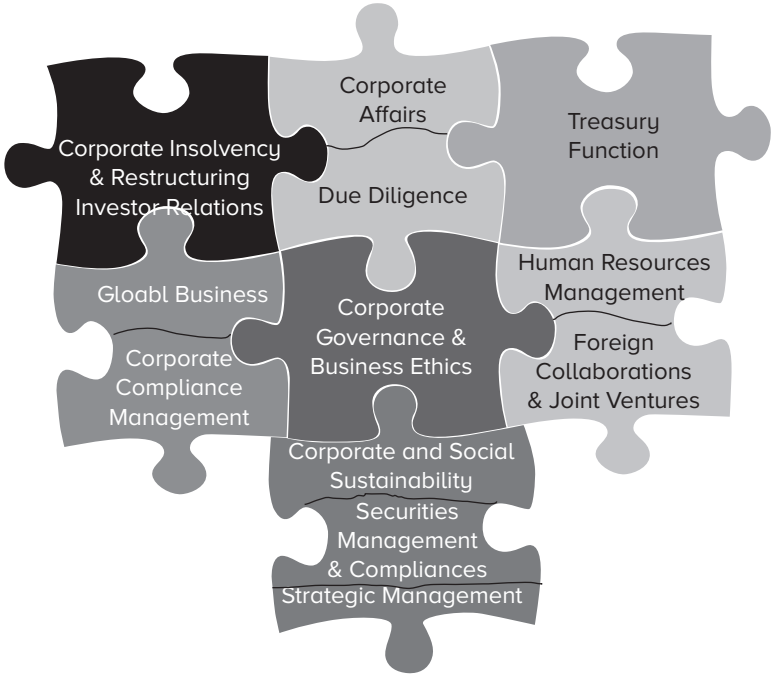
the modern Companies Act but also by the role which he plays in the day to day businesses of companies. He is no longer a mere clerk. He regularly makes representations on behalf of the company and enters into contracts on its behalf which come within the day to day running of the company's business. So much so that he may be regarded as held out as having authority to do such things on behalf of the company.....".

The above acknowledgement in the status of the company secretary coming as it did from no less a person of the stature of His Lordship was most definitely a defining moment announcing his arrival as an important cog in the wheel where a corporation was concerned. The growth in his stature was in keeping with the greater and wider acceptance of the corporate form of business, the emergence of corporate laws, bringing in its wake, the requirements of a host of compliances.

Functions and Duties of Company Secretaries

The expectations from the Company Secretaries, as they are increasingly being referred to as "governance professionals" now also extend to the areas of Corporate Social Responsibility (CSR), Business Responsibility and Sustainability Reporting (BRSR) and Environment Social Governance (ESG), all of which put together highlights the focus on sustainability, where the CS has infinite opportunities to excel as a preferred professional.

The Company Secretary is an in-house legal expert and a compliance officer of the company, possessing expertise in corporate laws, securities laws & capital market and corporate governance. The Company Secretary is chief advisor to the board of directors on best practices in corporate governance, bearing responsibility for all regulatory compliances of company, corporate planner and strategic manager. The role of company secretary may be understood by referring the below image:



According to the section 205 of the Companies Act, 2013 read with rule 10 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, the Company Secretary must perform the following functions and duties:

- To report to the Board about compliance with the provisions of this Act, the rules made thereunder and other laws applicable to the company;
- To ensure that the company complies with the applicable secretarial standards;

- To provide to the directors of the company, collectively and individually, such guidance as they may require, with regard to their duties, responsibilities and powers;
- To facilitate the convening of meetings and attend Board, committee and general meetings and maintain the minutes of these meetings;
- To obtain approvals from the Board, general meeting, the government and such other authorities as required under the provisions of the Act;
- To represent before various regulators, and other authorities under the Act in connection with discharge of various duties under the Act;
- To assist the Board in the conduct of the affairs of the company;
- To assist and advise the Board in ensuring good corporate governance and in complying with the corporate governance requirements and best practices; and
- To discharge such other duties as have been specified under the Act or rules; and
- Such other duties as may be assigned by the Board from time to time.

CASE LAW

Mayank Agarwal (Applicant) vs. M/s. Technology Frontiers (India) Private Limited (Respondent Company) National Company Law Tribunal (Chennai Bench) IA/2/2021 in CP/75/CHE/2021

The Company Secretary can represent before various regulators and other authorities in connection with discharge of various duties under the Act. The NCLT being a quasi-judicial authority the Company Secretary can very well do the same

In this case, the Company Secretary of the respondent company had sent the notice to the applicant under Section 90(5), (who is nominee director of the Respondent Company) on May 3rd, 2021 along with the form to disclose their Ultimate Beneficial Ownership of the shares held.

However, the applicant alleged that the company alone is empowered to apply to NCLT under Section-90(7) of the Companies Act, 2013 and Company Secretary has not taken approval from Board of directors to file the present petition.

The Company Secretary of Respondent Company in his written submission stated that he has the *locus standi* as per the board resolution passed for his appointment which clearly states that "he can perform any duties as required under Companies Act, 2013" and have the authority to enter into pleadings on behalf of company even in absence of formal board authorization. Further, he referred to the provisions of section 205 of the Companies Act 2013, under which he is authorized to represent and that it is his duty to do so.

Order: The usage of the words "Company shall give notice" under Section 90(5) makes it amply clear that the Key Managerial Personnel have to do this activity of seeking information; in order to find out the Ultimate Beneficial Owners. The Company Secretary has acted diligently and promptly to ensure compliance of the mandatory provisions. Hence, the application stand dismissed.

Further, as per regulation 6(2) of the SEBI (LODR) Regulations, 2015, a listed company is required to appoint a qualified company secretary as the compliance officer. The compliance officer of the Company is responsible for:

(a) ensuring conformity with the regulatory provisions applicable to the listed entity in letter and spirit;

(b) co-ordination with and reporting to the Board, recognised stock exchange(s) and depositories with respect to compliance with rules, regulations and other directives of these authorities in the manner as specified from time to time;

(c) ensuring that the correct procedures have been followed that would result in the correctness, authenticity and comprehensiveness of the information, statements and reports filed by the listed entity under these regulations;

(d) monitoring email address of grievance redressal division as designated by the listed entity for the purpose of registering complaints by investors:

However, the company secretary is also entrusted with the duties for ensuring compliance with SEBI (Prohibition of Insider Trading) Regulations, 2015 including maintenance of various documents and also to ensure compliance of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 etc.

Company Secretary as a part of Senior Management

The Regulation 16(d) of the SEBI (LODR) Regulations, 2015 provides that the senior management shall mean the officers and personnel of the listed entity who are members of its core management team, excluding the Board of Directors, and shall also comprise all the members of the management one level below the Chief Executive Officer or Managing Director or Whole-Time Director or Manager (including Chief Executive Officer and Manager, in case they are not part of the Board of Directors) and shall specifically include the functional heads, by whatever name called and the Company Secretary and the Chief Financial Officer.

Accordingly, the role of Company Secretary in the various segments, is performed in different capacities. Broadly the Company Secretary is having the opportunities in the following two domains:

Some Legal Terminologies and Interpretation

According to section 2(1)(c) of the Company Secretaries Act, 1980 **"**Company Secretary" means a person who is a member of the Institute of Company Secretaries of India.

Section 2(1)(j) of the Company Secretaries Act, 1980 states, "Register" means the Register of members of the Institute maintained under section 19 or the Register of firms of the Institute maintained under section 20B, as the case may be.

Under the Companies Act, 2013 Company Secretary has been defined under section 2(24) as: 'Company Secretary' or 'Secretary' means a Company Secretary as defined in clause (c) of sub section (1) of Section 2 of the Company Secretaries Act, 1980 who is appointed by a company to perform the functions of the Company Secretary under the Companies Act, 2013.

Section 2(25) of the Companies Act, 2013 defines "Company Secretary in Practice" means a company secretary who is deemed to be in practice under sub-section (2) of section 2 of the Company Secretaries Act, 1980.

Section 2(51) of the Companies Act, 2013 defines "key managerial personnel", in relation to a company, means—

(i) the Chief Executive Officer or the managing director or the manager;

(ii) the company secretary;

(iii) the whole-time director;

(iv) the Chief Financial Officer;

(v) such other officer, not more than one level below the directors who is in whole-time employment, designated as key managerial personnel by the Board; and

(vi) such other officer as may be prescribed.

ASSOCIATES AND FELLOWS

The members of the Institute shall be divided into two classes designated respectively as Associates and Fellows.

(1) Associate Members

"Associate" means an Associate Member of the Institute.

As per section 5 of the Company Secretaries Act, 1980, Any person other than a person to whom the provisions of sub-section (*4*) apply, shall, on his name being entered in the Register of members, be deemed to have become an Associate and as long as his name remains so entered, shall be entitled to use the letters "A.C.S." after his name to indicate that he is an Associate.

According to Regulation 4(1) of The Company Secretaries Regulations, 1982 as amended by the Company Secretaries (Amendment) Regulations, 2020.

No person shall be entitled to have his name entered in the Register of Members as an Associate, unless he,–

(a) has passed examinations conducted by the dissolved company and has completed practical training either as prescribed in the earlier regulations or as prescribed in the Company Secretaries (Amendment) Regulations, 2020; or

(b) has passed the qualifying examinations and completed the practical training as prescribed in these regulations; or

(c) has passed such other examination and completed such other training outside India as is recognised by the Central Government or the Council as being equivalent to the examination and training prescribed in these regulations; or

(d) had registered himself as a student with the Institute of Chartered Secretaries and Administrators, London on or before 31st December, 1972 and had passed the Final Examination or Professional Programme Examination of that Institute and had either possessed the required practical experience or undergone the prescribed practical training as stipulated for candidates passing the Final Examination or Professional Programme Examination conducted by the Institute; or

(e) is an Indian citizen who is a "person resident outside India" as defined in clause (w) of section 2 of the Foreign Exchange Management Act, 1999 and has become a member of the Institute of Chartered Secretaries and Administrators, London, after passing the qualifying examination conducted by that Institute and had either possessed and required practical experience in India or abroad, or undergone the prescribed practical training as stipulated for the candidates passing the Final Examination or Professional Programme Examination conducted by the Institute.

(2) Fellow Members

"Fellow" means a Fellow Member of the Institute.

As per section 5 of the Company Secretaries Act, 1980, A person, being an Associate who has been in continuous practice in India as a Company Secretary for at least five years and a person who has been an Associate for a continuous period of not less than five years and who possesses such qualifications or practical experience as the Council may prescribe with a view to ensuring that he has experience equivalent to the experience normally acquired as a result of continuous practice for a period of five years as a Company Secretary shall, on payment of such fees, as may be determined, by notification, by the Council, and on application made and granted in the prescribed manner, be entered in the Register of members as a Fellow.

According to Regulation 4(2) of The Company Secretaries Regulations, 1982 as amended by the Company Secretaries (Amendment) Regulations, 2020.

(i) No person shall be entitled to have his name entered in the Register of Members as a Fellow unless he,-

(a) was a Fellow including Honorary Fellow of the dissolved company immediately before the commencement of the Act; or

(b) was admitted as a Fellow under the earlier regulations; or

(c) is an Associate and has been in continuous practice in India as a Company Secretary for at least five years; or

(d) is an Associate for a continuous period of not less than five years and possesses such qualifications or practical experience as may be determined by the Council.

(ii) No Associate member shall be admitted as a fellow member of the Institute, if; -

(a) he has been found guilty of any professional or other misconduct and his name has been removed from the Register or he has been imposed fine referred in sub-section (3) of sections 21A or sub- section (3) of section 21B at any time during the preceding five years on the date of application; or

(b) he has not completed such minimum numbers of Professional Development Credit Hours as may be determined by the Council:

Provided that in the case of any person belonging to any of the classes mentioned in sub- regulations (1) and (2), who is not permanently residing in India, the Council may, by resolution, determine, such further qualifications and conditions, as it may deem necessary or expedient."

Certificate of practice

As per regulation 2(d) of the Company Secretaries Regulations, 1982 'certificate of practice' means a certificate granted under these or earlier regulations entitling the holder to practise as a Company Secretary.

A member is entitled to continue the practice of Company Secretary, whether in India or elsewhere, only after obtaining a Certificate of Practice.

Deemed "to be in practice"

As per section 2(2) of the Company Secretaries Act, 1980, a member of the Institute shall be deemed "to be in practice" when, individually or in partnership with one or more members of the Institute in practice or in partnership with members of such other recognised professions as may be prescribed, he, in consideration of remuneration received or to be received, –

(a) engages himself in the practice of the profession of Company Secretaries to, or in relation to, any company; or

(b) offers to perform or performs services in relation to the promotion, forming, incorporation, amalgamation, reconstruction, reorganization or winding up of companies; or

(c) offers to perform or performs such services as may be performed by –

(i) unauthorized representative of a company with respect to filing, registering, presenting, attesting or verifying any documents (including forms, applications and returns) by or on behalf of the company,

(ii) a share transfer agent,

(iii) an issue house,

(iv) a share and stock broker,

(v) a secretarial auditor or consultant,

(vi) an adviser to a company on management, including any legal or procedural matters,

(vii) issuing certificates on behalf of, or for the purposes of, a company, or

(d) holds himself out to the public as a Company Secretary in practice; or

(e) renders professional services or assistance with respect to matters of principle or detail relating to the practice of the profession of Company Secretaries; or

(f) renders such other services as, in the opinion of the Council, are or may be rendered by a Company Secretary in practice.

REGISTER OF MEMBERS

Regulation 3 of the Company Secretaries Regulations, 1982 specifies that the Institute shall maintain a Register of Members in the proforma referred to in Schedule 'A' manually or electronically or in any other mode as may be determined by the Council. The Register shall include the following particulars about every member of the Institute, namely:—

(a) his full name, date of birth, domicile, residential and professional addresses;

(b) membership number and the date on which his name is entered in the Register;

(c) his qualifications;

(d) whether he holds a certificate of practice;

(e) email-id, mobile number, telephone number if any, and such other particulars as may be determined by the Council.

The member shall communicate to the Institute any change of his details entered in the Register, within thirty days of such change.

Removal from the Register of Members

As per section 20 of the Company Secretaries Act, 1980, in the following cases the Council may remove from the Register the name of any member of the Institute—

(a) who is dead; or

(b) from whom a request has been received to that effect; or

(c) who has not paid any prescribed fee required to be paid by him; or

(d) who is found to have been subject at the time when his name was entered in the Register of members, or who at any time thereafter has become subject, to any of the disabilities mentioned in section 8, or who for any other reason has ceased to be entitled to have his name borne on the Register of members.

The Council shall remove from the Register of members the name of any member in respect of whom an order has been passed under this Act removing him from membership of the Institute.

Disciplinary Mechanism

The member of the Institute is subject to the Disciplinary mechanism provided for under Chapter V (Misconduct) of the Company Secretaries Act, 1980 (the Act).

Chapter II of the Company Secretaries (Procedure of Investigations of Professional and Other Misconduct and Conduct of Cases) Rules, 2007 prescribes procedures of Investigation related to Complaints and Information; Fee for filing complaint; Registration of complaint; Withdrawal of a complaint etc.

Disciplinary Directorate

Section 21 of the Act provides for the establishment of a Disciplinary Directorate headed by an officer of the Institute designated as Director (Discipline) and such other employees for making investigations in respect of any information or complaint received by it. On receipt of any information or complaint along with the prescribed fee, the Director (Discipline) shall arrive at a prima facie opinion on the occurrence of the alleged misconduct. The Disciplinary Directorate shall follow such procedure as may be specified to make investigations under the Act.

Where the Director (Discipline) is of the opinion that a member is guilty of any professional or other misconduct mentioned in the First Schedule, the matter shall be placed before the Board of Discipline.

Where the Director (Discipline) is of the opinion that a member is guilty of any professional or other misconduct mentioned in the Second Schedule or in both the Schedules, the matter shall be placed the Disciplinary Committee.

Chapter III of the Company Secretaries (Procedure of Investigations of Professional and Other Misconduct and Conduct of Cases) Rules, 2007 prescribes procedure of Investigation related to Procedure to be followed by Director on a complaint; Examination of the Complaint; Mode of Sending Notice; Time limit on entertaining complaint or information etc.

Board of Discipline

The Board of Discipline shall be constituted by the Council of the Institute under section 21A of the Company Secretaries Act, 1980. The Board of Discipline shall follow summary disposal procedure in dealing with all the cases before it.

Where the Board of Discipline is of the opinion that a member is guilty of a professional or other misconduct mentioned in the First Schedule, it shall afford to the member an opportunity of being heard before making any order against him and may thereafter take any one or more of the following actions, namely:—

(a) reprimand the member;

(b) remove the name of the member from the Register up to a period of three months;

(c) impose such fine as it may think fit which may extend to rupees one lakh.

The Director (Discipline) shall submit before the Board of Discipline all information and complaints where he is of the opinion that there is no prima facie case and the Board of Discipline may, if it agrees with the opinion of the Director (Discipline), close the matter or in case of disagreement, may advise the Director (Discipline) to further investigate the matter.

Chapter IV of the Company Secretaries (Procedure of Investigations of Professional and Other Misconduct and Conduct of Cases) Rules, 2007 prescribes Functioning of Board of Discipline; Procedure to be followed by the Board of Discipline; Orders of the Board of Discipline etc.

Disciplinary Committee

According to Section 21B of the Company Secretaries Act, 1980, a Disciplinary Committee shall be constituted by the Council. The Disciplinary Committee shall consist of the President or the Vice-President of the Council as the Presiding Officer and two members to be elected from amongst the members of the Council and two members to be nominated by the Central Government from amongst the persons of eminence having experience in the field of law, economics, business, finance or accountancy.

The Council may constitute more Disciplinary Committees as and when it considers necessary. The Disciplinary Committee, while considering the cases placed before it, shall follow such procedure as may be specified.

Where the Disciplinary Committee is of the opinion that a member is guilty of a professional or other misconduct mentioned in the Second Schedule or both the First Schedule and the Second Schedule, it shall afford to the member an opportunity of being heard before making any order against him and may thereafter take any one or more of the following actions, namely:—

(a) Reprimand the member;

(b) Remove the name of the member from the Register permanently or for such period, as it thinks fit;

(c) impose such fine as it may think fit, which may extend to rupees five lakhs.

Chapter V of the Company Secretaries (Procedure of Investigations of Professional and Other Misconduct and Conduct of Cases) Rules, 2007 prescribes Constitution and functioning of Committee; Allowances to the members nominated by the Central Government; Procedure to be followed by the Committee; Orders of the Committee etc.

Authority, Disciplinary Committee, Board of Discipline and Director (Discipline) to have Powers of Civil Court

Section 21C of the Company Secretaries Act, 1980 provides that for the purposes of an inquiry under the provisions of this Act, the Authority, the Disciplinary Committee, Board of Discipline and the Director (Discipline) shall have the same powers as are vested in a civil court under the Code of Civil Procedure, 1908, in respect of the following matters, namely:—

(a) summoning and enforcing the attendance of any person and examining him on oath;

(b) the discovery and production of any document; and

(c) receiving evidence on affidavit.

APPEAL TO AUTHORITY

As per section 22A of the Act the Appellate Authority constituted under sub-section (1) of section 22A of the Chartered Accountants Act, 1949, shall be deemed to be the Appellate Authority for the purposes of this Act, subject to certain modifications.

Accordingly, any member of the Institute aggrieved by any order of the Board of Discipline or the Disciplinary Committee imposing on him any of the penalties referred to in section 21A(3) and section 21B(3), may within ninety days from the date on which the order is communicated to him, prefer an appeal to the Authority.

The Director (Discipline) may also appeal against the decision of the Board of Discipline or the Disciplinary Committee to the Authority if so authorised by the Council, within ninety days.

The Authority may entertain any such appeal after the expiry of the said period of ninety days, if it is satisfied that there was sufficient cause for not filing the appeal in time.

The Authority may, after calling for the records of any case, revise any order made by the Board of Discipline or the Disciplinary Committee under sub-section (3) of section 21A and sub-section (3) of section 21B and may –

(a) confirm, modify or set aside the order;

(b) impose any penalty or set aside, reduce, or enhance the penalty imposed by the order;

(c) remit the case to the Board of Discipline or Disciplinary Committee for such further enquiry as the Authority considers proper in the circumstances of the case; or

(d) pass such other order as the Authority thinks fit.

Provided that the Authority shall give an opportunity of being heard to the parties concerned before passing any order.

CERTAIN PROVISIONS RELATING TO MISCONDUCT UNDER THE COMPANY SECRETARIES ACT, 1980

The expression "professional or other misconduct" has been defined under section 22 of the Act. It is deemed to include any act or omission provided in any of the Schedules, but nothing in the referred section shall be construed to limit or abridge in any way, the power conferred or duty cast on the Director (Discipline) under sub-section (1) of section 21 to inquire into the conduct of any member of the Institute under any other circumstances.

Professional misconduct in relation to members of the Institute is broadly structured under Schedule I and Schedule II of the Act:

(a) Professional misconduct in relation to Company Secretaries in Practice (Part I of the First Schedule);

(b) Professional misconduct in relation to members of the Institute in service (Part II of the First Schedule);

(c) Professional misconduct in relation to members of the Institute generally (Part III of the First Schedule);

(d) Other misconduct in relation to members of the Institute generally (Part IV of the First Schedule);

(e) Professional misconduct in relation to Company Secretaries in practice (Part I of the Second Schedule);

(f) Professional misconduct in relation to members of the Institute generally (Part II of the Second Schedule);

(g) Other misconduct in relation to members of the Institute generally (Part III of the Second Schedule).

The detailed provisions relating to misconduct and disciplinary mechanism are contained in Sections 21, 21A, 21B, 21C, 21D & 22 and the First and the Second Schedules to the Act and the Rules made thereunder.

Other Misconduct

The Supreme Court in *Council of the Institute of Chartered Accountants of India and Another v. B. Mukherjee [1957 AIR 72 1958 SCR 371]*, after examining the nature, scope and extent of the disciplinary jurisdiction

under the provisions of the Chartered Accountants Act, 1949 (which contains provisions analogous to those in the Company Secretaries Act, 1980), observed as follows:- "We therefore, take the view that, if a member of the Institute is found, prima facie, guilty of conduct, which, in the opinion of the Council renders him unfit to be a member of the Institute, even though such conduct may not attract any of the provision of the Schedules, it would still be open to the Council to hold an enquiry against the member in respect of such conduct and a finding against him, in such an enquiry, would justify appropriate action being taken by the High Court."

The following can be cited as illustrative examples of "other misconduct":

i. where a Company Secretary retains the records, books of account and documents of the client and fails to return to the client on request without a reasonable cause;

ii. where a Company Secretary makes a material misrepresentation;

iii. where a Company Secretary uses the services of his apprentice(s) for purposes other than professional practice;

iv. conviction by a competent court of law;

v. wrong publicity causing damage to the clients;

vi. where in the opinion of the Council member brings disrepute to the profession or the Institute as a result of his action whether or not related to his profession;

vii. member is held guilty by any civil or criminal court for an offence which is punishable with imprisonment for a term not exceeding six months;

viii. furnishing false declaration to the institute or any regulator; and

ix. non-compliance with Guidelines issued by the Council of the Institute.

The question what constitutes misconduct also came up for consideration before the Hon'ble Supreme Court of India in the case of *N. G. Dastane v. Shrikant S. Shivade & Anr. [AIR (2001) SC 2028].* This case was in the context of sub-section (1) of section 35 of the Advocates Act, 1961.

The said provision is extracted herein below:- "Where on receipt of a complaint or otherwise a State Bar Council has reason to believe that any Advocate on its roll has been guilty of professional or other misconduct, it shall refer the case for disposal to its disciplinary committee."

The Hon'ble Supreme Court of India observed in Paras 16 and 17 of the judgment as under:- "The collocation of the words "guilty of professional or other misconduct" has been used for the purpose of conferring power on the Disciplinary Committee of the State Bar Council. It is for equipping the Bar Council with the binocular as well as whip to be on the qui vive for tracing out delinquent Advocates who transgress the norms or standards expected of them in the discharge of their professional duties. The central function of the legal profession is to help promotion of administration of justice. Any misdemeanor or misdeed or misbehavior can become an act of delinquency, if it infringes such norms or standards and it can be regarded as misconduct.

In Black's Law Dictionary "misconduct " is defined as a "transgression of some established and definite rule of action, a forbidden act, a dereliction from duty, unlawful behavior, its synonyms are misdemeanor, misdeed, misbehavior, delinquency, impropriety, mismanagement, offence, but not negligence or carelessness."

In the aforesaid case, the Hon'ble Supreme Court quoted the following passage from the observations of Privy Council in *George Frier Grahame v. Attorney General [AIR 1936, PC, 224].* "Misconduct envisaged in Section 35 of the Advocates Act is not defined. The section uses the expression "misconduct, professional or otherwise." The word "misconduct" is relative term. It has to be considered to the subject–matter and the context wherein such term occurs. It literally means wrong conduct or improper conduct."

a. Professional misconduct in relation to Company Secretaries in Practice (Part I of the First Schedule to the Act)

Part I of the First Schedule to the Act deals with professional misconduct in relation to Company Secretaries in practice. It contains eleven clauses in all. The implications of various clauses in Part I are briefly explained herein below:

Clause (1)

Provides that a Company Secretary in Practice shall be deemed to be guilty of professional misconduct, if he -

"allows any person to practice in his name as a Company Secretary unless such person is also a Company Secretary in Practice and is in partnership with or employed by him."

This rule is intended to ensure that the professional work is done by a qualified professional so as to protect the client's/public interest. The rule permits another person to practice in the name of a Company Secretary in Practice provided such other person is also a Company Secretary in Practice and is in partnership with or is employed by the Company Secretary in Practice in whose name the work is to be carried out.

This clause read with clause 11 of Part I of the First scheduled does not permit PCS to allow any person to practice in his name as a Company Secretary or to allow any person to sign as PCS, unless such person is also a Company Secretary in Practice or is in partnership with or employed by him.

On a question as to how CA / CWA can become partner(s) of PCS, council has opined that though for the time being CA/CWA etc. cannot become partners of a PCS but after the amendments to the relevant provisions, person(s) who are non-members, may become partners of PCS and may be allowed to provide non-attestation services.

Two persons are said to be in Partnership when they work together on mutual faith and agency. Sharing of remuneration does not make them partners. Thus an associate who is not a part of decision making process does not become a partner. Following tests if fulfilled cumulatively may make two persons partners of each other:

i. Sharing of profits and or losses;

ii. Taking decisions together;

iii. Sharing the responsibilities of such decision making; and

iv. Acting on behalf of each other and binding other person with one own acts of commission or omission.

However, sharing of common infrastructure at same or different geographical location are not relevant at all to decide the relationship.

Clause (2)

Provides that a Company Secretary in Practice shall be deemed to be guilty of professional misconduct, if he—

"pays or allows or agrees to pay or allow, directly or indirectly, any share, commission or brokerage in the fees or profits of his professional business to any person other than a member of the Institute or a partner or a retired partner or the legal representative of a deceased partner or a member of any other professional body or with such other persons having such qualifications as may be prescribed, for the purpose of rendering such professional services from time to time in or outside India.

Explanation — in this item, 'partner' includes a person residing outside India with whom a Company Secretary in Practice has entered into partnership which is not in contravention of item (4) of this part."

This clause does not prohibit a Company Secretary in Practice from sharing fees, commission or brokerage in the fees or profits of his professional business, with any other member of the Institute or a partner or a retired partner or the legal representative of a deceased partner. Such sharing of fees, commission or brokerage in the

fees or profits of professional business is also permissible with members of such professional bodies or with such other persons having such qualifications as may be prescribed from time to time. This provision is made primarily to encourage multi-disciplinary partnership.

In terms of clause (2) of Part II of the First Schedule to the Act, a member of the Institute in service shall be deemed to be guilty of professional misconduct, if he being an employee of any company, firm or person, accepts or agrees to accept any part of fees, profits, or gains from a lawyer, a Company Secretary or broker engaged by such company firm or person or agent or customer of such company, firm or person by way of commission or gratification. Accordingly a Practicing Company Secretary cannot share fees with an employee Company Secretary. Therefore, words 'who is in practice' are to be read in Clause 2 of the Part I of the First Schedule, after the word "institute".

The term 'partner' used in this rule would include *'ipso facto'* another Company Secretary in Practice or a member of any other recognised profession under Section 2(2) of the Act. In regard to sharing of fees with the legal representative of a deceased partner it is desirable that the partnership deed contains a suitable covenanting this behalf. In the case of a sole proprietorship firm, on the death of the proprietor of the firm, there cannot be any sharing of fees between the purchaser of the goodwill of the firm and the legal representative of the proprietor. Payment of goodwill is permissible, which can be in installments as provided in the agreement of sale of goodwill. The payment of goodwill shall, in no circumstances be linked with participation in the earnings of the firm of the buyer of the goodwill.

It may appear that this Clause permits sharing of fees by PCS with members of the Institute who are not employed but are practicing as CA / CWA or an Advocate. However, this does not appear to be the intention. The term "Professional Business" used may be understood as professional activities.

CA/CWA may become partners of PCS only for non-attestation services i.e. only for the purposes as contemplated by clause nos. 2, 3, 4 & 5 of the First Schedule and CA / CWA cannot become full-fledged partners as contemplated by Clause 1 of Part I of the First Schedule. That is to say a PCS even if he is allowed to be a partner of a Chartered Accountant, will not be able to sign the Auditors report on behalf of the multidisciplinary firm.

In other words, a CA or CWA who does not hold CP of ICSI, cannot issue Secretarial Audit Report by a multidisciplinary firm even if such CA/ CWA is a partner of PCS for the purposes of Clause 2, 3, 4, & 5 of the First Schedule. Council in its 177th meeting held on 27th November 2007 has passed following resolution:

"168A. Other Professional bodies.—

(1) For the purposes of clauses (2), (3) and (5) of Part I of the First Schedule to the Act, a person has to be member of any of the following, namely:

(a) The Institute of Chartered Accountants of India established under the Chartered Accountants Act, 1949;

(b) The Institute of Cost Accountants of India established under the Cost and Works Accountants Act, 1959;

(c) The Bar Council of India established under the Advocates Act, 1961;

(d) The Indian Institute of Architects established under the Architects Act, 1972;

(e) The Institute of Actuaries of India established under the Actuaries Act, 2006;

(f) The membership of the professional bodies or institutions whose qualifications relating to Company Secretaryship are recognized by the Council under sub-section (2) of Section 38 of the Act.

(2) For the purposes of clauses (2), (3) and (5) of Part I of the First Schedule to the Act, the following shall be the persons qualified in India, namely:

(a) Chartered Accountant within the meaning of the Chartered Accountants Act, 1949;

(b) Cost Accountant within the meaning of the Cost and Works Accountants Act, 1959;

(c) Actuary within the meaning of the Actuaries Act, 2006;

(d) Bachelor in Engineering from a University established by law or an institution recognized by law;

(e) Bachelor in Technology from a University established by law or an institution recognized by law;

(f) Bachelor in Architecture from a University established by law or an institution recognized by law;

(g) Bachelor of Law from a University established by law or an institution recognized by law;

(h) Master in Business Administration from Universities established by Law or Technical Institutions recognized by All India Council for Technical Education."

The resolution amends the Company Secretaries Regulations, 1982. The amendment was notified in the Gazette of India Extraordinary dated 26th of July 2010.

Clause (3)

Provides that a Company Secretary in Practice shall be deemed to be guilty of professional misconduct, if he— "accepts or agrees to accept any part of the profits of the professional work of a person who is not a member of the Institute:

Provided that nothing herein contained shall be construed as prohibiting a member from entering into profit sharing or other similar arrangements, including receiving any share commission or brokerage in the fees, with a member of such professional body or other person having qualifications, as is referred to in item (2) of this part."

This is the converse of clause (2) discussed (supra at para 4.3) wherein a Company Secretary in Practice can partake of his profits with other members of the Institute and with members of any other professional bodies specified in this regard or with such other persons having such qualifications as may be prescribed, under clause a Company Secretary in Practice as recipient can enter into profit sharing arrangement with a member of the Institute and/or with a member of such other professional body or other person having qualifications, as is referred to in clause (2).

Clause (4)

Provides that a Company Secretary in Practice shall be deemed to be guilty of professional misconduct, if:

"he enters into partnership, in or outside India, with any person other than a Company Secretary in Practice or such other person who is a member of any other professional body having such qualifications as may be prescribed, including a resident who but for his residence abroad would be entitled to be registered as a member under clause (e) of sub-section (1) of section 4 - or whose qualifications are recognised by the Central Government or the Council for the purpose of permitting such partnerships ."

This clause prohibits a Company Secretary in Practice entering into partnership with any person other than a Company Secretary in Practice or a member of any other recognised profession. Even entering into partnership with persons, who are not members of the Institute, for the purposes of carrying on a business and not the profession of Company Secretaries, would attract the mischief of the clause.

Also, partnership with any other person residing outside India but possessing qualifications recognised by the Central Government or the Council under section 4(1)(e) of the Act, is permitted. The purpose

behind clause (4) is that a Company Secretary in Practice should not enter into partnership with any non-recognised professionals. In recognising any other profession for partnership, the compatibility of the other profession with the Company Secretaries' profession would be a relevant factor. The other professions referred to in this clause cannot be any different from those as may be recognised under section 2(2) of the Act. Practicing Company Secretary may share the fees or profits of the partnership both within and outside India.

The council has passed the resolution by inserting the following regulation in the Company Secretaries Regulations, 1982.

Clause (5)

Provides that a Company Secretary in Practice shall be deemed to be guilty of professional misconduct, if:

"he secures, either through the services of a person who is not an employee of such Company Secretary or who is not his partner or by means which are not open to a Company Secretary, any professional business.

Provided that nothing herein contained shall be construed as prohibiting any arrangement permitted in terms of items (2), (3) and (4) of this part."

This clause frowns upon discreditable practices in securing professional work. The clause covers instances of obtaining professional work by unethical means and by means which are not open to a Company Secretary.

Council has issued guidelines for advertisement by PCS. These guidelines were approved by the council in its 178th Meeting held on 29th of December, 2007. A PCS can therefore, within the parameters of the above guidelines issue advertisement / launch his own website and such action on the part of PCS would not be treated as violation of Clause 5 as well as Clause 6 of the Part I of the First Schedule.

Clause 5 of part I of first schedule is very clear that no member in practice should secure any professional business through propagation, etc., the member in practice have to be cautious that any kind of wording or message in the website created by them shall not indicate or imply securing/solicitation of business/client.

However any act of omission or commission beyond the permitted methods as per the guidelines would amount to misconduct. Text of the Advertisement Guidelines is placed as Annexure to this lesson.

"168B. Membership of Professional body for Partnership — (1) For the purposes of entering into partnership under clauses (4) and (5) of Part I of the First Schedule to the Act, a person shall be a member of any of the following professional bodies, namely:

(a) The Institute of Chartered Accountants of India established under the Chartered Accountants Act, 1949;

(b) The Institute of Cost Accountants of India established under the Cost and Works Accountants Act, 1959;

(c) Bar Council of India established under the Advocates Act, 1961;

(d) The Institute of Engineers or Engineering from a University established by law or an institution recognized by law;

(e) The Indian Institute of Architects established under the Architects Act, 1972;

(f) The Institute of Actuaries of India established, under the Actuaries Act, 2006;

(g) Professional bodies or institutions outside India whose qualifications relating to Company Secretary recognized by the Council under sub-section (2) of Section 38 of the Act."

Clause (6)

Provides that a Company Secretary in Practice shall be deemed to be guilty of professional misconduct, if:

"he solicits clients or professional work, either directly or indirectly, by circular, advertisement, personal communication or interview or by any other means: Provided that nothing herein contained shall be construed as preventing or prohibiting:

(i) any Company Secretary from applying or requesting for or inviting or securing professional work from another Company Secretary in practice; or

(ii) a member from responding to tenders or enquires issued by various users of professional services a organisations from time to time and securing professional work as a consequence."

This clause further fortifies the proposition under clause (5) supra about securing clients or professional work. Solicitation of clients or solicitation of professional work or both, are prohibited. Such a solicitation may be direct or indirect and such a solicitation may further be by means of a circular, advertisement, personal communication or interview or any other means. The bedrock of this rule is that a professional should gain recognition by rendering expert services, to a few though in the beginning, who would themselves lead others to him. A true professional should command honour and not demand it. The conduct of the member is noted all the times by the society at large and their ethics and integrity towards the profession itself is sufficient for growth. So, the purpose of this clause is, to ensure that a professional secures work by his credibility, reliability and integrity in the public eyes and not by advertisement adversely affecting the image of the professional and also the profession.

The word 'solicit' has various shades of meaning. According to Legal Thesaurus, it means bait, (lure) desire, importune, inquire, lobby, petition, plead (implore), apply (request), pray, pressure, pursue, (strive to gain), urge. 'Solicit' means 'ask for' or 'seek'. Means of solicitation may be a circular, advertisement, personal communication or by any other means. The phrase 'by any other means' used in this clause would perhaps exhaust other means like telephonic conversation, mail, electronic means and messages/social media or even third party solicitation.

The word 'indirectly' used in this clause suggests that even innuendos would not be tolerated under this clause. If the overall message of the alleged act is solicitation of clients or professional work, though this lurks or lies beneath what has apparently been done, clause 6 would stand attracted:

1. Circular or advertisement in newspapers indicating the range of services offered by him.
2. A circular letter offering secretarial services and professional work.
3. Any circular, advertisement or communication which creates an impression that certain professional work would be done much more expeditiously than is normally the case. Like for instance, registration of a company in, say, two days' time or registration of a charge in one day's time, etc.
4. Circular, advertisement or personal communication highlighting any provision of any law, to person other than existing clients, which provides for certification/ authentication by a Company Secretary in Practice of any form/return/application/document.
5. Issuing hand bills covering matters in (1) to (4) above.
6. Publication in the telephone directory, name and address in extra bold typeface or opting for more than one listing. However, where separate sections are devoted in the telephone directory (yellow pages, for instance) for a classified list, publishing the name and address by a member in such sub-section in the directory would not be treated as misconduct. But any kind of message or writing which indicates tall claims, supremacy and superiority in professional attainments will tantamount to solicitation of clients, indirectly.
7. Communicating or holding out, as being prepared to provide professional services at fees that are less than reasonable and appropriate in the circumstances, in order to obtain professional work.

8. Communicating or describing himself as a 'specialist' in any branch of law/work or knowingly permitting himself to be so described.

9. A member allowing a company to carry in its prospectus or other circular letters that 'Mr. X a specialist in corporate laws is the adviser to the company' would offend clause (6). However printing the name of Practicing Company Secretary as Secretarial Auditor in Annual Report will not violate the provisions of the Act.

10. Requesting his client(s) to recommend his/their acquaintances to him for professional work.

11. Frequent press announcements or circulars about his not being available for professional work for a certain period at the place whereat he normally has his office.

12. Highlighting or causing to be highlighted in public interviews over the television, AIR, etc. their professional attainments, more than just necessary or warranted by the circumstances of such an interview, making tall claims, indicating supremacy over other professional colleagues, etc. However sending bio data to organizers of the programmes/seminars, etc., where they have been invited as a faculty, is not violative of this clause.

13. Writing to any institution/agency that though, he is in the panel; no work has been allotted to him. Even approaching through a third person is violative of this clause.

14. Approaching any trade association/chamber of commerce/ business forum, communicating his ready availability for rendering any professional service to the constituents of any association or chamber.

15. Sending his profile to persons/companies/firms without any requisition for the same.

16. Including names of other professionals in his profile circulated to various persons.

The Professional Development Committee of the Council of the Institute has opined that listing of services by a Company Secretary with a group for creation of network of affiliates which is non-professional and not a group of company secretaries would amount to commercialization of the profession and therefore such listing would amount to violation of the Code of Conduct.

However, the following would not fall into the mischief of clause (6):

1. publishing in the journal of the Institute or newspaper any change in the professional address;

2. publishing in professional journals, newspapers and magazines in any classified column, any advertisement for recruitment of staff without in any way giving an impression about the services that he can render, or in other manner smacking of solicitation of work;

3. publishing information regarding changes in the constitution of firm, provided the information contained therein is limited to bare facts and consideration given to appropriateness of the area in which the newspaper or magazine is circulating and the number of insertions;

4. sending New Year or any other seasonal greetings without narrating the list of services, professional attainments, supremacy or any kind of indication seeking clients;

5. appearance in AIR, TV or any stage in private capacity as a speaker, actor or otherwise on programmes having no nexus with his profession. Any reference to him only as a Company Secretary and nothing beyond that in such programmes would not offend clause (6);

6. appearance or participation in professional capacity in the AIR/TV or other forums where a reasonable amount of biographical material may be given without in any way referring to the member as specialist in any branch of work;

7. editing/publishing any professional journal, newspaper and magazines;

8. writing articles/comments in professional journals, magazines and newspapers;

9. associating with charitable, other welfare associations and trade associations without in any way using such position to solicit clients/ professional work;

10. writing to his existing clients about implications/interpretations of any law or amendments thereof by way of any circular, newsletter or any personal communication or by way of print/electronic means of communication;

    The Council of the Institute in a case held that the Conduct of the member in practice by mentioning against his name 'Company Secretary' in the issue of 'Secretarial Aid' a journal edited by him was violative of Clause (6) of Part I of First Schedule to the Act. It was observed that the words 'for further clarification please contact the Editor' was an indirect attempt to solicit professional work;

    Responding to a specific letter or a follow up of personal discussions and sending a profile of a firm/ individual to specific addresses is not prohibited;

11. Stating the assignments handled by him in his profile. However, the name of the clients should be supplied only against specific request of the client for the same;

12. Issuing advertisement in Chartered Secretary for opening branch or seeking partnership with other members;

13. Issuing advertisement or launching website within the frame work of guidelines issued by the council about advertisement by PCS;

14. Securing professional work from another PCS is now expressly permitted;

15. Responding to tenders or enquires issued by various users of professional services and securing professional work as a consequence is now expressly permitted.

Clause (7)

Provides that a Company Secretary in Practice shall be deemed to be guilty of professional misconduct, if:

"He advertises his professional attainments or services, or uses any designation or expressions other than Company Secretary on professional documents, visiting cards, letterheads or signboards, unless it be a degree of a University established by law in India or recognised by the Central Government or a title indicating membership of the Institute of Company Secretaries of India or of any other institution that has been recognised by the Central Government or may be recognised by the Council.

Provided that a member in practice may advertise through a write up setting out the services provided by him or his firm and particulars of his firm subject to such guidelines as may be issued by the Council."

This clause covers two aspects –

(i) advertisement of professional attainments or services by a Company Secretary in Practice; and

(ii) using the designation 'Company Secretary'.

As regards the ban on advertisement of professional attainments or services, almost all the professions all over the world had this type of restriction at least to start with. The idea behind this restriction was that advertisement by professionals is incompatible with the qualities of integrity and independence which a professional is expected to possess, especially when these acts are motivated by a desire for personal gain. The advertisement of professional attainment or services under this clause is completely prohibited except where the Company Secretary in Practice advertises as per the guidelines issued by the council, through a write up setting forth services provided by him or his firm.

A PCS cannot include in his advertisement following particulars like the infrastructure available in his own office, details of Associate PCS, details of his networking in other places within & outside India, infrastructure at such networked offices, number of trainees who have completed training from his office, certain landmark achievements like number of companies incorporated since he started his practice, number of appearances made before CLB/ NCLT, CBDT, Tribunals , Regulatory Authorities, Commissions , number of Foreign Collaborations handled, number of Merger & Acquisitions handled, Number of due diligence carried out etc.

Council is of the view that a PCS can be permitted to allow his clients to use his name in their brochure/ hoardings etc. e.g. Builders invariably write the names of Architects, RCC Consultants, legal advisors on the Board at the construction site. Similarly the name of PCS may also be written. Certain software companies desire to use the name of PCS in their marketing brochure for their products while giving a list of satisfied customers. A PCS is permitted to allow his name to be used as one of the satisfied customers of particular software.

What amounts to advertisement of professional attainments or services is to be decided on a case to case basis, having regard to the attendant facts. For instance, where in the visiting card or name board or letterhead, a member in practice mentions that he is a specialist or expert in company law, tax law, etc. it would amount to advertisement of professional attainments or services.

Where a member in practice furnishes upon a specific request by a prospective client, a list of companies for whom he is a consultant/ retainer or writes his specific subjects of specialisation, it may not be objectionable.

Where in the letterhead or visiting card, a member in practice mentions that he was or is holding directorships in any company; it would be offending this clause.

Advertisement by a Practicing member for staff for his office in the press should in no way savour of any advertisement of professional attainments or services. The use of certain adjectives like “a reputed firm”, “a well-known firm”, etc. may be treated as inconsistent with the spirit of this clause. Similarly, announcement in the press by a Practicing member in regard to certain attainments like having been named for certain public awards, acquisition of merit in other professional examinations and other recognitions in any important committee, commission, governing body, etc. should be suitably modified so as not to be construed as amounting to advertisement of professional attainments or services. Advertisement for part-time assignments fall under the mischief of this clause.

Circulars or announcement regarding change of address, or change in the constitution of the firm should be very cautiously worded to tell just the minimum necessary facts.

Where a Company Secretary in Practice has been appointed as retainer/consultant by certain companies, it would not be proper to either list the names of such companies in letterheads, visiting cards or signboards or to circulate the list among prospective clients by way of circular. However, including such names, while sending individual profile in response to a specific enquiry is permitted.

Where a Company Secretary in Practice takes up the position of a director in a company, it is incumbent on his part to exercise great care in regard to references in any explanatory statement in notice of the general meeting reappointing the Practicing Company Secretary brochure or circular brought out in connection with an issue of securities of the company etc. The member concerned is to ensure personally that laudatory statements in such literature about his professional competence, while highlighting the Board’s competence as a whole, are avoided; otherwise liability under clause (7) would attract.

The Council held a member guilty of professional misconduct for misusing the Institute’s letter head, brochures, circulars, etc. mentioning his name with designation, description and the Practicing field other than as prescribed and thus misleading the readers by not mentioning his whole time employment.

This clause also speaks of using the designation ‘Company Secretary’ on professional documents, visiting cards, letterheads, sign-boards, etc. This requirement fortifies the provisions of section 7 of the Act and in fact is an extension of the requirement in regard to the use of proper designation. Designations like Company Law Consultant, Income Tax Consultant, Corporate Adviser, Investment Adviser, Management Consultant etc. are prohibited. The use of descriptions indicating membership of the Institute of Chartered Accountants of India, The Institute of Cost and Works Accountants of India and the Bar Councils is permitted provided members are not

holding certificate of practice issued by the Institute or using the description 'Company Secretary'. The use of the designation "Practicing Company Secretary". "Company Secretary in whole-time practice", etc. is not violative of this clause.

Where a member in practice had described himself in visiting cards and letter heads as "Company Secretary & Advocate, High Court", the Council held the member guilty of professional misconduct under this clause.

Clause (8)

Provides that a Company Secretary in Practice shall be deemed to be guilty of professional misconduct, if:

"he accepts the position of a Company Secretary in Practice previously held by another Company Secretary in Practice without first communicating with him in writing."

The primary requirement under this clause is of prior communication with the previous incumbent. This is intended for reasons of professional courtesy. The clause is not intended to prevent a client from changing over to another Company Secretary for his own reasons. The client as of right, has full freedom to change over to another Company Secretary.

It would be desirable for the new incumbent to obtain a letter from the company letting him know the name of the earlier incumbent or that no other Company Secretary has been appointed for the same assignment.

It is expressly clarified that the communication mentioned in this clause does not mean that no-objection or consent of the previous incumbent is a prerequisite of accepting the said assignment.

In regard to certification of Annual Return under Section 92 and for all exclusive attestation assignments, it is incumbent on the Company Secretary; to ascertain if any other Company Secretary had been appointed previously by the company concerned for certification of Annual Return or for issuance of compliance certificate, as the case may be. The appointee shall take positive steps to ascertain if anyone has been engaged earlier, for the same year, for the certification work. In such cases it is not only necessary for the Company Secretary to communicate with the earlier incumbent, but it is desirable to seek his consent in order to uphold the dignity and independence of the profession. lt is further clarified that though communication is a must, obtaining consent will not apply in cases of certification of Annual Returns for different years.

It would be necessary that the communication, in order to be effective, shall be by a registered letter or by hand with an acknowledgement so that there is positive evidence of the communication having been complete. In a case under a similar rule of conduct under the Chartered Accountants Act, 1949, the Rajasthan High Court in *J S Bhati* v. *Council of ICAI* (S.B. Civil Misc. Appeal No. 136 of 1973) observed that mere obtaining a certificate of posting does not fulfill the requirements of clause (8) of Schedule I as the presumption under section 114 of the Evidence Act that the letter in due course reached the addressee cannot replace that positive degree of proof of delivery of letter to the addressee which letters of the law in this case require.

The expression 'in communication with' when read in the light of the instructions contained in the booklet 'Code of Conduct' cannot be interpreted in any other manner but to mean that there should be positive evidence of the fact that the communication addressed to the outgoing auditor by the incoming auditor reached his hands. Certificate of posting of a letter cannot, in the circumstances, be taken as positive evidence of its delivery to the addressee. The Court, therefore, has expressed the view that the communication by a certificate of posting cannot be taken as a positive evidence of its delivery to the addressee. A communication sent by hand which has been properly acknowledged by the addressee would be effective communication.

With the advent of use of the technology, it would proper communication in this regard made by any other electronic medium viz., SMS, Whats App and such other Messenger apps is also permitted, provided the sender (the PCS taking up the assignment) is able to establish that the message is delivered to the recipient before he or she takes up the assignment. Needless to mention, that a reasonable time should be given to the previous incumbent to offer his response, if any, and it is not just a kind of formality. For sake of better clarity, the new incumbent should express clearly in the communication the details of assignment being taken up by him.

Members have been held guilty of professional misconduct under this clause for having accepted and commenced the certification of Annual Return of a company without first communicating with the earlier incumbent in writing. It has been concluded that mere posting of the letter is not sufficient to comply with the requirements of clause (8) of Part I of First Schedule to the Act, but the delivery of the message to the addressee of the same is essential. Oral communication is no communication as far as this clause is concerned.

To a question about whether communication 'with' contemplates a dialogue, the council is of the view that use of the preposition 'with ' instead of 'to ' does not make it mandatory for the PCS to obtain 'no objection' from the earlier incumbent. What is critical for PCS (new incumbent) is to prove that he has sent a written communication to the earlier incumbent before accepting a position of PCS.

It has been observed that majority of the Disciplinary cases were in respect of this clause about not sending written intimation by the new incumbent (PCS).

While clarifying the scope of the words "accepting a position of Company Secretary in Practice" Council has expressed a view that need for sending a previous communication to the earlier incumbent arises only in relation to exclusive area of practice under the Act. Therefore, in respect of following it shall not be mandatory (though desirable) to send a prior written communication to the earlier incumbent:

(a) certifying e-forms for various companies.

(b) giving Due Diligence Certificate for consortium borrowers.

(c) holding assignment as retainer for a company or group of companies.

(d) issuing search reports.

(e) Issuing certificates as contemplated under SEBI (LODR) Regulation, 2015.

(f) Giving legal opinion.

In respect of the following, it shall be mandatory to send a prior written communication to the earlier incumbent:

(i) Signing / Certification of Annual Return.

(ii) Issuance of Secretarial Audit Report in terms of Section 204 of the Companies Act, 2013.

(iii) Issuance of Certificate of Securities Transfers.

(iv) Certificate of reconciliation of capital, updation of Register of Members, etc. as per the Securities & Exchange Board of India's Circular D & CC/Cir-16/2002 dated December 31, 2002.

(v) Conduct of Internal Audit of Operations of the Depository Participants.

(vi) Certification of corporate governance under SEBI (LODR) Regulation, 2015.

Clause (9)

Provides that a Company Secretary in Practice shall be deemed to be guilty of professional misconduct, if:

"charges or offers to charge, accepts or offers to accept, in respect of any professional employment, fees which are based on percentage of profits or which are contingent upon the findings or results of such employment, except in cases which are permitted under any regulations made under this Act".

Which determine remuneration based on results. For instance, if the Company Secretary in Practice were to quote remuneration in an Excise Refund case, as a percentage of the final amount of refund that may be ordered by an appellate authority, it would be hit by this clause. The fundamental is that the fee should be more related to the expertise required and the time spent on a particular case without in any way linking the fee with the final results.

Clause (10)

Provides that a Company Secretary in Practice shall be deemed to be guilty of professional misconduct, if:

"engages in any business or occupation other than the profession of Company Secretary unless permitted by the Council so to engage:

Provided that nothing contained herein shall disentitle a Company Secretary from being a director of a company except as provided in the Companies Act."

This clause is intended to ensure that a PCS does not engage in vocations which are not compatible with the profession of Company Secretary. This has been provided with a view to ensure the profession develops in its true sense. Pursuant to the Company Secretaries Regulations, 1982, the Council has decided not to issue certificate of practice to members engaged in other professions such as Chartered Accountants, Cost Accountants and Advocates and also to members in employment. The said decision was taken by the Council to give an independent identity and status to the profession and a thrust to the concept of Company Secretary in whole-time practice.

The Council held a member guilty of professional misconduct under this clause for engaging himself in employment while holding a certificate of practice from the Institute.

The Council in an another case held a member guilty of professional misconduct under this clause for holding the certificate of practice of both the Institutes, i.e., ICAI & ICSI without the permission of the Council of the latter and also Practicing both the professions on whole-time bases simultaneously.

Regulation 168(2) of the Regulations provides that a Company Secretary may act as a secretary, trustee, executor, administrator, arbitrator, receiver, appraiser, valuer, internal auditor, management consultant or as a representative of financial matters including taxation and may take up appointment that may be made by the Central or any State Government, Courts of Law, labour tribunals, or any authority. From the reading of Regulation 168, it is clear that the various occupations provided in sub-regulation (2) thereof do not require a specific resolution to be passed by the Council.

It is pertinent to refer to Regulation 168(1) which provides that the prior permission of the Council by a resolution is required for a Company Secretary to engage in any business or occupation other than the profession of Company Secretary. The Council has expressly permitted a PCS to take up following vocations:

(i) Authoring Books and Articles.

(ii) Holding of Life Insurance Agency License for the limited purpose of getting renewal commission.

(iii) Holding of public elective offices such as M.P., M.L.A., M.L.C. and others.

(iv) Honorary office-bearership of charitable, educational or other non-commercial organisations.

(v) Acting as Justice of Peace, Special Executive Magistrate and the like.

(vi) Teaching assignment under the Coaching Organisation of the Institute and other Institutes such as the Institute of Cost & Works Accountants of India, the Institute of Chartered Accountants of India, Management Institutes, Universities and any college affiliated to a University, and such other organisation as may be recognised by the Council of the Institute from time to time, so long as the hours during which a member in practice is so engaged in teaching do not exceed average three hours in a day irrespective of the manner in which such assignment is described or the remuneration receivable (whether by way of fixed amount or on the basis of any time scale of pay or in any other manner) by the member in practice for such assignment.

(vii) carrying out valuation of papers, acting as a paper-setter, head examiner or a moderator, for any examination.

(viii) Acting as editor of professional journals.

Permission to be granted specifically

Members of the Institute in practice may engage in the following categories of business or occupation, after obtaining the specific and prior approval of the Executive Committee of the Council in each case:

1. Interest or association in family business enterprises even when he does not hold substantial interest in such enterprises.
2. Office of Managing Director or whole-time Director of a body corporate within the meaning of the Companies Act, 2013. The Council may refuse permission in individual cases though covered under any of the above categories.

For the purpose of the above, a member shall be deemed to have a "substantial interest" in a concern:

(i) in a case where the concern is a company, if its shares (not being shares entitled to a fixed rate of dividend whether with or without a further right to participate in profits) carrying not less than 25% of voting power at any time during the previous year, are owned beneficially by such member.

(ii) in the case of any other concern, if such member is entitled at any time during the previous year, to not less than 25% of the profits of such concern.

Clause (11)

Provides that a Company Secretary in Practice shall be deemed to be guilty of professional misconduct, if he— "allows a person not being a member of the Institute in practice or a member not being his partner to sign on his behalf or on behalf of his firm anything which he is required to certify as a Company Secretary, or any other statements related thereto."

This clause further fortifies clause (1) discussed already. It is not permissible for a Company Secretary in Practice to allow any person to sign on his behalf or on behalf of his firm anything which he is required to certify as a Company Secretary or any other statement related thereto. The purpose is not to allow a member to have his judgment and expertise substituted by the judgment of any other person who is not a member in practice or his partner in the firm. To take an instance, the annual return under Section 92 of the Companies Act, 2013 has to be certified by a Company Secretary in Practice himself. It is not possible to have the certification done by a Company Secretary, say, through a power of attorney holder, even though the holder of the power of attorney is an employee (of the Company Secretary) who has been associated with the checking up of various details furnished in the Annual Return.

PCS who is not a partner of another PCS can not sign on behalf of such other PCS on Annual Returns or Secretarial Audit Report or any other certificates.

In e-governance era, a PCS on many occasions attaches his Digital Signature to various forms / statements. Due care has to be taken that such digital signature is attached only by the PCS himself. It would be the exclusive duty and obligation of PCS to prevent any unauthorized use of his Digital signature. PCS is not expected to part with the password of his Digital signature.

b. Professional misconduct in relation to members of the Institute in service (Part II of the First Schedule)

Part II of First Schedule to the Act deals with professional misconduct of a member of the Institute (other than a member in practice) if he is an employee of any company, firm or person.

Part II of the First Schedule recognises the need for a member in employment also to observe a certain code of conduct. To be in 'employment' connotes to be in a 'contract of service' and not 'contract for service'. There are four indicia of a contract of service, namely :

(a) master's power of selection of his servant;

(b) payment of wages or other remuneration;

(c) master's right to control the method of doing the work; and

(d) the master's right of suspension or dismissal.

Lord Denning pointedly observed, "under a contract of service, a man is employed as part of a business, and his work is done as an integral part of the business; whereas under a contract for services, his work although done for the business is not integrated into it but is only accessory to it."

One important issue which very frequently comes up is, the conflict that may arise between the employer's interest and the interest of the member to uphold professional values and broader public interest. The code of conduct formulated by the Institute originally in 1977 emphasised the importance of a member in employment exercising professional independence in relation to his work as well as his endeavor to provide the highest quality of service attainable by him, without reference to the monetary compensation. The idea being, a member must have courage of conviction to express candidly his considered professional opinion to his employer.

The Royal Commission in its Final Report on legal services submitted to the British Parliament in October, 1979 categorically observed that the standards of professional conduct and integrity which a member of the legal profession in employment has to abide by are the same as those who practice on their own account. Even though the difference is that a salaried lawyer acts for only one client, unlike a lawyer in practice who acts for several clients, the former must uphold the same standards of honour and etiquette, observed the Royal Commission. The Report recognised the continuing conflict between loyalty to the employer and loyalty to the external body enforcing the code of conduct. Nevertheless, whether a member is in employment or in practice, his duty to uphold professional values shall gain precedence over all other exigencies.

Part II and Part III of the First Schedule to the Act specify certain instances of misconduct to which a Company Secretary in employment may stand attracted. It has been mentioned earlier that under section 21 of the Act, the Council's power to direct enquiry is not limited only to those contained in the Schedule to the Act, in view of the fact that the phrase 'other misconduct' used in section 21 is sufficiently broad enough to cover instances not enumerated in the Schedule.

Clause (1) of Part II of the First Schedule provides that a member of the Institute (other than member in practice) shall be deemed to be guilty of professional misconduct, if he, being an employee of any company, firm or person—

"pays or allows or agrees to pay, directly or indirectly, to any person any share in the emoluments of the employment undertaken by him."

This clause is analogous to clause (2) of Part I of the First Schedule in some respects. A member in employment shall not share emoluments of the employment with any other person, not even a member. Both direct and indirect sharing of the emoluments is prohibited. However, it may be noted that under Part I of the First Schedule, a member in practice can share the fee, commission or brokerage or profits with any other member of the Institute who is his partner.

Clause (2) of Part II of the First Schedule provides that a member of the Institute (who is in service) shall be deemed to be guilty of professional misconduct, if he, being an employee of any company, firm or person—

"accepts or agrees to accept any part of fees, profits or gains from a lawyer, a Company Secretary or broker engaged by such company, firm or person or agent or customer of such company, firm or person by way of commission or gratification."

This clause vindicates the confidence and trust that an employer reposes in an employee while the latter deals with any outsider on matters relating to business. It is an implied term of any employment that the employee concerned shall not secretly benefit from the employment.

This clause is also analogous in some respects to clause (3) of Part I of First Schedule.

c. Professional misconduct in relation to members of the Institute generally (Part III of the First Schedule to the Act)

Part III of the First Schedule to the Act covers cases of professional misconduct in relation to members of the Institute generally. Under this Part, three specific instances have been categorised as professional misconduct.

Clause (1) of Part lll of the First Schedule provides that a member of the Institute whether in practice or not shall be deemed to be guilty of professional misconduct, if he—

"not being a Fellow of the Institute, acts as a Fellow of the Institute."

This clause prohibits the practice of styling oneself as a Fellow, while in fact he is not a Fellow member. A person is entitled to have his name entered in the Register as a Fellow as per regulation 4(2) of the Regulations. The Fellowship of the Institute suggests a certain degree of status and seniority and obviously any wrongful representation of such seniority amounts to breach of code of conduct.

Clause (2) of Part III of the First Schedule provides that a member of the Institute whether in practice or not, shall be deemed to be guilty of professional misconduct, if he—

"does not supply the information called for or does not comply with the requirements asked for by the Institute, Council or any of its Committees, Director (Discipline) Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate Authority."

It is the duty of a member to supply information called for or to supply the requirements asked for by the Council or any of its Committees and other authorities. Non-compliance with this clause would tantamount to breach of code of conduct.

The Council of the Institute in a case of professional misconduct, held a member guilty of professional misconduct under this clause for failure to disclose the fact of holding of the certificate practice of the Institute of Chartered Accountants of India to the Council of ICSI which was required to be made at the time of renewal of Certificate of Practice.

A member of ICSI bound to give any and every kind of information called from him since not providing information is a misconduct under clause (2) of Part III of the First Schedule. It is presumed that the concerned authorities would call only relevant information.

Clause (3) of Part III of the First Schedule provides that a member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he—

"while inviting professional work from another Company Secretary or while responding to tenders or enquiries or while advertising through a write up, or anything as provided for in items (6) and (7) of Part I of this Schedule, gives information knowing it to be false."

d. Other Misconduct in relation to members of the Institute generally (Part IV of the First Schedule)

Clause 1 of Part IV

A member of the Institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if he is held guilty by any civil or criminal court for an offence which is punishable with imprisonment for a term not exceeding six months.

Clause 2 of Part IV

A member of the Institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if in the opinion of the Council, he brings disrepute to the profession or the institute as a result of his action whether or not related to his professional work.

Clause 2 of Part IV of the First Schedule provides that it shall be misconduct if in the opinion of the Council, a member of ICSI brings disrepute to the profession or the institute as a result of his action whether or not related to his professional work. Making an exhaustive list of such misconduct may not be possible.

Following may amount to misconduct under Clause 2 of Part IV of the First Schedule;

- Sending an e-mail to number of members (e-groups) criticizing the decisions of the Council in derogatory and filthy language.
- Discussing through e forums failures of the Council/ president/ secretary by using derogatory and filthy language.
- Writing letter(s) in an aggressive, loud and filthy language to the Ministry of Corporate Affairs, about working of ROC offices/ MCA site, inability to upload forms etc.
- Arranging DHARANA/ agitations at the gates of the Govt. Offices/Institute's offices in a manner not befitting a professional.
- Instigating Students or other members by creating a pandemonium in or around Institute's offices by raising issues pertaining to syllabus, training, examination or any other reason what so ever.
- Misusing the confidential data available with the offices of the Institute for personal purposes.
- Inviting Govt. Officers for Chapter's / Regional Council's Programs by spending heavily on their travel & stay arrangements, with an intention to get personal mileage.
- Tampering with the Books of Accounts/ Minutes of the meetings of the Managing Committees of Chapter/ Regional Councils.

e. Part I of the Second Schedule to the Act Section 21(3), 21(B)(3) and 22) where the matters are to be dealt with by the disciplinary committee constituted by the Council

Part I of the Second Schedule to the Act deals with ten instances of professional misconduct in relation to members in practice, which require action by a Disciplinary Committee. The implications of various clauses in Part I of the Second Schedule are briefly explained herein below:

Clause (1)

Provides that a Company Secretary in Practice shall be deemed to be guilty of professional misconduct, if he—

"Discloses information acquired in the course of his professional engagement to any person other than the client so engaging him, without the consent of such client, or otherwise than as required by any law for the time being in force."

This clause indicates the position of trust and confidence reposed by the client in a Company Secretary in practice. A Company Secretary in Practice in the course of his professional engagement may come into possession of vital information. Such information has to be kept confidential unless consent of the client has been obtained to disclose the same or the disclosure is required by any law. In the case of a sole proprietor client, consent must be from the sole proprietor. In case the client is a partnership firm, consent has to be given by all partners if the partnership deed so provides; if the deed is silent, any partner can give the consent on behalf of the firm in view of his implied authority. In the case of Board-managed companies, the Board has to give the consent unless it has specifically resolved to delegate the power to any executive. Where the company is managed by a managing director, he may give consent.

It is necessary to bear in mind that any communication acquired by a Company Secretary in Practice in the course of his professional engagement on behalf of his client, any communication or any advice given by him to his client in the course and for the purpose of his engagement is a privileged communication and should not be disclosed by him without the express consent of his client. Similarly, the Company Secretary in Practice should not disclose, without written consent of his client, the contents or conditions of any document with which he has become acquainted in the course and for the purpose of his professional engagement.

It is observed these days that PCS retains the digital signature of his client along with the password for the administrative convenience of uploading the forms from the office of PCS. It is suggested that in such a situation PCS should retain a formal letter signed by his client authorising PCS to make use of his Digital signature. The reason being once the forms are uploaded they appear on MCA portal and come to public domain. In order to avoid any future possible controversy, such authority letter would come handy for PCS.

Clause (2)

Provides that a Company Secretary in Practice shall be deemed to be guilty of professional misconduct, if he– "certifies or submits in his name or in the name of his firm a report of an examination of the matters relating to Company Secretarial practice and related statements unless the examination of such statements has been made by him or by a partner or any employee in his firm or by another Company Secretary in practice."

This clause is intended to imbibe in a member in practice, a higher degree of responsibility and care while certifying any fact or a statement. Either he himself or his partner or any employee of his firm should have examined what is being certified. The words "or by another Company Secretary in Practice" used in this clause envisage a situation where the responsibility for the certification is undertaken by a Company Secretary in Practice, who is neither a partner nor an employee of the Company Secretary concerned, for an examination done by another member in Practice.

This clause prohibits PCS from certifying or submitting in his name a report of an examination of the matters relating to company secretarial practice unless the examination of such statements has been made by him or by a partner or an employee in his firm or by another Company Secretary in Practice. Trainees working in the office of PCS are not to be considered as his employees for the purpose of this item . Reference to "another Company Secretary in Practice" at the end of paragraph refers to any PCS who may or may not be his partner. Thus a PCS would be justified in relying on the search report / examination done by another PCS and such reliance would not violate Clause 1 of the First Schedule.

Clause (3)

Provides that a Company Secretary in Practice shall be deemed to be guilty of professional misconduct, if he— "permits his name or the name of his firm to be used in connection with any report or statement contingent upon future transactions in a manner which may lead to the belief that he vouches for the accuracy of the forecast."

This clause underlines the duty of a Company Secretary in Practice to exercise utmost care in associating his name with any report or statement about future happenings or contingencies. A Company Secretary in Practice has to clearly disclose in the report or statement, as the case may be, the sources of his information and the premises on which the forecast is based. He shall further take care that he does not vouch for the accuracy of the forecast. Restraint is therefore required in subscribing to reports/statements, the contents of which may or may not turn out to be true.

The future is always uncertain and there is always an element of contingency. PCS can not become a fortune teller. PCS should not certify any possible happening or non happening or give a report about the future e.g. it would be improper for a PCS to certify the future earning capacity, future shareholding pattern , future profitability or similar future figures and numbers. If at all there is any occasion for a PCS to sign such document he should clearly insert appropriate disclaimer clause.

Clause (4)

Provides that a Company Secretary in Practice shall be deemed to be guilty of professional misconduct, if he—

"expresses his opinion on any report or statement given to any business enterprise in which he, his firm or a partner in his firm has a substantial interest;"

This clause ensures that a professional has to be independent while expressing any opinion. He should not have any substantial interest in the business enterprise to which the report or statement pertains. That would create a conflict with his duty. Expressing opinion or giving any report with appropriate disclosers about his interest in the

report was permitted earlier. However under the new clause there is a total ban on expressing opinion or giving any report about any business enterprise in which he, his firm or a partner in his firm has a substantial interest. 'Substantial interest' used in this clause is not limited to financial interest only.

In this connection it may be stated that the Council has, pursuant to Regulation 168 of the Regulations passed a resolution in which 'substantial interest' has been defined to mean an interest to the extent of 25%. The same guideline is relevant under the above clause also. If the business enterprise does not have a share capital, say a sports club, which may be a company limited by guarantee without Capital, the question whether PCS has substantial interest in such Club would be a question of fact.

Clause (5)

Provides that a Company Secretary in Practice shall be deemed to be guilty of professional misconduct, if he—

"fails to disclose a material fact known to him in his report or statement but the disclosure of which is necessary in making such report or statement, where he is concerned with such report or statement in a professional capacity."

This clause deals with the paramount duty of a member in practice towards the user of any statement or report. The clause underlines the need for full and complete disclosure as to make any statement or report with which he is associated, true in every possible respect. The aiding or abetting must be with reference to a material fact known to him. If the member in practice does not know a material fact, or he has no reason to come to know a material fact by any means, there cannot arise any liability under this clause; also where a material fact is known to him but in his considered opinion, there is no reason to disclose them, the onus of defense would be on him to prove that the non-disclosure of the material fact has not made the statement misleading.

The expectation provided in this clause is something similar to the golden rule in respect of prospectus. The report/ statement signed by PCS should contain truth, whole truth and nothing but the truth. Half truth at times is more disastrous. For example: making a statement that company has continuous track record of dividend declaration since incorporation, when the facts are that for last three years dividend was being declared from accumulated profits and not from current year's profit. Making a statement that company has continuous track record of dividend declaration since incorporation would be half truth. The reader would be made to believe that the company has sound financial health. Thus the full facts should be disclosed by PCS by mentioning the fact that company has continuous track record of dividend declaration since incorporation, however since last three years dividend is being declared out of reserves.

Clause (6)

Provides that a Company Secretary in Practice shall be deemed to be guilty of professional misconduct, if he—
"fails to report a material misstatement known to him and with which he is concerned in a professional capacity."

This clause deals with non-disclosure by a member in practice of a material misstatement known to him in any report with which he is concerned.

Clause (7)

Provides that a Company Secretary in Practice shall be deemed to be guilty of professional misconduct, if he—

"does not exercise due diligence, or is grossly negligent in the conduct of his professional duties."

This clause deals with due care that a member in practice has to exercise in the discharge of his professional duties. The words used in this clause "grossly negligent" imply that purely clerical errors or an omission to give more details in any recommended course of action will not fall within the sweep of this clause. What constitutes gross negligence would depend upon the facts and circumstances of each case.

The lCAl in their booklet 'Code of Conduct' have quoted the following extract from the judgment of the Karnataka High Court, in reference to an identical clause under the Chartered Accountants Act, 1949:

"It is the duty of an auditor to bring to bear on the work he has to perform that skill, care and caution which a reasonably competent and cautious auditor would use. What is reasonable skill, care and caution must

depend on the particular circumstances of each case. An auditor is not bound to be a detective, or, as was said, to approach his work with suspicion or with a foregone conclusion that there is something wrong. He is a watch dog but not a blood- hound. If there is anything calculated to excite suspicion he should probe it to the bottom; but in the absence of anything of that kind he is only bound to be reasonably cautious and careful. Professional misconduct is a term of fairly wide import but generally speaking, it implies fairly serious cases of misconduct of gross negligence. Negligence per se would not amount to gross negligence. In the case of minor errors and lapses, which do not constitute professional misconduct and which, therefore, do not require a reference to the disciplinary committee, the Council would nevertheless, bring the matter to the attention of its members so that greater care may be taken in the future in avoiding errors and lapses of a similar type".

In *NemiChand* v. *Commissioner, Nagpur Division* ILR (1947 Nag 256 at 265 ,AIR 1948 24 at 27) it was held that gross negligence imports high degree of careless conduct.

Where, for instance, a Company Secretary who is not in wholetime practice under Companies Act, 2013, certifies Annual Return pursuant to section 92 of Companies Act, he would be guilty of being grossly negligent under this clause. Similarly, where a member in practice gives a certificate to a financial institution regarding necessary powers of a company and its directors to enter into an agreement without thoroughly verifying the Memorandum and Articles of Association of the Company, he would be guilty of misconduct under this clause. So also failure to check the resolutions as contained in the minutes book while certifying copies of resolutions would attract liability under this clause.

The difference in between the two expressions "Not exercising due diligence" and "being grossly negligent"- is of degree. In both the situations it would amount to professional misconduct.

Clause (8)

Provides that a Company Secretary in Practice shall be deemed to be guilty of professional misconduct, if he—

"fails to obtain sufficient information which is necessary for expression of an opinion or its exceptions are sufficiently material to negate the expression of an opinion."

The first limb of this clause deals with the duty of a member in practice to obtain sufficient information to warrant expression of an opinion. Issuing of a wrong consumption certificate under the Import Export Regulations for instance, without obtaining all necessary information required for the purpose, would get attracted to this clause.

The second limb of this clause requires that any opinion expressed by a Company Secretary in Practice may be subject to certain exceptions. But, where the exceptions are sufficiently material, he should refrain from expressing an opinion, in other words, the second limb of this clause gives scope for making minor exceptions which are not important /material as to negate the very expression of opinion itself.

Clause (9)

Provides that a Company Secretary in Practice shall be deemed to be guilty of professional misconduct, if he—

"fails to invite attention to any material departure from the generally accepted procedure relating to the secretarial practice."

This clause deals with the duty of a member in practice to invite attention to material departure from generally accepted secretarial practice. As of now, there have evolved certain widely accepted sound practices in regard to, say, share issue and transfers, share transmission, servicing of corporate securities, meetings procedure and other approvals, which are generally accepted as good secretarial practices. Until the time the standard secretarial practices in respect to any matter are recommended by the Institute for adoption are made mandatory, a member in practice has to, by and large, conform to existing well- recognised secretarial practices and invite attention to departures which are material.

Clause (10)

Provides that a Company Secretary in Practice shall be deemed to be guilty of professional misconduct, if he—

"fails to keep moneys of his client other than fees or remuneration or money meant to be expended in a separate banking account or to use such moneys for purposes for which they are intended within a reasonable time."

The purpose of this clause is firstly to ensure that the client's money is separately accounted for and secondly such money is specifically used only for the purpose for which it is paid by the client.

Advance received from clients for expenses like traveling, conveyance to be incurred by PCS need not be kept in a separate account, however advance received from a client for payment of Statutory / filing fees, Stamp duty to be paid by PCS on Client's behalf , must be kept in a separate account, in case client has paid advance for certain specific purpose, say for payment of fees and stamp duty for incorporation of the company or for increase in authorized capital such amount should be used in reasonable time. If the decision to incorporate a company or increase in capital is postponed/ cancelled, PCS should promptly return such advance and should not adjust his fees from the amount so received for services rendered , if any, by him, unless such adjustment is authorised by the client.

f. Professional misconduct in relation to members of the Institute generally (Part II of the Second Schedule to the Act)

Part II of Second Schedule to the Act covers professional misconduct in relation to members of the Institute generally. The implications of the four clauses included in this Part are explained herein, below:

Clause (1) of Part II of Second Schedule

Provides that a member of the Institute whether in practice or not, shall be deemed to be guilty of professional misconduct, if he—

"contravenes any of the provisions of this Act or the regulations made there under or any guidelines issued by the Council."

This clause requires every member to pay due obedience to the Act, the Regulations and Guidelines issued by the council from time to time. For instance, a member of the Institute not having a certificate of practice representing that he is in practice (under section 24) or any violation of the rules relating to the conduct of elections (under Rule 42 of the Rules)would become guilty under this Clause; besides becoming liable for prosecution under section 24 of the Act.

The Council of the Institute, found a member guilty of professional misconduct under this clause for contravention of Section 6 of the Act as he certified an Annual Return of a company without holding a certificate of practice.

Following guidelines have been issued by the council so far:

1. Display of particulars on website
2. Approving firm's name
3. Compulsory attendance at PDP
4. Dress Code
5. Issuing Compliance Certificate
6. Maintenance of Register of attestation services
7. Issue of advertisement by PCS
8. Change of Name of a Concern/Firm
9. Guideline for use of own Logo by PCS.

It is necessary for all the members to understand the guidelines and follow the same in spirit and letter. It is also necessary to mention here that contravention of any of the provisions of the Company Secretaries Act, 1980 or the Company Secretaries Regulations, 1982 made there under or any guidelines issued by the council falls within the ambit of clause (1), part II of the Second Schedule to the Company Secretaries Act, 1980 and invites sterner actions.

Clause (2) of Part II of Second Schedule

Provides that a member of the Institute whether in practice or not, shall be deemed to be guilty of professional misconduct, if he—

"being an employee of any company, firm or person, discloses confidential information acquired in the course of his employment, except as and when required by any law for the time being in force or except as permitted by the employer."

The employer and employee relationship is of trust and confidence. This principle is embodied in this clause. The confidential information may pertain to technical secrets, important policy decisions, business strategies or any matter having a bearing on the interest of the employer.

Confidential information is a valuable asset for any employer. Confidentiality has be maintained about members, customers, employees, suppliers, product mix, future plans, proposals, list of associates, affiliates, stake holders, dealers and financial information. All confidential information must be used for the benefit and best interest of the employer. Employee member must maintain the confidentiality of the information which comes to his knowledge / custody except when disclosure is authorized or legally required. Confidential information includes all non-public information that might be harmful or may have potential to cause harm to the employer, if disclosed.

The confidential information, discussions, documents and data should be dealt with utmost care and should not be shared or passed on to undesirable persons / outsiders under any circumstances , directly or indirectly.

Clause (3) of Part II of Second Schedule

Provides that a member of the Institute whether in practice or not, shall be deemed to be guilty of professional misconduct, if he—

"includes in any information, statement, return or form to be submitted to the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate Authority any particulars knowing them to be false."

This clause covers situation where a member includes in any statement, return or form to be submitted to the Council any particulars knowing them to be false. The purpose of this clause is to ensure that a member submits accurate particulars, as are required to be furnished by him to the Council. It is pertinent to know that the clause is attracted only when the particulars furnished are known to the member to be false.

Metropolitan Life Insurance Co. vs. S. Adam that the word 'false' has two distinct and well recognized meanings—

(i) intentionally or knowingly or negligently untrue;

(ii) untrue by mistake or accident after the exercise of reasonable care.

It is in the former sense that the term 'false' is to be understood in this clause. This is abundantly made clear by the qualifying words, 'knowing them to be false'. The word false itself implies something more than mere untruth; it would even connote an intention to deceive.

Where for instance, while submitting the application for the issue/ restoration of certificate of practice under Regulation 10(1) of the Regulations, a member does not disclose that he is engaged in any business/occupation other than the profession of company secretaries when in fact he was so engaged, this clause would be attracted.

Clause (4) of Part II of Second Schedule

Provides that:

"a member of the Institute whether in practice or not, shall be deemed to be guilty of professional misconduct, if he defalcates or embezzles moneys received in his professional capacity."

This clause covers defalcation and embezzlement of moneys received in professional capacity by a member and not in any other capacity. The professional capacity referred to here would cover situations contemplated under Section 2(2) of the Act and those specifically covered under Regulation 168 of the Regulations. In as much as the Act deals with professional misconduct, logically the misconduct must be something having a nexus, direct in that, with the discharge of professional duties. However, this does not mean that other cases of embezzlement are not misconduct. Section 21 of the Act is wide enough to cover other acts not befitting to the member of the Institute.

g. Part III of the Second Schedule

This part is about other misconduct in relation to members of the Institute generally if a member of the Institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if he is held guilty by any civil or criminal court for an offence which is punishable with imprisonment for a term exceeding six months.

Part III does not get attracted at the very first instance of being held guilty but it is attracted only after the final appeal, as it may be, is disposed off and the member is held guilty.

It may be observed that this clause does not provide that the offence for which a member is held guilty by any civil or criminal court for an offence which is punishable with imprisonment for a term exceeding six months involves moral turpitude. Therefore even for an imprisonment for a term exceeding six months in an offense which does not involve moral turpitude would attract the consequences.

Complaints and Enquiries relating to Professional or other Misconduct of Members-Regulation 15 of the Company Secretaries Regulation, 1982

Applicable to a complaint or information pending before the Council or any inquiry initiated by the Disciplinary Committee or any reference or appeal made to a High Court prior to 17.11.2006

(1) Subject to the provisions of this regulation, any complaint received against a member of the Institute under Section 21 shall be investigated, and any enquiry relating to misconduct of such member shall be held, by the Disciplinary Committee.

Provided that if the subject matter of a complaint is, in the opinion of the President, substantially the same as or has been covered in any previous information of complaint received, the Secretary may file the complaint without any further action or inform the complainant, accordingly, as the case may be.

(2) A complaint under Section 21 shall be made to the Council in the appropriate from, duly verified as required therein.

(3) Every complaint shall contain the following particulars, namely-

(a) the acts or omissions which, if proved, would render the member complained against guilty of any professional or other misconduct;

(b) the oral and/or documentary evidence relied upon in support of the allegations made in the complaint.

(4) Every complaint other than a complaint made by or on behalf of the Central or any State Government, shall be accompanied by a deposit of rupees fifty which shall be forfeited, if the Council, after considering the complaint, comes to the conclusion that no prima facie case is made out and, moreover, that the complaint is either frivolous or has been made with mala fide intention.

(5) The Secretary shall return a complaint which is not in the proper form or which does not contain the aforesaid particulars or which is not accompanied by the deposit of rupees fifty to the complainant for resubmission after compliance with such requirements and within such time as the Secretary may specify.

(6) Ordinarily within sixty days of the receipt of a complaint under Section 21 the Secretary shall,-

(a) if it is against an individual member send particulars of the acts of omissions alleged or a copy of the complaint, as the case may be, to such member at his address as entered in the Register;

(b) if it is against a firm, send particulars of the acts or omissions or a copy of the complaint, as the case may be, to the firm concerned at the address of the head office of the firm as entered in the Register of offices and firms which a notice calling upon the firm of disclose the name(s) of the member(s) concerned and to send particulars of acts or omissions or a copy of the complaint, as the case may be to member(s).

Explanation-A notice shall be deemed to be a notice to all the members who are partner or employees of that firm.

(7) A member who has been intimated of the complaint made against him under sub-regulation (6) (hereinafter referred to as the respondent) shall, within fourteen days of issue of such intimation or within such further time as the Secretary may allow, forward to the Secretary a written statement in his defence verified in the same manner as the complaint.

(8) On a perusal of the complaint and written statement in any, the Secretary may call for such additional particulars or documents connected there with either from the complainant or the respondent, as he may consider necessary or as may be directed by the President, for perusal of the Council.

(9) Where on a perusal of the complaint, the written statement, if any, of the respondent and other relevant documents and papers, the Council is prima facie of opinion that any member has been guilty of professional or other misconduct, the Council shall cause an enquiry to be made in the matter by the Disciplinary Committee and where the Council is prima facie of opinion that there is no case against the respondent, the case shall be dismissed and the complainant, if any, and the respondent shall be informed accordingly.

Provided that the Council may, if deemed necessary, call for any additional particulars or documents connected therewith from the complainant, if any, or the respondent.

(10) (i) Every notice issued by the Secretary or by the Disciplinary Committee under this Regulation shall be sent to the member or the firm concerned by registered post with acknowledgement due.

(ii) If the notice is returned unserved with an endorsement to the effect that the addressee had refused to accept the notice, it shall be deemed to have been served.

(iii) If the notice is returned with an endorsement indicating that the addressee cannot be found at the address given, the Secretary shall ask the complainant to supply to him the correct address to the member or firm concerned and send a fresh notice to the member or firm at the address so supplied.

(11) The provision relating to a notice shall apply *mutatis mutandis* to a letter.

Procedure in enquiry before the Disciplinary committee- Regulation 18 of the Company Secretaries Regulation, 1982

Applicable to the complaint or information pending before the Council or any inquiry initiated by the Disciplinary Committee or any reference or appeal made to a High Court prior to 17.11.2006.

(1) It shall be the duty of the Secretary to place before the Disciplinary Committee all facts brought to his knowledge which are relevant for the purpose of any enquiry by the Disciplinary Committee.

(2) The Disciplinary Committee shall have the power to regulate its procedure in such manner as it considers necessary and during the course of enquiry, may examine witnesses on oath and receive evidences on affidavits and any other oral or documentary evidence, exercising its powers as provided in Sub-section (8) of Section 21.

(3) The Disciplinary Committee shall give the complainant and respondent a notice of the meeting at which the case shall be considered by the Committee.

(4) Such complainant and respondent may be allowed to defend themselves before the Disciplinary Committee either in person or through a legal practitioner or any other member of the Institute.

(5) Where, in the course of a disciplinary enquiry, a change occurs in the composition of the Disciplinary Committee, unless any of the parties to such enquiry makes a demand within fifteen days of receipt of a notice of a meeting of such Disciplinary Committee, that the enquiry be made de novo report of the Disciplinary Committee shall be called in question on the ground that any member of the Disciplinary Committee did not possess sufficient knowledge of the facts relating to such inquiry.

(6) The Disciplinary Committee shall after investigation report the result of its enquiry to the Council for its consideration.

Procedure in a hearing before the Council- Regulation 19 of the Company Secretaries Regulation, 1982

(1) The Council shall consider the report of the Disciplinary Committee and if in its opinion, a further enquiry is necessary, may cause such further enquiry to be made and a further report submitted by the Disciplinary Committee.

(2) After considering such report or further report of the Disciplinary Committee, as the case may be, where the Council finds that the respondent is not guilty of any professional or other misconduct, it shall record its findings accordingly and direct that the proceedings shall be filed or the complaint shall be dismissed as the case may be.

(3) After considering such report or further report of the Disciplinary Committee, as the case may be, where the Council finds that the respondent has been guilty of a professional or other misconduct, it shall record its findings accordingly and shall proceed in the manner as laid down in the succeeding sub- regulations.

(4) Where the finding is that the member of the Institute has been guilty of a professional or other misconduct, the Council shall afford to the member an opportunity of being heard before orders are passed against him in the case. The Council after hearing the respondent, if he appears in person or after considering the representations, if any, made by him, pass such orders as it may think fit, as provided under Subsection (4) of Section 21.

(5) The orders passed by the Council shall be communicated to the complainant and the respondent.

Multidisciplinary Firm – According to Regulation 165A of the Company Secretaries Regulations, 1982 inserted by the Company Secretaries (Amendment) Regulations, 2020- A member in practice may form multi-disciplinary firm with the member of other professional bodies as prescribed under regulations 168A and 168B of the Company Secretaries Regulations, 1982, in accordance with the regulating guidelines of the Council for functioning and regulation of such multidisciplinary firm.

(Cross Referencing: For more details students are advised to study Lesson 7 of the subject "Setting up of Business, Industrial & Labour Laws".)

UDIN

The Unique Document Identification Number as governed by the UDIN Guidelines shall verify the authenticity of various documents signed or certified by Company Secretaries in Practice. As per the UDIN Guidelines, a unique number for the identification of documents attested by Company Secretaries in Practice shall be generated at

the time of signing the Certificate/ Report which shall mandatorily be mentioned in the Certificate / Report along with the CoP number. UDIN shall be generated at the time of signing of Reports, Returns, Certificates and Other Documents or can be generated seven days in advance of the date of such signing as above.

What is Unique Document Identification Number (UDIN)?

UDIN is a 17 digit system generated number which is used to verify the authenticity of documents attested / certified by a Company Secretary in Practice. Quoting UDIN on certifications, w.r.t the professional services has been made mandatory w.e.f 1st October, 2019.

Illustration: A Certificate is signed on September 25, 2019. In such case, ideally the UDIN should be generated on September 25, 2019 but in exceptional cases, the UDIN may be generated 7 days in advance, i.e., any time during September 18, 2019 to September 25, 2019. Thereby, providing a window of advance seven days for UDIN generation.

The UDIN Guidelines have been issued by the Institute of Company Secretaries of India ("ICSI") in order to-

- Enable the stakeholders to verify the authenticity of various documents certified by Company Secretaries in Practice;
- Prevent counterfeiting of various attestations / certifications;
- Provide ease of maintaining the Register of Attestation /Certification services rendered by practicing members;
- Ensure compliance of the Guidelines issued by the Institute w.r.t ceilings on the number of the various certification / attestation services that may be rendered by the practitioners;
- Auto-prefill details of Certification / Attestation services rendered by practicing members in of the form for renewal of Certificate of Practice.

It is mandatory to mention UDIN in the Reports, Returns, Certificates and Other documents along with the Certificate of Practice number. In case of e Form-MGT 7 as mentioned in paragraph 3 (b) (xiv) of the ICSI UDIN Guidelines, 2019 or in case of any other e-Form(s), the UDIN shall be mentioned by way of attachment in the optional attachment, unless any specific field for the same is provided by the law.

eCSIN

The Employee Company Secretary Identification Number as governed by the eCSIN Guidelines shall enable the Institute to identify the appointments and cessations of Company Secretaries. eCSIN is a system- generated unique number for identification of the Company Secretaries employed in a particular company which shall be generated by the Company Secretary at the time of employment as a Company Secretary (KMP or otherwise), as well as at the time of demitting office in any manner. The members in employment with an active membership shall register at the designated website. The eCSIN shall be an eighteen-digit system generated random unique alphanumeric number.

Both the Guidelines have been made mandatory by the Council of ICSI w.e.f. 1st October, 2019.

ICSI (Guidelines for Advertisement by Company Secretaries), 2020

ICSI (Guidelines for Advertisement by Company Secretaries), 2020 became effective on and from 1st April, 2020 and shall be applicable to all advertisements by members of the Institute rendering any advisory, consultancy or representation services whether holding Certificate of Practice issued by the Council of the Institute or otherwise.

The following activities are permitted for a Company Secretary in Practice as means to advertise:

(i) Display the scope of work on his/her own website.

(ii) Creating a visual identity in compliance with the Guidelines for use of Individual Logo issued by the Council of ICSI.

(iii) Display of Location and décor of the workplace, meeting rooms, etc.

(iv) Display of Firm name, Logo or any other identity on Uniform, Office/s, office stationary& equipments/ material and providing Training to Staff.

(v) Professional Updates and Write ups in any mode.

(vi) Appearing on local radio or television.

(vii) Giving speeches/lectures at any platform including Seminars, Conferences, training programmes, Workshops, Conventions, etc so organised by any forum.

(viii) Holding professional seminars, conferences and workshops.

(ix) Sponsoring any event (cultural, professional or otherwise) or helping with community programmes or doing voluntary work as a professional for charitable organizations.

(x) Use of social media like Facebook, Instagram, Linkedin, Twitter, Youtube, WeChat, Telegram and Whatsapp or and other media of similar nature.

Advertisement Restrictions

The Advertisement shall:

(i) not be in violation of provisions of Company Secretaries Act, 1980;

(ii) not be false or misleading;

(iii) not claim superiority over any or all other Company Secretaries;

(iv) not be indecent, sensational or otherwise of such nature which may bring disrepute to the profession or the Institute (ICSI);

(v) not contain fabricated or false testimonials or endorsements concerning the Company Secretary;

(vi) not refer the Company Secretaries in the terms such as “specialists” or “experts”;

Explanation: The advertisements shall not be self-laudatory and not include the words such as “best,” “better” or “cheapest;”

(vi) not represent that the quality of the professional services to be performed is greater than the quality of professional services performed by other professionals. Statements comparing one professional’s services to that of another are not allowed;

(vii) not constitute a guarantee, warranty, or prediction regarding the outcome of any professional assignment;

(viii) in no way indicate that the charging of a fee is contingent on outcome, or that no fee will be charged in the absence of the desired outcome;

(ix) not contain any reference to past successes or results which indicates a guarantee, warranty or prediction of result of future professional assignments. eg. We made M/s. Xxx win the case, Meet the masters;

(x) not be designed for “pleasing customers,” which might mislead or eventually harm customers or third parties;

(xi) not contain any humorous slogans. E.g. Save Rs. Xxxx Come to us, we will tell you how.

The Company Secretary or a firm of Company Secretaries shall not list his/her service(s) on any aggregator website such as Sulekha, Olx, Urbanclap, JustDial, Quikr or any other aggregator of similar category.

The Company Secretary or a firm of Company Secretaries shall not join or project himself/herself/itself as a member of any networking association(s) or any Multi-Level Marketing Association(s) ("MLM") or any other organisation which require his/her Company Secretary member to add other person as member of the organisation or which require him / her to render such services which are not specifically approved as mentioned in clause 1.2 of this guideline.

The Advertiser shall also include the following Statement of Responsibility and Disclaimer on the Website: Disclaimer: The contents or claims in the website issued by the advertiser are the sole and exclusive responsibility of the Advertiser. The Institute of Company Secretaries of India does not own any responsibility whatsoever for such contents or claims by the Advertiser.

Any non-compliance or violation of these Guidelines, as may be in force from time to time, in any manner whatsoever shall be deemed to be a professional misconduct and the concerned member shall be liable to disciplinary action under the Company Secretaries Act, 1980.

PROFESSIONAL LIABILITIES

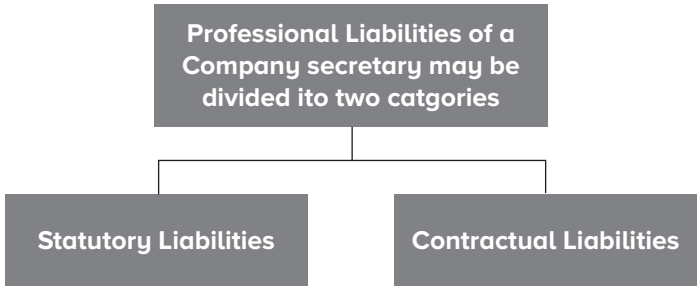
Though a Company Secretary is entitled to enjoy some rights and powers as laid down in the Companies Act, yet his position is not free from liabilities. The Companies Act and other laws related to company management provide the framework of certain liabilities for the Company Secretary.

> Professional liabilities in context of Company Secretary means the Company Secretary shall be liable as the officer in default in context of the non-compliances with the provisions of statutes to which he/she is entrusted with.

A Company Secretary may or may not be officer bearer as director, but they will often accounted for breach of duty in the same manner as Board of Directors. The Companies Act, 2013 specifies certain duties to Board of Directors and Company Secretary. Therefore, as an officer of the company, it is peculiar to work in interest of company and avoid situations leading to conflict of interest and always opt for independent judgment.

The Company Secretary has many statutory and administrative responsibilities, including filing returns and ensuring compliance with the Companies Act. Various sections in the Companies Act, 2013 provide that, where there is a failure of compliance, 'an offence is committed by every officer of the company who is in default'. If the Company Secretary is the person with main responsibility for the task, he will be the person in default and liable to the fine/penalty.

> For instance, default in filing annual return of company within sixty days from the date on which the annual general meeting is held, then ***every officer who is in default*** shall be liable to a penalty of ten thousand rupees and in case of continuing failure, with further penalty of one hundred rupees for each day during which such failure continues, subject to a maximum of two lakh rupees in case of a company and fifty thousand rupees in case of an officer who is in default. Further, if a company secretary in practice certifies the annual return otherwise than in conformity with the requirements of this section or the rules made thereunder, he shall be liable to a penalty of two lakh rupees.



Statutory Liabilities

Statutory liabilities of the Company Secretary refer to those that the Company Secretary is legally bound to obey. The followings are some of the statutory liability of Company Secretaries:

i) Maintenance of all records and documents of the company;

ii) Arranging a statutory meetings of the company;

iii) Issuing share certificates, dividend warrants, and bonus share certificates to the shareholders;

iv) Preparation of minutes of various meetings and maintaining minute books, etc.

CASE LAW

In Re *Saumil Dilip Mehta v. State of Maharashtra, High Court of Bombay, Writ Petition No. 548 OF 2001 dated October 18, 2001*, In this matter it was held that a director of a public limited company or private limited company can tender his resignation unilaterally and without filling in Form 32 and without sending notice to the Registrar of Companies. It is clear that the filling in of the said Form and the giving of due intimation and information to the Registrar of Companies is the duty of the company secretary and not of an individual director. The said letter has to be moved in the meeting of the directors of the company, it may be ordinary meeting or may be extraordinary or special meeting, as the case may be, and the board of directors have to take a decision - whether the Board is accepting his resignation or not. An intimation should be sent to such director and after such resolution is passed, the company secretary is under the obligation to comply with the legal formalities for giving a finishing touch to the resolution which has been passed in the said meeting of the board of directors. It is for the company secretary to fill in the forms as prescribed and to give due information and intimation to the ROC, as the law requires. Thereafter, it has to be so mentioned in all prescribed registers of the company, accounts and balance sheet of the company and thereafter the said fact is to be brought to the notice of the members of the company as early as possible and at the latest in annual general meeting.

Contractual Liabilities

The Company Secretary has also to take care of his/her contractual liabilities. The Company Secretary has to enter into a service contracts with company or client. Therefore, the company secretary has some liabilities arising out of his service contract.

Below mentioned are some of the contractual liabilities of the Company Secretary:

i) Liable for breaching or exceeding its authority;

ii) Liable for disclosing secret information of the company to outsiders;

iii) Liable for frauds etc.;

iv) Liable to abide by all terms and conditions of the service contract;

v) Protect the interest of the company.

LESSON ROUND-UP

- The members of the Institute shall be divided into two classes designated respectively as Associates and Fellows.
- The member of the Institute is subject to the Disciplinary mechanism provided for under Chapter V of the Company Secretaries Act, 1980 (the Act).

- Professional misconduct in relation to members of the Institute is broadly structured under Schedule I and Schedule II of the Act.
- On receipt of any information or complaint along with the prescribed fee, the Director (Discipline) shall arrive at a prima facie opinion on the occurrence of the alleged misconduct.
- Where the Director (Discipline) is of the opinion that a member is guilty of any professional or other misconduct mentioned in the First Schedule, the matter shall be placed before the Board of Discipline.
- Where the Director (Discipline) is of the opinion that a member is guilty of any professional or other misconduct mentioned in the Second Schedule or in both the Schedules, the matter shall be placed the Disciplinary Committee.
- According to section 2(1)(c) of the Company Secretaries Act, 1980 "Company Secretary" means a person who is a member of the Institute of Company Secretaries of India.
- As per regulation 2(d) of the Company Secretaries Regulations, 1982 'certificate of practice' means a certificate granted under these or earlier regulations entitling the holder to practise as a Company Secretary.
- The member of the Institute is subject to the Disciplinary mechanism provided for under Chapter V (Misconduct) of the Company Secretaries Act, 1980.

GLOSSARY

Associate Member: The person whose name is entered in the register of members of the Institute of Company Secretaries of India shall be deemed to be the Associate Members

Fellow Member: A person, being an Associate who has been in continuous practice in India as a Company Secretary for at least five years and a person who has been an Associate for a continuous period of not less than five years and who possesses such qualifications or practical experience as the Council may prescribe with a view to ensuring that he has experience equivalent to the experience normally acquired as a result of continuous practice for a period of five years as a Company Secretary shall, on payment of fees, be entered in the Register as a Fellow. Such person shall be a Fellow member.

PCS: Practicing Company Secretary

CoP/CP: Certificate of Practice

TEST YOURSELF

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation).

1. What is the Disciplinary Mechanism in case of misconduct of clause 5 of Part I of First Schedule of Company Secretaries Act, 1980?
2. Write short notes on:
   (a) Board of Discipline
   (b) Fellow member
   (c) Appellate authority
3. What are the Consequences of Non-Compliance of ICSI (Guidelines for Advertisement by Company Secretaries), 2020?
4. Mr. Y is appointed as Company Secretary in ABC Public Limited. Mr. X (Managing Director) of the company would like to know from Mr. Y him about the duties and functions of Company Secretary as per statutory norms. Prepare pointers to describe the duties and functions of company secretary in order to brief Mr. X.

5. Ashima, who is a Practicing Company Secretary is specialized in the areas of Secretarial Audit. On account of receiving many assignments and unable to handle the work alone, she permits Rajiv, her friend who is a Company Secretary but not in practice and who is also a lawyer but not a member of any Bar Council, to conduct the Secretarial Audit and give reports on her behalf. There is no written agreement between Ashima and Rajiv to this effect; however, the oral understanding between both of them is that the fees received from the assignments shall be passed on to Rajiv and Ashima in equal proportion. Check the validity of this arrangement in light of the relevant provisions related to misconduct under the Company Secretaries Act, 1980.
6. A complaint of professional misconduct is filed with ICSI against Ravi, a Practicing Company Secretary. The Disciplinary Committee of ICSI is of the opinion that Ravi is guilty of professional misconduct mentioned in the Second Schedule to the Company Secretaries Act, 1980. The Committee, after affording Ravi an opportunity of being heard, ordered for removal of his name from Register permanently and also imposed penalty of Rs.10 lakh. Is the action of the Committee valid ? What actions can the Board of Discipline (a separate authority) take if it is of the opinion that a member is guilty of professional misconduct mentioned in the First Schedule to the Act, 1980 ?
7. Rama, a practicing company secretary, posted a request on whatsapp group of practicing company secretaries for providing secretarial audit in any company. She also made a similar request on whatsapp to her college friends. Has she committed professional misconduct?

LIST OF FURTHER READINGS

- Bare Act- The Companies Act, 2013
- The Company Secretary Act, 1980
- The Company Secretary Regulations, 1982
- ICSI Guidance Note on Code of Conduct for Company Secretaries
- ICSI FAQs on UDIN
- ICSI (Guidelines For Advertisement By Company Secretaries), 2020
- FAQs on ICSI (Guidelines for Advertisement by Company Secretaries), 2020

OTHER REFERENCES (Including Websites and Video Links)

- https://www.mca.gov.in/content/mca/global/en/acts-rules/ebooks/acts.html?act=NTk2MQ==
- https://www.icsi.edu/media/webmodules/06072022_CS_A_PREFERRED_PROFESSIONAL.pdf
- https://www.icsi.edu/member/cs-practice/pcs-not-to-engage/
- https://www.icsi.edu/media/webmodules/ICSI_Book-1_CSAct1980IOPNov2020.pdf
- https://www.icsi.edu/media/webmodules/publications/Guidance_Note_CodeofConduct_CompanySecretaries.pdf
- https://stimulate.icsi.edu/udin/PDF/2021_12_06_FAQ.pdf
- https://discipline.icsi.edu/Content/DP/documents/Legal_Frame_Procedure.pdf

Values, Ethics and Professional Conduct

Lesson 5

KEY CONCEPTS

■ Professional Ethics ■ Ethical Principles ■ Ethical Dilemma ■ Integrity ■ High Standards of professional competence ■ Fair dealing

Learning Objectives

To understand:

- The importance of Ethics, values and good governance that are the fundamentals of life which should be followed in all circumstances and have been a matter of respect, be it in individual context or in the corporate world.
- How the Business dynamism demands various evils and vulnerable situations which have pointed out the need to imbibe and inculcate the culture for adherence to ethical practices, governance and leadership.
- Various practical aspects of ethical values, ethical dilemmas, and ethical leadership encompassing various human virtues which are ultimately built upon conscience.

Lesson Outline

- Introduction
- Types of Ethics
- Professional Ethics
- Ethical Principles for Company Secretaries
- Fundamental Duties of Professionals
- Ethical Dilemma
- Recent disciplinary case studies/cases on values, ethics and professional conduct
- Lesson Round-Up
- Glossary
- Test Yourself
- List of Further Readings
- Other References (Including Websites/Video Links)

INTRODUCTION

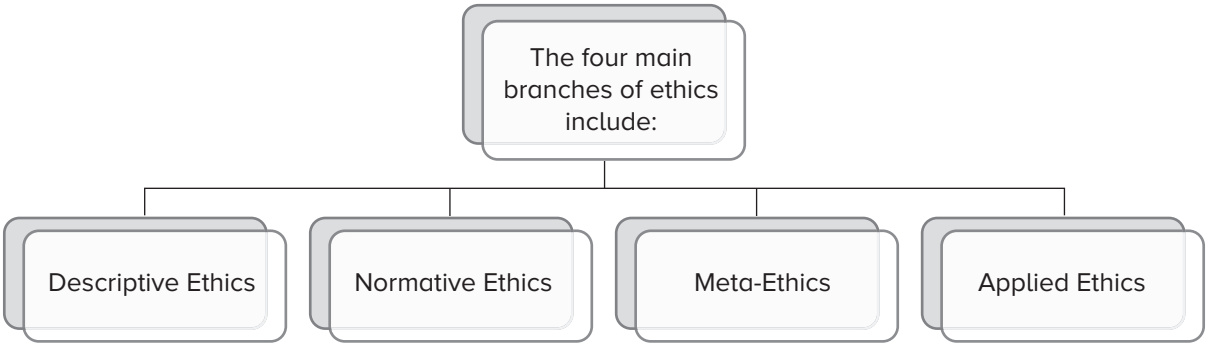
India has a very strong history and deep roots of culture, principles and ethics which have come down to us across generations, through the immortal Shrimad Bhagavad Gita which is useful in getting answers to various complex situations and ethical dilemmas. The great epic, Ramayana is also a very important document which has thrown light on aspects like values and character. *Nitishatak* by a noted scholar, *Bhartruhari,* and the teachings of Arya Chanakya *(Chanakya Neeti)* cannot be ignored while talking of character, ethical practices, values and good governance. Aesop's Fables, Panchatantra and Hitopadesh are also fictional sources of moral codes.

Today's doing business is full of temptations and distractions driven by greed to earn unlimited profits, market share, market-standing (in terms of numbers), performance, etc., coupled with tremendous pressure and compulsion to remain ahead; wherein organizations alluring individuals working therein to ignore or lose hold on ethical aspects of a business. Social life is dominated by numerical success where "the ends justify the means". Of late, this attitude and temperament believing the philosophy "the ends justify the means" has led to a substantial depletion of good character, ethical standards, practices and good governance. This has led to loss of humanity, and ultimately, happiness of self and society.

The term "ethics" is derived from the Greek word "ethos" which refers to character or customs or accepted behaviours. The Oxford Dictionary states ethics as "the moral principle that governs a person's behaviour or how an activity is conducted". The synonyms of ethics as per Collins Thesaurus are – conscience, moral code, morality, moral philosophy, moral values, principles, rules of conduct, standards.

In the world of intense competition, every professional work on certain principles and beliefs which are nothing but the values. Likewise, ethics is implemented in the organisation to ensure the protection of the interest of stakeholders like customers, suppliers, employees, society and government.

TYPES/BRANCHES OF ETHICS



These types of ethics can be defined as under:

Descriptive Ethics deals with what people actually believe (or made to believe) to be right or wrong and accordingly holds up the human actions acceptable or not acceptable or punishable under a custom or law. Descriptive Ethics is also called comparative ethics because it compares the ethics or past and present; ethics of one society and other.

Descriptive ethics: What do people think is right?

Normative Ethics deals with "norms" or set of considerations how one should act. Thus, it is a study of "ethical action" and sets out the rightness or wrongness of the actions. It is also called prescriptive ethics because it rests on the principles which determine whether an action is right or wrong.

Normative (prescriptive) ethics: How should people act?

Meta-Ethics or "analytical ethics" deals with the origin of the ethical concepts themselves. It does not consider whether an action is good or bad, right or wrong. Rather, it questions – what goodness or rightness or morality itself is. It is basically a highly abstract way of thinking about ethics.

Meta-ethics: What does "right" even mean?

Applied Ethics deals with the philosophical examination, from a moral standpoint, of particular issues in private and public life which are matters of moral judgment. This branch of ethics is most important for professionals in different walks of life including doctors, teachers, administrators, rulers and so on. There are six key domains of applied ethics viz. Decision ethics {ethical decision making process}, Professional ethics {for good professionalism}, Clinical Ethics {good clinical practices}, Business Ethics {good business practices}, Organizational ethics {ethics within and among organizations} and social ethics.

Applied ethics: How do we take moral knowledge and put it into practice?

Business Ethics is one of the branches of Applied Ethics which is mostly used in various organizations & Corporates. It can be defined as, "The application of a moral code of conduct to the strategic and operational management of a business."

KEY DIFFERENCES BETWEEN ETHICS AND VALUES

The fundamental differences between ethics and value are described in the given below points:

ETHICS	VALUES
Ethics refers to the guidelines for conduct, that address question about morality.	Value is defined as the principles and ideals, which helps them in making the judgement of what is more important.
Ethics is a system of moral principles.	In contrast to values, which is the stimuli of our thinking.
Ethics compels to follow a particular course of action.	On the other hand, Values strongly influence the emotional state of mind. Therefore it acts as a motivator.
Ethics are consistent in nature.	Whereas values are different for different persons, i.e. what is important for one person, may not be important for another person.
Ethics helps us in deciding what is morally correct or incorrect, in the given situation.	Values tell us what we want to do or achieve in our life.
Ethics determines to what extent our options are right or wrong.	As opposed to values, which defines our priorities for life.

To summaries ethics are consistently applied over the period and remains same for all the human beings. Ethics are moral principles that govern the behavior of individuals and organizations. Here are some examples of ethics:

1. Professional ethics: ethical standards that guide the conduct of professionals in various fields such as medicine, law, accounting, engineering, and journalism.
2. Business ethics: moral principles and values that guide the behavior of individuals and organizations in the business world.
3. Environmental ethics: ethical considerations related to the relationship between humans and the environment, and the responsibility to protect and preserve the natural world.

4. Social ethics: principles and values that guide the behavior of individuals and organizations in relation to social issues such as poverty, inequality, and social justice.
5. Religious ethics: moral principles and values that guide the behavior of individuals and organizations within religious contexts.

These are just a few examples of ethics, and different fields and cultures may have their own unique ethical considerations.

On the other hand, Values have an individualistic approach, i.e. it varies from person to person but remains stable, relatively unchanging but they can be changed over time due to a significant emotional event. Values are the principles and beliefs that guide the behavior and decision-making of individuals and organizations. Here are some examples of values:

1. Respect: treating others with dignity and courtesy.
2. Integrity: acting in a way that is consistent with one's values and beliefs.
3. Responsibility: being accountable for one's actions and decisions.
4. Honesty: telling the truth, not lying or deceiving others.
5. Empathy: showing concern and understanding for others.
6. Courage: standing up for what is right even in the face of difficulty or opposition.
7. Fairness: treating people equally and impartially.
8. Diversity: valuing and respecting differences in culture, ethnicity, gender, and other characteristics.
9. Sustainability: promoting responsible use of natural resources to protect the environment for future generations.

These are just a few examples of values, and different individuals and organizations may have their own unique values that guide their behavior and decision-making. Values can be both personal and cultural, and can play an important role in shaping the way we interact with the world around us.

ETHICAL PRACTICES

Beneficence: The principle of beneficence guides the decision maker to do what is right and good. This priority makes an ethical perspective and possible solution to a dilemma acceptable and resolvable. This is also related to the principle of utility, which states that one should attempt to generate the largest ratio of good over evil possibility. This principle stipulates that ethical theories should strive to achieve greatest amount of good because people benefit from the most good.

Least Harm: This theory deals with situations in which no choice appears beneficial. In such cases, decision makers seek to choose to do the least harm possible and to do harm to the fewest people. This principle is mainly associated with the utilitarian ethical theory discussed below.

Utilitarian: This is a normative ethical theory that places the locus of right and wrong solely on the outcome or consequences of choosing one action/policy over other. As such, it moves beyond the scope of one's own interest and takes into account the interest of others.

Autonomy: This principle states that decision making should focus on allowing people to be autonomous; that is, to be able to make decisions that apply to their own workplace or lives. In other words, people should have control over their own selves as much as possible because they are the only people who completely understand their chosen type of work/life style. Each individual deserves respect because only he/she has had those exact life experiences and understands own emotions, motivations, and physical capabilities in an intimate manner. In essence, this ethical principle is an extension of the ethical principle of beneficence because a person who is independent usually prefers to have control over his own experiences in order to secure the lifestyle that he/she enjoys.

Justice: The justice ethical principle states that decision makers should focus on actions that are fair to all those involved. This means that ethical decisions should be consistent with the ethical theory unless extenuating circumstances that can be justified and exist in the case. This also means that cases with extenuating circumstances must contain a significant and vital difference from other similar cases that justify the inconsistent decision.

The principles of integrity in business are guided by a set of core ethics that influence their decisions and behavior which includes: Accountability, Commitment to Excellence, Concern for Others, Fairness, Honesty, Integrity, Abiding Law, Leadership, Loyalty Morale, Keeping Promises, Reputation, Respect for others, Trustworthiness etc.

Question: The principle of ..... guides the decision maker to do what is right and good.

Options:

(A) Utilitarian (B) Autonomy

(C) Beneficence (D) Justice

Answer: (C)

The schedule VI of the Companies Act, 2013 also states to uphold ethical standards by independent directors:

I. Guidelines of professional conduct :

An independent director shall:

"(1) *uphold **ethical standards** of **integrity and probity**;*

(2) *act **objectively and constructively** while exercising his duties;*

(3) *exercise his responsibilities in a **bona fide manner** in the interest of the company;....."*

PROFESSIONAL ETHICS

Ethics arises from three main factors, moral attitudes as a result of consciousness or awareness-raising, culture as a result of education and the use of know-how and the application of standards as a result of learning and training.

Ethics amount to fundamental moral attitudes, binding values and irrevocable standards. A distinguishing characteristic of a profession is the ability to combine ethical standards with the performance of technical skills. The professionals being exclusive custodian of expertise need to profess high ethical and moral values and to redeem their noble traditions. Every professional should desire for introspection and a dynamic movement to promote a value revolution with deeper conviction and creative consciousness, leading himself to be good professional. The collective wisdom prevail to inculcate highest standards of professional ethics and moral values and adherence to Professional code of conduct in its true letter and spirit.

The principles which govern the conduct of a professional broadly encompasses, Integrity, Professional independence, Professional competence, Objectivity, Ethical behavior, Conformance to technical standards, if any and Confidentiality of information acquired in the course of professional work. The professionals are expected to conduct themselves in such a manned so as to uphold the grace, dignity and professional standing of the institute.

CASE LAW

In Re *Mahesh Chand Agrawal, IBBI/VALUATION/DISC./01/2022 dated 11.02.2022*, in this matter Mr. 'M', who was registered as member of Registered Valuer Organisation had concealed material information in his application form for registration regarding pendency of 3 FIRs filed by Central Bureau of Investigation on basis of complaint made by PNB for his role as valuer. It is duty of a prospective valuer to be responsible, accountable and to maintain integrity, however, in instant case concealment of material facts of chargesheet being filed by CBI against 'M' affected his integrity and reflected his inability to adhere to standards of professional ethics, which was in violation of rule 3(1)(k) of Companies (Registered Valuers and Valuation) Rules, 2017 and Model Code of Conduct for Registered Valuers and, therefore, registration of 'M' as Registered Valuer was to be cancelled.

Companies in the India have begun to fulfill their corporate social responsibility, either voluntarily or in compliance with mandates or statutes, respecting social ethics, thereby, setting up healthy and sensible corporate ethics on the following parameters:

- Complying with the laws of land where business is conducted and engaging in fair practices in the light of social ethics.
- Aiming to become a sensible corporate citizen and striving for harmony with local society.
- Disclosing information in a timely manner and engaging in honest and transparent communications mode.
- Protecting the irreplaceable earth and contributing to the preservation of the environment.
- Respecting fundamental human rights and individuality and building up a corporate culture with a broad vision which fosters the spirit of corporate ethics.

Illustration of professional ethics:

A business owner who upholds professional ethics will ensure that they treat their employees, customers, and suppliers with respect and fairness, comply with all applicable laws and regulations, and act with integrity in all of their dealings.

A financial advisor who adheres to professional ethics will prioritize the best interests of their clients, provide accurate and honest information, and avoid conflicts of interest or unethical practices that could harm their clients' financial well-being.

In general, upholding professional ethics involves acting with integrity, transparency, and a commitment to serving the best interests of all stakeholders.

MODEL ETHICAL PRINCIPLES FOR COMPANY SECRETARIES

Professionalism is the virtue, conduct, aim, value or quality that characterize or marks a profession or professional person; it implies quality of workmanship or service. Having a reputation for excellence and being thought of as someone who exhibits professionalism under any circumstances can open doors for him/her in the individual's workplace or personal ambition. Professionals like the Company Secretaries are highly valued by their profession. For any professional the below can be the Golden Rules of Ethics for Professionals. It is recommended to apply these Golden Rules of Professionalism for enjoying a reputable, professional and prosperous career in providing service to the client/ organization:

- **Strive for excellence:** This is the first step to achieving greatness in whatever endeavor one undertakes; it is the quality that marks one's work to stand-out. Excellence is a quality of service which is remarkably good and so it surpasses ordinary standards, it should be made a habit to make a good impression on clients and colleagues.
- **Be trustworthy:** In today's society trust is an issue and one who exhibits trustworthiness is on a fast track to professionalism. It is all about fulfilling an assigned task, not letting down the client's expectations, it is being dependable and reliable when called upon to deliver service. In order to earn this trust, worthiness and integrity it must be sustainably proven over a time-span.
- **Be accountable:** It implies that one should be able to stand tall and be counted upon for all actions undertaken; this is also construed as a quality of being credible and responsible for actions performed and their consequences - good or bad.
- **Be courteous and respectful:** Courteousness is more than being friendly, polite and well-mannered with a gracious consideration towards others. It makes social interactions in the workplace run smoothly; avoid conflicts and earn respect. Respect is a positive feeling of esteem or deference for a person or organization; it is built over span of time and can be lost with one single inconsiderate action; continual courteous interaction is required to be maintained to enhance the respect gained.

- **Be honest, open and transparent:** Honesty is a facet of moral character that connotes positive and virtuous attributes such as truthfulness, straightforwardness, good conduct, loyalty, fairness, sincerity, openness in communication and generally operating in a manner for others to notice the perfection with which actions are performed; a virtue highly appreciated and valued by clients, employers and colleagues because it builds trust and personal reputation.
- **Be competent and improve continually:** Competence is the core ability of a professional to do a job properly. It is a combination of quality of knowledge, skill, acumen and behaviour used to perform. Competency grows through experience and to the extent one is willing to learn and adapt. Continuous self-development is a pre-requisite in offering professional service at all times.
- **Be ethical:** Ethical behavior is acting within certain moral codes in accordance with the generally accepted code of conduct or rules. It is always safe for a professional to "play by the rules" where the rule book is inadequate; and acting with a clear moral conscience is the right way to adopt.
- **High Integrity:** Honorable action is behaving in a way that portrays "nobility of soul, magnanimity of person" derived from virtuous conduct and integrity in adherence to the dictum of "wholeness or completeness" of character in line with certain values, beliefs and principles with consistency in action and outcome.
- **Be respectful of confidentiality:** Confidentiality is respecting the set of rules or promises that restricts one from further or unauthorized dissemination of information. Over the course of one's career, information will come to be possessed in strict confidence - either from the organization or from colleagues; and it is important to be true to such confidentiality. One gains trust and respect of those confiding and enhances professional credibility within the organization.
- **Set Good Examples:** Applying the foregoing rules helps one to improve traits of professionalism by imparting knowledge to those around and below the rank and file. One ought to show and lead by setting good exemplary life all along. Modern corporate governance rightly demands a comprehensive, interdisciplinary approach to the management and control of companies.

Therefore, professionals need to practice with a sense of responsibility the evolving principles of good corporate governance across the globe on a continual basis. Excellence can be bettered through continuous up-gradation of research and interaction between the relevant practices and control of respective disciplines of Compliance, accounting, finance, law and management functions to deliver the highest quality of good corporate governance.

In this context the corporate looks upon Company Secretaries to provide the impetus, guidance and direction for achieving world-class ethical business practices and strategic corporate governance.

The ICSA (UK) Code of Professional Ethics and Conduct comprises four core principles to which all Fellows, Associates, graduates, students and affiliated members registered need to follow.

1. **Integrity**

   Integrity is the quality of being honest and having strong moral principles. The term has been described judicially as connoting "moral soundness, rectitude, and steady adherence to an ethical code". It requires that members are impartial, independent and informed. Displaying integrity includes:

   - acting professionally in your business dealings;
   - displaying a proper understanding and appreciation of your role and responsibilities;
   - being respectful of others at all times;
   - not accepting or offering improper gifts, hospitality or other inducements;
   - avoiding conflicts of interest, or, where a conflict arises, making sure that everyone involved is aware of the interest;

- recognising and considering the ethical issues arising from, and the interests of the groups or stakeholders who may be affected by, your choices, decisions and actions;
- avoiding involvement in any unethical, misleading, illegal or covert behaviour;
- not knowingly ignoring (or turning a blind eye to) unethical, misleading, illegal or obscure behaviour; and
- avoiding bringing the profession into disrepute.

2. High standard of service/professional competence

A high standard of service or professional competence should be delivered throughout one's working life. This involves an understanding of relevant technical, professional and business developments. Professional competence also takes account of the wider implications and expectations of our members. This includes:

- maintaining professional knowledge and skills which are required to perform the role which you are employed to carry out;
- completing CPD as required by the UKRIAT Committee (this does not apply to students);
- communicating effectively and promptly with your clients, colleagues and stakeholders to ensure that they are able to make informed decisions;
- acting within your level of competence; if this requires an admission to your client that you are unable to perform a task then this should be communicated effectively;
- upholding the requirements of the Royal Charter and byelaws made under it; and
- respecting the confidentiality of information acquired through professional relationships save where there is a legal or regulatory requirement to disclose or report that information.

3. Transparency

Transparency requires that members are clear and open in their business and professional conduct. This includes:

- being open and frank in any business dealings;
- not being underhand in any business transaction; and
- treating all work as if it was reported in the public domain.

4. Professional behavior

Professional behavior requires that members act in a way which conforms to the relevant laws of the jurisdiction in which they are residing and/or undertaking business transactions. It requires them also to pay regard to all regulations which may have a bearing on their actions and to adhere to the byelaws, specifically byelaw which states that the following actions or inactions may result in disciplinary proceedings:

- becoming bankrupt or insolvent;
- being convicted of an offence which might bring discredit on the Institute or the profession;
- failing to uphold the code of professional conduct and ethics;
- behaving, by doing something or not doing something, in a way considered by the Disciplinary Tribunal to bring the Institute or the profession into disrepute;
- disobeying any decisions of the Council or of one of its Divisional Committees;

- breaking any of the Institute's byelaws or Charter or Regulations;
- failing to comply or co-operate with a disciplinary investigation; or
- failing to comply with a decision or any conditions made by a Disciplinary or Appeal Tribunal.

The Singapore Association of the Institute of Chartered Secretaries and Administrators (ICSA) requires members to observe the highest standards of professional conduct and ethical behaviour in all their activities. By maintaining these standards, members enhance their reputation as corporate advisors and increase confidence in the management and administration of private and public sector organisations. As the conduct of an individual member can reflect upon the wider profession of corporate management and the Institute's membership as a whole, the Code sets out what are deemed to be appropriate standards of professional conduct:

- Members are required to uphold the Institute's Charter and comply with the Bye-laws.
- Members shall at all times be cognisant of their responsibilities as professional people toward the wider community.
- Members shall at all times safeguard the interests of their employers, colleagues or clients provided that Members shall not knowingly be a party to any illegal or unethical activity.
- Members shall not enter into any agreement or undertake any activity which may be in conflict with the legitimate interest of their employer or client or which would prejudice the performance of their professional duties.
- Members shall not use any confidential information obtained in the performance of their duties for personal gain nor in a manner which would be detrimental to their employer, client or any other party.
- Members shall ensure the currency of their knowledge, skills and technical competencies in relation to their professional activities.
- Members shall refrain from conduct or action which detracts from the reputation of the Institute.

Recent disciplinary case studies on values, ethics and professional conduct:

1. In 2021, the Securities and Exchange Board of India (SEBI) barred a company secretary from practicing for three years for submitting false documents and failing to conduct due diligence in relation to the issuance of securities by a company. The company secretary was found to have violated the code of conduct for practicing company secretaries, which requires them to act with integrity, objectivity, and professional competence.
2. In 2020, *SAT Order in the matter of B. Renganathan v. SEBI*, the markets watchdog SEBI imposed a penalty of Rs 5 lacs on Edelweiss Financial Services Limited (EFSL) compliance officer Mr. B Renganathan for failing to close the trading window during the existence of the unpublished price-sensitive information.

   SEBI on receipt of an examination report from the National Stock Exchange (NSE), conducted investigation in the dealings in the scrip of EFSL in order to examine possible violations of SEBI (Prohibition of Insider Trading) Regulations, for the period of January 2017 to April, 2017.

   During the course of investigation, it was observed that ECap Equities, a wholly-owned subsidiary of EFSL, had acquired Alternative Investment Market Advisors Pvt Ltd (AIMIN), a financial technology company, on April 5, 2017, by entering into a share purchase agreement. The same was disclosed by EFSL to the NSE and the BSE on the same day. The acquisition of AIMIN by ECap was a price-sensitive information that had come into existence on January 25, 2017, upon signing of term sheet. The acquisition of AIMIN by ECap was a price-sensitive information that had come into existence on January 25, 2017, upon signing of term sheet. According to SEBI, Mr. Renganathan, being the compliance officer of the company, failed to close the trading window during the period of January 25, 2017 to April 5, 2017.

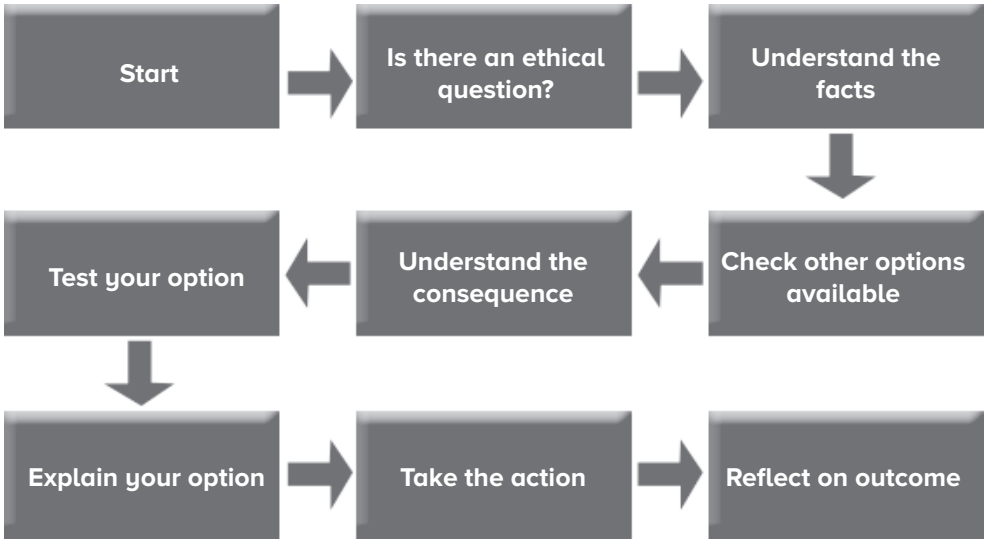
By his failure to close the trading window during this period, he has violated the provisions of minimum standards for code of conduct to regulate, monitor and report trading by insiders mentioned in the PIT Regulations, the regulator added. Further, he has admittedly begun intimating stock exchanges on trading window closure only from January 2019. Accordingly, the regulator levied the penalty of Rs 5 lacs on him.

3. In January 2022, the Disciplinary Committee of ICSI imposed a penalty of R. 10000 and reprimanded the company secretary on account of founding him guilty of professional misconduct under clause (7) of Part II of the Second schedule to the Companies Secretaries Act, 1980 for not exercising due diligence while issuing compliance certificate by stating that there were no allotment/transfer/transmission of securities during the financial year and wrongly certified nominal value per share of the company.
4. In 2018, the Institute of Company Secretaries of India (ICSI) suspended a company secretary from its membership for a period of three months for professional misconduct. The company secretary was found to have issued a certificate without proper verification of documents, which violated the ICSI's code of conduct.
5. In 2021, the Securities and Exchange Board of India (SEBI) imposed a penalty of Rs 10 lakhs on a company secretary for failing to disclose certain material information to the stock exchanges in a timely manner. The company secretary had violated the SEBI's listing obligations and disclosure requirements regulations.
6. In 2020, the Institute of Company Secretaries of India (ICSI) suspended a company secretary from its membership for three months for professional misconduct. The company secretary was found to have violated the ICSI's code of conduct and professional ethics, including making false statements and failing to maintain the confidentiality of client information.

Above mentioned cases demonstrate the importance of upholding ethical values and professional conduct for company secretaries, and the potential consequences of failing to do so. Company secretaries have a crucial role in ensuring compliance with legal and regulatory requirements, and in upholding the integrity and reputation of their clients and the profession.

Ethical Decision Worksheet

This worksheet is designed for assisting in making ethically responsible decision:



1.	**Analyse the situation?** *Analyse the situation?* *Check whether you have choices?* *What is at stake?*
2.	**Understand the facts** *What are the facts?* Is anything required to be done?
3.	**Understand the options available** *What al options are available?* Do any Rule/regulation/laws/professional ethics influence your options?
4.	**Understand the consequences of the options** *What are the consequences of each available option?* *Who will be affected by each available option?* *How will the parties be affected by these option?*
5.	**Test the option you plan to take** *Identify the best option.* *Review the difficulty level of preferred option:* *Is the option difficult for others to understand?* *Can I justify my actions on that option?* *How to implement the decision?*
6.	**Explain the option you have decided upon** *Explain the actions – you should be able to justify them in a logical manner You should have kept records of your decision.*
7.	**Act on the chosen option** *Make a plan to implement your decision?*
8.	**Reflect on the outcome** *How did my decision turn out?* *Who was affected and how?*

ICSI CODE OF CONDUCT

The purpose of Code of Conduct is to lay down certain ground rules to promote ethical conduct and good practices and to deter wrong-doing and also to make the relationship mutually pleasant and productive and to enhance the sense of community with common values and mission. Further, Code of Conduct is a step towards ethical decision making in which strategic management decisions result from due deliberations and objective analysis of facts, distanced from personal biases, leanings, subjectivity or emotional perceptions. The matters covered under the Code are of utmost importance to the Institute of Company Secretaries of India ("Institute"), its members, students and other stakeholders including Government, Regulators, Trade and Industry and other users of services of the Company Secretaries.

Fundamental duties of Professional

Fair Dealing	Not exploiting undue Professional Opportunity	No Misuse of Mistakes of Other Solicitor	Maintaining Confidentiality
Making Inadvertent Disclosure	Avoid Conflicts	Honour Undertakings of professionals	Maintaining Integrity of evidence
Due care while dealing with Client documents	Dealing with other persons	Promote Anti-discrimination and Anti-Harassment	Dealing with Media

(i) Fair Dealing

Each member of the institute should endeavor to deal fairly with the Clients, other members and students. No Member of the Institute should take unfair advantage of anyone through manipulation, concealment, abuse of privileged information, misrepresentation of material facts, or any other unfair dealing practice.

In addition to strict compliance with all legal aspects, all members are expected to observe the highest standards of business and personal ethics.

A Professional must also:

- act in the best interests of a client in any matter in which he represents the client;
- be honest and courteous in all dealings in the course of legal practice;
- deliver legal services competently, diligently and as promptly as reasonably possible;
- avoid any compromise to their integrity and professional independence; and
- comply with applicable Rules and the law.

(ii) Professional Opportunity

The professional should not exploit for their own personal gain, opportunities that are discovered through third party, information or position unless the opportunity is disclosed fully in writing and permits to pursue such opportunity.

(iii) Mistakes of Other Solicitor

A professional must not take unfair advantage of the obvious error of another professional or other person, if to do so would obtain for a client a benefit which has no supportable foundation in law or fact.

(iv) Confidentiality

The client's confidential information is a valuable asset. All confidential information must be used for the benefit and in the best interest of client. Every professional must safeguard the confidentiality as above.

The confidential information, discussions, documents and data should be dealt with utmost care and should not be shared or passed on to any person/outsider under any circumstances, directly or indirectly without authorization.

A professional must not disclose any information which is confidential to a client and acquired by him during the client's engagement to any person who is not:

- a partner, promoter, director, or employee of the firm of the professional; or
- a professional or an employee of, or person otherwise engaged by, the firm of professional or by an associated entity for the purposes of delivering or administering legal services in relation to the client, except the following:
  - the client expressly or impliedly authorises disclosure;
  - the professional is permitted or is compelled by law to disclose;
  - the professional discloses the information in a confidential setting, for the sole purpose of obtaining advice in connection with the solicitor's legal or ethical obligations;
  - the professional discloses the information for the sole purpose of avoiding the probable commission of a serious criminal offence;
  - the professional discloses the information for the purpose of preventing imminent serious physical harm to the client or to another person; or
  - the information is disclosed to the insurer of the professional or its associated entity.

(v) Inadvertent Disclosure

A professional who reads part or all of the confidential material before becoming aware of its confidential status must:

- notify the same or the other person immediately; and not read any more of the material.
- If a professional is instructed by a client to read confidential material received in error, the solicitor must refuse to do so.

(vi) Conflicts

Each professional should avoid any conflict of interests with that of the client. A 'conflict of interest' exists where the interests or benefits of one person or entity conflict with the interests or benefits of the client. The professional must avoid situations involving actual or potential conflict of interest.

Any situation that involves or may involve a conflict of interest must be promptly disclosed. No transaction, which involves an actual or potential conflict of interest, should be undertaken by professional.

A professional must not act for a client where there is a conflict between the duty to serve the best interests of a client and the interests of the professional or an associate of the professional, except as permitted.

A professional must not exercise any undue influence intended to dispose the client to benefit the professional in excess of the professional fair remuneration for legal services provided to the client.

A professional must not borrow any money, nor assist an associate to borrow money, receiving a financial benefit from a third party in relation to any dealing where the professional represents a client, or from another service provider to whom a client has been referred by the professional, provided that the professional advises the client:

(i) that a commission or benefit is or may be payable to the professional in respect of the dealing or referral and the nature of that commission or benefit;

(ii) that the client may refuse any referral and the client has given informed consent to the commission or benefit received or which may be received.

(vii) Undertakings

A professional who has given an undertaking in the course of legal practice must honour that undertaking and ensure the timely and effective performance of the undertaking, unless released by the recipient or by a court of competent jurisdiction.

A professional must not seek from another professional, or that professional's employee, associate, or agent, undertakings in respect of a matter, that would require the co-operation of a third party who is not party to the undertaking.

(viii) Integrity of evidence

A professional must not:

- advise or suggest to a witness that false or misleading evidence should be given nor condone another person doing so; or
- coach a witness by advising what answers the witness should give to questions which might be asked;

A professional will not have breached by:

- expressing a general admonition to tell the truth;
- questioning and testing in conference the version of evidence to be given by a prospective witness; or
- drawing the witness's attention to inconsistencies or other difficulties with the evidence, but must not encourage the witness to give evidence different from the evidence which the witness believes to be true.

(ix) Client documents

A professional with designated responsibility for a client's matter, must ensure that, upon completion or termination of the law practice's engagement:

- the client or former client, or another person authorised by the client or former client, is given any client documents, (or if they are electronic documents copies of those documents), as soon as reasonably possible when requested to do so by the client, unless there is an effective lien.
- a professional may destroy client documents after a period of 7 years has elapsed since the completion or termination of the engagement, except where there are client instructions or legislation to the contrary.

(x) Dealing with other persons

A professional must not in any action or communication associated with representing a client:

- make any statement which grossly exceeds the legitimate assertion of the rights or entitlements of the client, and which misleads or intimidates the other person;
- threaten the institution of criminal or disciplinary proceedings against the other person if a civil liability to the client is not satisfied; or
- use tactics that go beyond legitimate advocacy and which are primarily designed to embarrass or frustrate another person;
- In the conduct or promotion of a professional practice, the solicitor must not seek instructions for the provision of legal services in a manner likely to oppress or harass a person who, by reason of some recent trauma or injury, or other circumstances, is, or might reasonably be expected to be, at a significant disadvantage in dealing with the solicitor at the time when the instructions are sought.

(xi) Anti- discrimination and Harassment

A professional must not in the course of practice, engage in conduct which constitutes:

- discrimination;
- sexual harassment;
- workplace bullying – "bully by proxy".

(xii) Dealing with the Media

- A professional must not publish or take steps towards the publication of any material concerning current proceedings which may prejudice a fair trial or the administration of justice.
- To adhere to practice promotion, advertising and solicitation rules, codes and legislation in use and avoid Conflicts of interest.
- Maintaining public confidence and faith in the profession.

Question: A professional must not publish or take steps towards the publication of any material concerning ..... which may prejudice a fair trial or the administration of justice.

Option: (A) current proceedings (B) Past Proceedings (C) Future Proceedings (D) None of these

Answer: (A)

ETHICAL DILEMMA

Dilemma means a situation in which a difficult choice has to be made between two courses of action, either of which entails contravening a moral principle. An ethical dilemma or ethical paradox is a decision-making problem between two possible moral imperatives, neither of which is unambiguously acceptable or preferable. The complexity arises out of the situational conflict in which obeying one would result in transgressing another.

Ethical Dilemma is the situation where a person's view regarding selecting an object or the alternative includes series of outcomes, which is very confusing. Each outcome has a serious overlapping outcome, which cannot be at a time wrong for one person but the same may be ethically wrong for the other.

An "absolute" or "pure" ethical dilemma only occurs when two (or more) ethical standards apply to a situation but are in conflict with each other. In ethical dilemma, if we obey one decision then it would bring about disobeying another.

Ethical dilemma is also known as moral dilemma. Ethical dilemmas make the situations too difficult. A person has to choose only one way from two of them - a moral or an immoral way. Ethical dilemmas can be seen everywhere in daily lives. However, everybody has their own particular experience towards ethical dilemma. Ethical dilemmas assume that the chooser will abide by societal norms, such as codes of law or religious teachings, in order to make the choice ethically impossible.

Some examples of ethical dilemmas include:

- A secretary discovers her boss has been laundering money, and she must decide whether or not to turn him in.
- A doctor refuses to give a terminal patient morphine, but the nurse can see the patient is in agony.
- While responding to a domestic violence call, a police officer finds out that the attacker is the brother of the police chief, and the police chief tells the officer to "make it go away".
- A government contractor discovers that intelligence agencies have been spying on its citizens illegally, but is bound by contract and legalities to keep his confidentiality about the discovery.

Narayana Murthy Committee, 'Report of the SEBI Committee on Corporate Governance', has conceptualized the concept of corporate governance, *inter-alia,* thus:-

"Corporate Governance is about ethical conduct in business. Ethics is concerned with the code of values and principles that enables a person to choose between right and wrong, and therefore, select from alternative courses of action. Further, ***ethical dilemmas*** *arise from conflicting interests of the parties involved. In this regard, managers make decisions based on a set of principles influenced by the values, context and culture of the organization. Ethical leadership is good for business as the organization is seen to conduct its business in line with the expectations of all stakeholders".*

Common Causes of Loss of Ethics and Values

1. **Unclear Policies in some cases:** Managers and employees exhibit poor ethical behaviour because the company does not offer a clear model of ethics. Some businesses have no formal ethical policy documents and offer no guidance at all. Others have policies that are unclear, vague, inconsistent or not consistently enforced.

2. **Conflict between Organisational & Individual Goal:** When the Organizational & Individual Goals overlap, it becomes difficult to balance things. The problem arises when one thing has to be sacrificed for the sake of others. To achieve Organisational goal, Individual goal, has to be compromised and vice versa so this leads to Ethical Dilemma.

3. **Cultural Value & Background:** Every individual decision is based on background. For some people it may be ethical to give priority for self and then decide about others but for some others it may be other way round. Thus background & value system creates the ethical Dilemma.

4. **Situation when a decision is taken by a manager:** It may be so that situation demands him to decide on certain things which dealing with Ethical Dilemmas. Each Company's culture is different, but some companies stress profits and results above all. In these environments, management may turn a blind eye to ethical breaches if a worker produces results, given the firm's mentality of "the end justifies the means." are not beneficial for all but will benefit the company alone. Example - Automation of a plant.

5. **Dynamic & Different Human Nature:** Ethical Dilemma arises due to difference of the opinion among the group of people. Whatever is ethical for one person, may be unethical for another.

6. Ambition and Discrimination Individual workers may be under financial pressure or simply hunger for recognition. If they can't get the rewards they seek through accepted channels, they may be desperate enough to do something unethical, such as falsifying numbers or taking credit for another person's work to get ahead. Though diversity is an important part of business, some people may not be comfortable with people from different backgrounds and possibly be reluctant to treat them fairly. This kind of discrimination is not only unethical but illegal and still remains common.

7. **Pressure from Management:** Each company's culture is different, but some companies stress profits and results above all. In these environments, management may turn a blind eye to ethical breaches if a worker produces results, given the firm's mentality of "the end justifies the means." Whistle-blowers may be reluctant to come forward for fear of being regarded as untrustworthy and not a team player. Therefore, ethical dilemmas can arise when people feel pressurised to do immoral things to please their bosses or when they feel that they can't point out their co-workers' or superiors' bad behaviours.

8. **Negotiation Skills:** While these factors can cause ethical dilemmas for workers within their own companies, doing business with other firms can also present opportunities for breaches. Pressure to get the very best deal or price from another business can cause some workers to negotiate in bad faith or lie to get a concession.

9. **Conflicting Values:** Ethical dilemmas may occur because of conflicting values between two or more people in an organization. One manager may value product quality over quantity while another may value thriftiness. These managers may discuss changing to a cheaper supplier for a material used in production because of the potential to save money. However, the first manager may object because he knows the cheaper material will produce a product of lesser quality, which is not good for customers. Without a culture of shared values, the least ethical choice may be approved.

   Organisation for Economic Co-operation and Development (OECD) has also described various principles on "Corporate Governance" one of these Principle includes Disclosure and Transparency, which states "The Corporate Governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company."

   An Organization Transparency checklist includes the below mentioned traits:

   - Board meetings (Dates, times and locations of Board meetings are conveyed at least one week in advance of the meetings)
   - Financial disclosure statements (Non-profits should consider posting their audited financial statements on their website)
   - Freedom of information legislation (Rules that guarantee access to data held by the state; they establish a "right-to-know" legal process where requests can be made for government-held information)
   - Budgetary reviews
   - Annual audits
   - Annual Reports (Posted on the organization's website for easy access)
   - Strategic plans and priorities
   - Board of Directors and names of key staff as well as their contact information (Posted on the organization's website)
   - Straight talking leadership
   - Open culture and operations (many voices on behalf of the organization)
   - Disclosed partnerships
   - Frank, open communications including the good and bad
   - Core values & Code of conduct.

HOW TO RESOLVE ETHICAL DILEMMA

Think about outcomes if you find yourself in a situation when this approach doesn't work, you can resolve a right versus right dilemma by finding the highest "right." Kidder wrote that there are three ways to make the best choice when faced with these types of dilemmas:

Resolving Ethical dilemma		
Ends-based: Select the option that generates the most good for the most people.	**Rule-based:** Choose as if you're creating a universal standard. Follow the standard that you want others to follow.	**Care-based:** Choose as if you were the one most affected by your decision. Once you've identified an ethical right versus right dilemma, lay out your options according to these three principles. One approach will immediately present itself as the "most right".

STRATEGY FOR OVERCOMING FROM THE EVILS

For any organization the systematic and rigorous approach coupled with efforts is necessary to keep governance standards at the highest level by nurturing of ethical values and standards well embedded from the inception of the organization. It needs further conscious cultivation during the growth phase. It is equally important to remember that organizations or institutions act through its own employees.

Technology is only a means — a handmaid available at the disposal of humans and it cannot be a substitute; even in the society of the future where robots will take a dominating and universal position. Therefore, the human beings need proper and rigorous grooming. Thus, it is necessary that any attempt to address ethical issues is to be handled by human beings and not machines.

The human traits and characteristics shape human behavior and a few probable solutions are explained below:

(i) Satisfaction

To achieve happiness it is essential that the culture of 'being satisfied' is developed. However, the most challenging and unanswerable question on satisfaction is "How much is Enough". The issue is very difficult to resolve especially in the corporate field where expansion is the prime direction in which it is supposed to move; yet it is the need of the hour to understand and remain satisfied with what is achieved within the validly available means.

(ii) Ends not to justify the means

It is often said that the results matter and what was done to achieve the same is of no consequence. The statement may appear encouraging; but reading between the lines it is not the intention to achieve results by compromising ethics and values. The need of compromising ethics and values arises when there is a dearth of valid means to achieve the end-result. The thirst to succeed, vaulting ambition and flawed education are equally responsible elements. It is essential to note that however worth the cause may be, the means to achieve the same should also be equally valid. An irregular or an unethical action leading to a good outcome may not necessarily justify the method of achieving the goal.

(iii) Ethical Leadership

The Professional should lead the organisation like Krishna as he led Pandvas to success by guiding them to fight morally. It is the duty of the leader driving the organization to ensure use of proper and ethical means in his conduct. It is equally essential that the leader walks the talk and sets an example of good governance and ethical leadership.

(iv) Character

Professional should always consider the old idiom: If Character Is Lost Everything Is Lost. The idiom amply highlights the importance of good character. Character is generally built or earned by virtues

like courage, honesty, values and ethics. Great leaders and eminent personalities are judged by their character. A good character is synonymous to reliability.

Recent Cases on Values, Ethics and Professional conduct

1. Punjab National Bank Case

Punjab National Bank is one of the largest public sector banks in India. The scam of Rs. 11,300 crores in the Punjab National Bank scam has come into the limelight. The PNB scam and irregularities, forgery commenced in the year 2011 and continued for six long years with the knowledge of a few banking officials of PNB. It is a case where Letter of Undertaking (LOU) from Punjab National Bank was taken by Nirav Modi without having a sanctioned credit limit or collaterals. The dispute mainly started due to illegal LOUs issued to Nirav Modi by few PNB banking officials.

The chronological dates on which the events and transaction concerning the scam took place is briefed as under:

- Punjab National Bank filed an FIR against Nirav Modi, Mehul Chowskhi and other charged with criminal conspiracy and cheating amounting to the tune Rs 11,300 Crores.
- Central Bureau of Investigation (CBI) was handed over the investigation into the matter.
- The Enforcement Directorate (ED) had registered a money laundering case against Nirav Modi and others under the provisions of PMLA based on the FIR registered by CBI under Sections 120-B r/w 420 of IPC, 1860 read with Section 13(2) read with 13(1)(d) of PC Act, 1988
- The Enforcement Directorate seized some movable assets like diamond, gold and jewellery worth Rs. 56.74 billion from the house of Nirav Modi and his office CBI after an investigation into the matter arrested two employees of Punjab National Bank and detained one representation of Nirav Modi Group. Simultaneously, Government of India suspended passport of Nirav Modi and Mehul Choskwi for the involvement in the PNB Scam.
- Subsequently, the Central Bureau of Investigation arrested the Chief Financial Officer (CFO) and two Senior Executives of Nirav Modi firm. It also sealed the Nirav Modi farmhouse at Alibaug, Mumbai.
- CBI seized nine luxurious cars which belong to Nirav Modi and his firm which worth crores of money.
- The Magistrate Court issued first bailable arrest warrant against Nirav Modi and Mehul Chowski. Enforcement Directorate on the same day filed a petition before the Special Court, Mumbai for seeking issuance of a non– bailable warrant (NBW) against the diamantaire – Nirav Modi and his firm.
- Enforcement Directorate moves before the Special Court to issue extradition proceeding against Nirav Modi.
- Government of India sent a letter requesting the UK authorities to initiate extradition proceeding against Nirav Modi.
- CBI officials requested Interpol Manchester to detain Nirav Modi about Nirav Modi presence in the country.
- UK authorities confirm the presence of the accused – Nirav Modi in the country.
- In a British newspaper named as UK Daily Telegraph which published a report on Nirav Modi presence and roaming in London streets. After knowing the incident Enforcement Directorate requested the Government of UK to take further action on the extradition proceeding of Nirav Modi in the UK court.
- Government of UK took action on the request of the Government of India and the Westminister Court, London issued an arrest warrant against Nirav Modi Nirav Modi was arrested in London by Scotland Yard Officers and produced before the Westminister Court. He applied for which was rejected by the Court. The accused Nirav Modi was sent to Her Majesty's Prison (HMP), Wandsworth till 29th March, 2019.

- The Westminister Court rejected the bail petition of the accused /fugitive offender – Nirav Modi on the ground that he may not appear before the Court on the fixed dates for further hearing of the matter. (29th March ,2019)
- After the plea made by Enforcement Directorate, Nirav Modi has been declared as Fugitive Offender by the Mumbai Court under the Fugitive Offender Act ,2018. Nirav Modi is currently in Wandsworth Prison in London, from where he is fighting for extradition charges.

Action taken by RBI after detection of PNB Fraud

- Reserve Bank of India discontinued the practice of LOUs/ FLCs for trade credits for imports into India.
- RBI also ordered all the banks to reconcile transactions in Nostro accounts on a real-time basis so that unrecorded and illegal transactions can be identified immediately.

2. YES Bank Crisis

YES Bank was once the country's fifth-largest private lender by market capitalization. YES Bank was founded by Rana Kapoor and Ashok Kapoor in 2004. Fraud led to the unexpected and sudden fall of YES Bank which was emerging as a good competition to other private banks. The bank had a differentiated business model, with focus on technology, branches network, retail loans etc. and was ranked number 1 bank in the Business Today-KPMG Best Banks Annual Survey 2008.

What has led to a crisis at YES Bank?

Promoter of the bank, Rana Kapoor had, over a short period of time, built an overwhelming image in the industry and had developed contacts with top industrialists of the country. Most of the decision making on key matters including large loans was centralised in his hands. He had the ambition to make YES Bank the largest private bank of the country. It was this ambition which perhaps led to the sharp downfall in fortunes of the bank, steeper than its rise to an eminent position in the banking industry.

The bank's loan book on March 31, 2014, was Rs 55,633 crore, and its deposits were Rs 74,192 crore. Since then, the loan book has grown to nearly four times as much, at Rs 2.25 trillion as on September 30, 2019. While deposit growth failed to keep pace and increased at less than three times to Rs 2.10 trillion. The bank's asset quality also worsened and it came under regulator RBI's scanner. Yes bank was lending aggressively disregarding the risk limits and also under-reporting the bad loans. They were lending to corporates that were already in very risky businesses and facing some challenges in their business like the Anil Ambani-led Reliance group, DHFL and IL&FS. All this happened in Rana Kapoor's tenure. The exposure of loans to such bad performing companies was huge in Yes Bank's case, and to add up they were hiding the NPAs or misreporting the same. After the above fiasco, Ravneet Gill took charge of Yes Bank but struggled to revive as deposits kept depleting and he wasn't able to raise enough capital given the loss of confidence in the market. The tipping point came when one of the bank's independent directors Uttam Prakash Agarwal, resigned from the board in January 2020 citing governance issues.

Several reasons behind the crisis of YES bank were:

a. **NPAs**: YES Bank ran into trouble following the central bank's asset quality reviews in 2017 and 2018, which led to a sharp increase in its impaired loans ratio and uncovered significant governance lapses that led to a complete change of management. The bank subsequently struggled to address its capitalisation issues. YES Bank suffered a dramatic doubling in its gross NPAs between April and September 2019 to Rs 17,134 crore.

b. **NBFC crisis**: The crisis in India's shadow-banking space started with the unravelling of Infrastructure Leasing & Financial Services (IL&FS) and then extended to Dewan Housing Finance Limited (DHFL). YES Bank's total exposure to IL&FS and DHFL was 11.5 per cent as of September 2019. In April 2019, the bank had classified about Rs 10,000 crore of its exposures, representing 4.1 per cent of its total loans under watch list, as potential non-performing loans over the next 12 months.

c. **Governance issue**: YES Bank faced several governance issues that led to its decline. On January 10, independent director Uttam Prakash Agarwal quit citing deteriorating corporate governance standards and compliance failure at the lender. In 2018-19, the bank under-reported NPAs to the tune of Rs 3,277 crore, prompting RBI to dispatch R Gandhi, one of its former deputy governors, to the board of the bank. Rana Kapoor, who was instrumental in building YES Bank from scratch, was asked to step down as chief executive in January 2019.

d. **Excessive withdrawals**: YES Bank's financial condition dissuaded many depositors from keeping funds in the bank over a longer term. The bank showed a steady withdrawal of deposits, which burdened its balance sheet and added to its woes. The bank had a deposit book of Rs 2.09 trillion at the end of September 2019.

Steps taken by RBI against YES Bank

i. RBI has taken over the YES Bank management

ii. The central has imposed a moratorium on the lender

iii. RBI announced a draft 'Scheme of Reconstruction' that entails SBI investing capital to acquire a 49% stake in the restructured private lender.

3. Infrastructure Leasing & Financial Services Limited (IL&FS) Case

- IL&FS is a systemically important Core Investment Company with the Reserve Bank of India and is engaged in the business of giving loans and advances to its group companies (and holding an investment in such companies). IL&FS has a large number of group companies across various sectors such as Energy, Transportation, Financial Services.
- IL&FS Group, which had approximately over Rs. 91,000 crores in debt, was facing a severe liquidity crisis. Between July 2018 and September 2018, two of the subsidiaries of IL&FS Group reported having trouble in paying back loans and inter- corporate deposits to banks/lenders.
- In July 2018, the road arm of IL&FS was facing difficulty in making repayments due on its bonds. Further, in early September 2018, one of the subsidiaries of IL&FS Group was unable to repay a short-term loan of Rs. 1,000 crore taken from Small Industries Development Bank of India (SIDBI). Also, certain group companies defaulted in repayments of various short and long-term deposits, inter-corporate deposits, and commercial papers.
- IL&FS failed continuously to service its debt and the imminent possibility of a contagion effect in the financial market led the Central Government to move an application under Sections 241 and 242 of the Companies Act, 2013 before the NCLT (National Company law Tribunal). Section 241 deals with the cases of mismanagement and oppression by company's management.
- The NCLT suspended IL&FS board members and management and restrained the suspended members from alienating their personal assets.
- In view of the prima facie findings of ICAI and the SFIO interim report dated November 30, 2018, the Central Government filed a petition before the NCLT, Mumbai Bench under Section 130 of the Companies Act, seeking re-opening of the books of account of IL&FS and its group companies for the past five financial years. The NCLT vide its judgment dated January 1, 2019, allowed the petition of the Central Government.
- Upon an application filed by PTC India Financial Services Ltd, the NCLAT has, without going into the rival contention of the parties, made it clear that due to non-payment of dues by IL&FS or its entities including the 'Amber Companies', no financial institution will declare the accounts of IL&FS or its entities as NonPerforming Assets (NPA) without its prior permission.

- By its order dated May 2, 2019, NCLAT allowed the banks to declare as nonperforming assets the accounts of IL&FS and its group companies that have defaulted on payments. However, the tribunal clarified that the banks cannot initiate the recovery process and debit money.
- On May 30, 2019 SFIO submitted a chargesheet against 30 parties, including two auditor firms, for concealing information by not flagging the alleged criminal conspiracy and misreporting the financial statements of the IL&FS firms.
- MCA moved against the auditors, Deloitte Haskins and Sells as well as BSR and Associates LLP and their former auditors, under Section 140(5) of the Companies Act, for their role in "perpetuating the fraud" at IFIN, a subsidiary of IL&FS. The Ministry sought debarment of these audit firms and their audit partners. It also sought interim attachment of their properties, including bank accounts and lockers.
- On June 4, the Supreme Court allowed the SFIO to reopen and recast accounts of IL&FS and two of its subsidiary companies for the last five years. The MCA had approached the Supreme Court seeking a vacation of the stay imposed by the Supreme Court through its order passed on April 29.

Reasons for Failure

- IL&FS hadn't disclosed bad loans on its books for years despite a big part of its loan book having soured.
- As it was the shadow bank or NBFC, "Unscrupulous, negligent and dormant management decisions were the main root cause of failure.
- Poor fund management and controls as IL&FS lent funds to insolvent entities and troubled projects.
- "Deficient audit" by the auditors as they failed to issue warnings.
- The auditors did not highlight the Reserve Bank of India's (RBI's) inspection report, which had labelled IFIN as over-leveraged, besides failing to report negative cash flows and adverse key financial ratios.
- RBI or any other entity did not strictly regulated NBFCs. The IL&FS crisis has raised concerns over the management of such entities.

Steps taken by RBI

- RBI is constantly monitoring NBFC's to prevent systemic shocks.
- RBI is monitoring top 50 NBFCs more closely. These 50 NBFCs represent 75% of the sector.
- Wherever necessary, RBI is making deep dive into their books, their balance sheet and other numbers.

4. DHFL Case

Dewan Housing Finance Corporation Limited (DHFL) is a leading housing finance company, headquartered in Mumbai with branches in major cities across India. Mr. Rajesh Kumar Wadhawan is the Founder of DHFL.

- DHFL has sanctioned and paid funds in unsecured and dubious loans.
- Loan amounting to thousands of crores of rupees were given to newly incorporated shell companies.
- The said loans were provided without any security or collateral and the proceeds were utilized by for private asset creation.
- DHFL has not adequately disclosed the terms of loan and repayment in the financial statements. They also ensured that most of the shell companies have hidden the name of the lender i.e. DHFL.
- Approximately 6 lacs dummy accounts were established at one branch, using the names of borrowers who had already repaid their loans. These accounts were used to issue loans to promoter firms, which were then used to syphon funds. These loans turned out to be non-recoverable in the end.

- The act of DHFL ensured that the recovery of such dubious loans would be impossible since the companies or their directors themselves do not own any assets.
- The promoters and their associates used these dubious loans to acquire personal assets which were completely ring-fenced from the recovery process since the companies or their directors themselves do not own any of these assets.
- Due to poor Corporate Governance concerns, the Reserve Bank of India (RBI) superseded the board of debt-laden DHFL.
- RBI has initiated the process of resolution of the Company under the Insolvency and Bankruptcy (Insolvency and Liquidation Proceedings of Finance Service providers and Application to Adjudicating Authority rules, 2019.

Reasons for failure:

- DHFL case is absolute failure of Corporate Governance.
- The act of promotors in diversion of loan amounts to shell company without scrutiny or security shows a complete deviation from the corporate governance policies.

5. Hero MotoCorp

The country's largest two-wheeler maker Hero MotoCorp has sacked around 30 employees for violation of the company's code of conduct, These executives were found fudging travel expense bills, accepting personal favours, gifts and other benefits from some of vendors, suppliers and dealers in violation of the company's internal 'code of conduct'.

The executives were given marching orders after "thorough investigations" into the allegations against them, all due legal procedures were followed before taking the final action. Third-party independent investigators were appointed to look into these cases once the anomalies were detected in the activity record of these executives.

Stressing on the significance of the step, the official said," We have always had a clearly laid out Code of Conduct for all our employees and it is absolutely mandatory for everyone working at Hero to abide by it. Integrity and value-based behaviour is a way of life at Hero and no one violating these principles has any place in this organisation".

Hero MotoCorp's management was unanimous in its view that the concerned employees could not continue in the company, once it was established. The employees were given due opportunities to present their cases. When confronted with evidence, they owned up to the wrongdoing, official said. He, however, declined to share the names and designations of the sacked employees.

6. Volkswagen's Emissions Scandal:

In 2015, it was discovered that Volkswagen had installed "defeat devices" in its diesel cars that enabled the vehicles to cheat emissions tests. Many VW cars being sold in America had a "defeat device" - or software - in diesel engines that could detect when they were being tested, changing the performance accordingly to improve results. The German car giant has since admitted cheating emissions tests in the US.

The scandal resulted in a significant fine for the company and criminal charges for several executives. The case raised questions about ethical behavior and values within the automotive industry, as well as the need for stricter regulations and enforcement.

7. In 2020, the Securities and Exchange Commission (SEC) fined a major financial services company [VALIC Financial Advisors Inc. (VFA)] for failing to disclose conflicts of interest in its investment advice. The SEC charged VFA for making false and misleading statements about, and otherwise failing to disclose, conflicts related to its receipt of millions of dollars of financial benefits from client mutual fund investments. The SEC found that the company had recommended investments that generated higher fees for the company, even if they were not in the best interests of their clients. This violated the company's fiduciary duty to act in the best interests of their clients.

LESSON ROUND-UP

- The ethics include descriptive ethics, normative ethics, meta-ethics and applied ethics.
- Ethics refers to the guidelines for conduct, that address question about morality. Value is defined as the principles and ideals, which helps them in making the judgement of what is more important.
- Ethics arises from three main factors, moral attitudes as a result of consciousness or awareness-raising, culture as a result of education and the use of know-how and the application of standards as a result of learning and training.
- A professional must not exercise any undue influence intended to dispose the client to benefit the professional in excess of the professional fair remuneration for legal services provided to the client.
- The term "ethics" is derived from the Greek word "ethos" which refers to character or customs or accepted behaviours.
- Descriptive Ethics deals with what people actually believe (or made to believe) to be right or wrong and accordingly holds up the human actions acceptable or not acceptable or punishable under a custom or law.
- Normative Ethics deals with "norms" or set of considerations how one should act. Thus, it is a study of "ethical action" and sets out the rightness or wrongness of the actions.
- Meta-Ethics or "analytical ethics" deals with the origin of the ethical concepts themselves. It does not consider whether an action is good or bad, right or wrong.
- Applied Ethics deals with the philosophical examination, from a moral standpoint, of particular issues in private and public life which are matters of moral judgment.
- Value is defined as the principles and ideals, which helps them in making the judgement of what is more important.
- The principles which govern the conduct of a professional broadly encompasses, Integrity, Professional independence, Professional competence, Objectivity, Ethical behavior, Conformance to technical standards, if any and Confidentiality of information acquired in the course of professional work.
- Professionalism is the virtue, conduct, aim, value or quality that characterize or marks a profession or professional person; it implies quality of workmanship or service.
- The purpose of Code of Conduct is to lay down certain ground rules to promote ethical conduct and good practices and to deter wrong-doing and also to make the relationship mutually pleasant and productive and to enhance the sense of community with common values and mission.

TEST YOURSELF

(These are meant for recapitulation only, Answer to these questions are not to be submitted for evaluation)

1. Define ethics and the various types of ethics.
2. What are principles which should be adopted by the company Secretaries to become successful?
3. Describe the duties of professional which are to be performed by every professional.
4. Define the common causes of loss of ethics and values by professionals.
5. Prepare a Ethical Decision Worksheet for the below situation. Assume facts. "X has to take a decision, where the best service provider is his near relative".
6. As a Company Secretary, prepare a note differentiating between concept of Ethics and Values.

GLOSSARY

Descriptive Ethics: It deals with what people actually believe (or made to believe) to be right or wrong, and accordingly holds up the human actions acceptable or not acceptable or punishable under a custom or law. Descriptive Ethics is also called comparative ethics because it compares the ethics or past and present; ethics of one society and other.

Normative Ethics: It deals with "norms" or set of considerations how one should act. Thus, it's a study of "ethical action" and sets out the rightness or wrongness of the actions. It is also called prescriptive ethics because it rests on the principles which determine whether an action is right or wrong.

Meta-Ethics or "analytical ethics": It deals with the origin of the ethical concepts themselves. It does not consider whether an action is good or bad, right or wrong. Rather, it questions – what goodness or rightness or morality itself is. It is basically a highly abstract way of thinking about ethics.

Applied Ethics: It deals with the philosophical examination, from a moral standpoint, of particular issues in private and public life which are matters of moral judgment.

Beneficence: The principle of beneficence guides the decision maker to do what is right and good. This principle stipulates that ethical theories should strive to achieve greatest amount of good because people benefit from the most good.

Least Harm: This theory deals with situations in which no choice appears beneficial.

Utilitarian: This is a normative ethical theory that places the locus of right and wrong solely on the outcome or consequences of choosing one action/policy over other.

LIST OF FURTHER READINGS

Articles by the professionals and Firms

- Chartered Secretary: ICSI, New Delhi
- Guidance Note on Code of Conduct for Company Secretaries

OTHER REFERENCES (Including Websites / Video Links)

- http://www.icsi.edu/media/webmodules/unearthing-corporate-frauds.pdf
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Non-Compliances, Penalties and Adjudications

Lesson 6

KEY CONCEPTS

■ Offences ■ Cognizable Offence ■ Non-Cognizable Offences ■ Adjudication ■ Special Court ■ Penalties ■ Fine ■ Tribunal ■ SFIO

Learning Objectives

To understand:

- Non-Compliances under the Companies Act, 2013
- Penalties and Adjudications
- Prosecution procedures
- Complaints by Registrar and Serious Fraud Investigation Office
- Tribunals

Lesson Outline

REGULATORY FRAMEWORK

- The Companies Act, 2013
- The Companies (Adjudication of Penalties) Rules, 2014
- The SEBI Act, 1992
- The Securities Contracts (Regulation) Act, 1956
- The FEMA Act, 1999

INTRODUCTION

The efficacy of any statute depends upon the readiness with which the laws are enforced by punishing those who violate the law. Needless to say that laws provide regulatory mechanism to ensure that the activities, be it economic or social, are carried on in an orderly manner for the benefit of the country and its people.

Non-compliance of law by any section of society will have deleterious effect on the economy, particularly in the case of economic legislations like the Company Law, FEMA, Income-tax Act etc. In order to check such tendencies, penal provisions form an integral part of any statute and they are administered by the courts, tribunals etc. The more serious offences are considered as criminal offences which, on conviction, will result in either imprisonment for a definite term or fine or both. Such offences are indulged in by some sections of our society. Hence prosecution of such offenders requires greater degree of skill and preparation without which the offenders will go scot free from the clutches of law.

The Companies Act, 2013('Act') provides for various compliance norms that are essential for corporate operation and protecting the rights of stakeholders. Violations of such norms lead to offences with associated penalties and other consequences. To understand these provisions, it is essential to understand the meaning of terms - civil law and criminal law.

Particulars	Civil Law	Criminal Law
Deals with	Private disputes or defaults.	Offences that are committed against the society.
Objective	To resolve or redress and to make good the loss or damages suffered by one party on account of any act or omission by other party.	To punish the offender and is reflection of the public policy of a country.
Power of Court	The court in such cases can only pass judgement to compensate for damage done to the aggrieved party.	In these cases the court is empowered to charge a fine, imprison the guilty of a crime, or discharge the defendant.

Thus, the Companies Act, 2013 is mixture of both civil as well as criminal provisions. The civil and criminal provisions under the Act can be identified by observing the language used by Act, for consequences of non-compliances/contravention of its provisions. The words "liable to penalties" denote civil nature of non-compliances, whereas the words "punishable with fine and/or imprisonment and/or both" denote criminal nature of non-compliances.

NON-COMPLIANCES UNDER COMPANIES ACT, 2013

Various sections of the Companies Act 2013 provides relating to that section, as to what are the documents to be maintained by company, procedure to be followed by the company and the filing requirement and the specified time. Non-adherence of any of the provisions of the Companies Act attracts fine at the first place for the delayed compliance and penalty at the second place for the violation / non-adherence of the provisions of

the Act. In the process, for setting right the complaint, there is also the compounding procedure spelled out in the Act.

It is incorrect to come to a conclusion that the late compliance or delayed compliance set right everything and there is no violation. Violation is continue to be there for the company for the period it remained non-compliance and it definitely attracts penalty under the provisions of the Companies Act. Either the company could file suo-moto compounding application to set right the matter in order or the Regulator could take the required action later.

Difference between Fine & Penalty

Fine	Penalty
A fine is a penalty of money that a court of law or other authority decides has to be paid as punishment for a crime or other offense.	Penalty is "a punishment imposed for breaking a law, rule, or contract." In general language a penalty is imposed by an appropriate authority when a person have not complied with the law but have not committed any offence.
Fine has been used as punished for criminal offence.	Penalty has been used to indicate civil offence
Fine can be imposed only by a court of law.	penalty may be imposed even by an administrative officer.
Fine is imposed as a punitive measure.	Penalty is imposed as a compensatory measure or for breach of civil obligation.

Offences to be Non-cognizable [Section 439]

The terms 'Offences' is not defined under the Act. However, a general interpretation of the term can be derived from The Macmillan Dictionary as:

> *"a crime or illegal activity for which there is a punishment".*

As per Section 2(n) of the Code of Criminal Procedure, 1973 (CrPC), an Offence is defined as:

> *"any act or omission made punishable by any law for the time being in force and includes any act in respect of which a complaint may be made under section 20 of the Cattle Trespass Act, 1871".*

An Offence in a company may be done either by connivance i.e. when the officers of the Company are aware of an unlawful act being committed or by inadvertence i.e. when it was done accidently or unknowingly.

Section 439 of the Act prescribes that all the offences under the Act shall be non-cognizable except for the offences prescribed under section 212(6) i.e. those involving fraud.

> A non-cognizable offence as per section 2(l) of the CrPC means an offence for which, a police officer has no authority to arrest without a warrant.

According to section 439 of the Act:

1. No court shall take cognizance of any offence under this Act which is alleged to have been committed by any company or any officer thereof, except on the complaint in writing of the Registrar, a shareholder or a member of the company, or of a person authorised by the Central Government in that behalf:

   Provided that the court may take cognizance of offences relating to issue and transfer of securities and non-payment of dividend, on a complaint in writing, by a person authorised by the SEBI:

Provided further that nothing in this sub-section shall apply to a prosecution by a company of any of its officers.

2. Where the complainant mentioned above is the Registrar or a person authorised by the Central Government, the presence of such officer before the Court trying the offences shall not be necessary unless the court requires his personal attendance at the trial.

3. The provisions mentioned above shall not apply to any action taken by the liquidator of a company in respect of any offence alleged to have been committed in respect of any of the matters in Chapter XX or in any other provision of this Act relating to winding up of companies.

Explanation. – The liquidator of a company shall not be deemed to be an officer of the company within the meaning of sub-section (2).

Exception:

In case of government company, in Sub-section (2) of Section 439 the words "the Registrar, a shareholder of the company, or of" shall be omitted. - Notification dated 5th June, 2015

Offences to be Cognizable and Non-Bailable under Section 212(6)

As per Section 2(c) of the Code of Criminal Procedure, 1973 "cognizable offence" means an offence for which, and "cognizable case" means a case in which, a police officer may, in accordance with the First Schedule or under any other law for the time being in force, arrest without warrant;

Section 212(6) provides, offence covered under section 447 of the Companies Act, 2013 shall be cognizable and no person accused of any offence under those sections shall be released on bail or on his own bond unless-

(i) the Public Prosecutor has been given an opportunity to oppose the application for such release; and

(ii) where the Public Prosecutor opposes the application, the court is satisfied that there are reasonable grounds for believing that he is not guilty of such offence and that he is not likely to commit any offence while on bail:

Provided that a person, who, is under the age of sixteen years or is a woman or is sick or infirm, may be released on bail, if the Special Court so directs:

Provided further that the Special Court shall not take cognizance of any offence referred to this sub-section except upon a complaint in writing made by –

(i) the Director, Serious Fraud Investigation Office; or

(ii) any officer of the Central Government authorized, by a general or special order in writing in this behalf by that Government.

Except for instances of defaults listed herein, all other acts or omissions under the Act have been classified as offences punishable with (a) fine only, or (b) fine or imprisonment, or (c) fine or imprisonment or both, or (d) imprisonment only or (e) fine and imprisonment as may be prescribed under the relevant sections.

Further, wherever any section of the Act is silent on quantum of punishment or penalty for non-compliances, Section 450 of the Act comes into play and makes all such non-compliances are liable to a penalty of ten thousand rupees, and in case of continuing contravention, with a further penalty of one thousand rupees for each day after the first during which the contravention continues, subject to a maximum of two lakh rupees in case of a company and fifty thousand rupees in case of an officer who is in default or any other person.

Broadly the offences under the Act are classified, for the purpose of punishment, into two categories, namely, –

(a) offences involving frauds, and

(b) other offences.

The offences involving frauds are subject to punishment prescribed under section 447 of the Act. The other offences are punishable with such quantum of fine and/or imprisonment as prescribed under the respective sections.

Further, the offences under Act are also classified into:

In accordance with section 441(6) of the Act, an offence punishable under the Act with imprisonment only or with imprisonment and also with fine is a non-compoundable offence. Accordingly, all other offences, i.e., offences punishable with (a) fine only, or (b) fine or imprisonment and (c) fine or imprisonment or both are compoundable offences under the Act.

Decriminalisation of Offences under the Companies Act, 2013- Reduction in Penalties

The roots of necessity to decriminalize certain compoundable offences are elevated from the Ministry of Corporate Affairs (MCA) vide order dated 13.07.2018, wherein, the MCA has constituted a review Committee under the Chairmanship of Mr. Injeti Srinivas, to review the offences which are prescribed under the Act and to analyse, examine and peruse the need to decriminalize some of the offence by making recommendation to the Central Government inter-alia on re-categorisation of certain 'acts' punishable as compoundable offences to 'acts' carrying civil liabilities, improvements to be made in the in-house adjudication mechanism etc.

Based on the recommendations made by the Committee, the Central Government brought in relevant changes by passing of the Companies (Amendment) Act, 2019. Despite the ease in penal pressure brought about by the above enactment, the Government continued to feel the acute need to further liberalise and relax the stringent penal provisions of the Act. This clubbed with the urge to promote ease of doing business and to foster growth of corporates, led to the constitution of the Company Law Committee in September 2019. Company Law Committee recommended for the decriminalization of the Companies Act, 2013, as the much needed change in today's corporate world.

In line with global practices, it is essential to strike a balance between civil and criminal liabilities for corporates. It was noted that serious violations of the law, especially wrongful conduct involving fraudulent elements, should be dealt with under criminal law, due to the nature of such wrongs and the degree of public interest involved, it may be prudent to adopt a strict approach to fraudulent conduct.

However, procedural, technical and minor non-compliances, especially the ones not involving subjective determinations, may be dealt with through civil jurisdiction instead of criminal. The Companies (Amendment) Act, 2020 removes the imprisonment for certain offenses, substitutes fine by penalty in and reduces amount of payable as penalty across the board. In certain minor omissions, etc. penal consequence has been omitted.

It is important to note that the default or non-compliances of provisions of the Act also attracts restrictions, ineligibility or withdrawal of benefits provided under the Act in addition to liability to pay penalties. For e.g., default or failure in compliance with the provisions of section 92 (Annual Return) and/or section 137 (filing of financial statements) will, depending upon the period of default or failure, result into:

(a) withdrawal of exemptions available to a private company,

(b) company becoming ineligible to undertake buy-back of its equity shares or other specified securities,

(c) disqualification of directors, and

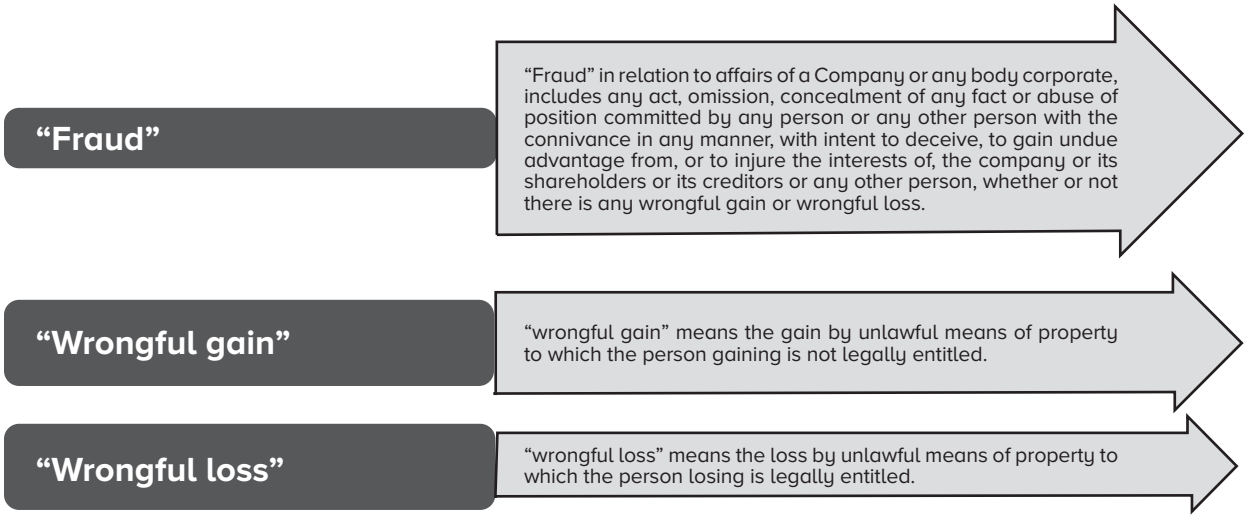
(d) company being classified into an inactive company etc.

Following is overview of penal provisions under Chapter XXIX (Miscellaneous) of the Companies Act, 2013

S. No.	Section	Particulars
1)	447	Punishment for frauds
2)	448	Punishment for false statement
3)	449	Punishment for false evidence
4)	450	Punishment where no specific penalty or punishment is provided
5)	451	Punishment in case of repeated default
6)	452	Punishment for wrongful withholding of property
7)	453	Punishment for improper use of 'Limited' or 'Private Limited'
8)	454	Adjudication of Penalties
9)	454A	Penalties for repeated defaults

Section 447- Punishment for Fraud

Key definitions relating to 'fraud':



Section 447 of the Act, stipulates that without prejudice to any liability including repayment of any debt under this Act or any other law for the time being in force, any person who is found to be guilty of:

Fraud	Punishments
Involving an amount of at least Rs. 10 Lakhs or 1% of the turnover of the company, whichever is lower	• imprisonment for a term which shall not be less than 6 months but which may extend to 10 years; and • shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud.
Where the fraud in question involves public interest	• term of imprisonment shall not be less than 3 years

Involves an amount less than Rs. 10 Lakhs or 1% of the turnover of the company, whichever is lower, and does not involve public interest, any person guilty of such fraud shall be punishable with:	• imprisonment for a term which may extend to 5 years or with fine which may extend to Rs. 50 Lakhs or with both.

The several sections of the Companies Act, 2013 refer to section 447 for punishing fraudulent conduct, the list of all such sections is as under:

S. No.	Section	Punishment for fraudulent conduct under the Companies Act, 2013
1	7(5) & (6)	fraud/false information during incorporation of company
2	8(11) Proviso	Formation of companies with charitable objects, etc.- fraudulent conduct of affairs
3	34	Criminal liability for misstatements in prospectus
4	36	Punishment for fraudulently inducing persons to invest money
5	38(1)	Punishment for personation for acquisition, etc., of securities
6	46(5)	Fraud in connection with duplicate Certificate of Shares
7	56(7)	Depository or depository participant, with an intention to defraud a person, has transferred shares
8	66(10)	Reduction of Share Capital fraud
9	76A Proviso	Punishment for contravention of section 73 or section 76
10	86	Wilfully furnishes any false or incorrect information or knowingly suppresses any material information
11	90(12)	False/incorrect information or suppression of any material information in respect of significant beneficial ownership
12	140(5) Proviso	Removal of Auditor involved in fraud
13	206(4) Proviso	Power to call for information, inspect books and conduct enquires - conducting affairs of the company in a fraudulent manner
14	213 Proviso	Investigation into company's affairs in other cases
15	229	Penalty for furnishing false statement, mutilation destruction of documents
16	251(1)	Fraudulent application for removal of name
17	339(3)	Liability for fraudulent conduct of business
18	448	Punishment for false statement

CASE LAW

In Re *Komal Chadha Vs. Serious Fraud Investigation Office, high Court of Delhi BAIL APPLN. NO. 1740 OF 2022*, The accused-petitioner was summoned in the matter through the summoning order made by the Special Judge (Companies Act) stating that she was the director of PPPL (first accused), being the wife of Suman Chadha, who was the other director of the company.

The gravamen of the offences alleged under section 447 of the Companies Act, 2013 was that the company, which was engaged in the trade of plastic granules, indulged in cash sales, in fictitious sale of food grain and in creation of accommodation/adjustment accounting entries, apart from misuse of cheque discounting

facilities. It was also alleged that the company manipulated financial statements, to project substantial growth in its revenues, to mislead banks, so as to induce them to extend and enhance credit limits, which monies were not used towards the business activity of the company but were diverted and siphoned-off to other entities, with no genuine underlying business transactions, thereby indulging in fraudulent diversion of funds to sister concerns.

This order which was based upon the criminal complaint filed by the SFIO under section 212(15), showed that the role ascribed to the petitioner was that of being an 'officer who was in default' within the meaning of section 2(60), since the petitioner was a director of the company and was liable for the affairs of the company under section 212(14).

Hence, petitioner being accused sought regular bail in the matter.

It was held that since there was no allegation against petitioner either intimidating any witnesses or tampering with evidence or otherwise interfering in course of investigation, she was to be admitted to regular bail

Section 448-Punishment for False Statement

If in any return, report, certificate, financial statement, prospectus, statement or other document required by, or for, the purposes of any of the provisions of this Act or the rules made thereunder, any person makes a statement,—

(a) which is false in any material particulars, knowing it to be false; or

(b) which omits any material fact, knowing it to be material,

he shall be liable under section 447 (Punishment for Fraud).

CASE LAW

In Re *Usha Martin Telematics Ltd. Vs. Registrar of Companies C.R.R. 494 OF 2019, High Court Of Calcutta*, the petitioner company applied to Reserve Bank of India for being registered as Core Investment Company (CIC) pursuant to Core Investment Companies (Reserve Bank) Directions, 2011 following which Reserve Bank of India sought certain clarifications and documents from petitioner company.

A meeting of Board of Directors of company was held and in course of preparing minutes of said meeting in compliance with section 118(1), it was erroneously recorded in minutes that company submitted application with Reserve Bank of India for its de-registration as NBFC and registration as a CIC. Such recording was an inadvertent/typographical error as company was not a registered Non-Banking Financial Company (NBFC) at relevant time and question of de-registration as NBFC did not arise, however, said error was detected by company subsequently and in a meeting of its Board of Directors said error was rectified.

A complaint case was filed by opposite party before Special Court, for offence punishable under section 118, read with section 448.

It was held that the typographical/inadvertent error in recording of minutes which was rectified subsequently could under no stretch of imagination be termed as an offence, far less an offence under provisions of Companies Act as alleged. The complaint lodged by opposite party did not prima facie reflect intent to deceive, gain undue advantage or injure interest of company or any person connected thereto on part of petitioners and, therefore, proceeding in respect of complaint case was liable to be quashed.

Section 449-Punishment for False Evidence

if any person intentionally gives false evidence—

(a) upon any examination on oath or solemn affirmation, authorized under this Act; or

(b) in any affidavit, deposition or solemn affirmation, in or about the winding up of any company under this Act, or otherwise in or about any matter arising under this Act,

he shall be punishable with imprisonment for a term which shall not be less than three years but which may extend to seven years and with fine which may extend to Rs. 10 Lakhs.

Section 450-Punishment Where No Specific Penalty or Punishment is Provided

If a company or any officer of a company or any other person contravenes any of the provisions of this Act or the rules made thereunder, or any condition, limitation or restriction subject to which any approval, sanction, consent, confirmation, recognition, direction or exemption in relation to any matter has been accorded, given or granted, and for which no penalty or punishment is provided elsewhere in this Act:	• the company and every officer of the company who is in default or such other person shall be liable to a penalty of Rs. 10,000, and • in case of continuing contravention, with a further penalty of Rs. 1000 for each day after the first during which the contravention continues, subject to a maximum of Rs. 2 Lakhs in case of a company and Rs. 50,000 in case of an officer who is in default or any other person.

CASE LAW

In Re *Doha Brokerage & Financial Services Ltd. Vs. Registrar of Companies C.P. NO. 13 (KOB) OF 2020 National Company Law Tribunal, Kochi Bench*, it was held that the petitioner sought compounding of offence punishable under section 450, wherein petitioner-company allotted equity shares to its subsidiary company in violation of section 19 (Subsidiary Company not to Hold Shares in its Holding Company), each officer in default as members of Board of Directors was to be subjected to a fine of Rs. 5000 as a deterrent for not repeating default in future and offence was ordered to be compounded subject to remittance of compounding fee imposed.

Section 451- Punishment in Case of Repeated Default

If a company or an officer of a company commits an offence punishable either with fine or with imprisonment and where the same offence is committed for the second or subsequent occasions within a period of three years, then, that company and every officer thereof who is in default shall be punishable with twice the amount of fine for such offence in addition to any imprisonment provided for that offence.

In Re *Pahuja Takii Seed Ltd. Vs. Registrar of Companies, NCT of Delhi & Haryana Company Appeal (AT)* Nos. 80 to 83 of 2018 National Company Law Appellate Tribunal, New Delhi, in this matter it was held that there is no bar on preferring a single application for compounding same offence committed during different financial years by company and its officers.

Section 452- Punishment for Wrongful Withholding of Property.

(1) If any officer or employee of a company—

(a) wrongfully obtains possession of any property, including cash of the company; or

(b) having any such property including cash in his possession, wrongfully withholds it or knowingly applies it for the purposes other than those expressed or directed in the articles and authorised by this Act,

he shall, on the complaint of the company or of any member or creditor or contributory thereof, be punishable with fine which shall not be less than Rs. 1 lakh but which may extend to Rs. 5 Lakhs.

(2) The Court trying an offence under sub-section (1) may also order such officer or employee to deliver up or refund, within a time to be fixed by it, any such property or cash wrongfully obtained or wrongfully withheld or knowingly misapplied, the benefits that have been derived from such property or cash or in default, to undergo imprisonment for a term which may extend to 2 years.

Further, imprisonment of such officer or employee, as the case may be, shall not be ordered for wrongful possession or withholding of a dwelling unit, if the court is satisfied that the company has not paid to that officer or employee, as the case may be, any amount relating to-

(a) provident fund, pension fund, gratuity fund or any other fund for the welfare of its officers or employees, maintained by the company;

(b) compensation or liability for compensation under the Workmen's Compensation Act, 1923 in respect of death or disablement.

Section 453 - Punishment for Improper Use of "Limited" or "Private Limited"

If any person or persons trade or carry on business under any name or title, of which the word "Limited" or the words "Private Limited" or any contraction or imitation thereof is or are the last word or words, that person or each of those persons shall, unless duly incorporated with limited liability, or unless duly incorporated as a private company with limited liability, as the case may be, punishable with fine which shall not be less than Rs. 500 but may extend to Rs. 2000 for every day for which that name or title has been used.

Comprehensive list of Penalties under the Companies Act, 2013

Sections	Particulars	Penalty
Section 4(5) – Reservation of Name	After reservation of name, if information given is not correct then: If the company has not been incorporated, the reserved name shall be cancelled; and	● the person making application shall be liable to a penalty which may extend to Rs. 1 Lakh.

Section 10A- Commencement of business etc.	If any default is made in complying with the requirements of this section	● the company shall be liable to a penalty of Rs.50,000 and ● every officer who is in default shall be liable to a penalty of Rs.1000 for each day during which such default continues but not exceeding an amount of Rs. 1 Lakh.
Section 12(8)-Registered office of company	If any default is made in complying with the requirements of this section	● the company and every officer who is in default shall be liable to a penalty of Rs.1000 for every day during which the default continues but not exceeding Rs. 1 Lakh.
Section 15(2)-Alteration of Memorandum or Articles to be noted in every copy	Default in noting alteration made in the memorandum or articles of a company in every copy of the memorandum or articles	● the company and every officer who is in default shall be liable to a penalty of Rs.1000 for every copy of the memorandum or articles issued without such alteration.
Section 16(3)-Rectification of Name of Company	If a Company makes any default in registration of name as in the opinion of Central Government the name for registration is identical to the name of company already registered	● the Central Government shall allot a new name to the company in such manner as prescribed and the Registrar shall enter the new name in the register of companies in place of the old name and issue a fresh certificate of incorporation with the new name, which the company shall use thereafter.
Section 17(2)- Copies of memorandum, articles, etc., to be given to members	If on request of member, company has not provided them a copy of: (i) MOA; (ii) AOA; and (iii) every agreement and every resolution referred in sub-section (1) of section 117	● the company and every officer of the company who is in default shall be liable for each default, to a penalty of Rs.1000 for each day during which such default continues or Rs. 1 lakh, whichever is less.
Section 33(3)- Issue of Application Forms for Securities	Any default in complying with the provisions of this section	● Company shall be liable to a penalty of Rs.50,000 for each default.
Section 39(5)-Allotment of Securities by Company	(i) If the company has not returned the application money received (ii) If a company having a share capital has not filed return of allotment with Registrar	● the company and its officer who is in default shall be liable to a penalty, for each default, of Rs.1000 for each day during which such default continues or Rs. 1 Lakh, whichever is less.

Section 42(9)- Offer or invitation for subscription of securities on private placement	Defaults in filing the return of allotment within the period prescribed	● the company, its promoters and directors shall be liable to a penalty for each default of Rs.1000 for each day during which such default continues but not exceeding Rs.25 Lakh.
Section 42(10)- Offer or invitation for subscription of securities on private placement	If a company makes an offer or accepts monies in contravention of this section	● the company, its promoters and directors shall be liable for a penalty which may extend to the amount raised through the private placement or Rs.2 Crore, whichever is lower, and ● the company shall also refund all monies with interest to subscribers within a period of thirty days of the order imposing the penalty.
Section 53(3)-Prohibition on issue of shares at discount	Failure of company to comply with the provisions of this section	● such company and every officer who is in default shall be liable to a penalty which may extend to an amount equal to the amount raised through the issue of shares at a discount or Rs.5 Lakhs, whichever is less, and ● the company shall also be liable to refund all monies received with interest at the rate of 12% per annum from the date of issue of such shares to the persons to whom such shares have been issued.
Section 56(6)- Transfer and Transmission of Securities	If a Company make any default in the provisions of transfer or transmission of Shares	● the company and every officer of the company who is in default shall be liable to a penalty of Rs.50,000.
Section 60(2)-Publication of authorised, subscribed and paid-up capital	If any default is made in complying with the provisions of publication of Authorised, Subscribed and Paid-Up Capital on Companies letter heads, business heads	● the company shall be liable to pay a penalty of Rs.10,000 and ● every officer of the company who is in default shall be liable to pay a penalty of Rs.5000, for each default.
Section 64(2)-Notice to be Given to Registrar for Alteration of Share Capital	If a Company fails to send notice to Registrar after alteration of Share Capital	● such company and every officer who is in default shall be liable to a penalty of Rs.500 for each day during which such default continues, subject to a maximum of Rs.5 Lakh in case of a company; and ● Rs.1 Lakh in case of an officer who is in default.
Section 86- Punishment for contravention of provisions of Charges	If a Company contravenes the provisions of Chapter VI- Registration of Charges	● the company shall be liable to a penalty of Rs.5 Lakh; and ● every officer of the company who is in default shall be liable to a penalty of Rs.50,000.

Section 88(5)- Register of Members, etc.	If a company does not maintain a register of members or debenture-holders or other security holders or fails to maintain them in accordance with the provisions of sub-section (1) or sub-section (2)	● the company shall be liable to a penalty of Rs.3 Lakhs; and ● every officer of the company who is in default shall be liable to a penalty of Rs.50,000.
Section 89-Declaration in Respect of Beneficial Interest in any Share	(i) If any person fails to make a declaration (ii) If a company, required to file a return under sub-section (6), fails to do so before the expiry of the time specified therein	● he shall be liable to a penalty of Rs.50000 and in case of continuing failure, with a further penalty of Rs.200 for each day after the first during which such failure continues, subject to a maximum of Rs.5 Lakhs. ● the company and every officer of the company who is in default shall be liable to a penalty of Rs.1,000 for each day during which such failure continues, subject to a maximum of Rs. 5 Lakhs in the case of a company and Rs. 2 Lakhs in case of an officer who is in default.
Section 90- Register of significant beneficial owners in a company	(i) If any person fails to make a declaration as required under sub-section (1) (ii) If a company, required to maintain register under sub-section (2) and file the information under sub-section (4) or required to take necessary steps under sub-section (4A), fails to do so or denies inspection as provided therein.	● he shall be liable to a penalty of Rs.50,000 and in case of continuing failure, with a further penalty of Rs.1,000 for each day after the first during which such failure continues, subject to a maximum of Rs. 2 Lakhs. ● the company shall be liable to a penalty of Rs.1 Lakh and in case of continuing failure, with a further penalty of Rs. 500 for each day, after the first during which such failure continues, subject to a maximum of Rs. 5 Lakh; and ● every officer of the company who is in default shall be liable to a penalty of Rs. 25,000 and in case of continuing failure, with a further penalty of Rs. 200 for each day, after the first during which such failure continues, subject to a maximum of Rs. 1 Lakh.

Section 91(2)-Power to Close Register of Members or Debenture-Holders or Other Security Holders.	If the register of members or of debenture-holders or of other security holders is closed without giving the notice as provided in sub-section (1), or after giving shorter notice than that so provided, or for a continuous or an aggregate period in excess of the limits specified in that sub-section	● the company and every officer of the company who is in default shall be liable to a penalty of Rs.5000 for every day subject to a maximum of Rs.1 Lakh during which the register is kept closed.
Section 92(5)-Annual Return	(i) If any company fails to file its annual return , before the expiry of the period specified therein (ii) If a company secretary in practice certifies the annual return otherwise than in conformity with the requirements of this section or the rules made thereunder	● such company and its every officer who is in default shall be liable to a penalty of Rs.10,000 and in case of continuing failure, with further penalty of Rs.100 for each day during which such failure continues, subject to a maximum of Rs.2Lakhs in case of a company and Rs.50,000 in case of an officer who is in default. ● he shall be liable to a penalty of Rs.2 Lakhs
Section 94(4)-Place of keeping and Inspection of Registers, Returns, etc.	If Company refuses to give copy of registers or to take extract thereof or deny inspection	● the company and every officer of the company who is in default shall be liable, for each such default, to a penalty of Rs.1000 for every day subject to a maximum of Rs.1 Lakh during which the refusal or default continues.
Section 99-Punishment for default in complying with provisions of sections 96 to 98.	If Company defaults in holding meeting in accordance with Section 96, 97 or 98 or in complying with any directions of the Tribunal	● the company and every officer of the company who is in default shall be punishable with fine which may extend to Rs.1 Lakh and ● in the case of a continuing default, with a further fine which may extend to Rs.5000 for every day during which such default continues.
Section 102(5)-Statement to be Annexed to Notice.	if any default is made in complying with the provisions of this section,	● every promoter, director, manager or other key managerial personnel of the company who is in default shall be liable to a penalty of Rs.50,000 or five times the amount of benefit accruing to the promoter, director, manager or other key managerial personnel or any of his relatives, whichever is higher.
Section 105(3)-Proxies	If any officer fails to annex a statement along with notice with regard to proxy.	● every officer of the company who is in default shall be liable to penalty of Rs.5,000.

Section111(5)-Circulation of Members' Resolution	If any default is made in complying with the provisions of this section	● the company and every officer of the company who is in default shall be liable to a penalty of Rs.25,000.
Section 117(2)-Resolutions and Agreements to be Filed	If any company fails to file the resolution or the agreement under sub-section (1) before the expiry of the period specified therein	● such company shall be liable to a penalty of Rs.10,000 and in case of continuing failure, with a further penalty of Rs.100 for each day after the first during which such failure continues, subject to a maximum of Rs.2 Lakhs; and ● every officer of the company who is in default including liquidator of the company, if any, shall be liable to a penalty of Rs.10,000 and in case of continuing failure, with a further penalty of Rs.100 for each day after the first during which such failure continues, subject to a maximum of Rs.50,000.
Section 118-Minutes of proceedings of general meeting, meeting of Board of Directors and other meeting and resolutions passed by postal ballot	If Company is not complying with the provisions of minutes of general meeting, Board Meeting and other meeting and resolutions passed by postal ballot	● the company shall be liable to a penalty of Rs.25,000; and ● every officer of the company who is in default shall be liable to a penalty of Rs. 5,000.
Section 119-Inspection of minute-books of general meeting	If Company refuses for inspection or copy of minutes of general meeting is not furnished within the time specified therein	● the company shall be liable to a penalty of Rs.25,000; and ● every officer of the company who is in default shall be liable to a penalty of Rs.5,000 for each such refusal or default, as the case may be.
Section 121-Report on Annual General Meeting	If the company fails to file the report to the ROC before the expiry of the period specified therein	● Company shall be liable to a penalty of Rs.1 Lakh and in case of continuing failure, with further penalty of Rs.500 for each day after the first during which such failure continues, subject to a maximum of Rs. 5 Lakhs; and ● Every officer of the company who is in default shall be liable to a penalty which shall not be less than Rs.25,000 and in case of continuing failure, with further penalty of Rs.500 for each day after the first during which such failure continues, subject to a maximum of Rs. 1 Lakh.

Section 124(7)- Unpaid Dividend Account	If a company fails to comply with any of the requirements of this section	● Company shall be liable to a penalty of Rs. 1 Lakh and in case of continuing failure, with a further penalty of Rs.500 for each day after the first during which such failure continues, subject to a maximum of Rs. 10 Lakhs; and ● Every officer of the company who is in default shall be liable to a penalty of twenty-five thousand rupees and in case of continuing failure, with a further penalty of one hundred rupees for each day after the first during which such failure continues, subject to a maximum of two lakh rupees.
Section 134(8)- Financial Statement, Board's Report, etc	If a company is in default in complying with the provisions of this section	● Company shall be liable to a penalty of Rs. 3 Lakhs; and ● Every officer of the company who is in default shall be liable to a penalty of Rs. 50,000.
Section 135-Corporate Social Responsibility	If a company is in default in complying with the provisions of sub-section (5) or sub-section (6) of this Section	● Company shall be liable to a penalty of twice the amount required to be transferred by the company to the Fund specified in Schedule VII or the Unspent Corporate Social Responsibility Account, as the case may be, or Rs. 1 Crore, whichever is less, and ● Every officer of the company who is in default shall be liable to a penalty of one-tenth of the amount required to be transferred by the company to such Fund specified in Schedule VII, or the Unspent Corporate Social Responsibility Account, as the case may be, or Rs. 2 Lakhs, whichever is less.
Section 136(3)- Right of Member to Copies of Audited Financial Statement	If any default is made in complying with the provisions of this section	● The company shall be liable to a penalty of Rs.25,000; and ● Every officer of the company who is in default shall be liable to a penalty of Rs.5,000.
Section 137(3)- Copy of Financial Statement to be Filed with Registrar	If a company fails to file the copy of the financial statements under sub-section (1) or sub-section (2), as the case may be, before the expiry of the period specified therein	● The company shall be liable to a penalty of Rs.10,000 and in case of continuing failure, with a further penalty of Rs.100 for each day during which such failure continues, subject to a maximum of Rs.2 Lakhs; and
		● The managing director and the Chief Financial Officer of the company, if any, and, in the absence of the managing director and the Chief Financial Officer, any other director who is charged by the Board with the responsibility of complying with the provisions of this section, and, in the absence of any such director, all the directors of the company, shall be liable to a penalty of Rs.10,000 and in case of continuing failure, with further penalty of Rs.100 for each day after the first during which such failure continues, subject to a maximum of Rs.50,000.

Section 140(3)- Removal, Resignation of Auditor and Giving of Special Notice	Failure of the auditor to intimate regarding his resignation	● he or it shall be liable to a penalty of Rs.50,000 or an amount equal to the remuneration of the auditor, whichever is less, and in case of continuing failure, with further penalty of Rs. 500 for each day after the first during which such failure continues, subject to a maximum of Rs. 2 Lakhs.
Section 143(15)- Powers and Duties of Auditors and Auditing Standards	If any auditor, cost accountant, or company secretary in practice does not comply with the provisions of sub-section (12)	He shall: (a) in case of a listed company, be liable to a penalty of Rs.5 lakh; and (b) in case of any other company, be liable to a penalty of Rs. 1 Lakh.
Section 157(2)- Company to Inform Director Identification Number to Registrar	If a company fails to furnish Director Identification Number	● Company shall be liable to a penalty of Rs.25,000 and in case of continuing failure, with further penalty of Rs. 100 for each day after the first during which such failure continues, subject to a maximum of Rs. 1 Lakh, and ● Every officer of the company who is in default shall be liable to a penalty of not less than Rs. 25,000 and in case of continuing failure, with further penalty of Rs. 100 for each day after the first during which such failure continues, subject to a maximum of Rs. 1 Lakh.
Section 159-Penalty for Default of Certain Provisions	If any individual or director of a company makes any default in complying with any of the provisions of section 152, section 155 and section 156	● Such individual or director of the company shall be liable to a penalty which may extend to Rs. 50,000 and where the default is a continuing one, with a further penalty which may extend to Rs. 500 for each day after the first during which such default continues.
Section 165- Number of Directorships	If a person accepts an appointment as a director in violation of this section	● he shall be liable to a penalty of Rs. 2000 for each day after the first during which such violation continues, subject to a maximum of Rs. 2 Lakhs.
Section 172- Penalty	If a company is in default in complying with any of the provisions of Chapter X-Appointment and Qualifications of Directors and for which no specific penalty or punishment is provided therein	● Company and every officer of the company who is in default shall be liable to a penalty of Rs. 50,000, and in case of continuing failure, with a further penalty of Rs. 500 for each day during which such failure continues, subject to a maximum of Rs. 3 Lakhs in case of a company and Rs. 1 Lakh in case of an officer who is in default.
Section 173(4)- Meetings of Board	Every officer of the company whose duty is to give notice under this section and who fails to do so	● Liable to penalty of Rs. 25,000

Section 178(8)- Nomination and Remuneration Committee and Stakeholders Relationship Committee	In case of any contravention of the provisions of section 177 and 178	● Company shall be liable to a penalty of Rs. 5 Lakhs; and ● Every officer of the company who is in default shall be liable to a penalty of Rs. 1 Lakh.
Section 184(4)- Disclosure of Interest by Director	If a director of the company contravenes the provisions of sub-section (1) or sub-section (2) of Section 184	● such director shall be liable to a penalty of Rs. 1 Lakh.
Section 187(4)- Investments of Company to be Held in its Own Name	If a company is in default in complying with the provisions of this section	● Company shall be liable to a penalty of Rs. 5 Lakhs; and ● Every officer of the company who is in default shall be liable to a penalty of Rs. 50,000.
Section 188(5)- Related Party Transactions	Any director or any other employee of a company, who had entered into or authorised the contract or arrangement in violation of the provisions of this section shall,	● In case of listed company, be liable to a penalty of Rs. 25 Lakhs; and ● In case of any other company, be liable to a penalty of Rs. 5 Lakhs.
Section 189(6)- Register of Contracts or Arrangements in Which Directors are Interested	Every director who fails to comply with the provisions of this section and the rules made thereunder shall be	● Liable to a penalty of Rs. 25,000.
Section 190(3)- Contract of Employment with Managing or Whole-Time Directors	If any default is made in complying with the provisions of sub-section (1) or sub-section (2) of this section	● Company shall be liable to a penalty of Rs. 25,000; and ● Every officer of the company who is in default shall be liable to a penalty of Rs. 5,000 for each default.
Section 191(5)- Payment to Director for Loss of Office, etc., in Connection with Transfer of Undertaking, Property or Shares	If a director of the company makes any default in complying with the provisions of this section	● Such director shall be liable to a penalty of Rs. 1 Lakh.
Section 197(15)- Overall Maximum Managerial Remuneration and Managerial Remuneration in Case of Absence or Inadequacy of Profits	If any person makes any default in complying with the provisions of this section	● He shall be liable to a penalty of Rs. 1 Lakh; and ● where any default has been made by a company, the company shall be liable to a penalty of Rs. 5 Lakhs.

Section 203(5)- Appointment of Key Managerial Personnel	If any company makes any default in complying with the provisions of this section	● Company shall be liable to a penalty of Rs. 5 Lakh; and ● Every director and key managerial personnel of the company who is in default shall be liable to a penalty of Rs. 50,000 and where the default is a continuing one, with a further penalty of Rs. 1000 for each day after the first during which such default continues but not exceeding Rs. 5 Lakhs.
Section 204-Secretarial Audit for Bigger Companies	If a company or any officer of the company or the company secretary in practice, contravenes the provisions of this section	● the company, every officer of the company or the company secretary in practice, who is in default, shall be liable to a penalty of Rs. 2 Lakhs.
Section 232(8)-Merger and Amalgamation of Companies.	If a company fails to file a certified copy of the order with the Registrar under sub-section (5),	● the company and every officer of the company who is in default shall be liable to a penalty of Rs. 20,000 and where the failure is a continuing one, with a further penalty of Rs.1000 for each day after the first during which such failure continues, subject to a maximum of Rs. 3 lakhs.
Section 238-Registration of Offer of Schemes Involving Transfer of Shares.	The director who issues a circular which has not been presented for registration and registered under clause (c) of sub-section (1)	● liable to a penalty of Rs. 1 Lakh
Section 247(3)-Valuation by Registered Valuers.	If a valuer contravenes the provisions of this section or the rules made thereunder	● The valuer shall be liable to a penalty of Rs. 50,000.
Section 378V-Meetings of Board and quorum of Producer Company	The Chief Executive shall give notice as aforesaid not less than seven days prior to the date of the meeting of the Board and if he fails to do so, he shall be	● liable to a penalty of Rs.5000.
Section 378X-Secretary of Producer Company	If a Producer Company fails to comply with the provisions of appointment of whole-time secretary	● the Company and every officer of the Company who is in default, shall be liable to a penalty of Rs. 100 for every day during which the default continues subject to a maximum of Rs. 1 Lakh.
Section 403(2) - Fee for Filing, etc.	Where a company fails or commits any default to submit, file, register or record any document, fact or information under sub-section (1) before the expiry of the period specified in the relevant section	● the company and the officers of the company who are in default, shall, without prejudice to the liability for the payment of fee and additional fee, be liable for the penalty or punishment provided under this Act for such failure or default.
Section 405(4)-Power of Central Government to Direct Companies to Furnish Information or Statistics.	If any company fails to comply with an order made under sub-section (1) or sub-section (3), or furnishes any information or statistics which is incorrect or incomplete in any material respect	● the company and every officer of the company who is in default shall be liable to a penalty of Rs. 20,000 and in case of continuing failure, with a further penalty of Rs. 1000 for each day after the first during which such failure continues, subject to a maximum of Rs. 3 Lakhs.

Section 446B-Penalty for small company and OPC	if penalty is payable for non-compliance of any of the provisions of this Act by a One Person Company, small company, start-up company or Producer Company, or by any of its officer in default, or any other person in respect of such company, then	● such company, its officer in default or any other person, as the case may be, shall be liable to a penalty which shall not be more than one-half of the penalty specified in such provisions subject to a maximum of Rs. 2 Lakhs in case of a company and Rs. 1 Lakh in case of an officer who is in default or any other person, as the case may be.
Section 450-Punishment Where No Specific Penalty or Punishment is Provided.	If a company or any officer of a company or any other person contravenes any of the provisions of this Act or the rules made thereunder, or any condition, limitation or restriction subject to which any approval, sanction, consent, confirmation, recognition, direction or exemption in relation to any matter has been accorded, given or granted, and for which no penalty or punishment is provided elsewhere in this Act,	● the company and every officer of the company who is in default or such other person shall be liable to a penalty of Rs. 10,000, and in case of continuing contravention, with a further penalty of Rs. 1000 for each day after the first during which the contravention continues, subject to a maximum of Rs. 2 Lakhs in case of a company and Rs. 50,000 in case of an officer who is in default or any other person.
Section 454A-Penalty for repeated default.	Where a company or an officer of a company or any other person having already been subjected to penalty for default under any provisions of this Act, again commits such default within a period of three years from the date of order imposing such penalty passed by the adjudicating officer or the Regional Director, as the case may be,	● it or he shall be liable for the second or subsequent defaults for an amount equal to twice the amount of penalty provided for such default under the relevant provisions of this Act.

ESTABLISHMENT OF SPECIAL COURTS

The provisions related to Special Courts were provided under Chapter XXVIII of the Companies Act, 2013. Although the provisions related to Special Courts i.e. Section 435 to 438 & 440 were not notified for being in force till 2016. In the Report of Companies Law Committee chaired by Shri Tapan Ray dated February 1, 2016 noted that the establishment/designation of Special Courts under the Act would result in faster prosecution of defaulting companies. The Committee recommended the early establishment/ designation of the Special Courts. It was also recommended to be considered that the Special Courts at the subordinate level may also be established, in addition to the Sessions Judge or Additional Sessions Judge.

Section 435(1) stipulates that the Central Government may, for the purpose of providing speedy trial of offences under this Act, except under section 452, by notification establish or designate as many Special Courts as may be necessary.

Consequently, Ministry of Corporate Affairs notified sections 435 to 438 and section 440 vide notification dated May 18, 2016.

Structure of Special Courts

A Special Court shall consist of—

(a) a single judge holding office as Session Judge or Additional Session Judge, in case of offences punishable under this Act with imprisonment of two years or more; and

(b) a Metropolitan Magistrate or a Judicial Magistrate of the First Class, in the case of other offences,

who shall be appointed by the Central Government with the concurrence of the Chief Justice of the High Court within whose jurisdiction the judge to be appointed is working.

Offences Triable by Special Courts (Section 436)

Notwithstanding anything contained in the Code of Criminal Procedure, 1973—

(a) all offences specified under section 435(1) shall be triable only by the Special Court established for the area in which the registered office of the company in relation to which the offence is committed or where there are more Special Courts than one for such area, by such one of them as may be specified in this behalf by the High Court concerned;

(b) where a person accused of, or suspected of the commission of, an offence under this Act is forwarded to a Magistrate under sub-section (2) or sub-section (2A) of section 167 of the Code of Criminal Procedure, 1973, such Magistrate may authorise the detention of such person in such custody as he thinks fit for a period not exceeding 15 days in the whole where such Magistrate is a Judicial Magistrate and 7 days in the whole where such Magistrate is an Executive Magistrate:

Provided that where such Magistrate considers that the detention of such person upon or before the expiry of the period of detention is unnecessary, he shall order such person to be forwarded to the Special Court having jurisdiction;

(c) the Special Court may exercise, in relation to the person forwarded to it under clause (b), the same power which a Magistrate having jurisdiction to try a case may exercise under section 167 of the Code of Criminal Procedure, 1973 in relation to an accused person who has been forwarded to him under that section; and

(d) a Special Court may, upon perusal of the police report of the facts constituting an offence under this Act or upon a complaint in that behalf, take cognizance of that offence without the accused being committed to it for trial.

When trying an offence under this Act, a Special Court may also try an offence other than an offence under this Act with which the accused may, under the Code of Criminal Procedure, 1973 be charged at the same trial.

Notwithstanding anything contained in the Code of Criminal Procedure, 1973, the Special Court may, if it thinks fit, try in a summary way any offence under this Act which is punishable with imprisonment for a term not exceeding three years:

In case of any conviction in a summary trial, no sentence of imprisonment for a term exceeding 1 year shall be passed:

Further that when at the commencement of, or in the course of, a summary trial, it appears to the Special Court that the nature of the case is such that the sentence of imprisonment for a term exceeding 1 year may have

to be passed or that it is, for any other reason, undesirable to try the case summarily, the Special Court shall, after hearing the parties, record an order to that effect and thereafter recall any witnesses who may have been examined and proceed to hear or rehear the case in accordance with the procedure for the regular trial.

CASE LAWS

In Re *S. Satyanarayana Vs. Energo Masch Power Engineering & Consulting (P.) Ltd. Criminal Appeal Nos. 516 - 518 Of 2010, Supreme Court of India*, In this case it was held that even if a number of persons are accused of offences under a special enactment such as Companies Act and as also IPC in respect of same transaction or facts and even if some could not be tried under special enactment, it is Special Court alone which would have jurisdiction to try all offences based on same transaction to avoid multiplicity of proceedings.

Roofit Industries Ltd. vs. SEBI (10th March, 2024) (Special Court)

Fact of the Case:

The three directors of Roofit Industries were found guilty of failing to fulfill the company's commitment to distribute a 5% dividend on its equity to shareholders as promised in 2001. The court opted for leniency, imposing a fine of ₹5 lakh each on the directors instead of sentencing them to jail. This decision was influenced by the directors' advanced age and frail health.

According to the prosecution, the complaint was lodged by A Chandra Sekhar Rao under the authority of the Securities and Exchange Board of India (SEBI) in accordance with Section 621 of the Companies Act, 1956. The complainant contended that SEBI, established as a body corporate under Section 3 of the SEBI Act, 1992, was mandated to safeguard investor interests in securities and regulate the Indian securities market.

The accused were the directors of Roofit Industries Ltd., a public limited company listed on the Mumbai Stock Exchange and the National Stock Exchange. The complaint alleged that during the Annual General Meeting held on October 30, 2001, the company had declared a dividend of ₹0.50 per share, totalling ₹79,94,720, to be distributed to shareholders. However, due to unforeseen financial constraints, the declared dividend could not be distributed within the stipulated 30-day period, leading the company to seek SEBI's approval to condone the delay.

SEBI, in response, issued a notice on July 26, 2002, to the managing director of RIL, questioning why criminal prosecution should not be initiated under Section 621 of the Companies Act, 1956. The notice, delivered on July 31, 2002, remained unanswered by the company. Consequently, SEBI filed the present complaint, asserting that the directors of RIL are liable for prosecution under Section 207 of the Companies Act, 1956, due to their failure to ensure timely payment of the declared dividend.

Order:

After hearing both sides, special judge ordered Rs. 5 Lakh penalty each to three directors of the Roofit Industries for knowingly failing to pay Rs. 80 lakhs dividend declared by company in 2002.

The accused were not awarded jail sentence.

https://www.hindustantimes.com/cities/mumbai-news/special-court-convicts-3-directors-of-roofit-industries-lets-them-off-only-with-fine-101710010479774.html

Section 438 stipulates that the provisions of the Code of Criminal Procedure, 1973 shall apply to the proceedings before a Special Court and for the purposes of the said provisions, the Special Court shall be deemed to be a Court of Session or the court of Metropolitan Magistrate or a Judicial Magistrate of the First Class, as the case may be and the person conducting a prosecution before a Special Court shall be deemed to be a Public Prosecutor.

The need and benefits of designating the special courts may be seen in the Para 6 of the Order dated 14.12.2018 passed by the Special Court in the matter of *Serious Fraud Investigation Office Vs. Rahul Modi and Ors.*

The extracts is as under: Admittedly as per the provisions of Section 212(3) of the Companies Act, the investigations ordered are required to be completed within the specified time. But the issue is even if it not so done, what should be consequences and whether further proceedings or investigations shall be unlawful. The answer to the mind of this court is simply no because the time frame mentioned is to complete the investigations in a time bound manner but the said time can be extended from time to time by the same authority.

The quantum of monetary impact on economy involved in corporate cases and the expertise required to deal with these cases swiftly, undoubtedly substantiates the need and importance of designation and establishment of Special Courts.

ADJUDICATION OF OFFENCES

Meaning:

"Adjudication" is the legal process by which an arbiter or judge reviews evidence and argumentation, including legal reasoning set forth by opposing parties or litigants to come to a decision which determines rights and obligations between the parties involved.

As per Ramanathan's Law Lexicon "Adjudication" is the determination of matters in dispute by the decision of a competent Court, arbitration of the determination of such matters by the decision of arbitrators, whose decision may not be binding until confirmed by a higher Court or assented to by the parties.

Genesis of Adjudication

Section 454 of the Act read with the Companies (Adjudication of Penalties) Rules, 2014 deals with the manner and procedure of adjudication of penalties. The Registrar of Companies (ROC) has been shouldered with the responsibility of adjudicating officer for their respective jurisdiction.

The Act envisages a natural justice-based mechanism of adjudication of penalties whereby the ROC has been mandated to provide reasonable opportunity of being heard to the Company and Officer in default before imposing any penalty.

It is not as if adjudication never happened before enactment of the Companies Act, 2013, for violation of certain sections in the Act. The erstwhile CLB had and now the NCLT has been adjudicating in a limited sense. However, the penal provisions which were in existence in many of the sections could not be implemented due to lack of judicial or quasi-judicial powers with the administrative authorities so much so that the show cause notices issued by the Registrar of Companies on the defaulting companies or the officers in default culminated in the launch of legal proceedings against them before a Magistrates Court or wherever compounding was possible and sought, the Regional Director could dispose of only those cases.

Clause 23 of the J.J. Irani Committee Report which is essentially the backbone of the Companies Act, 2013, recommended adjudication as a tool to empower the Registrar of Companies in levying penalties for offences under various sections of the Act to obviate the cumbersome legal process to bring the defaulters to book. Inter alia the Report stated that :

"Under the proposed "in-house" procedure, the power to impose penalty (in the form of fine) may be vested with the Registrar of Companies who is a statutory authority. Since the minimum and maximum quantum of fine would be defined in the Act, this would restrict the scope for discretionary exercise of power. However, it would be necessary to provide for a mechanism for appeals against the orders of such authorities. Such appellate authority may also be specified in the Act."

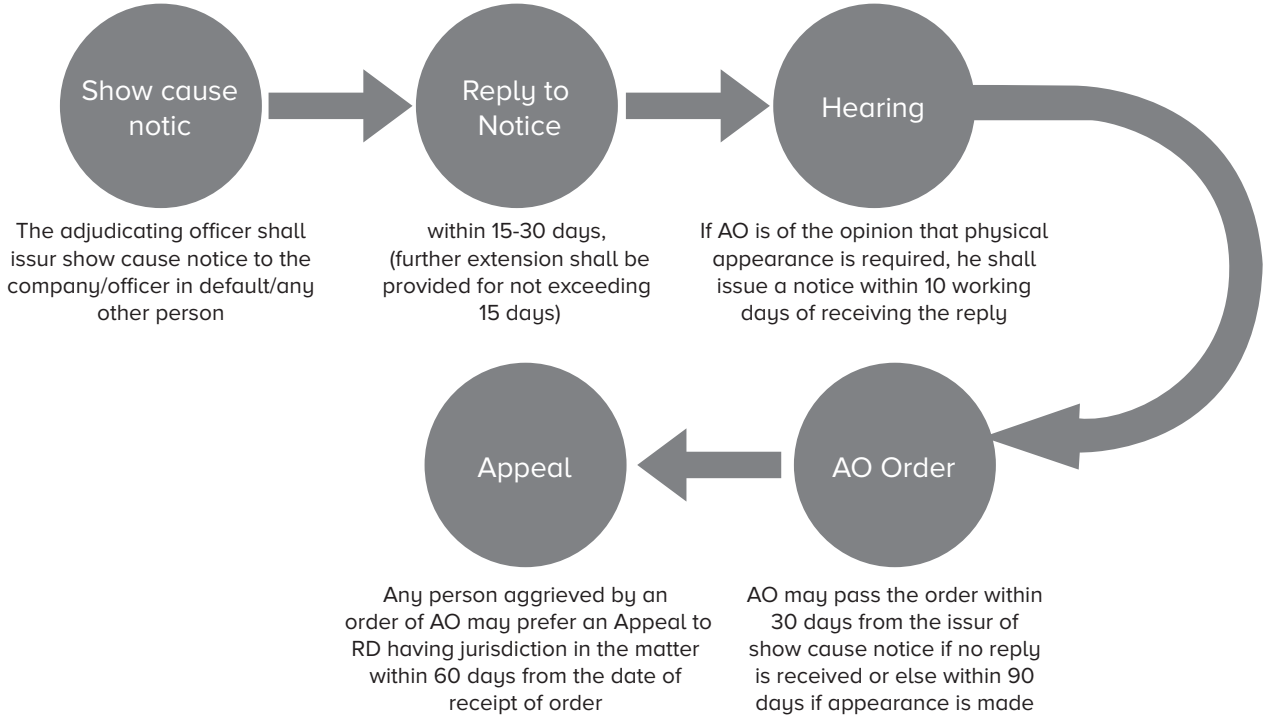
Thus, was born the formal adjudicating power which got vested with the Central Government in the form of section 454. Therefore, in exercise of the powers conferred by section 454 read with section 469 of the Companies Act, 2013, the Central Government has framed the rules titled the "Companies (Adjudication of Penalties) Rules, 2014.

Adjudication Process under the Companies Act, 2013

APPOINTMENT OF ADJUDICATING OFFICER

- Section 454 read with the Companies (Adjudication of Penalties) Rules, 2014, prescribes that the Central Government may appoint as many officers of the Central Government, not below the rank of Registrar, as adjudicating officers for adjudging penalty under the provisions of this Act in the manner as prescribed.
- Foremost Adjudication Officer will find out the defaults. Once adjudication officer will find out default will start process of adjudication.

Adjudication Process under the Companies Act, 2013



STEP-I: ISSUE OF SHOW CAUSE NOTICE TO COMPANY AND OFFICER IN DEFAULT:

- Before adjudging penalty, the adjudging officer shall issue a written notice in the specified manner, to the company, the officer who is in default or any other person, as the case may be, to show cause, within such period as may be specified in the notice (not being less than fifteen days and more than thirty days from the date of service thereon), "why the penalty should not be imposed on it or him". {Rule 3[2] of the Companies (Adjudication of Penalties) Rules, 2014)]}
- Every notice issued, shall clearly indicate the nature of non-compliance or default under the Act alleged to have been committed or made by such company, officer in default, or any other person, as the case may be and also draw attention to the relevant penal provisions of the Act and the maximum penalty which can be imposed on the company, and each of the officers in default, or the other person.
- The reply to such notice shall be filed in electronic mode only within the period as specified in the notice:

Provided that the adjudicating officer may, for reasons to be recorded in writing, extend the period referred to above by a further period not exceeding fifteen days, if the company or officer in default or any person as the

case may be, satisfies the adjudicating officer that it or he has sufficient cause for not responding to the notice within the stipulated period or the adjudicating officer has reason to believe that the company or the officer or the person has received a shorter notice and did not have reasonable time to give reply.

STEP-II: ENQUIRY BY ADJUDICATION OFFICER- NOTICE FOR HEARING:

- If, after considering the reply submitted by such company, its officer, or any other person, as the case may be, the adjudicating officer is of the opinion that physical appearance is required, he shall issue a notice, within a period of ten working days from the date of receipt of reply fixing a date for the appearance of such company, through its authorised representative, or officer of such company, or any other person, whether personally or through his authorised representative. {Rule 3[5] of the Companies (Adjudication of Penalties) Rules, 2014)]}
- If any person, to whom a notice is issued, desires to make an oral representation, whether personally or through his authorised representative and has indicated the same while submitting his reply in electronic mode, the adjudicating officer shall allow such person to make such representation after fixing a date of appearance.

MCA Compliance Monitoring System - MCACMS Portal

Compliance Monitoring System (MCACMS Portal) is an Artificial Intelligence initiative under system in MCA 21 by Ministry of Corporate Affairs to make compliance process easier and to ensure regular enforcement of Compliance requirements under Companies Act. 2013.

MCACMS Portal by Ministry of Corporate Affairs is for issuing show cause notices electronically for non compliances under Companies Act, 2013 and submitting replies from companies / directors with their clarifications and submissions. Based on the replies / submissions, the Register of Companies, Ministry of Corporate Affairs shall initiate penal actions for violations referred in the show cause notices.

Following are the steps for filing reply to the SCN:

1. Visit the MCA CMS portal;
2. Click on 'Reply for Show Cause Notice Tab;
3. Click the relevant section for which SCN has been issued;
4. Fill the CMS Reference number written on the SCN & click search. The system will validate the number;
5. After validation click on 'Send OTP' tab.
6. OTP will be sent on the email id on which SCN was received;
7. Click on 'Submit Reply' tab and reply once submitted cannot be altered;
8. The system will show a confirmation message and the 'Action' tab will show reply status.

STEP III- DATE OF HEARING

- On the date fixed for hearing and after giving a reasonable opportunity of being heard to the person concerned, the adjudicating officer may, subject to reasons to be recorded in writing, pass any order in writing as he thinks fit including as order for adjournment:
- Further, after hearing, adjudicating officer may require the concerned person to submit his reply in writing on certain other issues related to the notice, relevant for determination of the default.

STEP-IV-ORDER OF ADJUDICATING OFFICER

- The adjudicating officer shall pass an order,-

  (a) within thirty days of the expiry of the period in sub-rule (2),or of such extended period as referred therein, where physical appearance was not required under sub rule (5):

  (b) within ninety days of the date of issue of notice under rule (2),where any person appeared before the adjudicating officer under sub rule (5):

- In case an order is passed after the aforementioned duration, the reasons of the delay shall be recorded by the adjudicating officer and no such order shall be invalid merely because of its passing after the expiry of such thirty days or ninety days as the case may be.
- Every order of the adjudicating officer shall be duly dated and signed by him and shall clearly state the reasons for requiring the physical appearance.
- The adjudicating officer shall send a copy of the order passed by him to the concerned company, officer who is in default or any other person or all of them and to the Central Government and a copy of the order shall also be uploaded on the website.

S. No.	Brief Facts	Violation and penalty as per the provision of Companies Act, 1956/ 2013	Arguments by the company	Response by the Adjudicating Officer	Final Penalty Imposed
1.	**Haridra Laxmi Property Managements Private Limited** The Company filed a Suo-motto application for adjudication. The Company had taken a loan from a Multistate Credit Cooperative Society amounting to Rs.10 Crores as on 17.01.2022, but the declaration of commencement of business in Form INC-2OA was filed only on 14.02.2022 thereby violating the provisions of Section 10A of the Companies Act, 2013	**Violation:** Delay in filing Form INC 20A (Declaration of commencement of business) – by 28 days Penalty: Section 10A(2) states that penalty shall be levied on Company – Rs 50,000 Every Officer in default – Rs 1,000 per day during which such default continues but not exceeding an amount of Rs 1,00,000	Company stated that the default was caused inadvertently and unintentionally due to lack of knowledge.	After considering the factors for adjudicating the penalty, AO imposed the penalty as per Companies act, 2013.	**Penalty imposed on** ● Company – Rs 50,000 ● Officers in default – Rs 27,000 each (Rs 1000 per day) ● Here the penalty was imposed on both directors Total penalty – Rs 1,04,000

2.	**M/s Krazzy Fin Private Limited** Company filed suo-moto Compounding application in GNL-1, it mentioned in its compounding application that the company unintentionally allotted 216 Equity shares before completion of vesting period of 1 year.	**Violation:** Violation of Section 62(1)(b) r/w. rule 12 of the Companies (Share Capital and Debenture) Rule, 201,4 of the Companies Act, 2013.	The Company has orally submitted that the company is a small startup company and shares through approval by the company was issued earlier.	The said compounding application is not maintainable as the offence committed falls under the ambit of Adjudication of penalty for which Adjudicating Authority can adjudicate the default under the provisions of Section 454 of the Companies Act, 2013 read with Rules made thereunder. The compounding application filed by the company, the company come up with ESOP Scheme for the issue of 1379 equity shares of the company during the Year 2021,-22. The company has approved allotment of 500 equity shares (ESOP) Rs.10/- under ESOP scheme. Further again company approved through Board of Directors allotment of 1095 equity shares (ESoP) Rs.10/- under ESoP scheme to the directors. Thus, the company has allotted excessive 216 equity shares of Rs.10/- to Shri Divyansh Mathur and the company has filed PAS-3 with this office.	Penalty imposed on ● Company – Rs 1,00,000 ● Three Directors (Officer in default) Rs. 25000 each
3.	**M/s Herb Nutra Lab Private Limited** ROC examined the e-form PAS-3 filed by the company dated 16.01.2020 for issue of Rs. 9,00,000/- worth equity shares through private placement offer. ROC has inferred that the board meeting agenda speaks only about allotment of shares	**Violation:** Section 42 r/w Section 62 of the Companies Act, 2013. Penalty: As per Section 42 (10) if a company makes an offer or accepts monies in contravention of this section, The Company, its Promoters and directors shall be liable for a penalty which may extend to:	Based on the Adjudication notice issued to the company dated 29.03.2022, the director of the company replied that a fresh form will be filed with proper documentation.	Based on directions from the Regional Director, penal actions against the company and its officers in default were initiated. The AO then adjudicated the matter and imposed the final penalty	**Penalty imposed on:** 1. Company– Rs. 9,00,000/- 2. Each director (Officers in default) – Rs. 9,00,000/- each. Totaling to Rs. 36,00,000/-

	with no mentions of private placement to M/s Wellness Noni Limited. Minutes of the general meeting for allotment of 90,000 shares by private placement was not attached. The Director admitted that an EGM was not called for approving the issue.	a. Amount raised through the private placement; Or b. Rs 2 crores, Whichever is lower. The company shall also refund all monies with interest as specified in sub-section (6) to subscribers within a period of thirty days of the order imposing the penalty.	The Director then appeared and had confirmed that no EGM was conducted for allotment of the 90,000 shares through private placement to M/s Wellness Noni Limited and the consent of Shri A Shahul Hameed was also not obtained. The company and its directors had requested stating that they are wiling to avail professional help, and has therefore sought an adjournment of 2 weeks, which was granted by the officer. The practicing company secretary appointed by the company as a authorized representative then made representations and made submissions that the said violation may be adjudicated.		This order was later appealed before the RD. The company cancelled the allotment to Wellness Noni Limited and refunded the money, Penalty reduced to Rs 50,000 for company and each director.
4.	**M/s Contlo Technologies Private Limited** The Company filed a Suo-motto application where: The share capital of the Company is held by three shareholders, of which majority of the shares is held by a body corporate. .	**Violation:** Delay in filing the Form BEN -2 within the prescribed limit. Penalty: As per Section 90 (11),If a company, required to maintain register and file the information, fails to do so or denies inspection as provided therein,	The Company has suo-moto filed adjudication application on 22.08.2022 for violation of Section 90 (4) of the Companies Act, 2013 admitting the delay in filing.	Based on the oral and written submission made by the authorized representatives of the company it was seen that: ● The company is not a small company as the shareholding of the company mentioned in Form Ben-2 clearly states that 99.98% of the shares are held by Contlo INC, USA.	**Penalty imposed on** 1. Company- Rs. 1,81,500/- 2. Officers in default – Rs. 57,600/ each.

	The company had identified that significant beneficial ownership is applicable to the company. The company had received the declarations in Form BEN-1 on 20.01.2022 and was required to report the same to the ROC in Form BEN -2 within 30 days of obtaining the declarations. However, the company had filed the Form BEN-2 with a delay of 163 days violating the provisions of the Companies Act,2013	the company and every officer of the company who is in default shall be punishable with fine which shall not be less than ten lakh rupees but which may extend to fifty lakh rupees and where the failure is a continuing one, with a further fine which may extend to one thousand rupees for every day after the first during which the failure continues.		• The Company has made the necessary compliance though belatedly by filing e-form BEN -2 with a delay of 163 days. • Accordingly, the final penalty was imposed.	
5.	**M/s Reliance Broadcast Network Limited** The company could not maintain the minimum number of directors, as required to be maintained by the public limited company during the period 19.10.2018 – 14.12.2018.	**Violation:** non- maintenance of minimum number of Directors on the Board as per Section 149(1). Penalty: As per Section 172 company and every officer of the company who is in default shall be liable to penalty of Rs. 50,000/-, and In case of continuing failure, Rs. 500/- for each day subject to maximum of • Rs 3 Lakhs in case of a company • Rs 1 Lakh in case of an officer in default.	The Company had suo-moto applied for the adjudication proceedings for violation of the provisions of Section 149(1) of Companies Act, 2013. The submissions made by the authorized representatives stated that the company could not maintain the minimum number of three directors in the case of public company.	The company had not complied with the provisions for a period of 56 days. The AO imposed the final penalty by taking into account all the factors to be considered while adjudging the penalty	**Penalty imposed on** : 1. Company – Rs. 78,000/- 2. Officers in default CFO/ CEO– Rs. 78,000/ each. Total : 2,34,000/-.
6.	**Saiyoga Nidhi Limited** Adjudication notices were issued to the company and its managing director for non-filing of MGT 14 for Board Resolution passed for the approval of Financial statements	**Violation:** Non filing of Form MGT-14 for resolutions passed at meeting of the board under section 179(3)(g) Penalty: Section 117 (2) provides for the penalty on:	The company has responded to the notice received but the said reply was not tenable under the provisions of act.	The A.O is of the opinion that as the noticee's have not responded to the notices sent by A.O and continue in committing default by non filing the overdue return.	Penalty imposed for the FY ending 31.03.2020 • Company – Rs 87,700

	and Boards report for the Financial Year ending 31.03.2020 and 31.03.2021.	● Company- 10,000 Continuing failure- 100 per day, subject to maximum- 2,00,000 ● Officers in default- 10,000 Continuing failure- 100 per day Subject to maximum- 50,000			● Officers in default – Rs. 1,50,000 No of days default: 777 days Penalty imposed for the FY ending 31.03.2021 ● Company – Rs 54,200 ● Officers in default – Rs. 1,50,000 No of days default: 442 days
7.	**Sdu Holdings Private Limited** During the course of inquiry u/s206 the statutory register in MGT-1 was perused by the inspector and it was noticed that the register was incomplete and many columns remain unfilled such as nationality, email ID, occupation details & CIN of body corporates were left unfilled.	**Violation:** non maintenance of register of members as per Section 88 Penalty: section 88(5) provides the penalty for such violation to be imposed on: ● The company Rs. 3,00,000 ● Every officer in default Rs.50,000/-	The company accepted the default ● Informed that the offence has been made good by updating the register of members and ● Requested for a minimum penalty	AO was satisfied that the company has made a default and also noticed that as the company is a holding company, it cannot fall under the definition of small company and thus lesser penalty cannot be levied.	It was imposed on ● Company – Rs. 3,00,000/- ● Officer in default Rs. 50,000/- Total penalty – Rs. 3,50,000/-

POWERS OF ADJUDICATING OFFICER

- The adjudicating officer shall exercise the following powers, namely:-

  (a) to summon and enforce the attendance of any person acquainted with the facts and circumstances of the case after recording reasons in writing;

  (b) to order for evidence or to produce any document, which in the opinion of the adjudicating officer, may be relevant to the subject matter.

PENALTY IMPOSED BY ADJUDICATING OFFICER

- The adjudicating officer may, by an order-

  (a) impose the penalty on the company, the officer who is in default, or any other person, as the case may be, stating therein any non-compliance or default under the relevant provisions of this Act; and

(b direct such company, or officer who is in default, or any other person, as the case may be, to rectify the default, wherever he considers fit.

- If any person fails to reply or neglects or refuses to appear as required before the adjudicating officer, the adjudicating officer may pass an order imposing the penalty, in the absence of such person after recording the reasons for doing so.
- While adjudging quantum of penalty, the adjudicating officer shall have due regard to the following factors, namely:-

  (a) size of the company;

  (b) nature of business carried on by the company;

  (c) injury to public interest;

  (d) nature of the default;

  (e) repetition of the default;

  (f) the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default; and

  (g) the amount of loss caused to an investor or group of investors or creditors as a result of the default:

  Provided that, in no case, the penalty imposed shall be less than the minimum penalty prescribed, if any, under the relevant section of the Act.

- In case a fixed sum of penalty is provided for default of a provision, the adjudicating officer shall impose that fixed sum, in case of any default therein.
- Penalty shall be paid through Ministry of Corporate Affairs portal only.
- All sums realized by way of penalties under the Act shall be credited to the Consolidated Fund of India.

Explanation 1 - For the purposes of this rule, the term "specified manner" shall mean service of documents as specified under section 20 of the Act and rules made thereunder and details in respect of address (including electronic mail ID) provided in the KYC documents field in the registry shall be used for communication under this rule.

Explanation 2 - For the purposes of this rule, it is hereby clarified that the requirement of submission of replies in electronic mode shall become mandatory after the creation of the e-adjudication platform.

- In case the default relates to non-compliance of sub-section (4) of section 92 or sub-section (1) or sub-section (2) of section 137 and such default has been rectified either prior to, or within thirty days of, the issue of the notice by the adjudicating officer, no penalty shall be imposed in this regard and all proceedings under this section in respect of such default shall be deemed to be concluded.
- The adjudicating officer shall, before imposing any penalty, give a reasonable opportunity of being heard to such company, the officer who is in default or any other person.

APPEAL AGAINST THE ORDER OF ADJUDICATING OFFICER {Rule 4 of the Companies (Adjudication of Penalties) Rules, 2014)}

- Any person aggrieved by an order made by the adjudicating officer under sub-section (3) of the section 454 may prefer an appeal to the Regional Director having jurisdiction in the matter.

- Every appeal against the order of the adjudicating officer shall be filed in writing with the Regional Director having jurisdiction in the matter within a period of sixty days from the date of receipt of the order of adjudicating officer by the aggrieved party, in Form ADJ setting forth the grounds of appeal and shall be accompanied by a certified copy of the order against which the appeal is sought.
- Where the party is represented by an authorised representative, a copy of such authorisation in favour of the representative and the written consent thereto by such authorised representative shall also be appended to the appeal.
- Further that an appeal in Form ADJ shall not seek relief(s) therein against more than one order unless the reliefs prayed for are consequential.

REGISTRATION OF APPEAL {Rule 5 of the Companies (Adjudication of Penalties) Rules, 2014)}

- **Endorsement of Date on Appeal:** On the receipt of an appeal, office of the Regional Director shall endorse the date on such appeal and shall sign such endorsement.
- **Registration/Admission:** If, on scrutiny, the appeal is found to be in order, it shall be duly registered and given a serial number.
- Where the appeal is found to be defective, the Regional Director may allow the appellant such time, not being less than fourteen days following the date of receipt of intimation by the appellant from the Regional Director about the nature of the defects, to rectify the defects.
- **If the appellant fails to rectify the defects:** The Regional Director may by order and for reasons to be recorded in writing, decline to register such appeal and communicate such refusal to the appellant within a period of seven days thereof.
- **Extension of period of rectification of defects:** The Regional Director may, for reasons to be recorded in writing, extend the period referred to in the first proviso above by a further period of fourteen days if an appellant satisfies the Regional Director that the appellant had sufficient cause for not rectifying the defects within the period of fourteen days referred to in the first proviso.

DISPOSAL OF APPEAL BY REGIONAL DIRECTOR

- **Copy of Notice to Adjudication officer:** On the admission of the appeal, the Regional Director shall serve a copy of appeal upon the adjudicating officer against whose order the appeal is sought along-with a notice requiring such adjudicating officer to file his reply thereto within such period, not exceeding twenty-one days, as may be stipulated by the Regional Director in the said notice.
- Regional Director may, for reasons to be recorded in writing, extend the period referred above for a further period of twenty-one days, if the adjudicating officer satisfies the Regional Director that he had sufficient cause for not being able to file his reply to the appeal within the above-said period of twenty-one days.
- **Reply of Adjudication officer:** A copy of every reply, application or written representation filed by the adjudicating officer before the Regional Director shall be forthwith served on the appellant by the adjudicating officer.
- **Intimation of Date of Hearing by RD:** The Regional Director shall notify the parties, the date of hearing of the appeal which shall not be a date earlier than thirty days following the date of such notification for hearing of the appeal.
- **Hearing by RD:** On the date fixed for hearing the Regional Director may, subject to the reasons to be recorded in writing, pass any order as he thinks fit including an order for adjournment of the hearing to a future date.

- **Ex-parte hearing:** In case the appellant or the adjudicating officer does not appear on the date fixed for hearing, the Regional Director may dispose of the appeal ex-parte.
- **Setting aside ex-parte order:** Where the appellant appears afterwards and satisfies the Regional Director that there was sufficient cause for his non-appearance, the Regional Director may make an order setting aside the ex-parte order and restore the appeal.
- **Order**: The Regional Director may, after giving the parties to the appeal an opportunity of being heard, pass such order as he thinks fit, confirming, modifying or setting aside the order appealed against.
- **Signing of Order:** Every order passed under this rule shall be dated and signed by the Regional Director.
- **Communication:** A certified copy of every order passed by the Regional Director shall be communicated to the adjudicating officer and to the appellant forthwith and to the Central Government.
- **Fine:** Where company fails to comply with the order made under sub-section (3) or sub-section (7), as the case may be, within a period of ninety days from the date of the receipt of the copy of the order, the company shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees.

Where an officer of a company or any other person who is in default fails to comply with the order made under sub-section (3) or sub-section (7), as the case may be within a period of ninety days from the date of the receipt of the copy of the order, such officer shall be punishable with imprisonment which may extend to six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees, or with both.

Some Orders of adjudicating authority

An order was passed by the adjudicating authority under Section 454 of Companies Act, 2013 read with Rule 3 of the Companies (Adjudication of Penalties) rule 2014 for violation of Section 12 of the Companies Act, 2013.

1. M/S Kodagu Heritage

Facts of the case

M/s Kodagu Heritage is a private limited company which was incorporated on April 11, 2017. An order was filed by the adjudicating authority because the company had violated Section 12 of the Companies Act, 2013.

As per Section 12(2) of Companies Act, 2013 the company, as soon as it is incorporated, shall furnish to the registrar the verification of registered office within thirty days in Form INC-22. But the company filed the form after the three years that's on January 1, 2019. The company and its officers in default had admitted that they have violated the provision of Section 12(2) of Companies Act, 2013. The adjudicating authority issued a notice to the company and its officers in default to appear before the authority along with their representatives before September 5, 2019, in the chamber of a registrar of the company.

The authorised representative was present on said date but the notice was not signed by all the directors. According to Section 12(8) of Companies act, 2013, if a company and officer in default contravenes the provisions of Section 12 of Companies Act, 2013 shall be liable to pay a penalty of INR 1000 for every day during which the default continues but it shall not exceed INR 1 lakh.

Order

The company and its officers in default are liable to pay INR 1 lakh each. As per Section 454(1) and (3) of Companies Act, 2013 and considering the delay of 621 days they have imposed of a penalty of INR 1 lakh on the company and its directors and are required to pay the amount on MCA portal and proof of payment to be produced within thirty days from the date of receipt of order. An appeal shall be filed as per Section 454(1) and (3) of Companies Act, 2013 to the regional director within sixty days from the date of order of adjudicating authority and it shall be submitted in the prescribed form and with prescribed fees.

2. Ms Joy Ice Cream (Bangalore) Private Limited

Facts of the case

Ms Joy Ice Cream (Bangalore) Private Limited was incorporated on July 25, 1996. The matter before the adjudicating authority is as per Section 12(1) of Companies Act, 2013 a company shall, within thirty days of its incorporation, have registered office which shall be capable of receiving and acknowledging all the communications and notices which are addressed to it. In case there is a change in the registered office of the company, the company shall give notice of change in the registered office within thirty days after the date of incorporation and shall submit in Form INC 22 to the registrar. On the verification of the record, the authority came to the conclusion that it has not filed the Form INC 22. When the office issued a letter on July 27, 2018, for seeking reply with regard to complaints received against the company. The letter was returned unserved with no such firm. The adjudicating authority issued a notice to the company and the officers in default under section 454 of Companies Act, 2013 for violation of Section 12 of Companies, Act 2013.

Order

The Company and its officers in default were called upon along with the representatives to present before the registrar of companies. But none of them was present on the said date. The adjudicating authority under section 454(3) of Companies act, 2013 issued a penalty of INR 1 lakh to each director and the company and were required to pay the amount on MCA portal and proof of payment to be produced within thirty days from the date of receipt of order.

In case a company does not pay the penalty within ninety days as specified under section 454(8) of Companies Act, 2013 the company shall be liable to pay a fine which shall not be less than INR 25 thousand but may extend to INR 5 lakhs. An officer in default or any other person is in default shall be punishable with imprisonment which may extend to six months or with a fine which shall not be less than INR 25,000 but which may extend to INR 1 lakh or with both.

Order for Penalty under Section 454 for violation of Section 173 of the Companies Act, 2013 In The Matter Of Narangs International Hotels Private Limited

Facts about the Case

The Company, filed application for adjudication of penalties for offence under Section 454 of the Companies Act, 2013 for violation of provisions of Section 173(1) of the Companies Act, 2013. Whereas, every company shall hold the first meeting of the Board of Directors within thirty days of the date of its incorporation and thereafter hold a minimum number of four meetings of its Board of Directors every year in such a manner that not more than one hundred and twenty days shall intervene between two consecutive meetings of the Board.

As per the application and records of this office, it is noticed that the Company has failed to hold a minimum number of four meetings of its Board of Directors every year in such a manner that not more than one hundred and twenty days shall intervene between two consecutive meetings of the Board during the financial year ended 2020-21. Further, the MCA vide circular dated 24.03.2020 extended the number of days to 180 days. However, the number of days between the two consecutive meetings of the Board of Directors, i.e. between 13.12.2019 and 11.09.2020 was 273 days which is 93 days more than the prescribed 180 days accordingly, there was contravention of Section 173 of the Companies Act, 2013. The delay in days is calculated from 10.06.2020 instead of 13.12.2019 till 11.09.2020 as per extension of 180 days by the Ministry. Thus, there was a delay of 943 days in conducting the Board Meeting.

Therefore, the Regional Director in exercise of power conferred under sub-Section 3 of Section 454 of the Companies Act, 2013 had issued hearing notice dated 18.03.2021, to the Company and Officers in default for giving an opportunity to be heard and for submissions in the matter, if any. In response to the hearing notice, representative of the Company, appeared 25.03.2021 and gave consent to pass necessary orders as per the provisions of the Companies Act, 2013.

Factors to be taken into account by the Adjudicating Officer:- While adjudging quantum of penalty under Section 173(4) of the Act, the Adjudicating Officer shall have due regard to the following factors, namely:

a. The amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of default.

b. The amount of loss caused to an investor or group of investors as a result of the default.

c. The repetitive nature of default.

With regard to the above factors to be considered while determining the quantum of penalty, it is noted that the disproportionate gain or unfair advantage made by the Noticee or loss caused to the investor as a result of the delay on the part of the Noticee to redress the investor grievance are not available on record.

Further, it may also be added that it is difficult to quantify the unfair advantage made by the Noticee or the loss caused to the investors in a default of this nature.

Order

Having considered the facts and circumstances of the case and after taking into account the factors above, penalty of Rs.25,000/- (Rupees Twenty Five Thousand only} on each of its Directors for violation of provisions of Section 173 of the Companies Act, 2013 was imposed.

Order for Penalty for Violation of section 39(4) of the Companies Act, 2013 R/w Rule 12(1) of Companies (Prospectus and Allotment of Securities) Rules 2014. In The Matter of Sunshakti Solar Power Projects Private Limited

Facts about the Case

The company and its director(s) have suo-moto filed application vide e-form GNL-1 dated 19.11.2021 for compounding of offence under the provisions of section 441 of the Companies Act, 2013, however, as the matter was dealt with adjudication under section 454 of the Act, the subject company submitted a letter to this office dated 12.04.2022 and made request to treat the said e-form GNL-1 as filed for adjudication, The petition submitted by company stated as under:- During the financial year ended 31.03.2018, the company issued 37,500, 10% Compulsorily Convertible Debentures with face value of Rs, 10,000/- each amounting to Rs, 37,50,00,000 on Private Placement basis, pursuant to section 62 and section 42 r/w Companies (Prospectus and allotment of securities) Rules 2014 of the Act details of which are as under:

Name of Allottee	No. of CCDs issued	Nominal value of CCDs/-	Total amount	Date of approval of Board	Date of shareholder approval
Sky Power Southeast Asia III Investment Limited	37,500	10,000	37,50,00,000	05.09.2017	30.09.2017

The company approved the issuance of 37,500 10% Compulsorily Convertible Debentures by passing special resolution in its Annual General Meeting held on 30.09.2017 and Letter of offer in form PAS-4 was circulated to the offeree accordingly. The company allotted the CCDs to allottess namely Skypower Southeast Asia II Investment Limited vide dated 06.01.2018 after receiving subscription money in its escrow account. The necessary e-form PAS:3 (Return of Allotment} for allotment of 37,5000 10% Compulsorily Convertible Debentures was filed on 31.03.2018. Further, the company and officers in default submitted their reply on 20th June 2022 in response to the show cause notice issued by this office.

Further, an authorized Representative of the Company appeared on 09.11.2022 for hearing on behalf of company.

The default in the instant case was related to the delay in filing of Return of allotment (Form PAS-3) and Letter of offer (in PAS-4) by 69 days and 151 days respectively. The authorized representative submitted that the company will submit written submission regarding delay filing of Letter of offer (in Form PAS-4) within 7 days from the date hereof. The default regarding aforésaid forms has been made good by the company. However, the delay in filing of PAS-3 has been admitted.

Further, company submitted written submission wherein stated that delay in filing of PAS-4 by 151 days was unintentional and also request to grant relief pursuant to Rule 13 of the Companies (Share Capital and Debentures) Rules, 2014 in filing of offer letter in form PAS-4 by delay of 151 days.

Adjudication of penalty

In the instant case, the default relating to late filing of return of allotment was not subject of penalty under section 42 (10) of the Act as on the date of the default. As default relating to delay in allotment of securities was not recovered within such provision, this default will instead lead to penalty under section 39(5) for violation of section 39 (4) r/w Rule 12(1) of Companies (Prospectus and Allotment of Securities) Rules 2014.

Now in exercise of the powers conferred and having considered the reply submitted by the noticee(s) in response to the notice(s) issued to company, Regional Director hereby imposed the penalty on the company and its officers in default for violation of section 39 (4) r/e Rule 12(1) of Companies (Prospectus and Allotment of Securities) Rules 2014.

PENALTIES AND ADJUDICATION UNDER SEBI ACT, 1992

SEBI is empowered under Section 11B of SEBI Act, 1992 to levy penalties after adjudication of the matter if it finds that any such statutory contravention has occurred. SEBI, in general practice, assesses factual circumstances and establishes whether or not an offense has been made by the assessee, and levies the penalty stipulated under chapter VIA of the SEBI Act, 1992. The purpose of any adjudicatory proceeding, is not for a mere assessment of facts but must also be a determination of the gravity of the offense and imposing a penalty that is proportionate to the same. SEBI has time and again, imposed penalties at a flat rate in a mechanical, "automatic" manner.

Securities Appellate Tribunal is a statutory body established under the provisions of Section 15K of the Securities and Exchange Board of India Act, 1992 to hear and dispose of appeals against orders passed by the Securities and Exchange Board of India or by an adjudicating officer under the Act; and to exercise jurisdiction, powers and authority conferred on the Tribunal by or under the Act or any other law for the time being in force.

Enforcement Department The Enforcement Department is responsible for handling Appeals against SEBI orders filed before the Hon'ble Securities Appellate Tribunal (SAT), Appeals filed against the SAT order in the Hon'ble Supreme Court, Criminal Complaints filed by SEBI in appropriate Courts and Settlement Proceedings. The Department Comprises of three divisions, namely:

SAT Litigation	**Division of Prosecution**	**Settlement Division**
Responsible for handling appeals against orders of SEBI or its Adjudicating Officers. While undertaking defence representation in contentious matters involving complex issues of law, the Division would liase with Senior Advocates, law firms, solicitors firms and represent the interest of SEBI at Securities Appellate Tribunal (SAT).	The division shall handle work related to filing prosecution proceedings through the courts and follow up to obtain conviction. The Division will also frame procedures for cooperation with public prosecutors, other agencies and for making referrals to prosecutors and other government agencies.	Handles the Settlement Applications filed by the Applicant for the Settlement of the Specified Proceedings that have been initiated or may be initiated by SEBI. Settlement Applications are processed as per SEBI (Settlement of Administrative and Civil Proceedings) Regulations, 2014 [Settlement Regulations] and if settlement is arrived at, the Settlement Orders are passed.

The Division would also be an interface between SEBI and SAT, while collaborating with other departments of SEBI. It would also assist SEBI in filing affidavits/written submissions, as and when needed, while attending hearings.		Responsible for handling Registration of Settlement Application, Calculation of Settlement amount as per the Settlement Regulations, organizing Internal Committee Meeting between the Applicants and Internal Committee Members for formulating the settlement amount/terms, Organizing High Powered Advisory Committee (HPAC) Meeting, placing the recommendation before Whole Time Members for approval.

Other Jurisdiction of SAT

Consequent to Government Notification, SAT hears and disposes of appeals against orders passed by the Pension Fund Regulatory and Development Authority (PFRDA) under the PFRDA Act, 2013. Further, in terms of Government Notification No.DL-(N)/04/0007/2003-15 dated 23rd March, 2015, SAT hears and disposes of appeals against orders passed by the Insurance Regulatory Development Authority of India (IRDAI) under the Insurance Act, 1938, the General Insurance Business (Nationalization) Act, 1972 and the Insurance Regulatory and Development Authority Act, 1999 and the Rules and Regulations framed thereunder.

Case law on Adjudication by SEBI

S. No.	Brief Facts	Violation and penalty as per the SEBI Act, 1992	Arguments by the company	Response by the AO	Final Penalty Imposed (May 24, 2023)
1.	**Raghukul Shares India Private Limited** SEBI observed regarding large scale reversal of trades in stock options leading to creation of artificial volume at BSE. In view of the same, SEBI conducted an investigation into the trading activities of certain entities in illiquid stock options at BSE for the period April 1, 2014 to September 30, 2015.	SEBI initiated adjudication proceedings against the Noticee for violation of the provisions of Regulations 3(a), (b), (c), (d), 4(1) and 4(2)(a) of SEBI (Prohibition of Fraudulent and Unfair Trade Practices) Regulations, 2003	No reply has been received from the Noticee in reference to the SCN issued to it.	AO noted that from the website of MCA that the status of the Noticee is being shown as "Strike Off".	In exercise of the powers conferred under Section 15-I of the SEBI Act read with Rule 5 of the Adjudication Rules, the proceedings initiated against Noticee viz.

				When a company is struck-off, it is a non-existing company and the adjudication proceedings against the non-existing company is not feasible Struck-off company cannot perform any operations. In view of the fact that the Noticee has been struck-off and liabilities in respect of the present proceedings had not accrued as on the date of dissolution of the Noticee, it would not be appropriate to determine liability against a company which no longer exists.	Raghukul Shares India Pvt. Ltd., vide SCN dated December 08, 2021 Stands disposed off.

Test Yourself

Question: Whether adjudicating officer can impose penalty on non-compliance or default under the provisions of Companies Act, 2013?

Answer: Yes, as per Section 454(3) Adjudicating officer can impose penalty on non-compliance or default under the provisions of Companies Act, 2013 and direct such Company, or officer who is in default, or any other person, as the case may be to rectify the default, wherever he considers fit.

Note: In case the default relates to non-compliance of Section 92(4) or Section 137 (1) or (2) and such default has been rectified either prior to, or within 30 days of, the issue of notice by the Adjudicating officer, no penalty shall be imposed in this regard and all the proceedings under this section in respect of such default shall be deemed to be concluded.

Question: On whom penalties may be imposed by adjudicating officer ?

Answer: Companies and officer in Default and any other person ("any other person" was inserted by Companies (Amendment) Act, 2019.

Question: Arun, an individual shareholder of M/s. BEL Ltd. is holding 2% of the voting rights. He made a complaint before the Adjudicating Authority that investments proposed to be made by the Company are without any adequate security and prayed for injunction to restrain the company from making such investments. Whether Arun will succeed in his attempt ? Explain with decided case law.

Answer: Where the directors representing the majority of shareholders perform an illegal or ultra vires act, an individual shareholder has right to bring an action. The majority of shareholders have no right to confirm an illegal or ultra vires transaction of the company. In such case a shareholder has the right to restrain the company by an order or injunction of the court from carrying out an ultra vires act.

In *Bharat Insurance Ltd. vs. Kanhya Lal, A.I.R. 1935 Lah. 792,* the plaintiff was a shareholder of the Bharat Insurance Company. One of the objects of the company was "To advance money at interest on the security of land, houses, machinery and other property situated in India..." The plaintiff complained that "several investments had been made by the company directors on behalf of the company without adequate security and contrary to the provisions of the memorandum and therefore, prayed for perpetual injunction to restrain it from making such investments".

The Court observed: "In all matters of internal management, the company itself is the best judge of its affairs and the Court should not interfere. But application of assets of a company is not a matter of internal management. As directors are acting ultra vires in the application of the funds of the company, a single member can maintain a suit" Hence in the given case, Arun will succeed in his attempt.

Power of SEBI to Issue Directions and Levy Penalty [Section 11B]

The power to issue directions under this section shall include and always be deemed to have been included the power to direct any person, who made profit or averted loss by indulging in any transaction or activity in contravention of the provisions of this Act or regulations made thereunder, to disgorge an amount equivalent to the wrongful gain made or loss averted by such contravention.

Section 11B of the Act provides that if the SEBI is satisfied after making or causing to be made an enquiry, that it is necessary:

(i) in the interest of investors, or orderly development of securities market; or

(ii) to prevent the affairs of any intermediary or other persons being conducted in a manner detrimental to the interests of investors or securities market; or

(iii) to secure the proper management of any such intermediary or person, SEBI may issue such directions:
(a) to any person or class of persons, or associated with the securities market; or

(b) to any company in respect of matters relating to issue of capital, transfer of securities and other matter incidental thereto, as may be appropriate in the interests of investors in securities and the securities market.

Penalty for failure to furnish information, return, etc.

As per Section 15A of the SEBI Act, 1992, A, if any person, who is required under this Act or any rules or regulations made thereunder,—

(a) to furnish any document, return or report to the Board, fails to furnish the same or who furnishes or files false, incorrect or incomplete information, return, report, books or other documents, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one

lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees;

(b) to file any return or furnish any information, books or other documents within the time specified therefor in the regulations, fails to file return or furnish the same within the time specified therefor in the regulations or who furnishes or files false, incorrect or incomplete information, return, report, books or other documents, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees;

(c) to maintain books of account or records, fails to maintain the same, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees.

Penalty for failure by any person to enter into agreement with clients.

As per Section 15B of the SEBI Act, 1992, if any person, who is registered as an intermediary and is required under this Act or any rules or regulations made thereunder to enter into an agreement with his client, fails to enter into such agreement, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees.

Penalty for failure to redress investors' grievances.

As per Section 15C of the SEBI Act, 1992, if any listed company or any person who is registered as an intermediary, after having been called upon by the Board in writing including by any means of electronic communication, to redress the grievances of investors, fails to redress such grievances within the time specified by the Board, such company or intermediary shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees.

Penalty for certain defaults in case of mutual funds.

As per Section 15D of the SEBI Act, 1992, if any person, who is—

(a) required under this Act or any rules or regulations made thereunder to obtain a certificate of registration from the Board for sponsoring or carrying on any collective investment scheme, including mutual funds, sponsors or carries on any collective investment scheme, including mutual funds, without obtaining such certificate of registration, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which he sponsors or carries on any such collective investment scheme including mutual funds subject to a maximum of one crore rupees;

(b) registered with the Board as a collective investment scheme, including mutual funds, for sponsoring or carrying on any investment scheme, fails to comply with the terms and conditions of certificate of registration, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees;

(c) registered with the Board as a collective investment scheme, including mutual funds, fails to make an application for listing of its schemes as provided for in the regulations governing such listing, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees;

(d) registered as a collective investment scheme, including mutual funds, fails to despatch unit certificates of any scheme in the manner provided in the regulation governing such despatch, he

shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees;

(e) registered as a collective investment scheme, including mutual funds, fails to refund the application monies paid by the investors within the period specified in the regulations, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees;

(f) registered as a collective investment scheme, including mutual funds, fails to invest money collected by such collective investment schemes in the manner or within the period specified in the regulations, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees.

Penalty for failure to observe rules and regulations by an asset management company.

As per Section 15E of the SEBI Act, 1992, where any asset management company of a mutual fund registered under this Act, fails to comply with any of the regulations providing for restrictions on the activities of the asset management companies, such asset management company shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees.

Penalty for default in case of alternative investment funds, infrastructure investment trusts and real estate investment trusts.

As per Section 15EA of the SEBI Act, 1992, where any person fails to comply with the regulations made by the Board in respect of alternative investment funds, infrastructure investment trusts and real estate investment trusts or fails to comply with the directions issued by the Board, such person shall be liable to penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees or three times the amount of gains made out of such failure, whichever is higher.

Penalty for default in case of investment adviser and research analyst.

As per Section 15EAB of the SEBI Act, 1992, where an investment adviser or a research analyst fails to comply with the regulations made by the Board or directions issued by the Board, such investment adviser or research analyst shall be liable to penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees.

Penalty for default in case of stock brokers.

As per Section 15F of the SEBI Act, 1992, if any person, who is registered as a stock broker under this Act,—

(a) fails to issue contract notes in the form and manner specified by the stock exchange of which such broker is a member, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one crore rupees for which the contract note was required to be issued by that broker;

(b) fails to deliver any security or fails to make payment of the amount due to the investor in the manner within the period specified in the regulations, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees;

(c) charges an amount of brokerage which is in excess of the brokerage specified in the regulations, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to five times the amount of brokerage charged in excess of the specified brokerage, whichever is higher.

Penalty for insider trading.

As per Section 15G of the SEBI Act, 1992, if any insider who,—

(i) either on his own behalf or on behalf of any other person, deals in securities of a body corporate listed on any stock exchange on the basis of any unpublished price-sensitive information; or

(ii) communicates any unpublished price-sensitive information to any person, with or without his request for such information except as required in the ordinary course of business or under any law; or

(iii) counsels, or procures for any other person to deal in any securities of any body corporate on the basis of unpublished price-sensitive information, shall be liable to a penalty which shall not be less than ten lakh rupees but which may extend to twenty-five crore rupees or three times the amount of profits made out of insider trading, whichever is higher.

Penalty for non-disclosure of acquisition of shares and takeovers.

As per Section 15H of the SEBI Act, 1992, if any person, who is required under this Act or any rules or regulations made thereunder, fails to,—

(i) disclose the aggregate of his shareholding in the body corporate before he acquires any shares of that body corporate; or

(ii) make a public announcement to acquire shares at a minimum price; or

(iii) make a public offer by sending letter of offer to the shareholders of the concerned company; or

(iv) make payment of consideration to the shareholders who sold their shares pursuant to letter of offer, he shall be liable to a penalty which shall not be less than ten lakh rupees but which may extend to twenty-five crore rupees or three times the amount of profits made out of such failure, whichever is higher.

Penalty for fraudulent and unfair trade practices.

As per Section 15HA of the SEBI Act, 1992, if any person indulges in fraudulent and unfair trade practices relating to securities, he shall be liable to a penalty which shall not be less than five lakh rupees but which may extend to twenty-five crore rupees or three times the amount of profits made out of such practices, whichever is higher.

Penalty for alteration, destruction, etc., of records and failure to protect the electronic database of Board.

As per Section 15HAA of the SEBI Act, 1992, any person, who—

(a) knowingly alters, destroys, mutilates, conceals, falsifies, or makes a false entry in any information, record, document (including electronic records), which is required under this Act or any rules or regulations made thereunder, so as to impede, obstruct, or influence the investigation, inquiry, audit, inspection or proper administration of any matter within the jurisdiction of the Board.

Explanation.—For the purposes of this clause, a person shall be deemed to have altered, concealed or destroyed such information, record or document, in case he knowingly fails to immediately report the matter to the Board or fails to preserve the same till such information continues to be relevant to any investigation, inquiry, audit, inspection or proceeding, which may be initiated by the Board and conclusion thereof.

(b) without being authorised to do so, access or tries to access, or denies of access or modifies access parameters, to the regulatory data in the database;

(c) without being authorised to do so, downloads, extracts, copies, or reproduces in any form the regulatory data maintained in the system database;

(d) knowingly introduces any computer virus or other computer contaminant into the system database and brings out a trading halt;

(e) without authorisation disrupts the functioning of system database;

(f) knowingly damages, destroys, deletes, alters, diminishes in value or utility, or affects by any means, the regulatory data in the system database; or

(g) knowingly provides any assistance to or causes any other person to do any of the acts specified in clauses (a) to (f), shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to ten crore rupees or three times the amount of profits made out of such act, whichever is higher.

Explanation.—In this section, the expressions "computer contaminant", "computer virus" and "damage" shall have the meanings respectively assigned to them undersection 43 of the Information Technology Act, 2000.

Penalty for contravention where no separate penalty has been provided.

As per Section 15HB of the SEBI Act, 1992, whoever fails to comply with any provision of this Act, the rules or the regulations made or directions issued by the Board thereunder for which no separate penalty has been provided, shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one crore rupees.

Power to adjudicate (Section 15 I)

- For the purpose of adjudging under sections 15A, 15B, 15C, 15D, 15E, 15EA, 15EB,15F, 15G,15H, 15HA and 15HB, the Board may appoint any officer not below the rank of a Division Chief to be an adjudicating officer for holding an inquiry in the prescribed manner after giving any person concerned a reasonable opportunity of being heard for the purpose of imposing any penalty.
- While holding an inquiry the adjudicating officer shall have power to summon and enforce the attendance of any person acquainted with the facts and circumstances of the case to give evidence or to produce any document which in the opinion of the adjudicating officer, may be useful for or relevant to the subject-matter of the inquiry and if, on such inquiry, he is satisfied that the person has failed to comply with the provisions of any of the sections specified in subsection (1), he may impose such penalty as he thinks fit in accordance with the provisions of any of those sections.
- The Board may call for and examine the record of any proceedings under this section and if it considers that the order passed by the adjudicating officer is erroneous to the extent it is not in the interests of the securities market, it may, after making or causing to be made such inquiry as it deems necessary, pass an order enhancing the quantum of penalty, if the circumstances of the case so justify:

  Provided that no such order shall be passed unless the person concerned has been given an opportunity of being heard in the matter:

  Provided further that nothing contained in this sub-section shall be applicable after an expiry of a period of three months from the date of the order passed by the adjudicating officer or disposal of the appeal under section 15T, whichever is earlier.

Holding Of Inquiry (Rule 4 Securities and Exchange Board of India (Procedure for Holding Inquiry and Imposing Penalties) Rules, 1995

- The Board or the adjudicating officer shall, in the first instance, issue a notice to such person requiring him to show cause within such period as may be specified in the notice (being not less than fourteen days from the date of service thereof) why an inquiry should not be held against him. [Rule 4(1)]
- Every notice under sub-rule (1) to any such person shall indicate the nature of offence alleged to have been committed by him. [Rule 4(2)]
- If, after considering the cause, if any, shown by such person, the Board or the adjudicating officer is of the opinion that an inquiry should be held, he shall issue a notice fixing a date

for the appearance of that person either personally or through his lawyer or other authorised representative. [Rule 4(3)]

- On the date fixed, the Board or the adjudicating officer shall explain to the person proceeded against or his lawyer or authorised representative, the offence, alleged to have been committed by such person indicating the provisions of the Act, rules or regulations in respect of which contravention is alleged to have taken place. [Rule 4(4)]
- The Board or the adjudicating officer shall then give an opportunity to such person to produce such documents or evidence as he may consider relevant to the inquiry and if necessary the hearing may be adjourned to a future date and in taking such evidence the Board or the adjudicating officer shall not be bound to observe the provisions of the Evidence Act, 1872. [Rule 4(5)]
- Provided that the notice referred to in sub-rule (3), and the personal hearing referred to in sub-rules (3), (4) and (5) may, at the request of the person concerned, be waived.

  The Board may appoint a presenting officer in an inquiry under this rule.
- While holding an inquiry under this rule the Board or the adjudicating officer shall have the power to summon and enforce the attendance of any person acquainted with the facts and circumstances of the case to give evidence or to produce any document which, in the opinion of the Board or the adjudicating officer, may be useful for or relevant to, the subject-matter of the inquiry. [Rule 6]
- If any person fails, neglects or refuses to appear as required by sub-rule (3) before the Board or the adjudicating officer, the Board or the adjudicating officer may proceed with the inquiry in the absence of such person after recording the reasons for doing so. [Rule 7]

Order of the Board or the adjudicating officer (Rule 5)

If, upon consideration of the evidence produced before the Board or the adjudicating officer, the Board or the adjudicating officer is satisfied that the person has become liable to penalty under any of the specified sections, he may, by order in writing, impose such penalty as he thinks fit in accordance with the provisions of the relevant section.

Factors to be taken into account while adjudging quantum of penalty (Section 15 J)

While adjudging quantum of penalty under 15-I or section 11 or section 11B, the Board or the adjudicating officer shall have due regard to the following factors, namely :—

(a) the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default;

(b) the amount of loss caused to an investor or group of investors as a result of the default;

(c) the repetitive nature of the default.

Explanation.—For the removal of doubts, it is clarified that the power to adjudge the quantum of penalty under sections 15A to 15E, clauses (b) and (c) of section 15F, 15G, 15H and 15HA shall be and shall always be deemed to have been exercised under the provisions of this section.

Crediting sums realised by way of penalties to Consolidated Fund of India (Section 15 JA)

All sums realised by way of penalties under this Act shall be credited to the Consolidated Fund of India.

Settlement of administrative and civil proceedings. (Section 15 JB)

- Notwithstanding anything contained in any other law for the time being in force, any person, against whom any proceedings have been initiated or may be initiated under section 11, section 11B, section

11D, sub-section (3) of section 12 or section 15-I, may file an application in writing to the Board proposing for settlement of the proceedings initiated or to be initiated for the alleged defaults.

- The Board may, after taking into consideration the nature, gravity and impact of defaults, agree to the proposal for settlement, on payment of such sum by the defaulter or on such other terms as may be determined by the Board in accordance with the regulations made under this Act.
- The settlement proceedings under this section shall be conducted in accordance with the procedure specified in the regulations made under this Act.
- No appeal shall lie under section 15T against any order passed by the Board or adjudicating officer, as the case may be, under this section.
- All settlement amounts, excluding the disgorgement amount and legal costs, realised under this Act shall be credited to the Consolidated Fund of India.

UNDER SECTION 15-I OF SECURITIES AND EXCHANGE BOARD OF INDIA ACT, 1992, IN THE MATTER OF TRADING IN ILLIQUID STOCK OPTIONS AT BSE

- Securities and Exchange Board of India (SEBI) has initiated Adjudication Proceedings against Sita Devi Bagaria (hereinafter referred to as "Noticee"), under SEBI (Procedure for Holding Inquiry and Imposing Penalties) Rules, 1995 (hereinafter referred to as "Adjudication Rules") for allegedly violating Regulations 3(a),(b),(c),(d) and 4(1), 4(2)(a) of SEBI (Prohibition of Fraudulent and Unfair Trading Practices relating to Securities Markets) Regulations, 2003 (hereinafter referred to as "PFUTP Regulations"), in the matter of trading in illiquid stock options at Bombay Stock Exchange Ltd. (hereinafter referred to as "BSE").
- SEBI had conducted an investigation into large scale reversal of trades in Stock Options segment of the BSE during the period of April 01, 2014 to September 30, 2015. Pursuant to investigation, it was observed that during the investigation period, the Noticee had indulged in reversal trades, which allegedly created false and misleading appearance of trading thereby generated artificial volumes in the Stock Options Segment of BSE during the investigation period. The trades entered in the unique contracts were reversed on the same day with same counterparties, at a price difference which had no underlying basis and without an intention of performing it or there being a change of ownership/rights in the contracts. These factors indicate that these trades were allegedly artificial and non- genuine in nature. In the above facts and circumstances, it was alleged by SEBI that the Noticee by indulging in execution of nongenuine reversal trades in Stock Options, created false and misleading appearance of trading in securities market and thereby, violated provisions of Regulation 3(a), (b), (c), (d) and 4(1) and 4(2)(a) of the PFUTP Regulations. Adjudication Order with respect to Sita Devi Bagaria Page 2 of 2 In the matter of trading in illiquid stock options at BSE.
- Accordingly, in terms of Rule 4(1) of the Adjudication Rules read with Section 15I of the SEBI Act, a notice to show cause dated 04/08/2022 (hereinafter referred to as 'SCN') was issued to the Noticee calling upon her to show cause as to why an inquiry should not be held against her in terms of Rule 4 of the Adjudication Rules and penalty be not imposed under Section 15HA of the SEBI Act for the aforesaid alleged violations. The SCN sent to the Notice was duly served upon the Noticee via SPAD/email.
- Thereafter, vide email dated 20/12/2022, Rajesh Bagaria informed that Noticee, Meera Angnani had died on 10/05/2021 at the age of 85 years. In view of the fact of demise of the Noticee no reply/ submissions can be procured for considering this case under Rule 4(2) of the Adjudication Rules for further inquiry qua this Noticee. Thus, the instant matter does not deserve further inquiry under rule 4(3) of the Adjudication Rules qua this Noticee and accordingly, I proceed to dispose of this matter.
- A death certificate dated 10/05/2021 was issued by Kolkata Municipal Corporation, Department of Health & Family Affairs, Government of West Bengal bearing certificate no. HO013/2021/002051 mentioned that Noticee died on 06/05/2021.

- In this case, the allegations have been levelled against the Noticee in his personal capacity. Thus, the proceedings are against the acts of omission and commission of a person who is no more to face the charges. In view of the foregoing, the proceedings against the Noticee is liable to be abated without going into the merits of the case qua him and the SCN dated August 04, 2022 issued against the Noticee is disposed of accordingly.

CASE STUDY

Ignorance of law is not an excuse for escaping from liability of violation of law

The Appellant, Mega Resources Limited, is aggrieved by the order dated 13.08.2014 passed by the Adjudicating Officer, SEBI imposing a penalty of Rs. 2,00,000/- under Section 15A(b) of the SEBI Act and Rs. 50,00,000/- under Section 15 H(ii) of the SEBI Act for failure on the part of the appellant to comply with the provisions of Regulation 7(1) read with Regulation 7(2) and Regulation 11(1) read with Regulation 14(1) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.

The appellant has admitted that pursuant to the acquisition of 25000 equity shares through off-market transactions the shareholding of the Promoters/Promoter Group of the Company had increased from 50.46% to 60.46% of the Target Company. This triggered Regulation 11(1) of the erstwhile SAST Regulations along with the requirement of submission of certain disclosures under Regulation 7(1) and 7(2) of the erstwhile Regulations. It is admitted by the appellant that the non-compliance with the disclosure requirements in respect of acquisition of shares and failure to make an open offer to the shareholders of the Company was due to lack of awareness of the erstwhile regulations on the part of the Appellant and purely unintentional and without any malafide intentions.

However, it is trite law that ignorance of law will not excuse the appellant to escape the liability of violating the law nor ever absolve the wrongdoer of his crime or misconduct. Further, the appellant contended that in the matter of imposition of penalty, the Section 15(H)(ii) of the SEBI Act, 1992 was amended dated October 29, 2002 and the penalty for non-disclosure of acquisition of shares and takeovers was enhanced from a maximum of Rs.5 lakh to Rs.25 crore. It is argued that since the violation in Appeal was committed in February, 2001, the appellant would be governed by the erstwhile provisions of Section 15H(ii) of the SEBI Act, which existed on the date of violation in question.

Decision

It is true that the maximum monetary penalty imposable for non-disclosure of acquisition of shares and takeovers under the erstwhile SEBI Act on the date of violation by the Appellant was Rs. 5 Lakh and by the amendment dated October 29, 2002 it is up to Rs. 25 Crore or three times of the amount of profits made out of such failure, whichever is higher. However, the moot point in this connection to be noted is that as on October 29, 2002 the obligation to make disclosure and public announcement under Regulations 7(1) read with 7(2) and 11(1) read with 14(1) continued. Therefore, because the violation was continued even after October 29, 2002, the appellant has been rightly imposed penalty under the amended provisions of Section 15H(ii) of the SEBI Act. Since the punishment imposable now for such non-disclosure and public announcement is up to Rs. 25 Crore, SAT finds that the penalty of Rs. 50 Lakh is just and reasonable and not disproportionate. The contention of the appellant in this regard is, therefore, liable to be turned down. Therefore, in the peculiarity of the facts and circumstances of the case and, in particular, the continuity of the obligation to make disclosure and public announcement, the penalty of Rs. 50 lakh is upheld and the appeal is dismissed.

PENALTIES UNDER SECURITIES CONTRACTS(REGULATION) ACT, 1956

The object of Securities Contracts (Regulation) Act, 1956 is to provide for the regulation of stock exchanges, and of transactions in securities dealt on them with a view to prevent undesirable speculation. The Act also seeks

to regulate the buying and selling of securities outside the limits of stock exchanges, through the licensing of security dealers.

The Act prescribes various penalties against persons who might be found guilty of offences under section 23 the Act. These offences are listed below –

Section 23

Any person who-

(a) without reasonable excuse (the burden of proving which shall be on him) fails to comply with any requisition made under sub-section (4) of section 6; or

(b) enters into any contract in contravention of any of the provisions contained in section 13 or section 16; or

(c) contravenes the provisions contained in section 17 or section 17A, or section 19; or

(d) enters into any contract in derivative in contravention of section 18A or the rules made under section 30;

(e) owns or keeps a place other than that of a recognised stock exchange which is used for the purpose of entering into or performing any contracts in contravention of any of the provisions of this Act and knowingly permits such place to be used for such purposes; or

(f) manages, controls, or assists in keeping any place other than that of a recognised stock exchange which is used for the purpose of entering into or performing any contracts in contravention of any of the provisions of this Act or at which contracts are recorded or adjusted or rights or liabilities arising out of contracts are adjusted, regulated or enforced in any manner whatsoever; or

(g) not being a member of a recognised stock exchange or his agent authorised as such under the rules or bye-laws of such stock exchange or not being a dealer in securities licensed under section 17 wilfully represents to or induces any person to believe that contracts can be entered into or performed under this Act through him; or

(h) not being a member of a recognised stock exchange or his agent authorised as such under the rules or bye-laws of such stock exchange or not being a dealer in securities licensed under section 17, canvasses, advertises or touts in any manner either for himself or on behalf of any other persons for any business connected with contracts in contravention of any of the provisions of this Act; or

(i) joins, gathers or assists in gathering at any place other than the place of business specified in the bye-laws of a recognised stock exchange any person or persons for making bids or offers or for entering into or performing any contracts in contravention of any of the provisions of this Act;

shall, without prejudice to any award of penalty by the Adjudicating Officer or the Securities and Exchange Board of India under this Act, on conviction, be punishable with imprisonment for a term which may extend to ten years or with fine, which may extend to twenty-five crore rupees, or with both.

Any person who enters into any contract in contravention of the provisions contained in section or who fails to comply with the provisions of section 21 or section 21A or with the orders of or section 22or with the orders of the Securities Appellate Tribunal shall, without prejudice to any award of penalty by the Adjudicating Officer under this Act, on conviction, be punishable with imprisonment for a term which may extend to ten years or with fine, which may extend to twenty-five crore rupees, or with both.

Penalty for failure to furnish information, return, etc. [Section 23A]

Any person, who is required under this Act or any rules made thereunder,—

(a) to furnish any information, document, books, returns or report to the recognised stock exchange or to the Board, fails to furnish the same within the time specified therefor in the listing agreement or conditions or bye-laws of the recognised stock exchange or the Act or rules made thereunder, or who furnishes false,

incorrect or incomplete information, document, books, return or report, shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees for each such failure;

(b) to maintain books of account or records, as per the listing agreement or conditions, or bye-laws of a recognised stock exchange, fails to maintain the same, shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees.

Penalty for failure by any person to enter into an agreement with clients.[Section 23B]

If any person, who is required under this Act or any bye-laws of a recognised stock exchange made thereunder, to enter into an agreement with his client, fails to enter into such an agreement, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees for every such failure.

Penalty for failure to redress investors' grievances. [Section 23C]

If any stock broker or sub-broker or a company whose securities are listed or proposed to be listed in a recognised stock exchange, after having been called upon by the Securities and Exchange Board of India or a recognised stock exchange in writing, to redress the grievances of the investors, fails to redress such grievances within the time stipulated by the Securities and Exchange Board of India or a recognised stock exchange, he or it shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees.

Penalty for failure to segregate securities or moneys of client or clients. [Section 23D]

If any person, who is registered under section 12 of the Securities and Exchange Board of India Act, 1992 as a stock broker or sub-broker, fails to segregate securities or moneys of the client or clients or uses the securities or moneys of a client or clients for self or for any other client, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one crore rupees.

Penalty for failure to comply with provision of listing conditions or delisting conditions or grounds. [Section 23E]

If a company or any person managing collective investment scheme or mutual fund or real estate investment trust or infrastructure investment trust or alternative investment fund, fails to comply with the listing conditions or delisting conditions or grounds or commits a breach thereof, it or he shall be liable to a penalty which shall not be less than five lakh rupees but which may extend to twenty-five crore rupees.

Penalty for excess dematerialisation or delivery of unlisted securities. [Section 23F]

If any issuer dematerialises securities more than the issued securities of a company or delivers in the stock exchanges the securities which are not listed in the recognised stock exchange or delivers securities where no trading permission has been given by the recognised stock exchange, he shall be liable to a penalty which shall not be less than five lakh rupees but which may extend to twenty-five crore rupees.

Penalty for failure to furnish periodical returns, etc. [Section 23G]

If a recognised stock exchange fails or neglects to furnish periodical returns or furnishes false, incorrect or incomplete periodical returns to the Securities and Exchange Board of India or fails or neglects to make or amend its rules or bye-laws as directed by the Securities and Exchange Board of India or fails to comply with directions issued by the Securities and Exchange Board of India, such recognised stock exchange shall be liable to a penalty which shall not be less than five lakh rupees but which may extend to twenty-five crore rupees.

Penalty for failure to conduct business in accordance with rules, etc. [Section 23GA]

Where a stock exchange or a clearing corporation fails to conduct its business with its members or any issuer or its agent or any person associated with the securities markets in accordance with the rules or regulations made

by the Securities and Exchange Board of India and the directions issued by it under this Act, the stock exchange or the clearing corporations, as the case may be, shall be liable to penalty which shall not be less than five crore rupees but which may extend to twenty-five crore rupees or three times the amount of gains made out of such failure, whichever is higher.

Penalty for contravention where no separate penalty has been provided. [Section 23H]

Whoever fails to comply with any provision of this Act, the rules or articles or bye- laws or the regulations of the recognised stock exchange or directions issued by the Securities and Exchange Board of India for which no separate penalty has been provided, shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one crore rupees.

Power to Adjudicate [Section 23I]

For the purpose of adjudging under sections 23A, 23B, 23C, 23D, 23E, 23F,23G and 23H, the Securities and Exchange Board of India may appoint any officer not below the rank of a Division Chief of the Securities and Exchange Board of India to be an adjudicating officer for holding an inquiry in the prescribed manner after giving any person concerned a reasonable opportunity of being heard for the purpose of imposing any penalty.

While holding an inquiry, the adjudicating officer shall have power to summon and enforce the attendance of any person acquainted with the facts and circumstances of the case to give evidence or to produce any document, which in the opinion of the adjudicating officer, may be useful for or relevant to the subject-matter of the inquiry and if, on such inquiry, he is satisfied that the person has failed to comply with the provisions of any of the sections specified in sub-section (1), he may impose such penalty as he thinks fit in accordance with the provisions of any of those sections.

The Board may call for and examine the record of any proceedings under this section and if it considers that the order passed by the adjudicating officer is erroneous to the extent it is not in the interests of the securities market, it may, after making or causing to be made such inquiry as it deems necessary, pass an order enhancing the quantum of penalty, if the circumstances of the case so justify:

Provided that no such order shall be passed unless the person concerned has been given an opportunity of being heard in the matter:

Provided further that nothing contained in this sub-section shall be applicable after an expiry of a period of three months from the date of the order passed by the adjudicating officer or disposal of the appeal under section 23L, whichever is earlier.

Factors to be taken into account while adjudging quantum of penalty. [Section 23J].

While adjudging the quantum of penalty under section 12A or section 23-I, the Securities and Exchange Board of India or the adjudicating officer shall have due regard to the following factors, namely:—

(a) the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default;

(b) the amount of loss caused to an investor or group of investors as a result of the default;

(c) the repetitive nature of the default.

[Explanation.—For the removal of doubts, it is clarified that the power of an adjudicating officer to adjudge the quantum of penalty under sections 23A to 23C shall be and shall always be deemed to have exercised under the provisions of this section.]

Settlement of administrative and civil proceedings [Section 23JA]

(1) Any person, against whom any proceedings have been initiated or may be initiated under section 12A or section 23-I, may file an application in writing to the Board proposing for settlement of the proceedings initiated or to be initiated for the alleged defaults.

(2) The Board may, after taking into consideration the nature, gravity and impact of defaults, agree to the proposal for settlement, on payment of such sum by the defaulter or on such other terms as may be determined by the Board in accordance with the regulations made under the Securities and Exchange Board of India Act, 1992.

(3) For the purposes of settlement under this section, the procedure as specified by the Board under the Securities and Exchange Board of India Act, 1992 shall apply.

(4) No appeal shall lie under section 23L against any order passed by the Board or the adjudicating officer, as the case may be, under this section.

(5) All settlement amounts, excluding the disgorgement amount and legal costs, realised under this Act shall be credited to the Consolidated Fund of India.

Recovery of amounts [Section 23JB]

- If a person fails to pay the penalty imposed under this Act or fails to comply with a direction of disgorgement order issued under section 12A or fails to pay any fees due to the Board, the Recovery Officer may draw up under his signature a statement in the specified form specifying the amount due from the person (such statement being hereafter in this Chapter referred to as certificate) and shall proceed to recover from such person the amount specified in the certificate by one or more of the following modes, namely:–

  (a) attachment and sale of the person's movable property;

  (b) attachment of the person's bank accounts;

  (c) attachment and sale of the person's immovable property;

  (d) arrest of the person and his detention in prison;

  (e) appointing a receiver for the management of the person's movable and immovable properties,

  and for this purpose, the provisions of sections 220 to 227, 228A, 229, 232, the Second and Third Schedules to the Income-tax Act, 1961 and the Income-tax (Certificate Proceedings) Rules, 1962, as in force from time to time, in so far as may be, apply with necessary modifications as if the said provisions and the rules thereunder were the provisions of this Act and referred to the amount due under this Act instead of to income-tax under the Income-tax Act, 1961.

Explanation 1. – For the purposes of this sub-section, the person's movable or immovable property or monies held in bank accounts shall include any property or monies held in bank accounts which has been transferred, directly or indirectly on or after the date when the amount specified in certificate had become due, by the person to his spouse or minor child or son's wife or son's minor child, otherwise than for adequate consideration, and which is held by, or stands in the name of, any of the persons aforesaid; and so far as the movable or immovable property or monies held in bank accounts so transferred to his minor child or his son's minor child is concerned, it shall, even after the date of attainment of majority by such minor child or son's minor child, as the case may be, continue to be included in the person's movable or immovable property or monies held in bank accounts for recovering any amount due from the person under this Act.

Explanation 2. – Any reference under the provisions of the Second and Third Schedules to the Income-tax Act, 1961 and the Income-tax (Certificate Proceedings) Rules, 1962 to the assesse shall be construed as a reference to the person specified in the certificate.

Explanation 3. – Any reference to appeal in Chapter XVIID and the Second Schedule to the Income-tax Act, 1961, shall be construed as a reference to appeal before the Securities Appellate Tribunal under section 23L of this Act. 2.

The Recovery Officer shall be empowered to seek the assistance of the local district administration while exercising the powers under sub-section (1).

- Notwithstanding anything contained in any other law for the time being in force, the recovery of amounts by a Recovery Officer under sub-section (1), pursuant to non-compliance with any direction issued by the Board under section 12A, shall have precedence over any other claim against such person.
- For the purposes of sub-sections (1), (2) and (3), the expression "Recovery Officer" means any officer of the Board who may be authorized, by general or special order in writing to exercise the powers of a Recovery Officer.

Continuance of proceedings [Section 23JC]

- Where a person dies, his legal representative shall be liable to pay any sum which the deceased would have been liable to pay, if he had not died, in the like manner and to the same extent as the deceased:

  Provided that, in case of any penalty payable under this Act, a legal representative shall be liable only in case the penalty has been imposed before the death of the deceased person.

- For the purposes of sub-section (1), –

  (a) any proceeding for disgorgement, refund or an action for recovery before the Recovery Officer under this Act, except a proceeding for levy of penalty, initiated against the deceased before his death shall be deemed to have been initiated against the legal representative, and may be continued against the legal representative from the stage at which it stood on the date of the death of the deceased and all the provisions of this Act shall apply accordingly;

  (b) any proceeding for disgorgement, refund or an action for recovery before the Recovery Officer under this Act, except a proceeding for levy of penalty, which could have been initiated against the deceased if he had survived, may be initiated against the legal representative and all the provisions of this Act shall apply accordingly.

- Every legal representative shall be personally liable for any sum payable by him in his capacity as legal representative if, while his liability for such sum remains undischarged, he creates a charge on or disposes of or parts with any assets of the estate of the deceased, which are in, or may come into, his possession, but such liability shall be limited to the value of the asset so charged, disposed of or parted with.
- The liability of a legal representative under this section shall, be limited to the extent to which the estate of the deceased is capable of meeting the liability.

  Explanation.–For the purposes of this section ''Legal representative" means a person who in law represents the estate of a deceased person, and includes any person who intermeddles with the estate of the deceased and where a party sues or is sued in a representative character, the person on whom the estate devolves on the death of the party so suing or sued.

Crediting sums realized by way of penalties to Consolidated Fund of India [Section 23K]

- All sums realized by way of penalties under this Act shall be credited to the Consolidated Fund of India.

Appeal to Securities Appellate Tribunal [Section 23L]

- Any person aggrieved, by the order or decision of the recognized stock exchange or the adjudicating officer or any order made by the Securities and Exchange Board of India under or sub-section (3) of section 23-I, may prefer an appeal before the Securities Appellate Tribunal and the provisions of sections 22B, 22C, 22D and 22E of this Act, shall apply, as far as may be, to such appeals.
- Every appeal made above shall be filed within a period of forty-five days from the date on which a copy of the order or decision is received by the appellant and it shall be in such form and be accompanied by such fee as may be prescribed:

- Provided that the Securities Appellate Tribunal may entertain an appeal after the expiry of the said period of forty-five days if it is satisfied that there was sufficient cause for not filing it within that period.
- On receipt of an appeal under sub-section (1), the Securities Appellate Tribunal may, after giving the parties to the appeal, an opportunity of being heard, pass such orders thereon as it thinks fit, confirming, modifying or setting aside the order appealed against.
- The Securities Appellate Tribunal shall send a copy of every order made by it to the parties to the appeal and to the concerned adjudicating officer.
- The appeal filed before the Securities Appellate Tribunal under sub-section (1) shall be dealt with by it as expeditiously as possible and endeavour shall be made by it to dispose of the appeal finally within six months from the date of receipt of the appeal.

Offences [Section 23M]

- Without prejudice to any award of penalty by the adjudicating officer or the Securities and Exchange Board of India under this Act, if any person contravenes or attempts to contravene or abets the contravention of the provisions of this Act or of any rules or regulations or bye-laws made thereunder, for which no punishment is provided elsewhere in this Act, he shall be punishable with imprisonment for a term which may extend to ten years, or with fine, which may extend to Rs.25 crore rupees or with both.
- If any person fails to pay the penalty imposed by the adjudicating officer or the Securities and Exchange Board of India or fails to comply with the direction or order, he shall be punishable with imprisonment for a term which shall not be less than one month but which may extend to ten years, or with fine, which may extend to Rs.25 crore, or with both.

Composition of certain offences [Section 23N]

- Notwithstanding anything contained in the Code of Criminal Procedure, 1973, any offence punishable under this Act, not being an offence punishable with imprisonment only, or with imprisonment and also with fine, may either before or after the institution of any proceeding, be compounded by a Securities Appellate Tribunal or a court before which such proceedings are pending.

Power to grant immunity [Section 23-O]

- The Central Government may, on recommendation by the Securities and Exchange Board of India, if the Central Government is satisfied, that any person, who is alleged to have violated any of the provisions of this Act or the rules or the regulations made thereunder, has made a full and true disclosure in respect of alleged violation, grant to such person, subject to such conditions as it may think fit to impose, immunity from prosecution for any offence under this Act, or the rules or the regulations made thereunder or also from the imposition of any penalty under this Act with respect to the alleged violation:

  Provided that no such immunity shall be granted by the Central Government in cases where the proceedings for the prosecution for any such offence have been instituted before the date of receipt of application for grant of such immunity:

  Provided further that the recommendation of the Securities and Exchange Board of India under this sub-section shall not be binding upon the Central Government.
- An immunity granted to a person under sub-section (1) may, at any time, be withdrawn by the Central Government, if it is satisfied that such person had, in the course of the proceedings, not complied with the condition on which the immunity was granted or had given false evidence, and thereupon such person may be tried for the offence with respect to which the immunity was granted or for any other offence of which he appears to have been guilty in connection with the contravention and shall also become liable to the imposition of any penalty under this Act to which such person would have been liable, had not such immunity been granted.

Contravention by companies [Section 24]

- Where a contravention of any of the provisions of this Act or any rule, regulation, direction or order made thereunder has been committed by a company, every person who, at the time when the contravention was committed, was in charge of, and was responsible to, the company for the conduct of the business of the company, as well as the company, shall be deemed to be guilty of the contravention, and shall be liable to be proceeded against and punished accordingly:

  Provided that nothing contained in this sub-section shall render any such person liable to any punishment provided in this Act, if he proves that the contravention was committed without his knowledge or that he exercised all due diligence to prevent the commission of such contravention.

- Notwithstanding anything contained in sub-section (1), where a contravention of any of the provisions of this Act or any rule, regulation, direction or order made thereunder has been committed by a company and it is proved that the contravention has been committed with the consent or connivance of, or is attributable to any gross negligence on the part of any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer of the company, shall also be deemed to be guilty of that contravention and shall be liable to be proceeded against and punished accordingly.

  Explanation. – For the purpose of this section, –

  (a) "company" means anybody corporate and includes a firm or other association of individuals, and

  (b) "director", in relation to –

  (i) a firm, means a partner in the firm;

  (ii) any association of persons or a body of individuals, means any member controlling the affairs thereof.

The Securities Contracts (Regulation) (Procedure for Holding Inquiry and Imposing Penalties) Rules, 2005.

In exercise of the powers conferred by clause (hd) and clause (i) of sub-section (2) of section 30 of the Securities Contracts (Regulation) Act, 1956 (Act), the Central Government has made The Securities Contracts (Regulation) (Procedure for Holding Inquiry and Imposing Penalties) Rules, 2005 for holding inquiry for the purpose of imposing penalty under sections 23A, 23B, 23C, 23D, 23E, 23F, 23G, 23GA and 23H of the Act, namely :—

Appointment of adjudicating officer for holding inquiry (Rule 3) - Whenever the Securities and Exchange Board of India is of the opinion that there are grounds for adjudging under sections 23A, 23B, 23C, 23D, 23E, 23F, 23G and 23H of the Act, it may appoint any of its officer not below the rank of Division Chief to be an adjudicating officer for holding an inquiry for the said purpose.

Holding of inquiry (Rule 4)

1) **Show Cause Notice:** In holding an inquiry for the purpose of adjudging under sections 23A, 23B, 23C, 23D, 23E, 23F,23G, 23GA and 23H of the Securities Contract (Regulation) Act, 1956, whether any person has committed contraventions as specified in any of sections as mentioned above, the Board or the adjudicating officer shall, in the first instance, issue a notice to such person requiring him to show cause within such period as may be specified in the notice (being not less than fourteen days from the date of service thereof) why an inquiry should not be held against him.

2) **Content of Notice:** Every notice under sub-rule (1) to any such person shall indicate the nature of offence alleged to have been committed by him.

3) Date of Appearance: If, after considering the cause, if any, shown by such person, the Board or the adjudicating officer is of the opinion that an inquiry should be held, he shall issue a notice fixing a

date for the appearance of that person either personally or through his lawyer or other authorised representative.

4) **Personal Hearing:** On the date fixed, the Board or the adjudicating officer shall explain to the person proceeded against or his lawyer or authorised representative, the offence, alleged to have been committed by such person indicating the provisions of the Act, rules or regulations in respect of which contravention is alleged to have taken place.

5) **Opportunity to produce Evidence:** The Board or the adjudicating officer shall then give an opportunity to such person to produce such documents or evidence as he may consider relevant to the inquiry and if necessary the hearing may be adjourned to a future date and in taking such evidence the Board or the adjudicating officer shall not be bound to observe the provisions of the Evidence Act, 1872.

The notice referred to in sub-rule (3), and the personal hearing referred to in sub-rules (3), (4) and (5) may, at the request of the person concerned, be waived.

6) **Enforcement of Attendance:** While holding an inquiry under this rule the Board or the adjudicating officer shall have the power to summon and enforce the attendance of any person acquainted with the facts and circumstances of the case to give evidence or to produce any document which, in the opinion of the Board or the adjudicating officer, may be useful for or relevant to, the subject-matter of the inquiry.

7) If any person fails, neglects or refuses to appear as required by sub-rule (3) before the Board or the adjudicating officer, the Board or the adjudicating officer may proceed with the inquiry in the absence of such person after recording the reasons for doing so.

Order of the Board or the adjudicating officer (Rule 5)

1) **Imposition of Penalty:** If, upon consideration of the evidence produced before the Board or the adjudicating officer, the Board or the adjudicating officer is satisfied that the person has become liable to penalty under any of the sections specified in sub-section (1) or sub-section (2) of section 12A or section 23-I of the Securities Contracts (Regulations) Act, 1956, he may, by order in writing, impose such penalty as he thinks fit in accordance with the provisions of the relevant sections.

2) **Quantum of Penalty:** While adjudging the quantum of penalty under sub-section (2) of section 12A or section 23-I of the Securities Contracts (Regulations) Act, 1956, the Board or the adjudicating officer shall have due regard to the following factors, namely :—

   (a) the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default ;

   (b) the amount of loss caused to an investor or group of investors as a result of the default ;

   (c) the repetitive nature of the default.

3) **Content of Order:** Every order made under sub-rule (1) shall specify the provisions of the Act in respect of which default has taken place and shall contain brief reasons for such decisions.

4) **Date & Sign:** Every such order shall be dated and signed by the Board or the adjudicating officer.

5) **Rectification of Error:** The Board or the adjudicating officer who has passed an order, may rectify any error apparent on the face of record on such order, either on its own motion or where such error is brought to his notice by the affected person within a period of fifteen days from the date of such order.

Explanation: For the purpose of this rule, “error apparent on the face of record” shall mean any typographical errors that creep in inadvertently into the order and includes such other errors that do not require a long drawn out reasoning process to ascertain such a mistake.

Copy of the order (Rule 6)

The Board or the adjudicating officer shall send a copy of every order made under rules by it to the person concerned and to the Securities and Exchange Board of India.

Service of notices and orders (Rule 7)

1) A notice or an order issued under these rules shall be served on the person through any of the following modes, namely:–

   (a) by delivering or tendering it to that person or his duly authorised agent; or

   (b) by sending it to the person by fax or electronic mail or electronic instant messaging services along with electronic mail or by courier or speed post or registered post:

   The courier or speed post or registered post shall be sent to the address of his place of residence or his last known place of residence or the place where he carried on, or last carried on, business or personally works, or last worked, for gain, with acknowledgment due:

   A notice sent by fax shall bear a note that the same is being sent by fax and in case the document contains annexure, the number of pages being sent shall also be mentioned:

   A notice sent through electronic mail or electronic instant messaging services along with electronic mail shall be digitally signed by the competent authority and bouncing of the electronic mail shall not constitute valid service.

2) In case of failure to serve a notice or an order through any one of the modes provided under sub-rule (1), the notice or order may be affixed on the outer door or some other conspicuous part of the premises in which the person resides or is known to have last resided, or carried on business or personally works, or last worked, for gain and a written report thereof shall be prepared in the presence of two witnesses.

3) In case of failure to affix the notice or order on the outer door as provided under sub-rule (2), the notice or order shall be published in at least two newspapers, one of which shall be in an English daily newspaper having nationwide circulation and another shall be in a newspaper having wide circulation published in the language of the region where that person was last known to have resided or carried on business or personally worked for gain.

CONTRAVENTION AND PENALTIES, ADJUDICATION AND APPEAL UNDER FOREIGN EXCHANGE MANAGEMENT ACT (FEMA), 1999

Penalties (Section 13)

- If any person contravenes any provision of this Act, or contravenes any rule, regulation, notification, direction or order issued in exercise of the powers under this Act, or contravenes any condition subject to which an authorisation is issued by the Reserve Bank, he shall, upon adjudication, be liable to a penalty up to thrice the sum involved in such contravention where such amount is quantifiable, or up to two lakh rupees where the amount is not quantifiable, and where such contravention is a continuing one, further penalty which may extend to five thousand rupees for every day after the first day during which the contravention continues.
- If any person is found to have acquired any foreign exchange, foreign security or immovable property, situated outside India, of the aggregate value exceeding the threshold prescribed under the proviso to sub- section (1) of section 37A, he shall be liable to a penalty up to three times the sum involved in such contravention and confiscation of the value equivalent, situated in India, the Foreign exchange, foreign security or immovable property
- If the Adjudicating Authority, in a proceeding deems fits, he may, after recording the reasons in writing, recommend for the initiation of prosecution and if the Director of Enforcement is satisfied, he may, after recording the reasons in writing, may direct prosecution by filing a Criminal Complaint against the guilty person by an officer not below the rank of Assistant Director.

- If any person is found to have acquired any foreign exchange, foreign security or immovable property, situated outside India, of the aggregate value exceeding the threshold prescribed under the proviso to subsection (1) of section 37A, he shall be, in addition to the penalty imposed under sub-section (1A), punishable with imprisonment for a term which may extend to five years and with fine.
- No court shall take cognizance of an offence under sub-section (1C) of section 13 except as on complaint in writing by an officer not below the rank of Assistant Director referred to in sub-section (1B).
- Any Adjudicating Authority adjudging any contravention under sub-section (1), may, if he thinks fit in addition to any penalty which he may impose for such contravention direct that any currency, security or any other money or property in respect of which the contravention has taken place shall be confiscated to the Central Government and further direct that the foreign exchange holdings, if any, of the persons committing the contraventions or any part thereof, shall be brought back into India or shall be retained outside India in accordance with the directions made in this behalf.

  Explanation.– For the purposes of this sub-section, "property" in respect of which contravention has taken place, shall include –
  (a) deposits in a bank, where the said property is converted into such deposits;
  (b) Indian currency, where the said property is converted into that currency; and
  (c) any other property which has resulted out of the conversion of that property.

Enforcement of the orders of Adjudicating Authority (Section 14)

- Subject to the provisions of section 19(2), if any person fails to make full payment of the penalty imposed on him under section 13 within a period of ninety days from the date on which the notice for payment of such penalty is served on him, he shall be liable to civil imprisonment under this section.
- No order for the arrest and detention in civil prison of a defaulter shall be made unless the Adjudicating Authority has issued and served a notice upon the defaulter calling upon him to appear before him on the date specified in the notice and to show cause why he should not be committed to the civil prison, and unless the Adjudicating Authority, for reasons in writing, is satisfied –

  (a) that the defaulter, with the object or effect of obstructing the recovery of penalty, has after the issue of notice by the Adjudicating Authority, dishonestly transferred, concealed, or removed any part of his property, or

  (b) that the defaulter has, or has had since the issuing of notice by the Adjudicating Authority, the means to pay the arrears or some substantial part thereof and refuses or neglects or has refused or neglected to pay the same.
- Notwithstanding anything contained in sub-section (1), a warrant for the arrest of the defaulter may be issued by the Adjudicating Authority if the Adjudicating Authority is satisfied, by affidavit or otherwise, that with the object or effect of delaying the execution of the certificate the defaulter is likely to abscond or leave the local limits of the jurisdiction of the Adjudicating Authority.
- Where appearance is not made pursuant to a notice issued and served under sub-section (1), the Adjudicating Authority may issue a warrant for the arrest of the defaulter.
- A warrant of arrest issued by the Adjudicating Authority under sub-section (3) or sub-section (4) may also be executed by any other Adjudicating Authority within whose jurisdiction the defaulter may for the time being be found.
- Every person arrested in pursuance of a warrant of arrest under this section shall be brought before the Adjudicating Authority issuing the warrant as soon as practicable and in any event within twenty-four hours of his arrest (exclusive of the time required for the journey):

  Provided that, if the defaulter pays the amount entered in the warrant of arrest as due and the costs of the arrest to the officer arresting him, such officer shall at once release him.

Explanation. – For the purposes of this sub-section, where the defaulter is a Hindu undivided family, the karta thereof shall be deemed to be the defaulter.

- When a defaulter appears before the Adjudicating Authority pursuant to a notice to show cause or is brought before the Adjudicating Authority under this section, the Adjudicating Authority shall give the defaulter an opportunity showing cause why he should not be committed to the civil prison.
- Pending the conclusion of the inquiry, the Adjudicating Authority may, in his discretion, order the defaulter to be detained in the custody of such officer as the Adjudicating Authority may think fit or release him on his furnishing the security to the satisfaction of the Adjudicating Authority for his appearance as and when required.
- Upon the conclusion of the inquiry, the Adjudicating Authority may make an order for the detention of the defaulter in the civil prison and shall in that event cause him to be arrested if he is not already under arrest:

  Provided that in order to give a defaulter an opportunity of satisfying the arrears, the Adjudicating Authority may, before making the order of detention, leave the defaulter in the custody of the officer arresting him or of any other officer for a specified period not exceeding fifteen days, or release him on his furnishing security to the satisfaction of the Adjudicating Authority for his appearance at the expiration of the specified period if the arrears are not satisfied.
- When the Adjudicating Authority does not make an order of detention under sub-section (9), he shall, if the defaulter is under arrest, direct his release.
- Every person detained in the civil prison in execution of the certificate may be so detained,–

  (a) where the certificate is for a demand of an amount exceeding rupees one crore, up to three years, and

  (b) in any other case, up to six months:

  Provided that he shall be released from such detention on the amount mentioned in the warrant for his detention being paid to the officer-in-charge of the civil prison.
- A defaulter released from detention under this section shall not, merely by reason of his release, be discharged from his liability for the arrears, but he shall not be liable to be arrested under the certificate in execution of which he was detained in the civil prison.
- A detention order may be executed at any place in India in the manner provided for the execution of warrant of arrest under the Code of Criminal Procedure, 1973.

Power of recover arrears of penalty (Section 14A)

- Save as otherwise provided in this Act, the Adjudicating Authority may, by order in writing, authorize an officer of Enforcement not below the rank of Assistant Director to recover any arrears of penalty from any person who fails to make full payment of penalty imposed on him under section 13 within the period of ninety days from the date on which the notice for payment of such penalty is served on him.
- The officer referred to in sub-section (1) shall exercise all the like powers which are conferred on the income-tax authority in relation to recovery of tax under the Income-tax Act, 1961 (43 of 1961) and the procedure laid down under the Second Schedule to the said Act shall mutatis mutandis apply in relation to recovery of arrears of penalty under this Act.

Appointment of Adjudicating Authority (Section 16)

- For the purpose of adjudication under section 13, the Central Government may, by an order published in the Official Gazette, appoint as many officers of the Central Government as it may think fit, as the Adjudicating Authorities for holding an inquiry in the manner prescribed after giving the person alleged to have committed contravention under section 13, against whom a complaint has been

made under sub-section (3) (hereinafter in this section referred to as the said person) a reasonable opportunity of being heard for the purpose of imposing any penalty:

Provided that where the Adjudicating Authority is of opinion that the said person is likely to abscond or is likely to evade in any manner, the payment of penalty, if levied, it may direct the said person to furnish a bond or guarantee for such amount and subject to such conditions as it may deem fit.

- The Central Government shall, while appointing the Adjudicating Authorities under sub-section (1), also specify in the order published in the Official Gazette, their respective jurisdictions.
- No Adjudicating Authority shall hold an enquiry under sub-section (1) except upon a complaint in writing made by any officer authorized by a general or special order by the Central Government.
- The said person may appear either in person or take the assistance of a legal practitioner or a chartered accountant of his choice for presenting his case before the Adjudicating Authority.
- Every Adjudicating Authority shall have the same powers of a civil court which are conferred on the Appellate Tribunal under sub-section (2) of section 28 and–

  (a all proceedings before it shall be deemed to be judicial proceedings within the meaning of sections 193 and 228 of the Indian Penal Code;

  (b) shall be deemed to be a civil court for the purposes of sections 345 and 346 of the Code of Criminal Procedure, 1973.
- Every Adjudicating Authority shall deal with the complaint under sub-section (2) as expeditiously as possible and endeavour shall be made to dispose of the complaint finally within one year from the date of receipt of the complaint:

  Provided that where the complaint cannot be disposed of within the said period, the Adjudicating Authority shall record periodically the reasons in writing for not disposing of the complaint within the said period.

Appeal to Special Director (Appeals) (Section 17)

- The Central Government shall, by notification, appoint one or more Special Directors (Appeals) to hear appeals against the orders of the Adjudicating Authorities under this section and shall also specify in the said notification the matter and places in relation to which the Special Director (Appeals) may exercise jurisdiction.
- Any person aggrieved by an order made by the Adjudicating Authority, being an Assistant Director of Enforcement or a Deputy Director of Enforcement, may prefer an appeal to the Special Director (Appeals).
- Every appeal under sub-section (1) shall be filed within forty-five days from the date on which the copy of the order made by the Adjudicating Authority is received by the aggrieved person and it shall be in such form, verified in such manner and be accompanied by such fee as may be prescribed:

  Provided that the Special Director (Appeals) may entertain an appeal after the expiry of the said period of forty-five days, if he is satisfied that there was sufficient cause for not filing it within that period.
- On receipt of an appeal under sub-section (1), the Special Director (Appeals) may after giving the parties to the appeal an opportunity of being heard, pass such order thereon as he thinks fit, confirming, modifying or setting aside the order appealed against.
- The Special Director (Appeals) shall send a copy of every order made by him to the parties to appeal and to the concerned Adjudicating Authority.
- The Special Director (Appeals) shall have the same powers of a civil court which are conferred on the Appellate Tribunal under sub-section (2) of section 28 and –

(a) all proceedings before him shall be deemed to be judicial proceedings within the meaning of sections 193 and 228 of the Indian Penal Code ;

(b) shall be deemed to be a civil court for the purposes of sections 345 and 346 of the Code of Criminal Procedure, 197)

Appellate Tribunal (Section 18)

The Appellate Tribunal constituted under section 12(1) of the Smugglers and Foreign Exchange Manipulators (Forfeiture of Property) Act, 1976, shall, on and from the commencement of Part XIV of Chapter VI of the Finance Act, 2017, be the Appellate Tribunal for the purposes of this Act and the said Appellate Tribunal shall exercise the jurisdiction, powers and authority conferred on it by or under FEMA.

Appeal to Appellate Tribunal (Section 19)

- Save as provided in sub-section (2), the Central Government or any person aggrieved by an order made by an Adjudicating Authority, other than those referred to in section 17(1), or the Special Director (Appeals), may prefer an appeal to the Appellate Tribunal:

  Provided that any person appealing against the order of the Adjudicating Authority or the Special Director (Appeals) levying any penalty, shall while filing the appeal, deposit the amount of such penalty with such authority as may be notified by the Central Government:

  Provided further that where in any particular case, the Appellate Tribunal is of the opinion that the deposit of such penalty would cause undue hardship to such person, the Appellate Tribunal may dispense with such deposit subject to such conditions as it may deem fit to impose so as to safeguard the realisation of penalty.

- Every appeal under sub-section (1) shall be filed within a period of forty-five days from the date on which a copy of the order made by the Adjudicating Authority or the Special Director (Appeals) is received by the aggrieved person or by the Central Government and it shall be in such form, verified in such manner and be accompanied by such fee as may be prescribed:

  Provided that the Appellate Tribunal may entertain an appeal after the expiry of the said period of forty-five days if it is satisfied that there was sufficient cause for not filing it within that period.

- On receipt of an appeal under sub-section (1), the Appellate Tribunal may, after giving the parties to the appeal an opportunity of being heard, pass such orders thereon as it thinks fit, confirming, modifying or setting aside the order appealed against.

- The Appellate Tribunal shall send a copy of every order made by it to the parties to the appeal and to the concerned Adjudicating Authority or the Special Director (Appeals), as the case may be.

- The appeal filed before the Appellate Tribunal under sub-section (1) shall be dealt with by it as expeditiously as possible and endeavour shall be made by it to dispose of the appeal finally within one hundred and eighty days from the date of receipt of the appeal:

  Provided that where any appeal could not be disposed of within the said period of one hundred and eighty days, the Appellate Tribunal shall record its reasons in writing for not disposing off the appeal within the said period.

- The Appellate Tribunal may, for the purpose of examining the legality, propriety or correctness of any order made by the Adjudicating Authority under section 16 in relation to any proceeding, on its own motion or otherwise, call for the records of such proceedings and make such order in the case as it thinks fit.

Procedure and powers of Appellate Tribunal and Special Director (Appeals) (Section 28)

- The Appellate Tribunal and the Special Director (Appeals) shall not be bound by the procedure laid down by the Code of Civil Procedure, 1908, but shall be guided by the principles of natural justice and,

subject to the other provisions of this Act, the Appellate Tribunal and the Special Director (Appeals) shall have powers to regulate its own procedure.

- The Appellate Tribunal and the Special Director (Appeals) shall have, for the purposes of discharging its functions under this Act, the same powers as are vested in a civil court under the Code of Civil Procedure, 1908, while trying a suit, in respect of the following matters, namely:–

  (a) summoning and enforcing the attendance of any person and examining him on oath;

  (b) requiring the discovery and production of documents;

  (c) receiving evidence on affidavits;

  (d) subject to the provisions of sections 123 and 124 of the Indian Evidence Act, 1872 (1 of 1872); requisitioning any public record or document or copy of such record or document from any office;

  (e) issuing commissions for the examination of witnesses or documents;

  (f) reviewing its decisions;

  (g) dismissing a representation of default or deciding it ex parte;

  (h) setting aside any order of dismissal of any representation for default or any order passed by it ex parte; and

  (i) any other matter which may be prescribed by the Central Government.

- An order made by the Appellate Tribunal or the Special Director (Appeals) under this Act shall be executable by the Appellate Tribunal or the Special Director (Appeals) as a decree of civil court and, for this purpose, the Appellate Tribunal and the Special Director (Appeals) shall have all the powers of a civil court.

- Notwithstanding anything contained in sub-section (3), the Appellate Tribunal or the Special Director (Appeals) may transmit any order made by it to a civil court having local jurisdiction and such civil court shall execute the order as if it were a decree made by that court.

- All proceedings before the Appellate Tribunal and the Special Director (Appeals) shall be deemed to be judicial proceedings within the meaning of sections 193 and 228 of the Indian Penal Code and the Appellate Tribunal shall be deemed to be a civil court for the purposes of sections 345 and 346 of the Code of Criminal Procedure, 1973.

Civil court not to have jurisdiction (Section 34)

No civil court shall have jurisdiction to entertain any suit or proceeding in respect of any matter which an Adjudicating Authority or the Appellate Tribunal or the Special Director (Appeals) is empowered by or under this Act to determine and no injunction shall be granted by any court or other authority in respect of any action taken or to be taken in pursuance of any power conferred by or under this Act.

Appeal to High Court (Section 35)

- Any person aggrieved by any decision or order of the Appellate Tribunal may file an appeal to the High Court within sixty days from the date of communication of the decision or order of the Appellate Tribunal to him on any question of law arising out of such order:

  Provided that the High Court may, if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed within a further period not exceeding sixty days.

  Explanation.–In this section "High Court" means –

  (a) the High Court within the jurisdiction of which the aggrieved party ordinarily resides or carries on business or personally works for gain; and

  (b) where the Central Government is the aggrieved party, the High Court within the jurisdiction

of which the respondent, or in a case where there are more than one respondent, any of the respondents, ordinarily resides or carries on business or personally works for gain.

Foreign Exchange Management (Adjudication Proceedings and Appeal) Rules, 2000

In exercise of the powers conferred by section 46 read with sub-section (1) of section 16, sub-section (3) of section 17 and sub-section (2) of section 19 of the Foreign Exchange Management Act, 1999 (Act), the Central Government has made the Foreign Exchange Management (Adjudication Proceedings and Appeal) Rules, 2000 for holding enquiry for the purpose of imposing penalty and appeals under Chapter V of the said Act, namely:–

Appointment of Adjudicating Authority (Rule 3)

The Central Government may, by an order published in the Official Gazette, appoint as many officers of the Central Government as it may think fit, as the Adjudicating Authorities for holding inquiry under the provisions of Chapter IV of the Act.

Holding of inquiry (Rule 4)

1) **Issue of Show Cause Notice**- For the purpose of adjudicating under section 13 of the Act whether any person has committed any contravention as specified in that section of the Act, the Adjudicating Authority shall, issue a notice to such person requiring him to show cause within such period as may be specified in the notice (being not less than ten days from the date of service thereof) why an inquiry should not be held against him.

2) **Content of Notice**- Every notice under sub-rule (1) to any such person shall indicate the nature of contravention alleged to have been committed by him.

3) **Date of Appearance**- After considering the cause, if any, shown by such person, the Adjudicating Authority is of the opinion that an inquiry should be held, he shall issue a notice fixing a date for the appearance of that person either personally or through his legal practitioner or a chartered accountant duly authorised by him.

4) **Personal Hearing-** On the date fixed, the Adjudicating Authority shall explain to the person proceeded against or his legal practitioner or the chartered accountant, as the case may be, the contravention, allowed to have been committed by such person indicating the provisions of the Act or of rules, regulations, notifications, directions or orders or any condition subject to which an authorisation is issued by the Reserve Bank of India in respect of which contravention is alleged to have taken place.

5) **Opportunity to produce Evidence**-The Adjudicating Authority shall, then, given an opportunity to such person to produce such documents or evidence as he may consider relevant to the inquiry and if necessary, the hearing may be adjourned to a future date and in taking such evidence the Adjudicating Authority shall not be bound to observe the provisions of the Indian Evidence Act, 1872

6) **Power to summon and enforce attendance-**While holding an inquiry under this rule the Adjudicating Authority shall have the power to summon and enforce attendance of any person acquainted with the facts and circumstances of the case to give evidence or to produce any document which in the opinion of the Adjudicating Authority may be useful for or relevant to the subject matter of the inquiry.

7) If any person fails, neglects or refuses to appear as required by sub-rule (3) before the Adjudicating Authority, the Adjudicating Authority may proceed with the adjudication proceedings in the absence of such person after recording the reasons for doing so.

8) **Order by the Adjudicating Authority-** If, upon consideration of the evidence produced before the Adjudicating Authority, the Adjudicating Authority is satisfied that the person has committed the contravention, he may, by order in writing, impose such penalty as he thinks fit, in accordance with the provisions of section 13 of the Act.

9) Every order made under sub-rule (8) of the rule 4 shall specify the provisions of the Act or of the rules, regulations, notifications, directions or orders or any condition subject to which an authorisation is issued by the Reserve Bank of India in respect of which contravention has taken place and shall contain reasons for such decisions.

10) Every order made under sub-rule (8) shall be dated and signed by the Adjudicating Authority.

11) A copy of the order made under sub-rule (8) of rule 4 shall be supplied free of charge to the person against whom the order is made and all other copies of proceedings shall be supplied to him on payment of copying fee @ Rs. 2 per page.

12) The copying fee referred to in sub-rule (11) shall be paid in cash or in the form of demand draft in favour of the Adjudicating Authority.

Appeal to Special Director (Appeals) (Rule 5)

Form of appeal —

(1) Every appeal presented to the Special Director (Appeals) under section 17 of the Act shall be in the Form I signed by the applicant. The appeal shall be filed in triplicate and accompanied by three copies of the order appealed against. Every appeal shall be accompanied by a fee of Rupees five thousand in the form of cash or demand draft payable in favour of the Special Director (Appeals).

(2) The appeal shall set forth concisely and under distinct heads the grounds of objection to the order appealed against without any argument of narrative and such grounds shall be numbered consecutively; and shall specify the address for service at which notice or other processes may be served on the applicant, the date on which the order appealed against was served on the applicant.

(3) Where the appeal is presented after the expiry of the period of forty-five days referred to in sub-section (3) of section 17, it shall be accompanied by a petition, in triplicate, duly verified and supported by the documents, if any, relied upon by the applicant, showing cause how the applicant had been prevented from preferring the appeal within the said period of forty five days.

(4) Any notice required to be served on the applicant shall be served on him in the manner specified in rule 9 at the address for service specified in the appeal.

Procedure before Special Director (Appeals) (Rule 6)

1) On receipt of an appeal under rule 5, the Special Director (Appeals) shall send a copy of the appeal, together with a copy of the order appealed against, to the Director of Enforcement.

2) The Special Director (Appeals) shall, then, issue notices to the applicant and the Director of Enforcement fixing a date for hearing of the appeal.

3) On the date fixed for hearing of the appeal or any other day to which the hearing of the appeal may be adjourned, the applicant as well as the presenting officer of the Directorate of Enforcement shall be heard.

4) Where on the date fixed, or any other day to which the hearing of the appeal may be adjourned, the applicant or the presenting officer fail to appeal when the appeal is called for hearing, the Special Director (Appeals) may decide the appeal on the merits of the case within one hundred and eighty days from the date of such appeal.

Contents of the Order in appeal (Rule 7)

1) The order of Special Director (Appeals) shall be in writing and shall state briefly the grounds for the decision.

2) The order referred to in sub-rule (1) shall be signed by the Special Director (Appeals) hearing the appeal.

Representation of party (Rule 8)

Any applicant who has filed an appeal before the Special Director (Appeals) under section 17 of the Act, may appoint a legal practitioner or a chartered accountant to appear and plead and act on his behalf before the Special Director (Appeal) under the Act.

Service of notices, requisitions or orders (Rule 9)

A notice, requisition or an order issued under these rules shall be served on any person in the following manner, that is to say,—

(a) by delivering or tendering the notice or requisition or order to that person or his duly authorised person;

(b) by sending the notice or requisition or order to him by registered post with acknowledgment due to the address of his place of residence or his last known place or residence or the place where he carried on or last carried on, business or personally works or last worked for gain; or

(c) by affixing it on the outer door or some other conspicuous part of the premises in which the person resides or is known to have last resided or carried on business or personally works or last worked for gain and that written report thereof should be witnesses by two persons; or

(d) if the notice or requisition or order cannot be served under clause (a) or clause (b) or clause (c), by publishing in a leading newspaper (both in vernacular and in English) having wide circulation of area or jurisdiction in which the person resides or is known to have last resided or carried on business or personally works or last worked for gain.

Appeal to the Appellate Tribunal (Rule 10)

Form of appeal

1) Every appeal presented to the Appellate Tribunal under section 19 of the Act shall be in the Form II signed by the applicant. The appeal shall be sent in triplicate and accompanied by three copies of the order appealed against. Every appeal shall be accompanied by a fee of Rupees ten thousand in the form of cash or demand draft payable in favour of the Registrar, Appellate Tribunal for Foreign Exchange, New Delhi:

   Provided that the applicant shall deposit the amount of penalty imposed by the Adjudicating Authority or the Special Director (Appeals) as the case may be, to such authority as may be notified under the first proviso to section 19 of the Act:

   Provided further that where in a particular case, the Appellate Tribunal is of the opinion that the deposit of such penalty would cause undue hardship to such person, the Appellate Tribunal may dispense with such deposit subject to such conditions as it may deem fit to impose so as to safeguard the realisation of penalty.

2) The appeal shall set forth concisely and under distinct head the grounds of objection to the order appealed against without any argument of narrative and such grounds shall be numbered consecutively; and shall specify the address for service at which notice or other processes may be served on the applicant, the date on which the order appealed against was served on the applicant; and the sum imposed by way of penalty under section 13 and the amount of fee prescribed in sub-rule (1) has been deposited or not.

3) Where the appeal is presented after the expiry of the period of forty-five days referred to in sub-section (2) of section 19, it shall be accompanied by a petition, in triplicate, duly verified and supported by the documents, if any, relied upon by the applicant, showing cause how the applicant had been prevented from preferring the appeal within the said period of forty-five days.

4) Any notice required to be served on the applicant shall be served on him in the manner prescribed in rule 14 at the address for service specified in the appeal.

Procedure before Appellate Tribunal (Rule 11)

1) On receipt of an appeal under rule 10, the Appellate Tribunal shall send a copy of the appeal together with a copy of the order appealed against, to the Director of Enforcement.

2) The Appellate Tribunal shall, then, issue notices to the applicant and the Director of Enforcement fixing a date for hearing of the appeal.

3) On the date fixed for hearing of the appeal, or any other day to which the hearing of the appeal may be adjourned, the applicant as well as the presenting officer of the Directorate of Enforcement shall be heard.

4) Where on the date fixed, or any other day to which the hearing of the appeal may be adjourned the applicant or the presenting officer fail to appeals when the appeal is called on for hearing, the Appellate Tribunal may decide the appeal on the merits of the case.

Contents of the Order in appeal (Rule 12)

1) The order of Appellate Tribunal shall be in writing and shall state briefly the grounds for the decision.

2) The order referred to in sub-rule (1) shall be signed by the Chairman or Member of the Appellate Tribunal hearing the appeal.

Representation of party (Rule 13)

Any applicant who has filed an appeal before the Appellate Tribunal under section 19 of the Act may appoint a legal practitioner or a chartered accountant to appeals and plead and act on his behalf before the Special Director (Appeals) under the Act,

Service of notices, requisitions or orders (Rule 14)

A notice, requisition or an order issued under these rules shall be served on any person in the following manner, that is to say,—

a) by delivering or tendering the notice or requisition or order to that person or his duly authorised person,

b) by sending the notice or requisition or order to him by registered post with acknowledgment due to the address of his place of residence or his last known place or residence or the place where he carried on, or last carried on, business or personally works or last worked for gain, or

c) by affixing it on the outer door or some other conspicuous part of the premises in which the person resides or is known to have last resided or carried on business or personally works or has worked for gain and that written report thereof should be witnesses by two persons, or

d) if the notice or requisition or order cannot be served under clause (a) or clause (b) or clause (c), by publishing in a leading newspaper (both in vernacular and in English) having wide circulation or area or jurisdiction in which the person resides or is known to have last resided or carried on business or personally works or last worked for gain.

Penalty for repeated default (Section 454A)

Where a company or an officer of a company or any other person having already been subjected to penalty for default under any provisions of this Act, again commits such default within a period of three years from the date of order imposing such penalty passed by the adjudicating officer or the Regional Director, as the case may be, it or he shall be liable for the second or subsequent defaults for an amount equal to twice the amount of penalty provided for such default under the relevant provisions of this Act.

Differences between Section 441 and Section 454 under the Companies Act, 2013

Compounding (Section 441)	Adjudication (Section 454)
Regional Director or on an authorized officer of the Central Government can compound offence upto Rs. 25 Lakhs; and NCLT can compound offence above Rs. 25 Lakhs.	no monetary limits stipulated for exercising the powers by the adjudicating officers.
The compounding order is delivered generally based on a consensus arrived at by both parties with the compounding authority having a final say on the outcome of the application and the quantum of penalty.	the adjudicating officer's order is more arbitrary and not on consensus, though a reasonable opportunity may be given to the company and the officer in default as required u/s 454(4) before the imposition of any penalty.
Compounding order is generally not appealable. Once he agrees on the compounding order, he cannot go on appeal against it.	adjudication order is appealable with the higher authorities as per the express provision provided in section 454, with the procedure being provided by the Rules,

TEST YOURSELF

Under what circumstances can adjudication be ordered u/s 454? Or in short what triggers an action u/s 454? Is it on the findings of the MCA that an offence has occurred following an inspection u/s 206 or on scrutiny of the Balance Sheet or from the statutory auditors' report or from the secretarial audit report?;

- There must have been a default or non-compliance of the provisions of the Companies Act, 2013;
- The default has to be ascertained and the nature of non-compliance must be identified by the concerned office of the ROC or emanate from inspection/investigation or from the statutory auditor's report or the secretarial audit report;
- Fine is not the same as penalty. Penalty is a broader term which includes fine. Before initiating adjudication proceedings u/s 454, it has to be ascertained if the penal provisions in the section alleged to have been violated for which these proceedings are sought to be initiated are in the nature of fine or penalty.

  In general usage, these two words are used synonymously. In the Companies Act, 2013, there are many sections which talk of "fine" and many other sections talk of "penalty". Those sections which have stipulated "fines" will necessarily be outside the purview of section 454 since Section 454(3) clearly authorizes the adjudicating officer with a power to impose only penalty and it is implied that he has to take cognizance of the penalty stipulated under the section which has been violated. In whichever fines have been stipulated, the defaulting parties can take recourse to seeking compounding of the offence whether a show-cause notice is issued or not.

  Who orders adjudication proceedings u/s 454? Can the RoC himself order?

  In which case can the Central Government appoint him as the adjudicating officer? Either the ROC himself on a scrutiny of documents filed with him and on his satisfaction has to come to a conclusion that there has been non-compliance of the provisions of the Act as arrived at under section 206(4) or has to come to a conclusion of such non-compliances based on any report on inspection or investigation, if any, under the relevant provisions of the Companies Act,2013, or on the qualifications of the statutory auditors in the Annual Report or by the secretarial auditors in their Secretarial Audit Report whereby he can ascertain and identify the nature of non-compliance or default. In all these cases, he himself cannot initiate any adjudicating proceedings if he is the adjudicating officer even as he may be clothed with a power of adjudication.

Therefore, if adjudicating powers are under his jurisdiction, any other officer who is independent of his office has to identify the existence of violation as otherwise the adjudicating officer, being the head of his office may be biased. This is a grey area to be addressed by the Central Government as otherwise the adjudicating officer will be sitting on a judgement of the findings of his own office.

It is pertinent to note that it would, therefore, be only logical, prudent and wise for the concerned Regional Director not to appoint as the adjudicating officer pursuant to section 454(2), the same jurisdictional Registrar of Companies whose office has identified the violation.

When there is a provision for compounding u/s 441 how does section 454 come into play? Does Section 454 override Section 441 since it is a later section? Or do both sections play parallelly? Which section prevails?

Both these sections are independent of each other. The question of one section overriding the other does not arise, as they operate concurrently. The Regional Director cannot set the compounding process in motion u/s 441 and simultaneously the ROC cannot order adjudication u/s. 454.

Section 441 deals with compounding and Section 454 deals with adjudication. The adjudicating officer has no power to compound. The Regional Director alone can compound.

If he has to authorize another officer it has to be u/s 441(1)(b) and not under 454. The adjudicating officer u/s 454 can only adjudicate on the quantum of penalty. He has no right to go into the merits and demerits of the default. Within the parameters set under the sections which are under default he can wander. In fact, he can only revise the fee upwards not downwards as can be seen from the parameters set under Rule 3(9) of the Companies (Adjudication of Penalties) Rules, 2014. Whereas, the Regional Director or the NCLT can afford to give lot of concessions on the quantum of penalty depending on the facts of the case. The power to compound vested with the Regional Director or the NCLT is more subjective.

When a suo motto application for compounding is made, how does Section 454 come into play?

The moot question here will be, should the Regional Director or the NCLT take cognizance of adjudication proceedings u/s 454(2) when a suo moto application made by the defaulter for composition involving an offence, the nature of which the defaulter himself has identified, is pending with him/NCLT for disposal and stop the adjudication proceedings? Therefore, it appears that prima facie section 454 will not come into play. The ROC who has forwarded the compounding application to either of them with his report has to seek directions from the RD/NCLT in such a case. The Regional Director/NCLT may agree for adjudication after giving justifiable reasons for his choice for adjudication overriding the compounding application in a speaking manner. But this decision can be challenged before the same RD under section 454(5) by the applicants to a suo moto compounding application if the ROC, being the adjudicating officer exercises his power u/s 454, on the grounds that the defaulting party itself has identified the non-compliance and none else and therefore, the offence will obviously be outside the purview of Section 454.

To sum up, there is no contradiction between section 441 and 454 as they operate under their own separate spheres. Earlier, the ROC could only initiate the launching of criminal proceedings to implement the penal provisions of the sections which have been violated and the Magistrate's court gave the verdict after trial. Section 454 read with its rules has now given powers to the adjudicating officers from the administrative machinery to adjudicate the penalty instead of launching criminal proceedings before the Magistrate's Court as was being done earlier except when the offences fall under the appropriate Special Courts established under section 435 which is expected to speed up the delivery of justice. Compounding Powers continue to vest with the NCLT/ Regional Director in cases where the sections violated indicate fines.

COMPLAINT BY REGISTRAR AND SERIOUS FRAUD INVESTIGATION OFFICE

As per the Companies Act, 2013, Serious Fraud Investigation Office (SFIO) has been established through the Government of India vide Notification No. S.O.2005(E) dated 21.07.2015. It is a multi-disciplinary organization under the Ministry of Corporate Affairs, consisting of experts in the field of accountancy,

forensic auditing, banking, law, information technology, investigation, company law, capital market and taxation, etc. for detecting and prosecuting or recommending for prosecution white-collar crimes/frauds. As per section 210 of the Act an investigation into the affairs of a company is assigned to SFIO, where Government is of the opinion that it is necessary to investigate into the affairs of a company –

1. on receipt of a report of the Registrar or inspector under section 208 of the Companies Act, 2013;
2. on intimation of a special resolution passed by a company that its affairs are required to be investigated;
3. in public interest, it may order an investigation into the affairs of the company;
4. Where an order is passed by a court or the Tribunal in any proceedings before it that the affairs of a company ought to be investigated, the Central Government shall order an investigation into the affairs of that company.

SFIO is headed by a Director as Head of Department in the rank of Joint Secretary to the Government of India. The Director is assisted by Additional Directors, Joint Directors, Deputy Directors, Senior Assistant Directors, Assistant Directors Prosecutors, and other secretarial staff. The Headquarter of SFIO is in New Delhi, with five Regional Offices in Mumbai, New Delhi, Chennai, Hyderabad & Kolkata.

The SFIO is headed by a Director, who shall be an office not below the rank of a Joint Secretary to Government of India having knowledge and experience in Corporate Affairs, and consist of expertise in the fields of investigations, cyber forensics, financial accounting, management accounting, cost accounting and any other fields as may be necessary for the efficient discharge of Serious Fraud Investigation Office (SFIO) functions under the Act.

The Central Government may appoint such experts and other officers and employees in the Serious Fraud Investigation Office as it considers necessary for the efficient discharge of its functions under this Act.

Investigation

Section 212(1) of the Companies Act, 2013 empowers Central Government to investigate into the affairs of the company by SFIO.

(a) on receipt of a report of the Registrar or inspector under section 208;

(b) on intimation of a special resolution passed by a company that its affairs are required to be investigated;

(c) in the public interest; or

(d) on request from any Department of the Central Government or a State Government.

The Central Government may, by order, assign the investigation into the affairs of the said company to the Serious Fraud Investigation Office and its Director, may designate such number of inspectors, as he may consider necessary for the purpose of such investigation.

Section 212(2) stipulates that, where any case has been assigned by the Central Government to the Serious Fraud Investigation Office for investigation under this Act, no other investigating agency of Central Government or any State Government shall proceed with investigation in such case in respect of any offence under this Act and in case any such investigation has already been initiated, it shall not be proceeded further with and the concerned agency shall transfer the relevant documents and records in respect of such offences under this Act to Serious Fraud Investigation Office.

The investigation into the affairs of a company shall be conducted in the manner and by following the procedure specified in Chapter XIV of Companies Act, 2013. The SFIO shall submit its report to the Central Government within the period specified in the order. {Section 212(3)}

The Director SFIO shall cause the affairs of the company to be investigated by an investigating officer, who shall have the powers of the Inspector under section 217 of the Companies Act, 2013. {Section 212(4)}

It shall be the responsibility of the company, its officers and employees, who are or have been in the employment of the company to provide all information, explanation, documents and assistance to the investigating officer as he may require for conduct of business. {Section 212(5)}

Section 212(6) stipulates that the offence covered under Section 447 of the Companies Act, 2013 is a cognizable offence, and no person accused of any offence under those sections shall be released on bail or on his own bond unless—

(i) the Public Prosecutor has been given an opportunity to oppose the application for such release; and

(ii) where the Public Prosecutor opposes the application, the court is satisfied that there are reasonable grounds for believing that he is not guilty of such offence and that he is not likely to commit any offence while on bail:

Provided that a person, who, is under the age of sixteen years or is a woman or is sick or infirm, may be released on bail, if the Special Court so directs:

Provided further that the Special Court shall not take cognizance of any offence referred to this sub-section except upon a complaint in writing made by—

(i) the Director, Serious Fraud Investigation Office; or

(ii) any officer of the Central Government authorised, by a general or special order in writing in this behalf by that Government.

POWER TO ARREST:

- If any officer, not below the rank of Additional Director, of SFIO has a reason to believe that any person is guilty of any offence punishable under Section 447 of the Companies Act, 2013 on basis of material in his possession, the office can arrest that person and will inform him the grounds of such arrest. {Section 212(8)}
- A copy of arrest order along with the material in his possession which basis such arrest is forwarded by the concerned officer to SFIO in a sealed envelope. {Section 212(9)}
- Every person arrested by the SFIO officer shall within twenty-four hours be taken to Special Court or Judicial Court or Metropolitan Magistrate, as the case may be, having appropriate jurisdiction over such matter. The period of twenty-four hours excludes the time required for journey from place of arrest to appropriate court. [Section 212(10)]

As per the Companies (Arrests in connection with investigations by SFIO) Rules, 2017

- Where the Director, Additional Director or Assistant Director of the Serious Fraud Investigation Office (herein after referred to as SFIO) investigating into the affairs of a company other than a Government company or foreign company has, on the basis of material in his possession, reason to believe (the reason for such belief to be recorded in writing) that any person has been guilty of any offence punishable under section 212 of the Act, he may arrest such person.
- Provided that in case of an arrest being made by Additional Director or Assistant Director, the prior written approval of the Director SFIO shall be obtained.
- The Director SFIO shall be the competent authority for all decisions pertaining to arrest.
- Where an arrest of a person is to be made in connection with a Government company or a foreign company under investigation, such arrest shall be made with prior written approval of the Central Government.

Provided that the intimation of such arrest shall also be given to the Managing Director or the person in-charge of the affairs of the Government Company and where the person arrested is the Managing Director or person in-charge of the Government Company, to the Secretary of the administrative ministry concerned, by the arresting officer.

- The Director, Additional Director or Assistant Director, while exercising powers under sub-section (8) of section 212 of the Act, shall sign the arrest order together with personal search memo in the Form appended to these rules and shall serve it on the arrestee and obtain written acknowledgement of service.
- The Director, Additional Director or Assistant Director shall forward a copy of the arrest order along with the material in his possession and all the other documents including personal search memo to the office of Director, SFIO in a sealed envelope with a forwarding letter after signing on each page of these documents, so as to reach the office of the Director, SFIO within twenty four hours through the quickest possible means.
- An arrest register shall be maintained in the office of Director, SFIO and the Director or any officer nominated by Director shall ensure that entries with regard to particulars of the arrestee, date and time of arrest and other relevant information pertaining to the arrest are made in the arrest register in respect of all arrests made by the arresting officers.
- The entry regarding arrest of the person and information given to such person shall be made in the arrest register immediately on receipt of the documents as specified under rule 5 in the arrest register maintained by the SFIO office.
- The office of Director, SFIO shall preserve the copy of arrest order together with supporting materials for a period of five years
  - (a) From the date of judgment or final order of the Trial Court, in cases where the said judgment has not been impugned in the appellate court; or
  - (b) From the date of disposal of the matter before the final appellate court, in cases where the said judgment or final order has been impugned, whichever is later.
- The provisions of the Code of Criminal Procedure, 1973 (2 of 1974), relating to arrest shall be applied mutatis mutandis to every arrest made under this Act.

REPORT TO CENTRAL GOVERNMENT:

- The Serious Fraud Investigation Office shall submit an interim report, if so, directed by the Central Government {Section 212(11)}
- On completion of investigation, the SFIO shall submit the Investigation Report to the Central Government. {Section 212(12)}
- On receipt of the Investigation Report, the Central Government will examine the report and after taking legal advice, if required, may direct SFIO to initiate prosecution against the company and its officers or employees, who are or have been in employment of the company or any other person directly or indirectly connected with the affairs of the company. {Section 212(14)}
- Where the report under sub-section (11) or sub-section (12) states that fraud has taken place in a company and due to such fraud any director, key managerial personnel, other officer of the company or any other person or entity, has taken undue advantage or benefit, whether in the form of any asset, property or cash or in any other manner, the Central Government may file an application before the Tribunal for appropriate orders with regard to disgorgement of such asset, property or cash and also for holding such director, key managerial personnel, other officer or any other person liable personally without any limitation of liability. {Section 212(14A)}

- It is important to note that the investigation report filed with the Special Court for framing of charges against any person shall deemed to be a report filed by a Police Officer under Section 173 of the Code of Criminal Procedure, 1973 {Section 212(15)}

INFORMATION FROM OTHER DEPARTMENT(S):

- Section 212(17) provides that if any other investigating agency, State Government, police authority, income-tax authorities having any information or documents in respect of such offence shall provide all such information or documents available with it to the Serious Fraud Investigation Office for any offence being investigated under the Companies Act, 2013.
- Further, the Serious Fraud Investigation Office shall share any information or documents available with it, with any investigating agency, State Government, police authority or income tax authorities, which may be relevant or useful for such investigating agency, State Government, police authority or income-tax authorities in respect of any offence or matter being investigated or examined by it under any other law.
- It is pertinent to note that the Central Government has ordered and assigned investigation cases involving many companies where alleged fraudulent activities by corporates are reported which includes cases of misappropriation of funds by the promoters / top management and cheating the lenders.

Financial Year	No. of Cases Ordered and Assigned to SFIO	
	No of Cases	No of Companies
2018-19	33	414
2019-20	26	326
2020-21	20	49
2021-22	14	95

(Source: https://pib.gov.in/PressReleseDetail.aspx?PRID=1808295)

Investigation Completed*

Financial Year	Investigation Completed
2018-2019	12
2019-2020	12
2020-2021	7
2021-2022	13
2022-2023	29**

**(Source: https://sfio.gov.in/en/investigation-completed/)*

***Note: The figure for the financial year 2022-2023 includes 19 main cases and 10 supplementary/other cases.*

TEST YOURSELF

Q1. What is the procedure of investigation into the affairs of a company by SFIO?

Ans. The investigation into the affairs of a company shall be conducted in the manner and by following the procedure specified in Chapter XIV of Companies Act, 2013.

Q2. Under what circumstances, investigation into the affairs of a company is assigned to SFIO by the Government?

Ans. As per Section 212 (1) of the Companies Act, 2013, the Central Govt. may assign the investigation into the affairs of a company to the Serious Fraud Investigation Office –

(a) on receipt of report of the Registrar or Inspector under section 208;

(b) on intimation of a special resolution passed by a company requesting an investigation into its affairs;

(c) in public interest;

(d) on the request of any Department of Central Government or State Government.

Q3. What are the terms and conditions of service of Director experts and other officers and employees of SFIO?

Ans. The terms and conditions of service of Director, experts and other officers and employees of SFIO are stated in Companies (Inspection, Investigation and Inquiry) Rules, 2014 issued by Govt. of India Notification F.NO. 01/12/2013(Part-1) (CL.V) dated 31st March, 2014.

Q4. What is the composition of SFIO?

Ans. The Serious Fraud Investigation Office is headed by a director and consist of experts from different fields viz banking, corporate affairs, taxation, forensic audit, capital market, information technology, law etc.

Q5. How the serious Fraud investigation Officer (SFIO) has been established ?

Ans. in exercise of the powers conferred by sub section (i) of section 211 of the companies Act,2013 the Central Government has established the Serious Fraud Investigation office vide notification F. No .A-35011/2011-admn.III dated 21st of July ,2015.Earlier this office was established vide Government of India's Resolution No.45011/16/2003-admn-1 dated 2nd July, 2003.

(Source: https://sfio.gov.in/en/faq/)

TRIBUNALS

Section 2(90): "Tribunal" means the National Company Law Tribunal constituted under section 408.

The setting up of NCLT as a specialized institution for corporate justice is based on the recommendations of the Justice Eradi Committee, a committee set up to examine the existing law relating to winding up proceedings of companies in order to re-model it in line with the latest developments and innovations in the corporate law and governance and to suggest reforms in the procedure at various stages followed in the insolvency proceedings of companies to avoid unnecessary delays in tune with the international practice in this field.

The setting up of the NCLT and NCLAT are part of the efforts to move to a regime of faster resolution of corporate disputes, thus improving the ease of doing business in India.

The National Company Law Tribunal (NCLT) & The National Company Law Appellate Tribunal (NCLAT) were established on 1st June, 2016 under the Companies Act, 2013. The NCLT & NCLAT are quasi-judicial bodies in India that adjudicate issues relating to Indian Companies. The constitution of the aforesaid Tribunals is in exercise of the powers conferred by Sections 408 and 410 respectively of the new Companies Act, 2013.

Section 408 stipulates that the National Company Law Tribunal shall consist of a President and such number of Judicial and Technical members, as the Central Government may deem necessary, to be appointed by it by notification, to exercise and discharge such powers and functions as are, or may be, conferred on it by or under this Act or any other law for the time being in force.

Section 410 stipulates that National Company Law Appellate Tribunal shall consist of a chairperson and such number of Judicial and Technical Members, as the Central Government may deem fit, to be appointed by it for hearing appeals against,—

(a) the order of the Tribunal or of the National Financial Reporting Authority] under this Act; and

(b) any direction, decision or order referred to in section 53A of the Competition Act, 2002 in accordance with the provisions of that Act.

Qualification of Chairperson and Members of Tribunal (Section 409)

- The President shall be a person who is or has been a Judge of a High Court for five years.

  A person shall not be qualified for appointment as a Judicial Member unless he—

  (a) is, or has been, a judge of a High Court; or

  (b) is, or has been, a District Judge for at least five years; or

  (c) has, for at least ten years been an advocate of a court.

  Explanation.—For the purposes of clause (c), in computing the period during which a person has been an advocate of a court, there shall be included any period during which the person has held judicial office or the office of a member of a tribunal or any post, under the Union or a State, requiring special knowledge of law after he become an advocate.

- A person shall not be qualified for appointment as a Technical Member unless he—

  (a) has, for at least fifteen years been a member of the Indian Corporate Law Service or Indian Legal Service and has been holding the rank of Secretary or Additional Secretary to the Government of India; or

  (b) is, or has been, in practice as a chartered accountant for at least fifteen years; or

  (c) is, or has been, in practice as a cost accountant for at least fifteen years; or

  (d) is, or has been, in practice as a company secretary for at least fifteen years; or

  (e) is a person of proven ability, integrity and standing having special knowledge and professional experience of not less than fifteen years in industrial finance, industrial management, industrial reconstruction, investment and accountancy;

  (f) is, or has been, for at least five years, a presiding officer of a Labour Court, Tribunal or National Tribunal constituted under the Industrial Disputes Act, 1947.

Qualification of President and Members of Appellate Tribunal (Section 411)

- The chairperson shall be a person who is or has been a Judge of the Supreme Court or the Chief Justice of a High Court.
- A Judicial Member shall be a person who is or has been a Judge of a High Court or is a Judicial Member of the Tribunal for five years.
- A technical member shall be a person of proven ability, integrity and standing having special knowledge and professional experience of not less than twenty-five years in industrial finance, industrial management, industrial reconstruction, investment and accountancy.

Selection of Members of Tribunal and Appellate Tribunal (Section 412)

- The President of the Tribunal and the chairperson and Judicial Members of the Appellate Tribunal, shall be appointed after consultation with the Chief Justice of India.
- The Members of the Tribunal and the Technical Members of the Appellate Tribunal shall be appointed on the recommendation of a Selection Committee consisting of—

  (a) Chief Justice of India or his nominee—Chairperson;

  (b) a senior Judge of the Supreme Court or Chief Justice of High Court— Member;

  (c) Secretary in the Ministry of Corporate Affairs—Member; and

  (d) Secretary in the Ministry of Law and Justice—Member.

- Where in a meeting of the Selection Committee, there is equality of votes on any matter, the Chairperson shall have a casting vote.
- The Secretary, Ministry of Corporate Affairs shall be the Convener of the Selection Committee.
- The Selection Committee shall determine its procedure for recommending persons under sub-section (2).
- No appointment of the Members of the Tribunal or the Appellate Tribunal shall be invalid merely by reason of any vacancy or any defect in the constitution of the Selection Committee

Term of Office of President, Chairperson and Other Members (Section 413)

- The President and every other Member of the Tribunal shall hold office as such for a term of five years from the date on which he enters upon his office, but shall be eligible for re-appointment for another term of five years.
- A Member of the Tribunal shall hold office as such until he attains,—

  (a) in the case of the President, the age of sixty-seven years;

  (b) in the case of any other Member, the age of sixty-five years:

  Provided that a person who has not completed fifty years of age shall not be eligible for appointment as Member:

  Provided further that the Member may retain his lien with his parent cadre or Ministry or Department, as the case may be, while holding office as such for a period not exceeding one year.
- The chairperson or a Member of the Appellate Tribunal shall hold office as such for a term of five years from the date on which he enters upon his office, but shall be eligible for re-appointment for another term of five years.
- A Member of the Appellate Tribunal shall hold office as such until he attains,—

  (a) in the case of the Chairperson, the age of seventy years;

  (b) in the case of any other Member, the age of sixty-seven years:

  Provided that a person who has not completed fifty years of age shall not be eligible for appointment as Member:

  Provided further that the Member may retain his lien with his parent cadre or Ministry or Department, as the case may be, while holding office as such for a period not exceeding one year.

Powers of the Tribunal under the Act

Section 430 provides that no civil court shall have jurisdiction to entertain any suit or proceeding in respect of any matter which the Tribunal or the Appellate Tribunal is empowered to determine by or under this Act or any other law for the time being in force and no injunction shall be granted by any court or other authority in respect of any action taken or to be taken in pursuance of any power conferred by or under this Act or any other law for the time being in force, by the Tribunal or the Appellate Tribunal.

Some of the Powers of the Tribunal under the Act

S.No.	Provision	Power
1.	Sub-section (7) of section 7	Powers of the Tribunal to give various orders for regulation or winding up of company when the company has been incorporated by furnishing false or incorrect information or by suppressing material facts

2.	Sub-section (9) of section 8	Powers to impose conditions for disposal surplus remaining after the winding up of a section 8 company
3.	Sub-section (2) of section 48	Power to set aside the variation of shareholders' rights
4.	Sub-section (3) of section 55	Power to approve the redemption of unredeemed preference shares by issuing further preference shares
5.	Sub-section (5) of section 58	Powers to direct registration of transfer of transmission or rectification of register in case of refusal to register the transfer
6.	Sub-section (2) and (4) of section 59	Powers for rectification of register of members
7.	Proviso to clause (b) of sub section (1) of section 61	Power to approve the consolidation or division which changes the voting percentage of shareholders
8.	Proviso to sub-section (4) of section 62	Power to pass orders as it deems fit for conversion of Government owned debentures or loan given by Government into equity
9.	Sub-section (1) of section 66	Power to approve the reduction of share capital
10.	Sub-section (9) and (10) of section 71	Powers to grant relief in case of inability to redeem debentures
11.	Sub-section (4) of section 73	Powers of Tribunal to direct the company to pay sum due for any loss incurred by depositor
12.	Sub-section (2) of section 74	Powers of Tribunal to extend the time for repayment of deposit
13.	Sub-section (1) of section 97	Power of Tribunal to call annual general meeting
14.	Sub-section (1) of section 98	Power of Tribunal to call meetings other than annual general meeting
15.	Sub-section (4) of section 119	Power to direct immediate inspection of minutes book
16.	Sub-section (1) of section 130	Power to order re-opening of books of accounts or re-casting of financial statements in case of preparation in fraudulent manner or mismanagement of the affairs of the company
17.	Sub-section (1) of section 131	Power to approve the voluntary revision of financial statements or Board's Report
18.	Second proviso to sub-section (4) of section 140	Powers to waive the requirement of circulation of representation of the auditor sought to be removed
19.	Sub-section (5) of section 140	Power to direct the company to change the auditors
20.	Second proviso to sub-section (4) of section 169	Power to waive the requirement of circulation of representation of the director sought to be removed
21.	Section 213	Powers to order investigation into affairs of the company
22.	Sub-section (1) of section 218	Powers to approve the action against the employee during the course of investigation by the company
23.	Sub-section (1) of section 221	Powers to freeze the assets of the company during inquiry and investigation
24.	Sub-section (1) of section 222	Imposing restriction on the securities of the company during investigation
25.	Sub-section (1) of section 230	Powers to call a meeting to consider compromise or arrangement with the creditors or members or any class of them
26.	Sub-section (6) and (7) of section 230	Power to approve the compromise or arrangement by an order
27.	Sub-section (12) of section 230	Powers to grant relief in case of takeover offer of companies other than listed companies

28.	Sub-section (1) and (2) of section 231	Power to supervise and enforce Compromise or Arrangement
29.	Sub-section (1) and (3) of section 232	Powers to approve merger and amalgamation
30.	Sub-section (2) of section 235	Power to grant relief to the minority shareholders where their shares are proposed to be acquired by the majority
31.	Sub-section (4) of section 237	Power to hear appeals regarding compensation in case of amalgamation of companies in public interest
32.	Sub-section (2) of section 238	Power to hear appeal against the order of Registrar refusing to register the scheme for transfer of shares
33.	Sub-section (1) and (2) of section 242	Granting of relief in case of oppression and Mismanagement
34.	Sub-section (1) of section 244	Powers to waive the requirement of minimum members to apply under section 241
35.	Sub-section (1) of section 245	Power to hear and pass orders for class action Suits
36.	Sub-section (1) and (3) of section 252	Power to hear appeals against removal of name and order restoration of name of company
37.	Part I of Chapter XX- Section 271 to section 303	Winding up by the Tribunal
38.	Section 328	Power to set aside transactions amounting to fraudulent preference
39.	Sub-section (3) and (4) of section 331	Power to decide the liabilities in reference to fraudulent preference
40.	Sub-section (1), (3), (5) and (6) of section 333	Power to allow disclaimer of onerous property
41.	Sub-section (2) of section 334	Power to allow the transfer of property after the commencement of winding up
42.	Sub-section(1) and (2)of section 339	Power to charge a director, manager, officer or any other person who was knowingly a party to the carrying on of business of the company in a fraudulent manner with unlimited liability
43.	Sub-section(1) and (2) of section 340	Power to assess damages against a delinquent Person
44.	Sub-section (1) of section 342	Power to direct the liquidator to prosecute the officer or member of the company who is guilty of an offence relating to a company
45.	Sub-section (1) and (3) of section 343	Power to sanction the exercise of certain powers by the Company Liquidator
46.	Sub-section (1) of section 347	Power to direct the disposal of books and papers of the company wound up by the Tribunal
47.	Section 350	Power to permit the opening of bank account with any specified bank and to authorize the retention of money by Liquidator
48.	Sub-section (1) of section 353	Power to direct the company liquidator to make good the default in filing the returns etc. required to be filed
49.	Sub-section (1) of section 354	Power to direct the meetings of the creditors and contributories
50.	Sub-section (1) of section 356	Power to declare the dissolution of the company to be void
51.	Sub-section (4) of section 364	Powers to pass necessary orders in respect of Appeals against the decisions of Official Liquidator under section 363
52.	Section 373	Power to grant leave for commencement or proceeding of a suit or other legal proceeding against the company

53.	Sub-section (3) and (4) of section 375	Powers with respect to winding up of unregistered companies
54.	Sub-section (2) of section 399	Power to issue process for compelling the production of document kept by the Registrar
55.	Sub-section (1) of section 424	Power to regulate their own procedure
56.	Section 425	Power to punish for contempt
57.	Section 426	Delegation of Powers
58.	Sub-section (1) of section 429	Power to seek assistance of Chief Metropolitan Magistrate or District Collector etc.
59.	Sub-section (1) of section 441	Power to compound offences punishable with fine of more than Rs. 25 lakhs
60.	Sub-section (2) and (3) of section 442	Reference of matter to Mediation and Conciliation Panel

Procedure Before Tribunal and Appellate Tribunal (Section 424)

- The Tribunal and the Appellate Tribunal shall not, while disposing of any proceeding before it or, as the case may be, an appeal before it, be bound by the procedure laid down in the Code of Civil Procedure, 1908, but shall be guided by the principles of natural justice, and, subject to the other provisions of this Act or of the Insolvency and Bankruptcy Code, 2016 and of any rules made thereunder, the Tribunal and the Appellate Tribunal shall have power to regulate their own procedure.
- The Tribunal and the Appellate Tribunal shall have, for the purposes of discharging their functions under this Act or under the Insolvency and Bankruptcy Code, 2016, the same powers as are vested in a civil court under the Code of Civil Procedure, 1908 while trying a suit in respect of the following matters, namely:—
  (a) summoning and enforcing the attendance of any person and examining him on oath;
  (b) requiring the discovery and production of documents;
  (c) receiving evidence on affidavits;
  (d) subject to the provisions of sections 123 and 124 of the Indian Evidence Act, 1872, requisitioning any public record or document or a copy of such record or document from any office;
  (e) issuing commissions for the examination of witnesses or documents;
  (f) dismissing a representation for default or deciding it ex parte;
  (g) setting aside any order of dismissal of any representation for default or any order passed by it ex parte; and
  (h) any other matter which may be prescribed.
- Any order made by the Tribunal or the Appellate Tribunal may be enforced by that Tribunal in the same manner as if it were a decree made by a court in a suit pending therein, and it shall be lawful for the Tribunal or the Appellate Tribunal to send for execution of its orders to the court within the local limits of whose jurisdiction,—
  (a) in the case of an order against a company, the registered office of the company is situate; or
  (b) in the case of an order against any other person, the person concerned voluntarily resides or carries on business or personally works for gain.
- All proceedings before the Tribunal or the Appellate Tribunal shall be deemed to be judicial proceedings within the meaning of sections 193 and 228, and for the purposes of section 196 of the Indian Penal Code, and the Tribunal and the Appellate Tribunal shall be deemed to be civil court for the purposes of section 195 and Chapter XXVI of the Code of Criminal Procedure, 1973.

Few Forms w.r.t. NCLT Rules, 2016

Form No.	Description
NCLT-1	Petition or application or reference shall be filed with the Tribunal with attachments thereto accompanied by Form No. NCLT.2
NCLT-4	The general heading for Proceedings
NCLT-6	General Affidavits verifying Petition
NCLT-5	Notice to be issued by the Tribunal to the opposite party
NCLT-12	Memorandum of Appearance

Orders of Tribunal (Section 420)

- The Tribunal may, after giving the parties to any proceeding before it, a reasonable opportunity of being heard, pass such orders thereon as it thinks fit.
- The Tribunal may, at any time within two years from the date of the order, with a view to rectifying any mistake apparent from the record, amend any order passed by it, and shall make such amendment, if the mistake is brought to its notice by the parties.
- No such amendment shall be made in respect of any order against which an appeal has been preferred under this Act.
- The Tribunal shall send a copy of every order passed under this section to all the parties concerned.

Appeal from Orders of Tribunal (Section 421)

- Any person aggrieved by an order of the Tribunal may prefer an appeal to the Appellate Tribunal.
- No appeal shall lie to the Appellate Tribunal from an order made by the Tribunal with the consent of parties.
- Every appeal shall be filed within a period of forty-five days from the date on which a copy of the order of the Tribunal is made available to the person aggrieved and shall be in such form, and accompanied by such fees, as prescribed:
- The Appellate Tribunal may entertain an appeal after the expiry of the said period of forty-five days from the date aforesaid, but within a further period not exceeding forty-five days, if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal within that period.
- On the receipt of an appeal, the Appellate Tribunal shall, after giving the parties to the appeal a reasonable opportunity of being heard, pass such orders thereon as it thinks fit, confirming, modifying or setting aside the order appealed against.
- The Appellate Tribunal shall send a copy of every order made by it to the Tribunal and the parties to appeal.

Appeal to Supreme Court (Section 423)

Any person aggrieved by any order of the Appellate Tribunal may file an appeal to the Supreme Court within sixty days from the date of receipt of the order of the Appellate Tribunal to him on any question of law arising out of such order:

Provided that the Supreme Court may, if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed within a further period not exceeding sixty days.

Securities Appellate Tribunals (SAT)

Securities Appellate Tribunal (SAT) is a statutory body established under the provisions of Section 15K of the Securities and Exchange Board of India Act, 1992 to hear and dispose of appeals against orders passed by the Securities and Exchange Board of India or by an adjudicating officer under the Act; and to exercise jurisdiction, powers and authority conferred on the Tribunal by or under SEBI Act, 1992 or any other law for the time being in force.

Consequent to Government Notification No.DL-33004/99 dated 27th May, 2014, SAT also hears and disposes of appeals against orders passed by the Pension Fund Regulatory and Development Authority (PFRDA) under the PFRDA Act, 2013. Further, in terms of Government Notification No.DL-(N)/04/0007/2003-15 dated 23rd March, 2015, SAT hears and disposes of appeals against orders passed by the Insurance Regulatory Development Authority of India (IRDAI) under the Insurance Act, 1938, the General Insurance Business (Nationalization) Act, 1972 and the Insurance Regulatory and Development Authority Act, 1999 and the Rules and Regulations framed thereunder.

(Cross Referencing: For more details students are advised to study "lesson 13: Adjudications and Appeals" under SEBI Laws of the paper Drafting, Pleadings and Appearances.)

LESSON ROUND-UP

- "Fraud" in relation to affairs of a Company or any body corporate, includes any act, omission, concealment of any fact or abuse of position committed by any person or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss.
- "Cognizable offence" means an offence for which, and a police officer may, in accordance with the First Schedule or under any other law for the time being in force, arrest without warrant.
- That the default or non-compliances of provisions of the Act also attracts restrictions, ineligibility or withdrawal of benefits provided under the Act in addition to liability to pay penalties.
- Penalty is "a punishment imposed for breaking a law, rule, or contract." In general language a penalty is imposed by an appropriate authority when a person have not complied with the law but have not committed any offence.
- "Adjudication" is the legal process by which an arbiter or judge reviews evidence and argumentation, including legal reasoning set forth by opposing parties or litigants to come to a decision which determines rights and obligations between the parties involved.
- The President of the Tribunal and the chairperson and Judicial Members of the Appellate Tribunal, shall be appointed after consultation with the Chief Justice of India.

GLOSSARY

Tribunal: any person or institution with authority to judge, adjudicate on, or determine claims or disputes

Adjudicate: the legal process of resolving.

TEST YOURSELF

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. ABC Exports Limited aggrieved by an order of Adjudication Authority under Foreign Exchange Management Act, 1999, wants to file an appeal against the order in Civil Court. As a Company Secretary, advise ABC Exports Limited whether the civil court has jurisdiction to entertain such a suit If not, suggest an alternate remedy.
2. Can Registrar of Companies order adjudication proceedings under Section 454 of Companies Act, 2013 In what cases can the Central Government appoint him as the Adjudicating Officer
3. XYZ Software Technologies Limited of Bengaluru was engaged in business of software exports. During the past years, it had exported services to its Parent entity in United States of America (USA), but failed to realize and repatriate the foreign exchange due on its exports to India, within the stipulated time. The Adjudicating Authority imposed a penalty under the provisions of Foreign Exchange Management Act, 1999. Being aggrieved by this penalty, the Company seeks your advice to file an appeal. Advise the Company.
4. What are the penal provisions under the Companies Act, 2013 for giving incorrect Secretarial Audit Report or making false statements therein?
5. Enumerate the Adjudication Authorities under Companies Act, 2013. Write the procedure for Adjudication in brief.
6. The Board of Directors of BIJI Private Limited made an application to the Registrar of Companies under section 248(2) of the Companies Act, 2013 for removal of name of the Company. The Board submitted an affidavit that Company has no pending liabilities.

   However, it was later found that few amounts were still payable to creditors. What penalties can be levied under the Companies Act, 2013 for such an application
7. Differentiate Fine and Penalty as per the Companies Act, 2013
8. Differentiate Cognizable' and 'Non-bailable' offences under the Companies Act, 2013.
9. What do you mean by 'Adjudicating' under the Companies Act, 2013 What factors Adjudicating Officer shall consider while adjudging quantum of penalty?
10. Amexo International Ltd. is aggrieved by the Order of Deputy Director of Enforcement Directorate (ED), and is evaluating to seek further remedies in this regard. Advise the Company regarding the Appellate jurisdiction under FEMA and also explain in brief the procedure for making such Appeal.
11. ABD Limited (listed Company) has failed to redress investors' grievances relating to the Transfer of the share and indulges in fraudulent and unfair trade practices relating to securities. Write down the penalties which could be faced by the company under SEBI Act, 1992.

LIST OF FURTHER READINGS

- The Companies Act, 2013 and Rules made thereunder
- SEBI Act, 1992
- FEMA Act, 1999

OTHER REFERENCES (Including Websites / Video Links)

- https://www.mca.gov.in/content/mca/global/en/home.html
- https://www.indiacode.nic.in/

Relief and Remedies

Lesson 7

KEY CONCEPTS

■ Compounding ■ Officer in default ■ Mediation ■ Settlement ■ Conciliation ■ Offences ■ Contravention ■ Consent Order

Learning Objectives

To understand:

- Compoundable and Non-Compoundable Offences
- Authority to Compound the offences
- Pecuniary limit of Compounding of offences by the competent authorities
- Procedure of Compounding of offences
- Compounding of offences under the Companies Act, 2013, SEBI Act, 1992, SCRA Act, 1956 Depositories Act, 1996 & FEMA Act, 1999
- Concept of Mediation and Conciliation

Lesson Outline

REGULATORY FRAMEWORK

- The Companies Act, 2013 and rules made thereunder
- The SEBI Act, 1992
- The Securities Contracts (Regulation) Act, 1956 (SCRA)
- The Depositories Act, 1996
- The FEMA Act, 1999

INTRODUCTION

What is Compounding?

The term "Compounding of offences" found its way into the Companies Act in the year 1988 when the Companies Act, 1956, was amended with the insertion of a new Section 621A under the recommendation of Sachar Committee vide the Companies (Amendment) Act, 1988. The amendment provided for composition of certain offences for the first time under that Act. Earlier all offences under that Act were required to be tried by the Court (Section 622) on a complaint filed by the Registrar or by a shareholder of the Company, or by a person authorized by the Central Government in that behalf (Section 621).

The term "Compounding" refers to the exercise of voluntarily admitting the contravention, pleading guilty and seeking redressal for the same. Whereas, the term "Offence" mean any act or omission made punishable by any law for the time being in force.

In Re *Kiran Mazumdar Shaw C.A. NO. 161/621A/CB/2015 NCLT Bengalore Bench*, in this matter the company filed Form 2 for allotment of shares with defective list of allottees and subsequently filed proper Form, since delay was not wilful, in view of ROC's observations, offence was to be compounded on payment of compounding fees.

It is also known as Composition of Offence in certain countries. Compounding of an offence is a **settlement mechanism**, by which, the offender is given an option to pay money in lieu of his prosecution, thereby avoiding a prolonged litigation. There is no definition of the word "compounding" in the Companies Act 2013, however, the legal meaning of compounding is "**doing good the default/non-compliance**".

As per the Black's Law Dictionary, to "Compound" means "to settle a matter by a money payment, in lieu of other liability." As per this definition Compounding is akin to a Settlement Mechanism, a settlement by paying the penalty in lieu of facing the prosecution for the offence committed. Compounding is essentially a compromise or arrangement between administrator of the enactment and person committing an offence.

A compounding of offense has three basic constituents i.e.:

(1) Consciousness of offence;

(2) The agreement not to prosecute; and

(3) The receipt of penalty.

In simple words, we can define that Compounding of offence is a process whereby the person or entity committing default will file an application to the compounding authority accepting that he/it has committed an offence. The compounding authority (RD/NCLT) in case of the Companies Act, 2013 (the Act) may compound the offence and ask the defaulter to deposit fee which is compounding fees as decided by it on case to case basis.

Once the said compounding fee is paid, the defaulter will no more be treated in default of the offence which has been so compounded.

CASE LAWS

- In *P P Varkey v. STO (1999) 114 STC 224 (Bom HC DB),* it was held that once an offence is compounded, penalty or prosecution proceeding cannot be taken for same offence.
- In *S Viswanathan v. State of Kerala (1993) 113 STC 182 (Ker HC DB)*, it was held that once the matter is compounded, neither department nor assessee can challenge the compounding order. Department cannot reopen the matter on the reason that actual suppression was much higher.
- Compounding is compromise between the administrator and person commit offence for an agreement not to prosecute one who has committed offence *[Reliance Industries Ltd. 1997]*. The accuse and Administrator (ROC) make a joint application to the NCLT/RD that the parties have come to terms and the case may not be proceeded further.

What is an Offence?

Term "Offence" has been extracted from section 3(38) of General Clauses Act, 1897, which says that "Offence" shall mean any act or omission made punishable by any law for the time being in force. Corporate offences are classified into civil and criminal offences. An offence may be "Compoundable" or "Non-Compoundable".

COMPOUNDING OF OFFENCES PROVISIONS UNDER THE COMPANIES ACT, 2013

The Companies Act, 2013 does not define compounding of offences. However, it provides enabling provisions by which, the Company or its director or officers can apply for compounding thereby avoiding the prolonged litigation. The provisions pertaining to compounding of offences under the Act are set forth under Section 441 of the Companies Act, 2013.

Section 441(1) starts with a non-obstante clause containing "Notwithstanding anything contained in the Code of Criminal Procedure, 1973", which overrides the provision of Code of Criminal Procedure relating to compounding of offence.

In the case of J.I.K. Industries Ltd. and Ors. vs. Amarlal V. Jumani and Anr. Criminal Appeal No 263 of 2012,SC, it is clear that as a result of the words "Notwithstanding anything contained in the Code of Criminal Procedure, 1973" appearing in Section 441(1) of the Companies Act, 2013 offences under the Act to the extent specified therein are compoundable. The deviation between Section 441 of the Companies Act, 2013 and Section 147 of the Negotiable Instruments Act, 1881 is that Section 441(1) of the Companies Act, 2013 goes further and appoints compounding authorities for compounding of the offences specified therein. Further this sub-section provides a lot of guidance to the compounding authorities and introduces procedure and forms thereof for such compounding as a result of the procedure contemplated under Section 320 will not apply.

Persons eligible to make a compounding application

Following persons are eligible to make application to the compounding authorities for compounding of offences:

- A company (any director of the company authorized by its board in this behalf) and/or;
- Officers in default of the company who are liable for prosecution under the respective provisions for non-compliances.

Who will be considered as an "Officer in default"?

As per Section 2(60) "officer who is in default" for the purpose of any provision in this Act which enacts that an officer of the company who is in default shall be liable to any penalty or punishment by way of imprisonment, fine or otherwise, means any of the following officers of a company, namely:—

(i) whole-time director;

(ii) key managerial personnel;

(iii) where there is no key managerial personnel, such director or directors as specified by the Board in this behalf and who has or have given his or their consent in writing to the Board to such specification, or all the directors, if no director is so specified;

(iv) any person who, under the immediate authority of the Board or any key managerial personnel, is charged with any responsibility including maintenance, filing or distribution of accounts or records, authorises, actively participates in, knowingly permits, or knowingly fails to take active steps to prevent, any default;

(v) any person in accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act, other than a person who gives advice to the Board in a professional capacity;

(vi) every director, in respect of a contravention of any of the provisions of this Act, who is aware of such contravention by virtue of the receipt by him of any proceedings of the Board or participation in such proceedings without objecting to the same, or where such contravention had taken place with his consent or connivance;

(vii) in respect of the issue or transfer of any shares of a company, the share transfer agents, registrars and merchant bankers to the issue or transfer.

Benefits of Compounding of Offences:

1. Acts as a deterrent and prevents commission of offence;
2. Avoid heavy fines and penalty;
3. Keep the flow of business activity unhindered;
4. Help to maintain dignity;
5. Does not burden court with cases;
6. Less time consuming and summary proceedings;
7. No disqualification for Directors, since fees payable on compounding are not treated as penalty.

Which offences can be compounded?

Not all offences under the Companies Act, 2013 can be compounded. Only the following offences (whether committed by a company or any officer thereof) as mentioned below, can be compounded under Section 441 of the Companies Act, 2013:

1. Offences punishable with "fine only".
2. Offences punishable with "fine or imprisonment or both" or "fine or imprisonment".

Which offences cannot be compounded?

No compounding shall be done in the following cases:

1. Offence punishable with "imprisonment only"; or
2. Offence punishable with "imprisonment and fine"; or
3. Where investigation has been initiated or is pending against the company;
4. An offence committed by a company or its officer within a period of three years from the date on which a similar offence committed by it or him was compounded under this section.

CASE LAWS

In Re Cibersites India (Pvt) Ltd. CP - 42/2021 dated 13.05.2021, NCLT Bengaluru Bench, it was held that where applicant company filed application under section 441 for compounding of offences under section 125, 138 and 142, since nature of violations committed were not criminal in nature and same were committed un-intentionally, lenient view was to be taken and ad valorem fine for all offences/violations was to be imposed.

In the matter of *Capital Small Finance Bank Ltd Vs. Registrar of Companies Co No. 52/Chd/Pb/2021 NCLT Chandigarh Bench dated 26.11.2021,* it was held that where applicant company had inadvertently and under bona-fide mistake breached thresholds provided under section 67(3) of the Companies Act, 1956 and report of RoC stated that there were no complaints and there was no investigation pending and it could be seen from records of applicant company that an exit option to all identified current holders of security has been made, applicant having made an application *suo moto* and stated that this or similar offences had not been compounded during last three years, it would be reasonable to compound offence under section 67(3).

M/S UW International Training & Education Centre for Health Pvt. Ltd. (NCLT Delhi) UW International Training & Education Centre for Health Pvt. Ltd., the petitioner company filed an suo moto application to NCLT Delhi with respect to delay in issue of share certificate to the subscribers of the Company, resulting in non-compliance of the time prescribed under s 56(4)(a) of the Act.

The petitioner submits that the company was incorporated on 15.10.2015 and therefore the share certificates were required to be issued to the subscribers of the MOA on or before 15.12.2015.The petitioners could only issue the share certificates to the subscribers on 23.05.2016, i.e. beyond the time prescribed under the statute. The petitioners submit that owing to the cumbersome and numerous procedural formalities involved, the bank account of the company could not be opened within two months from the incorporation of the company. Due to the delay in opening bank account and receipt of share subscription money, the petitioners failed to issue and deliver the share certificates to the subscribers within the prescribed time of two months from the date of incorporation.

Issue Raised

The issues before the Hon'ble Tribunal were two:

1) Whether NCLT can levy a higher or lower penalty in compounding cases than the penalties as prescribed under the Act?
2) What are the guiding principles for imposing penalty in compounding cases?

Observations

NCLT Delhi in its Order against application of UW International Training & Education Centre for Health Pvt. Ltd. held that the sentencing or penalty provisions prescribed under the Act cannot be lowered or altered in cases

of prosecution holding the defaulter guilty. However, principle of imposing minimum fine on compounding matters is not mandatory.

NCLT noted that compounding of offence can be accepted by a Court even by admonishing the defaulter or issuing a warning. NCLT further noted that the procedural delay of issuance of share certificates cannot be discounted and accordingly imposed a penalty of Rs. 10,000/- on Company and defaulting officers as opposed to penalty prescribed under Section 56(6) of the Act.

It is pertinent to note that NCLAT in the matter of Viavi Solutions India (P.) Ltd. v. Registrar of Companies, NCT Delhi & Haryana dated 28th February, 2016 laid down that NCLT is required to notice the relevant factors while compounding any offence, such as gravity of offence, malafide intention, maximum punishment prescribed, report of Registrar of Companies (ROC), period of default, suo motu compounding or after ROC notice/imposition of the punishment.

Thus it can be concluded that, in suo motu compounding cases, NCLT may, based on the aforementioned factors, impose a lower penalty than as prescribed under the penalty provisions of the Act.

Effect of investigation, if any

In view of the third proviso under sec 441(1) of the Companies Act, 2013, whenever an investigation against a company has been directed to be carried out and has already been initiated or when such an investigation is pending to be initiated, the power of the compounding authorities under this sub-section gets eclipsed.

Case Scenario

For instance, if at or about the same time, there is an application before the Tribunal by eligible members or other persons for an investigation into the affairs of a company and also an application for compounding any offence under the Act, the Tribunal may be justified in adjourning the matter to decide on compounding until the other application for investigation is disposed of. A mere application or apprehension about the prospect of an investigation cannot be a ground for refusing to entertain an application for compounding. It is altogether a different issue that even without there being an order directing an investigation, the compounding authority may, on merits, not agree to permit the compounding as the power of the compounding authority under sec 441(1) is discretionary.

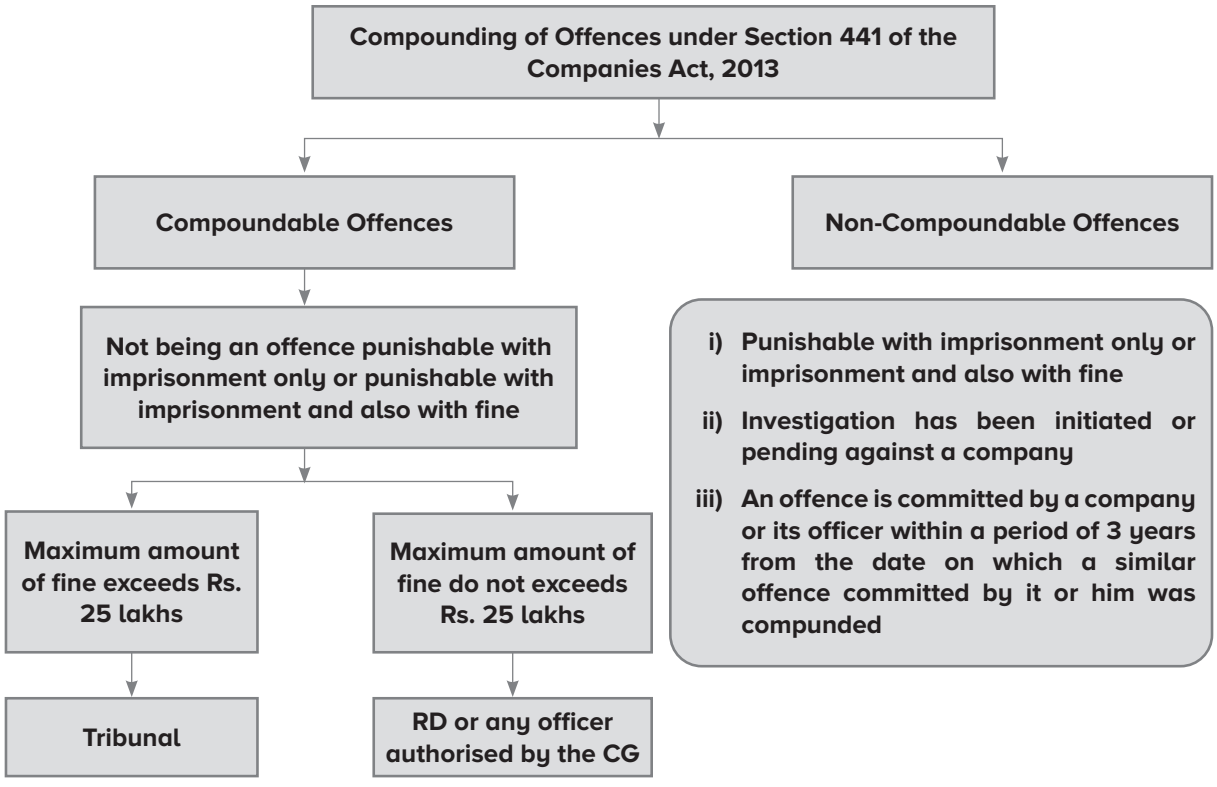
When compounding can be done?

Certain offenses committed by a company or its officers that are punishable with a fine may be compounded. Examples of such offenses include failure to file certain documents with the Registrar of Companies, failure to hold an Annual General Meeting, or failure to maintain statutory registers etc. Compounding can be done either before (or) after the institution of any prosecution.

Who are the Compounding Authorities/who can Compound the Offence?

The following are the two compounding authorities:

- **Regional Director**: Where the maximum amount of fine which may be imposed for an offence does not exceed Rs.25 lakhs, the Regional Director or any officer authorized by the Central Government can compound the offence.
- **Tribunal:** The National Company Law Tribunal is authorized to compound in all other cases exceeding Rs. 25 Lakhs.



CASE LAWS

- In the case of *UW International Training & Education Centre for Health Private Limited, C.A. No. 16/59/2017* (NCLT Delhi) in a *suo motu* application wherein in an application for compounding of an offence punishable under sec 56(6) of the Companies Act 2013 (relates to delay in issuing share certificates to subscribers of shares), the bench held that the minimum amount of fine specified in the penal clause of the section would apply only when a criminal court is seized of the matter and a compounding authority is not constrained by the said provision. Compounding of an offence could be done even by admonishing the defaulter or by issuing a warning.
- In the case of *Registrar of Companies cum Official Liquidator vs. Gyan Chand Agarwal, Company Appeal (AT) No. 249 of 2018*, in relation to an offence falling under sec 165 of the Companies Act, 2013 the NCLT New Delhi Bench had imposed a compounding fee of INR 10,00,000/- considering that the applicant had violated the stipulation under sec 165 for 849 days. In the appeal before NCLAT, preferred by the Department, the NCLAT observed that the fine imposed should not be less than INR 5000/- which can be extended to INR 25,000/- for every day after the first during which the contravention continues and the default continued for a period of 849 days w.e.f. 01st April, 2015 to 18th July, 2017.

NCLAT observed that the Tribunal had no jurisdiction to reduce the fine to less than the minimum prescribed for the offence prescribed under the aforesaid provision and hence imposed INR 42,45,000/- (Rupees Forty Two Lakh Forty Five Thousand Only) on the respondent/petitioner to be payable within a period of 45 days.

LIST OF OFFENCES COMPOUNDABLE IN NATURE (POWERS VESTED WITH REGIONAL DIRECTOR)

Section	Nature of Offences	Fine/Imprisonment
26(9)	Contravention of provisions relating to issue of a prospectus	● the company shall be punishable with fine which shall not be less than Rs.50,000/- but which may extend to Rs. 3 lakhs; and ● every person who is knowingly a party to the issue of such prospectus shall be punishable with fine which shall not be less than Rs.50,000/- but which may extend to Rs.3 Lakhs.
46(5)	Fraudulently issuing of duplicate share certificates by a company	● the company shall be punishable with fine which shall not be less than five times the face value of the shares involved in the issue of the duplicate certificate but which may extend to ten times the face value of such shares or Rs. 10 crores whichever is higher; and ● every officer of the company who is in default shall be liable for action under section 447.
68(11)	Power of company to purchase its own Securities	● the company shall be punishable with fine which shall not be less than Rs. 1 lakh but which may extend to Rs. 3 lakhs; and ● every officer of the company who is in default shall be punishable with fine which shall not be less than Rs. 1 Lakh but which may extend to Rs. 3 Lakhs.
99	Default in holding a meeting of the company in accordance with section 96 to 98 or in complying with any directions of the Tribunal	● the company and every officer of the company who is in default shall be punishable with fine which may extend to Rs. 1Lakh and in the case of a continuing default, with a further fine which may extend to Rs.5000 for every day during which such default continues.
128(6)	Failure to keep proper books of account	● fine which shall not be less than Rs.50,000 but which may extend to Rs.5 Lakhs [For managing director, the whole-time director in charge of finance, the Chief Financial Officer or any other person of a company charged by the Board with the duty of complying with the provisions of this section]
129(7)	Failure to keep proper financial statement	● the managing director, the whole-time director in charge of finance, the Chief Financial Officer or any other person charged by the Board with the duty of complying with the requirements of this section and in the absence of any of the officers mentioned above, all the directors shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than Rs.50,000 but which may extend to Rs.5 lakhs, or with both.
147(1)	Failure of company to comply with the provisions of sections 139 to 146 with regard to auditors	● fine which shall not be less than Rs.25000 but which may extend to Rs. 5 Lakhs; and ● every officer of the company who is in default shall be punishable with fine which shall not be less than Rs.10,000 but which may extend to Rs. 1 Lakh.

166(7)	Default in complying with the provisions of this section relating to duties of directors	● fine not less than Rs. 1 Lakh but which may extend to Rs. 5 Lakhs on Directors.
167(2)	Functioning as a director after vacation of office	● fine which shall not be less than Rs.1 Lakh but which may extend to Rs. 5 Lakhs.
185(4)	Contravention of the provision of this section relating to loans to directors	● the company shall be punishable with fine which shall not be less than Rs.5 Lakhs but which may extend to Rs. 25 Lakhs; ● every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than Rs.5 Lakhs but which may extend to Rs.25 Lakhs; and ● the director or the other person to whom any loan is advanced or guarantee or security is given or provided in connection with any loan taken by him or the other person, shall be punishable with imprisonment which may extend to six months or with fine which shall not be less than Rs.5 Lakhs but which may extend to Rs.25 Lakhs, or with both.
206(7)	If a company fails to furnish any information or explanation or produce any document required under this section	● the company and every officer of the company, who is in default shall be punishable with a fine which may extend to Rs.1 lakh and in the case of a continuing failure, with an additional fine which may extend to Rs.500 for every day after the first during which the failure continues.
221(2)	Freezing of assets of company on inquiry and investigation	● the company shall be punishable with fine which shall not be less than Rs.1 Lakh but which may extend to Rs.25 Lakhs; and ● every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than Rs.50,000 but which may extend to Rs.5 Lakhs or with both.
222(2)	Imposition of restrictions upon securities	● the company shall be punishable with fine which shall not be less than Rs.1 Lakh but which may extend to Rs.25 Lakhs; and ● every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than Rs.25,000 but which may extend to Rs.5 Lakhs, or with both.
242(8)	Contravention of the order of Tribunal relating to alterations in memorandum or articles	● the company shall be punishable with fine which shall not be less than Rs.1Lakh but which may extend to Rs.25 Lakhs; and ● every officer of the company who is in default shall be punishable with fine which shall not be less than Rs.25000 but which may extend to Rs. 1Lakh.
249(2)	Filing of application in restricted cases for removal of name	● Company shall be punishable with fine which may extend to Rs.1 Lakh.

344(2)	Failure to give statement that the company is in liquidation	● the company, and every officer of the company, the Company Liquidator and any receiver or manager, who wilfully authorises or permits the non-compliance, shall be punishable with fine which shall not be less than Rs.50,000 but which may extend to Rs.3 Lakhs.
347(4)	Contravention of any rule framed or an order made under sub- section (3) regarding disposal of books	● he shall be punishable with fine which may extend to Rs.50,000.
392	Contravention of the provisions of Chapter XXII by a foreign company	● the foreign company shall be punishable with fine which shall not be less than Rs.1 Lakh but which may extend to Rs.3 Lakhs and in the case of a continuing offence, with an additional fine which may extend to Rs.50,000 for every day after the first during which the contravention continues; and ● every officer of the foreign company who is in default shall be punishable with fine which shall not be less than Rs.25000 but which may extend to Rs.5 Lakhs.
441(5)	Failure to comply with the order made by Tribunal or Regional Director in relation to Compounding of offences	● If any officer or other employee of the company who fails to comply with any order made by the Tribunal or the Regional Director or any officer authorised by the Central Government, the maximum amount of fine for the offence proposed to be compounded under this section shall be twice the amount provided in the corresponding section in which punishment for such offence is provided.
447	Punishment for fraud involves an amount less Rs.10 lakh or 1%of the turnover of the company, whichever is less and does not involve public interest,	● any person guilty of such fraud shall be punishable with imprisonment for a term which may extend to five years or with fine which may extend to Rs. 50 lakhs or with both.
451	Repeated default within 3 years	● If a company or an officer of a company commits an offence punishable either with fine or with imprisonment and where the same offence is committed for the second or subsequent occasions within a period of three years, then, that company and every officer thereof who is in default shall be punishable with twice the amount of fine for such offence in addition to any imprisonment provided for that offence.
452(1)	Punishment for wrongful withholding of property	● Any officer or employee of a company on the complaint of the company or of any member or creditor or contributory be punishable with fine which shall not be less than Rs.1 Lakh but which may extend to Rs.5 Lakhs.
453	Improper use of the words “limited” and “private limited”	● Fine not less than Rs.500 but may extend to Rs.2000 for every day for which that name or title has been used.

454(8)	Failure to pay the penalty imposed by the adjudicating officer or Regional Director	● The company shall be punishable with fine which shall not be less than Rs.25,000 but which may extend to Rs.5 lakhs. ● Where an officer of a company or any other person who is in default shall be punishable with imprisonment which may extend to six months or with fine which shall not be less than Rs.25,000 but which may extend to Rs.1 lakh, or with both.
464(3)	Prohibition of association or partnership of persons exceeding certain number	● Every member of an association or partnership carrying on business in contravention of sub-section (1)shall be punishable with fine which may extend to Rs. 1 Lakh and shall also be personally liable for all liabilities incurred in such business.
469(3)	Contravention of the Rules framed by Central Government	● Fine upto Rs.5,000 and further fine up to Rs.500 for each day of default in case of contravention continues.

LIST OF OFFENCES COMPOUNDABLE IN NATURE (POWERS VESTED WITH THE TRIBUNAL)

Section	Nature of Offences	Fine/Imprisonment
8(11)	Committing default in complying with the requirements relating to formation of companies with charitable objects, etc.	● If a company makes any default in complying with any of the requirements laid down in this section, the company shall be punishable with fine which shall not be less than Rs.10 Lakhs but which may extend to Rs.1 Crore and the directors and every officer of the company who is in default shall be punishable with fine which shall not be less than Rs.25000 but which may extend to Rs.25 Lakhs. ● If it is proved that the affairs of the company were conducted fraudulently, every officer in default shall be liable for action under section 447.
40(5)	Committing default in complying with the provisions of this section relation to securities to be dealt with in stock exchanges	● the company shall be punishable with a fine which shall not be less than Rs.5 Lakh but which may extend to Rs.50 Lakh; and ● every officer of the company who is in default shall be punishable with fine which shall not be less than Rs.50,000 but which may extend to Rs.3 Lakhs.
46(5)	Fraudulently issuing of duplicate share certificates by a company	● the company shall be punishable with fine which shall not be less than five times the face value of the shares involved in the issue of the duplicate certificate but which may extend to ten times the face value of such shares or Rs. 10 crores whichever is higher; and ● every officer of the company who is in default shall be liable for action under section 447.
74(3)	Repayment of deposits, etc., accepted before commencement of this Act	● the company shall, in addition to the payment of the amount of deposit or part thereof and the interest due, be punishable with fine which shall not be less than Rs.1 crore but which may extend to Rs.10 crore; and ● every officer of the company who is in default shall be punishable with imprisonment which may extend to seven years or with fine which shall not be less than Rs.25 Lakhs but which may extend to Rs.2 crore, or with both.

221(2)	In case of any removal, transfer or disposal of funds, assets, or properties of the company in contravention of the order of the Tribunal under sub-section (1)	● the company shall be punishable with fine which shall not be less than Rs.1 Lakh but which may extend to Rs.25 Lakhs; and ● every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than Rs.50,000 but which may extend to Rs.5 Lakhs or with both.
222(2)	Where securities in any company are issued or transferred or acted upon in contravention of an order of the Tribunal under sub-section (1)	● the company shall be punishable with fine which shall not be less than Rs.1 Lakh but which may extend to Rs.25 Lakhs; and ● every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than Rs.25,000 but which may extend to Rs.5 Lakhs, or with both.
242(8)	Contravention of the order of Tribunal relating to alterations in memorandum or articles	● the company shall be punishable with fine which shall not be less than Rs.1Lakh but which may extend to Rs.25 Lakhs; and ● every officer of the company who is in default shall be punishable with fine which shall not be less than Rs.25000 but which may extend to Rs. 1Lakh.
447	Punishment for fraud involves an amount less Rs.10 lakh or 1%of the turnover of the company, whichever is less and does not involve public interest	● any person guilty of such fraud shall be punishable with imprisonment for a term which may extend to five years or with fine which may extend to Rs. 50 lakhs or with both.
453	Improper use of the words “limited” and “private limited”	● Fine not less than Rs.500 but may extend to Rs.2000 for every day for which that name or title has been used.
464(3)	Prohibition of association or partnership of persons exceeding certain number	● Every member of an association or partnership carrying on business in contravention of sub-section (1)shall be punishable fine which may extend to Rs. 1 Lakh and shall also be personally liable for all liabilities incurred in such business.
469(3)	Contravention of the Rules framed by Central Government	● Fine upto Rs.5,000 and further fine up to Rs.500 for each day of default in case of contravention continues.

LIST OF OFFENCES NON-COMPOUNDABLE IN NATURE

Section	Nature of Offences	Fine/Imprisonment
57	deceitfully personating as an owner of any security or interest in a company	● Imprisonment for a term which shall not be less than one year but which may extend to three years and with fine which shall not be less than Rs.1 Lakh but which may extend to Rs.5 Lakhs.
58(6)	Contravention of an order of the Tribunal regarding the refusal of registration and appeal against refusal	● Imprisonment for a term which shall not be less than one year but which may extend to three years and with fine which shall not be less than Rs.1 Lakh but which may extend to Rs.5 Lakhs.

67(5)	Contravention of provisions relating to purchase by company or loans by company for purchase of its own shares	● Fine which shall not be less than Rs.1 Lakh but which may extend to Rs.25 Lakhs; and ● Every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years and with fine which shall not be less than Rs.1 Lakh but which may extend to Rs.25 Lakhs.
118(12)	Tampering with the minutes of the proceedings of meeting	● imprisonment for a term which may extend to two years and with fine which shall not be less than Rs.25,000 but which may extend to Rs.1 Lakh.
127	Failure to distribute dividend within thirty days	● imprisonment which may extend to two years and with fine which shall not be less than Rs.1000 for every day during which such default continues (for every director); and ● the company shall be liable to pay simple interest at the rate of 18% per annum during the period for which such default continues.
147(2)	Failure of auditor to comply with the provisions of sections 139, 144 and 145 If knowingly contravenes	● The auditor shall be punishable with fine which shall not be less than Rs.25000 but which may extend to Rs.5 Lakhs or four times the remuneration of the auditor, whichever is less. ● If an auditor has contravened such provisions knowingly or wilfully with the intention to deceive the company or its shareholders or creditors or tax authorities, he shall be punishable with imprisonment for a term which may extend to one year and with fine which shall not be less than Rs.50,000 but which may extend to Rs.25 Lakhs or eight times the remuneration of the auditor, whichever is less.
182(4)	Political contribution made in contravention of this section	● the company shall be punishable with fine which may extend to five times the amount so contributed; and ● every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months and with fine which may extend to five times the amount so contributed.
186(13)	Contravention of the provisions of this section relating to loans and investment	● the company shall be punishable with fine which shall not be less than Rs.25000 but which may extend to Rs. 5 Lakhs; and ● every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to two years and with fine which shall not be less than Rs.25000 but which may extend to Rs.1 Lakh
207(4)	Disobeys the direction issued by the Registrar or inspector under this section	● If any director or officer of the company disobeys the direction issued by the Registrar or the inspector under this section, the director or the officer shall be punishable with imprisonment which may extend to one year and with fine which shall not be less than Rs.25000 but which may extend to Rs. 1 Lakh.
217(6)	Disobeys the direction issued by the Registrar or inspector under this section in relation to investigation	● the director or the officer shall be punishable with imprisonment which may extend to one year and with fine which shall not be less than Rs.25000 but which may extend to Rs. 1 Lakh

217(8)	Failure to provide information, books or papers, etc. to inspector during investigation	● imprisonment for a term which may extend to six months and with fine which shall not be less than Rs.25000 but which may extend to Rs.1 Lakh, and also with a further fine which may extend to Rs.2000 for every day after the first during which the failure or refusal continues.
245(7)	Committing default in complying with the order of Tribunal under this section related to Class Action	● Company shall be punishable with fine which shall not be less than Rs.5 Lakhs but which may extend to Rs. 25 Lakhs. ● every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years and with fine which shall not be less than Rs. 25000 but which may extend to Rs. 1 Lakh.
247(3) Proviso	Contravention of the provisions of this section by the valuer willfully	● if the valuer has contravened such provisions with the intention to defraud the company or its members, he shall be punishable with imprisonment for a term which may extend to one year and with fine which shall not be less than Rs.1 Lakh but which may extend to Rs. 5 Lakhs.
336(1)	Offences by officers of companies in liquidation	● Person shall be punishable with imprisonment for a term which shall not be less than three years but which may extend to five years and with fine which shall not be less than Rs.1 Lakh but which may extend to Rs. 3 Lakhs.
336(2)	Offences by officers of companies in liquidation covered under sub-Section (viii) of Section (d) of sub-section (1)	● Person shall be punishable with imprisonment for a term which shall not be less than three years but which may extend to five years and with fine which shall not be less than Rs.3 Lakhs but which may extend to Rs. 5 Lakhs.
337	Frauds by officers	● Person punishable with imprisonment for a term which shall not be less than one year but which may extend to three years and with fine which shall not be less than Rs.1 lakh but which may extend to Rs. 3 lakhs.
338(1)	Failure to keep proper books of account before winding up	● every officer of the company who is in default shall, unless he shows that he acted honestly and that in the circumstances in which the business of the company was carried on, the default was excusable shall be punishable with imprisonment not less than one year but may be extended to three years and fine not less than Rs. 1 lakh but may be extended to Rs.3 lakh.
447	Punishment for guilty of fraud	● Without prejudice to any liability including repayment of any debt under this Act or any other law for the time being in force, any person who is found to be guilty of fraud involving an amount of at least Rs.10 Lakhs or 1% of the turnover of the company, whichever is lower shall be punishable with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud.
447	Punishment for fraud If the fraud involves public interest	● Imprisonment not less than three years.

449	Intentionally gives false evidence	● Imprisonment not less than three years but may be extended to seven years and fine upto Rs. 10 lakh.
452(2)	Wrongful withholding of property	● To deliver up or refund any such property or cash wrongfully obtained; the benefits that have been derived, imprisonment for a term which may extend to two years

In the matter of Pahuja Takii Seed Ltd. and Ors. Vs ROC, NCT of Delhi & Haryana

NCLAT, New Delhi vide company appeal No. 80 of 2018 in the matter arising out of orders dated 16th February, 2018 passed by the NCLT, New Delhi Bench- III in various company applications, vide its order dated 27th September, 2018

Fact of the Case: The Appellants, Companies along with its Officers, filed applications under Section 441 of the Companies Act, 2013 for compounding of the offence(s) committed by them, on the ground that corrective measures have already been taken, which have been dismissed/disposed of by the National Company Law Tribunal (hereinafter referred to as "Tribunal"), New Delhi Bench-III, by common order dated 16th February, 2018.

Observations:

The questions require for determination in these appeals are:

i. **Whether the Companies Act, 2013 bars filing of a joint application for compounding of offence by a defaulting company along with its officers in default?**

NCLAT observed that in absence of any specific bar of 'joinder of parties' or joinder of separate cause of actions in preferring a compounding application, joinder of parties for same offence is permitted. Since facts leading to any non-compliance under the Act on the part of a company and its officers in default will be same, any suggestion to the contrary will only lead to multiplication of proceedings and different findings, which is not desirable.

ii. **Whether the Companies Act, 2013 bars filing of a joint application for compounding of the same offence committed in different years?**

There is no bar on preferring a single application for compounding the same offence committed during different financial years by the Company and its Officers, nor there is any bar on a joint application being preferred by a Company along with its Officers in default. It is trite that procedures are deemed to be permitted unless expressly prohibited.

iii. **Whether the Tribunal has jurisdiction to compound offences where the fine prescribed for such offence are less than its monetary jurisdiction?**

NCLAT had clarified that Section 441 only puts a restriction on the power of the 'Regional Director' and 'the authorised officers of the Central Government' permitting them to compound the offences wherein the maximum amount of fine does not exceed five lakh rupees (now Rs. 25 Lakhs) and is punishable with 'fine only'. No such fetter has been put on powers of the Tribunal, which is the main forum for such compounding of offences, the other forum of 'Regional Director' and 'Officer of the Central Government' being alternative but restricted by extent of quantum of punishment. The NCLAT held that, the Tribunal has the powers to compound all the offences irrespective of any pecuniary limit as evident.

iv. **How to quantify the limit of Rs. 25 lacs in order determine the jurisdiction of RD?**

In this regard, RD has the jurisdiction to compound an offence which has a maximum fine of Rs. 25 lacs. Now the question arises how to determine this quantum whether it is per compounding application or per applicant. The NCLAT has not specifically answered this question but has re-affirmed the observation of NCLT that the quantum of Rs. 25 lacs shall be determined based upon each applicant and is not required to be consolidated of all the applicants where joint application is moved.

So, for calculating the monetary jurisdiction, fine shall be calculated on the basis of each of the application and shall not be aggregated. If in any case, quantum of fine on a company is less than Rs 25 Lacs but more than the said amount for officer in default, then either a joint application can be filed with Tribunal or company can file the application with RD and officer in default with the Tribunal.

Compounding of repeated offences

Sub-sec (2) of sec 441 makes it clear that an offence committed by a company or its officer within a period of 3 years from the date on which a similar offence committed by it or him was compounded under this section cannot be compounded.

An explanation under this sub section makes it clear that for the purposes of this section:

(a) any second or subsequent offence committed after the expiry of a period of three years from the date on which the offence was previously compounded, shall be deemed to be a first offence;

(b) "Regional Director" means a person appointed by the Central Government as a Regional Director for the purposes of this Act.

The above provision is a negative exception to the general rule contained in sec 441(1) of the Companies Act, 2013 in relation to compoundable offences. It creates a carve out for second and subsequent offence and puts an restriction on the facility of compounding. The thrust is on the date of commission of the offence. If the company or an officer commits a similar offence after the expiry of a period of 3 years from the date on which the offence was previously compounded, this bar will not apply.

Whether an offence punishable under the relevant provisions of the Companies Act, 2013 with 'fine only' or with 'imprisonment or fine', if repeated within a period of three years results into a mandatory imprisonment for the defaulters and whether the same can be compounded or not?

Sub-sec (2) of sec 441 makes it clear that an offence committed by a company or its officer within a period of 3 years from the date on which a similar offence committed by it or him was compounded under this section cannot be compounded and the provisions of Section 451 also becomes applicable.

Section 451 prescribes that, if a company or an officer of a company commits an offence punishable either with fine or with imprisonment and where the same offence is committed for the second or subsequent occasions within a period of three years, then, that company and every officer thereof who is in default shall be punishable with twice the amount of fine for such offence in addition to any imprisonment provided for that offence.

The Company committed a compoundable offence during the financial year 2015-16, 2016-17 & 2017-18. On application of the Company the offence was compounded for the year 2015-16 vide order dated 31st March 2019. The Company has committed same offence during 2018-19 also and wants to go for compounding of the same. Can the Company get the offence compounded for the Year 2016-17, 2017-18 & 2018-19?

Yes, all three years offence can be compounded as these offences were committed prior to compounding order. If same offence is repeated during 2019-20 that cannot be compounded. Section 441(2) provides that an offence committed by a company or its officer within a period of three years from the date on which a similar offence committed by it or him was compounded under this section, cannot be compounded.

Application to Registrar of Companies - section 441(3)

Section 441(3) (a) says that the application for compounding of an offence is required to be made to the registrar of companies. The registrar shall forward the application, together with his comments thereon, to the Tribunal or the regional director or any officer authorised by the Central Government, as the case may be.

(b) Where any offence is compounded under this section, whether before or after the institution of any prosecution, an intimation thereof shall be given by the company to the Registrar within seven days from the date on which the offence is so compounded.

(c) Where any offence is compounded before the institution of any prosecution, no prosecution shall be instituted in relation to such offence, either by the Registrar or by any shareholder of the company or by any person authorised by the Central Government against the offender in relation to whom the offence is so compounded.

(d) Where the compounding of any offence is made after the institution of any prosecution, such compounding shall be brought by the Registrar in writing, to the notice of the court in which the prosecution is pending and on such notice of the compounding of the offence being given, the company or its officer in relation to whom the offence is so compounded shall be discharged.

Section 441(4) provides that the Tribunal or the Regional Director or any officer authorised by the Central Government, as the case may be, while dealing with a proposal for the compounding of an offence for a default in compliance with any provision of this Act which requires a company or its officer to file or register with, or deliver or send to, the Registrar any return, account or other document, may direct, by an order, if it or he thinks fit to do so, any officer or other employee of the company to file or register with, or on payment of the fee, and the additional fee, required to be paid under section 403, such return, account or other document within such time as may be specified in the order.

CASE LAWS

- **In the matter of *Schneider Electric IT Business India Private Limited & Ors.,* the question is whether offence can be compounded even though prosecution was pending against the Applicants ?**

  It is contended that, even though prosecution was launched against the Applicants, yet violation can be compounded by the Tribunal and no prior permission from the Special Court for Economic Offence at Bangalore is required and the power given to the Company Law Board (now Tribunal) under section 621A(1) of the Companies Act, 1956 which is independent of exercise of powers by the court under sub-section (7) and all offences other than those which are punishable with imprisonment only or with imprisonment and also fine can be compounded by the Tribunal without any reference to the sub-section (7) even in cases where the prosecution is pending in a criminal court.

  Thus, it is clear if offence is compounded after institution of the prosecution, then Registrar has to bring to the notice of the Court where prosecution is pending in writing and on such notice of composition the Court shall discharge the company or its officers against whom prosecution is pending.

- In the matter of *RSPL Limited & Ors.,* the company had filed its cost audit report after a delay of four years of the prescribed time period. The NCLT (Allahabad bench) held that the application for compounding is to be allowed as the company, though acted belatedly, had shown its bona fide effort to make good the default.

Illustration:

Are the following offences compoundable and if yes, by whom ?

(i) Fraudulently issuing duplicate share certificates

(ii) Failure to keep proper books of accounts

(iii) Tampering with minutes of meetings.

(i) Fraudulently issuing duplicate share certificates

Since the offence is punishable under section 46(5) of the Companies Act, 2013 with fine only it is compoundable by under section 441 of Companies Act, 2013 by the RD/National Company Law Tribunal.

(ii) Failure to keep proper books of accounts
It is compoundable by Regional Director

(iii) Tampering with minutes of proceedings of meetings

This offence is punishable under section 118(12) of the Companies Act, 2013 and the prescribed punishment for the same is by way of imprisonment and fine. Therefore, this offence is not compoundable under section 441 of Companies Act, 2013.

PQR Ltd. failed to file return of allotment against the 16 lakh shares allotted by the Board of directors at its meeting held on 20th April, 2019 and got order for compounding of offence on 10th June, 2020. The company again failed to file return of allotment against the 11 lakh shares allotted by the Board of directors at its meeting held on 4th March, 2022. What options are available to the company in respect of this default ?

Interval between two similar offences for compounding under section 441of the Companies Act, 2013

Sec 441(2) of the Companies Act, 2013 expressly provides that if any offence which was committed by company or the officers was compounded under section 441 of the Act, and an offence similar to what was compounded earlier is committed again by a company or its officers within a period of three years from the date on which the earlier offence was compounded, then the provisions of section 441 will not be applicable and the company and the officers concerned will not be eligible for compounding again. In other words, similar offence can be compounded only once in three years.

Hence, in the given case, the company cannot go for compounding for non-filing of return of allotment. However, there is no such restriction imposed under section 454 on adjudicating a penalty by the adjudicating officer. The adjudicating officer may, by an order-

(a) impose the penalty on the company, the officer who is in default, or any other person, as the case may be, stating therein any non-compliance or default under the relevant provisions of this Act; and

(b) direct such company, or officer who is in default, or any other person, as the case may be, to rectify the default, wherever he considers fit.

According to section 460(b) of Companies Act, 2013, where any document required to be filed with the Registrar of Companies (ROC) under any provision of the Companies Act, 2013 is not filed within the time specified therein, the Central Government may, for reasons to be recorded in writing, condone the delay. So, the option of adjudication and condonation of delay is available to the company.

An offence under the Companies Act, 2013 was compounded by the Company and Compounding order was issued by the Compounding Authority specially for offences by the Company and the Directors of the Company as officer in default. The Company has paid the Compounding Fee. However, one of the Director, who is also a party to the Compounding as officer in default feels that compounding fee is high and he would like to go for an Appeal. Evaluate whether the Director will be allowed to make an appeal. Also indicate the penal provision for non-compliance of compounding orders.

It is necessary to refer to the below cases to understand the applicable law in the given circumstances.

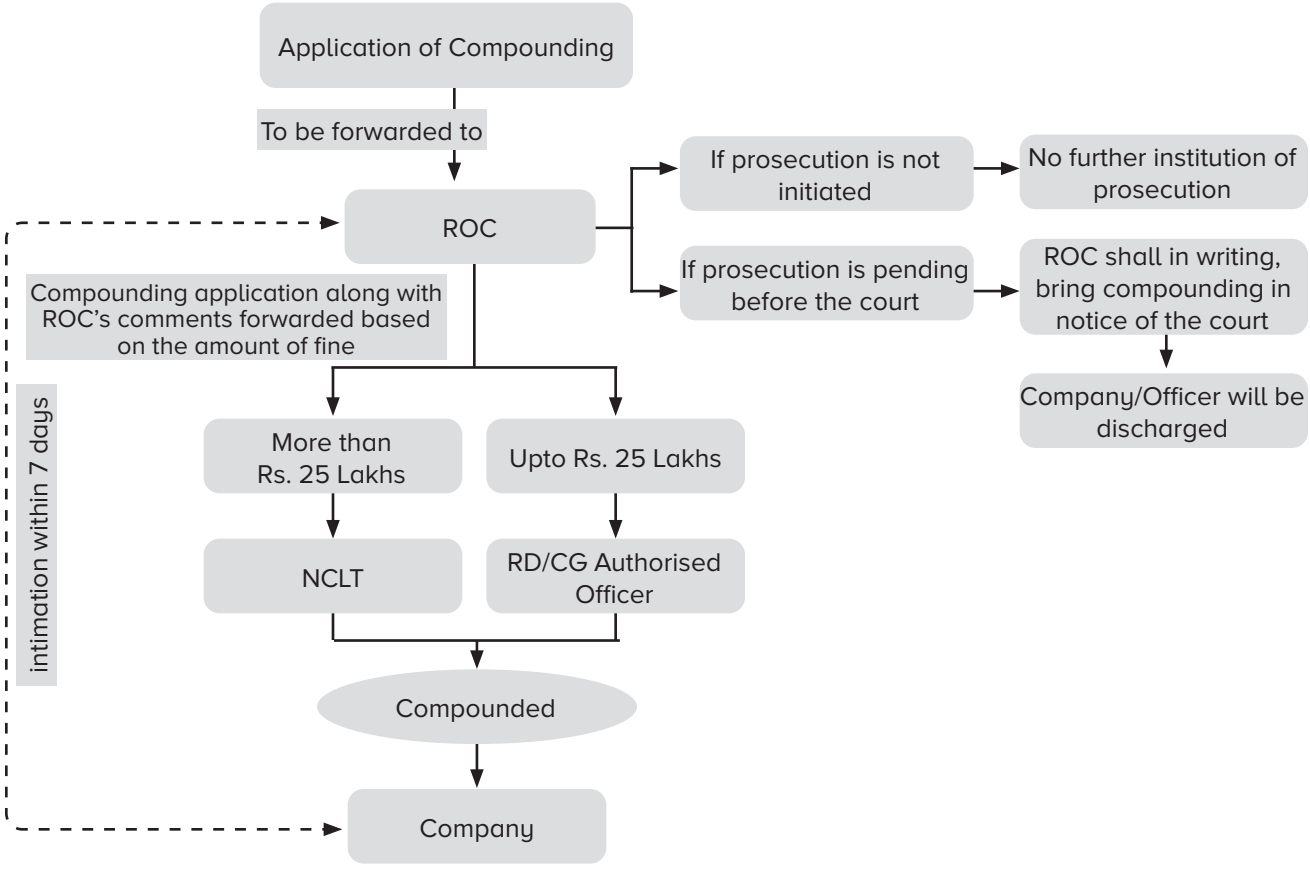
No appeal against order of composition : A person having agreed to the composition of offence is not entitled to challenge the said proceeding by filing an appeal. *[S V Bagi v. State of Karnataka (1992) 87 STC 138].*

No penalty or prosecution after compounding : In *P P Varkey v. STO (1999) 114 STC 224 (Bom HC DB),* it was held that once an offence is compounded, penalty or prosecution proceeding cannot be taken for same offence.

No challenge to the compounding order : In *S Viswanathan v. State of Kerala (1993) 113 STC 182 (Ker HC DB),* it was held that once the matter is compounded, neither department nor assessee can challenge the compounding order. Department cannot reopen the matter on the reason that actual suppression was much higher.

In view of the above, it can be said that the director will not be allowed to make an appeal.

Process of Compounding



Procedure for Compounding of Offence under the Companies Act, 2013:

S.No.	Procedure	Forms
Step 1	● Check the provisions under the Act, if such offence are compoundable or not. ● Make the default good.	
Step 2	● Before filing an application for compounding of offence, the company must hold a board meeting to consider, determine the offence and calculate the fine to be paid by the company and/or officer in default as per the relevant section.	E-Form MGT-14 for filing of Board Resolution to ROC in case of Public Company
	Pass the following Board resolution : ✓ For filing of the application for compounding; ✓ To authorize any Director or Officer of the company to sign and submit the application on behalf of the company; ✓ To appoint professionals (lawyer/CS/CA) to appear before the authority.	

Step 3	Filing Application for Compounding of Offence with ROC (As Per NCLT Rules, 2016) ● Detailed compounding application is required in Triplicate; ● Board resolution passed for the purpose of making an application; ● Affidavit verifying the application/petition; ● General profile and history of the company containing details such as name, date of incorporation, main objects of the company; ● Memorandum of appearance or power of attorney; ● Copy of notice received from ROC or any other competent authority in case application for compounding of offence is filed in pursuance to notice received from ROC or any other authority; ● Other documents based on requirements. *Note: The application (e-form GNL-1) can be filed for Company, Director or Manager/Secretary or Others. Enter number of person(s) and their details excluding Company. Details of only 8 persons can be entered in the e-Form. If number of persons is greater than 8, then additional details can be provided in optional attachment.*	E-Form GNL-1 With Fees of Rs. 1000
Step 4	● This application will be forwarded by ROC together with his comments thereon, to NCLT/Regional Director based on the amount of fine.	
Step 5	● Once the NCLT/RD receives the application for compounding, the concerned authority would send a notice to the company for personal hearing and the authorized representative of the company is liable to make their submission and admit the contravention committed under relevant sections of the Companies Act, 2013 and rules made thereunder.	
Step 6	● Payment of fees for compounding within the time period mentioned.	
Step 7	● Passing of order by the RD/Tribunal	
Step 7	● Intimation of order of NCLT or RD to RoC within 7 days of receipt of order. ROC will take note of the same.	INC-28

Specimen Board Resolution for Compounding of Offence under Companies Act 2013

"**RESOLVED THAT** pursuant to the provisions of Section ..... and other applicable provisions, if any, of the Companies Act, 2013 ('the Act') read with relevant rules made thereunder (including any statutory modification(s) or amendment(s) thereto or re- enactment thereof for the time being in force), consent of the board be and is hereby accorded for making an application/ petition under the Act for compounding of offence under the above mentioned sections and sections incidental to the above mentioned sections for the Company, Directors of the Company and Officers in Default as on date.

RESOLVED FURTHER THAT .....(Director/Officer of the Company) be and is hereby authorized on behalf of the Company:

a. To verify, sign, execute and deliver the Petition and Applications / Documents / Deeds / Affidavits / Confirmations / Declarations or such other papers forming part of the Petition/ Application, as may be required to/ with the Regulatory Authority/ Competent Authority for compounding of offence;

b. To delegate the authorities/ powers bestowed on them in pursuance of this resolution by appointing /engaging Practicing Professionals or Consultants, or Counsels or Pleaders to file and pursue all Petitions, Applications, reports, amendments, alterations, additions, deletions and other documents as may be necessary to give effect to the Petition/ Application, and to represent the Company before the Regulatory Authority / Competent Authority for compounding of offence;

c. To sign and submit any electronic forms to be submitted / filed / uploaded with the National Company Law Tribunal/ Registrar of Companies or any of the Appropriate/ Competent Authority, in relation to the Petition;

d. To respond to queries that may arise in relation to the Petition/ Application including execution of the documents without being required to seek any further consent or approval of the Board, with the intent that the Board of Directors shall be deemed to have given their approval thereto expressly by the authority of this resolution and to do all such acts, things, deeds etc. as may be considered necessary and expedient in relation thereto;

RESOLVED FURTHER THAT Mr. ....., Company Secretary in whole-time practice be and is hereby authorized to enter appearance before the authority for compounding of above said default and to do all such acts incidental thereto.

RESOLVED FURTHER THAT a certified true copy of the said resolution be furnished to the concerned authority as and when required."

Is there any discretionary power to reject the Application?

No, neither of the NCLT or the RD has been authorized with discretionary power to reject a compounding application without due consideration (In Re *Amadhi Investments Ltd.)*.

Whether NCLT has powers to review its own decision?

The NCLAT in the case *"APC Credit Rating Private Limited Vs. Registrar of Companies, NCLAT of Delhi and Haryana, [2018] 143 CLA 166 (NCLAT)* held that; "it is clear that there is no inherent power to review, as is under Order 47 Rule 11 of the Code of Civil Procedure, 1980 but the Tribunal has power conferred by sub-section (2) of Section 420 of the Act, 2013 to rectify any mistake apparent from the record and to amend the order accordingly."

Therefore, we can categorically say that NCLT has power to review its own orders unless the statue is amended to make way for such review.

OTHER PROVISIONS OF COMPOUNDING OF OFFENCES UNDER SECTION 441 OF THE COMPANIES ACT, 2013

- Section 441(1) makes it clear that the compounding authority can direct the applicant company or any officer thereof to pay to the credit of the Central Government such sum as the compounding authority may deem fit as a pre-condition for such compounding. The sum so determined by the compounding authority (the Tribunal or the regional director) should be paid by the company or the officer, as the case may be, to the Central Government account.
- Only after remittance of the sum specified by the compounding authority, can it be said that the offence in question has been compounded. The compounding authority, upon receipt of evidence proving the payment of the compounding fee will issue an order stating that the offence is compounded.
- The first proviso under sub-sec (1) of sec 441 specifies that the sum so specified shall not, in any case, exceed the maximum amount of fine which may be imposed for the offence so compounded.

Accordingly, the maximum compounding fee that could be imposed cannot exceed the maximum amount of fine that could be levied if the offence is prosecuted to its logical conclusion.

- The second proviso under sub-sec (1) of sec 441 states that while determining the sum required to be paid or credited by the applicant for compounding of an offence, the amount should be determined after duly taking into account any additional fee that the company would have paid under sec 403(2) of the Companies Act, 2013.
- From the above proviso it is also clear that prior to making the application for the compounding of offence arising from any failure or default in relation to which a fee and additional fee is payable as prescribed under sub-sec (1) of Section 403, it is essential to ensure to put an end to the failure or for removal of the default so that the compounding authority could take the additional fee paid into consideration.

Penalty for Non – Compliance of Order of Compounding Authorities

Section 441(5) provides that any officer or other employee of the company who fails to comply with any order made by the NCLT or the RD or any officer authorized by the Central Government, the maximum amount of fine for the offence proposed to be compounded under section 441 shall be twice the amount provided in the corresponding section in which punishment for such offence is provided.

As per 441(6), notwithstanding anything contained in the Code of Criminal Procedure, 1973, any offence which is punishable under this Act with imprisonment only or with imprisonment and also with fine shall not be compoundable.

COMPOUNDING PROVISIONS UNDER THE SECURITIES AND EXCHANGE BOARD OF INDIA ACT, 1992 ("SEBI ACT"), SECURITIES CONTRACTS (REGULATION) ACT, 1956 (SCRA) & DEPOSITORIES ACT, 1996

Composition of certain offences

Securities and Exchange Board of India Act, 1992, Securities Contracts (Regulation) Act, 1956 and the Depositories Act, 1996 (collectively referred to as SEBI Laws here for brevity) contain penalty provisions for contravention. Section 24A of the Securities and Exchange Board of India Act, 1992, Section 23 N of the Securities Contracts (Regulation) Act, 1956 and section 22A of the Depositories Act, 1996 provide for composition of certain offences thereunder:

Notwithstanding anything contained in the Code of Criminal Procedure, 1973, any offence punishable under this Act, not being an offence punishable with imprisonment only, or with imprisonment and also with fine, may either before or after the institution of any proceeding, be compounded by a Securities Appellate Tribunal or a court before which such proceedings are pending. Thus, if the offence is punishable with fine only or imprisonment or fine or with fine or imprisonment or both alone can be compounded.

The contours and the essential elements of Section 24A of the SEBI Act were recently explored and elaborately explained by the Hon'ble Supreme Court ("**Court**") in *Prakash Gupta v. Securities and Exchange Board of India ("**Prakash Gupta**").*

CASE STUDY

Prakash Gupta v. Securities and Exchange Board of India, dated July 23, 2021

Fact of the Case: The appellant is being prosecuted for an offence under Section 24(1) of the Securities and Exchange Board of India Act, 1992 ("SEBI Act"). The appellant sought the compounding of the offence under Section 24A. By an order dated 15 November 2018, the Additional Sessions Judge – 02 Central District at Tis Hazari Courts, Delhi ("Trial Judge"), rejected the application, upholding the objection of the Securities and Exchange Board of India that the offence could not be compounded without its consent.

Mr. Prakash Gupta, director of Ideal Hotels & Industries Limited ("Company"), was accused of having engaged in price rigging and insider trading during the Initial Public Offer ("IPO") of the Company, in violation of Regulations 4(a) and (e) of the SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 1995, along with other provisions of the Takeover Regulations, 1994 and 1997.

On 27 June 1996, SEBI received a complaint from Mr Vijay Miglani alleging that certain Delhi/Bombay based brokers had, on the instructions of the Company, purchased its shares and that huge deliveries were kept outstanding in the grey market. SEBI also received an anonymous complaint in October 1996, alleging price rigging and insider trading in the scrip of the Company.

During its investigation, SEBI obtained the details of the top brokers who traded in the shares of the Company during this period on the Delhi Stock Exchange and Bombay Stock Exchange, and also of their clients who had made significant purchases or sales on the scrip. Consequently, SEBI came up with the name of six entities who had purchased approximately 51 per cent of the 38 lac equity shares on offer during the period between 28 January 1996 and 29 February 1996. They were found to have continued buying shares even after that period, and had ultimately purchased 28,38,000 equity shares, which was approximately 75 per cent of the post issue floating stock of the Company. As such, it was assumed that these entities were, therefore, responsible for the upward price movement in the scrip.

A criminal complaint was filed against Mr. Gupta before the Trial Court alleging the above violations and an Adjudicating Officer under the SEBI Act was appointed. Prior to any orders in the aforesaid proceedings, the Chairman of SEBI, under the provisions of the SEBI Act, allowed Mr. Gupta to purchase the shares of the shareholders at a higher price than that fixed during the IPO, thereby supposedly resolving the issue. However, the AO, pursuant to noting the offences committed by Mr. Gupta, levied a fine of INR 20,000 on him and other co-promotors. This penalty too was paid by the accused.

Thereafter, a compounding application under Section 24A of the SEBI Act was filed by Mr. Gupta before the Trial Court which was objected to by the High Powered Advisory Committee ("HPAC") of SEBI. The Trial Court rejected the compounding application on the grounds that SEBI had not provided its consent to the same, which was upheld by the High Court of Delhi. Hence, the present appeal before the Court.

Issue:

Whether under section 24A of the SEBI Act, the express consent of SEBI is required prior to the compounding of offences by the Securities Appellate Tribunal or the court before which proceedings are pending?

Observation:

While a plain reading of the section 24A does not provide for the consent of SEBI, it was considered whether such consent should be read into Section 24A, on the grounds of *casus ommisus*.

In the present case, it is evident that Section 24A does not stipulate that the consent of SEBI is necessary for the SAT or the Court before which such proceedings are pending to compound an offence. Where Parliament intended that a recommendation by SEBI is necessary, it has made specific provisions in that regard in the same statute. Section 24B provides a useful contrast. Section 24B(1) empowers the Union Government on the recommendation of SEBI, if it is satisfied that a person who has violated the Act or the Rules or Regulations has made a full and true disclosure in respect of the alleged violation, to grant an immunity from prosecution for an offence subject to such conditions as it may impose.

The second proviso clarifies that the recommendation of SEBI would not be binding upon the Union Government. In other words, Section 24B has provided for the exercise of powers by the Central Government to grant immunity from prosecution on the recommendation of SEBI. In contrast, Section 24A is conspicuously silent in regard to the consent of SEBI before the SAT or, as the case may be, the Court before which the proceeding is pending can exercise the power. Hence, it is clear that SEBI's consent cannot be mandatory before SAT or the Court before which the proceeding is pending, for exercising the power of compounding under Section 24A.

Judgement:

In the present case, we are clearly of the view that the nature of the allegations against the appellant are such so as to preclude a decision to compound the offences.

1. The factors as listed in the Frequently Asked Questions in relation to the 'Guidelines for Consent Order and for considering requests for composition of offences' dated April 20, 2007 should be adhered to;
2. The opinion of SEBI and its HPAC must be given due deference as the same indicates their position on the effect that non-prosecution of the offence may have on market structures. The Securities Appellate Tribunal or the courts should only differ from the opinion of SEBI/ the HPAC, if it has reasons to believe that the said opinion is *mala fide* or manifestly arbitrary;
3. The principle behind the compounding proceeding should be that the aggrieved party has been restituted and that it has consented to end the dispute. Since the aggrieved party may not be before the court, and that the offences are usually of public nature, it becomes even more essential to rely on SEBI's opinion to understand if restitution has taken place; and
4. Even if restitution has taken place, but the offence is of public character and non-prosecution of the same would affect the public at large, such offence should not be compounded.

The judgment of the Supreme Court in *Prakash Gupta* is significant as it not only underlines the importance of the role played by SEBI in market regulation and addressal of investors, but also appreciates the intention of the legislators while doing so. Further, it fills in the lacune that earlier existed by providing detailed guidelines on the factors to be take into consideration while passing an order under Section 24A of the SEBI Act.

https://main.sci.gov.in/supremecourt/2019/17875/17875_2019_35_1501_28712_Judgement_23-Jul-2021.pdf

SETTLEMENT PROCEEDINGS / CONSENT ORDERS UNDER SEBI LAWS-APPLICABLE FOR COMPOSITION OF OFFENCE

In SEBI Laws, the term Settlement / Consent Order is significant and has to be understood along with or at the time of learning composition of offence.

Consent order may be passed at any stage after probable cause of violation has been found under SEBI Laws. However, in the event of a serious and intentional violation, the process should not be completed till the fact-finding process is completed whether by way of investigation or otherwise.

Compounding of Offence can take place after filing criminal complaint by SEBI. Where a criminal complaint has not yet been filed but is envisaged, the process for consent orders will be followed.

Consent orders provide flexibility of a wider array of enforcement actions which will achieve the twin goals of an appropriate sanction and deterrence without resorting to long drawn litigation before SEBI, SAT, and Courts. Passing of consent orders also reduce regulatory costs and save time and efforts in pursuing enforcement actions.

It is an order settling administrative or civil proceedings between the regulator and a person (Party) who may prima facie be found to have violated securities laws. It may settle all issues or reserve an issue or claim, but it must precisely state what issues or claims are being reserved. A Consent Order may or may not include a determination that a violation has occurred.

Consent Order cannot be construed as waiver of statutory powers by the Board. The Board always has the right to proceed for appropriate action if it cannot achieve its objectives through a consent order.

This effort could more effectively be used for pursuing cases which require the full process of enforcement action and for policy initiatives.

For more details students are advised to refer paper "Drafting, Pleadings and Appearances" Lesson 13 (Adjudication and Appeals under SEBI Laws)

Under the Securities and Exchange Board of India Act, 1992, Securities Contracts (Regulation) Act, 1956 (SCRA) and the Depositories Act, 1996 (collectively also known as securities laws), SEBI pursues two streams of enforcement actions i.e., Administrative /Civil (or) Criminal.

Administrative/civil actions include issuing directions such as remedial orders, cease and desist orders, suspension or cancellation of certificate of registration and imposition of monetary penalty under the respective statutes and action pursued or defended in a court of law/tribunal. Criminal action involves initiating prosecution proceedings against violators by filing complaint before a criminal court.

Settlement order

(Lotus Chocolate Company Limited) (February 29, 2024)

Promoter of the Applicant had acquired 1,000 equity shares in physical form on September 07, 2011. The information regarding the said acquisition, as stated by the Applicant, was inadvertently not included in the promoter/promoter group shareholding of the Applicant which was disseminated on the stock exchange platform under Regulation 31(4) read with Regulation 31(1) of the LODR Regulations, 2015 and Circular No. CIR/CFD/CMD/13/2015 dated November 30, 2015 and Clause 35 of the erstwhile Listing Agreement.

Further, the details of shareholdings of three shareholders, who are a part of the promoter group of the Applicant, holding 12,500 shares each, were also, as stated by the Applicant, inadvertently not included in the shareholding pattern under Clause 35 of the Listing Agreement from the quarter ended December 31, 2010 to the quarter ended September 30, 2012.

The Applicant filed revised shareholding details for the quarter ended December 31, 2010 to the quarter ended December 31, 2021, incorporating the shares held by three shareholders as part of the promoter/ promoter group shareholding , under Regulation 31 of the LODR Regulations and Clause 35 of the erstwhile listing agreement on June 29, 2023.

In view of the aforesaid facts, the Applicant *suo motu* filed the present application for the purpose of settling the proceedings that may be initiated against it for the said delayed compliance.

Pursuant to the receipt of the application, the authorized representatives of the Applicant had a meeting with the Internal Committee of SEBI on November 22, 2023, wherein the Abovementioned were deliberated along with the terms of the settlement. Thereafter, vide email dated November 27, 2023, the Applicant proposed revised settlement terms to settle any enforcement proceedings that may be initiated against it for the violations as stated above.

The High Powered Advisory Committee (hereinafter referred to as "HPAC") in its meeting held on December 21, 2023, considered the revised settlement terms proposed by the Applicant and recommended the case for settlement upon payment of ₹7,14,400/- (Rupees Seven lakhs fourteen thousand four hundred only).

The recommendation of the HPAC was accepted by the Panel of Whole Time Members of SEBI on January 19, 2024.

On the basis of the facts stated above, in exercise of the powers conferred under Section 15JB read with Section 19 of the Securities and Exchange Board of India Act, 1992 and in terms of Regulation 23 of the Settlement Regulations, it is hereby ordered that any proceedings that may be initiated for the violations as mentioned above, are settled in respect of the Applicant ,on the basis of specified terms dictated by SEBI.

Settlement of Administrative and Civil Proceedings

Section 15JB of SEBI Act, 1992 deals with settlement of administrative and civil proceeding by SEBI:

- Any person, against whom any proceedings have been initiated or may be initiated under section 11, section 11B, section 11D, sub-section (3) of section 12 or section 15-I, may file an application in writing to the Board proposing for settlement of the proceedings initiated or to be initiated for the alleged defaults.

- SEBI may, after taking into consideration the nature, gravity and impact of defaults, agree to the proposal for settlement, on payment of such sum by the defaulter or on such other terms as may be determined by the Board in accordance with the regulations made under this Act.
- The settlement proceedings under this section shall be conducted in accordance with the procedure specified in the regulations made under this Act.
- No appeal shall lie under section 15T against any order passed by the Board or adjudicating officer, as the case may be, under this section.
- All settlement amounts, excluding the disgorgement amount and legal costs, realised under this Act shall be credited to the Consolidated Fund of India.

CASE STUDY

Shareholders of the *Kapashi Commercials Ltd.* on 10th July, 2020, a BSE Listed company, have settled with SEBI a case of alleged violation of takeover norms by paying over Rs. 34 lakh amount towards settlement terms. They have filed an application with the SEBI proposing to settle the case for alleged violation of SAST (Substantial Acquisition of Shares and Takeovers) Regulations in respect of change in their shareholding in Kapashi Commercials. It was alleged that the four individuals made delayed disclosures to the company and BSE, about the change in their shareholding in Kapashi Commercials.

SECURITIES AND EXCHANGE BOARD OF INDIA (SETTLEMENT PROCEEDINGS) REGULATIONS, 2018

In exercise of the powers conferred by Section 15JB of the Securities and Exchange Board of India Act, 1992, Section 23JA of the Securities Contracts (Regulation) Act, 1956 and Section 19-IA of the Depositories Act, 1996 read with Section 30 of the Securities and Exchange Board of India Act, 1992, Section 31 of the Securities Contracts (Regulation) Act, 1956 and Section 25 of the Depositories Act, 1996, SEBI has by notification dated 30th November 2018 has made the following regulations to provide for the terms of settlement and the procedure of settlement and matters connected therewith or incidental thereto known as Securities and Exchange Board of India (Settlement Proceedings) Regulations, 2018.

Application for Settlement (Regulation 3)

(1) A person against whom any specified proceedings have been initiated and are pending or may be initiated, may make an application to the Board in the Form specified in Part-A of the Schedule-I.

(2) The application made above shall be accompanied by a non-refundable application fee as specified in Part-B of Schedule I and the undertakings and waivers as specified in Part-C of Schedule-I.

Provided that the rejection or withdrawal of the application shall not affect the continued validity of the undertakings and waivers given in respect of limitation or laches in respect of the initiation or continuation or restoration of any legal proceeding and the waivers given under sub-paras (d), (e), (f) and (g) of para 12 of the undertaking and waivers as provided in Part-C of the Schedule-I and subject to such undertakings and waivers, the Board or the applicant, shall be free to initiate or pursue such proceedings as may be appropriate in accordance with law.

(3) The applicant shall make full and true disclosures in the application in respect of the alleged default(s):

Provided that the facts established against the applicant or admitted in any ongoing or concluded proceedings in India or outside India, with respect to the same cause of action, under any law, shall be deemed to be admitted by the applicant in respect of the proceedings proposed to be settled.

(4) The applicant shall make one application for settlement of all the proceedings that have been initiated or may be initiated in respect of the same cause of action.

(5) An application that is not complete in all respects or does not conform to the requirements of these regulations shall be returned to the applicant.

(6) The applicant whose application has been returned under sub- regulation (5) may, within fifteen days from the date of communication from the Board, submit the complete and revised application that conforms to the requirements of these regulations:

Provided that no further opportunity shall be given to the applicant to make an application in respect of the alleged default at the same stage of the proceedings, as indicated in Table I in Schedule-II.

(7) Where the applicant is an association or a firm or a body corporate or a limited liability partnership, the application and undertakings and waivers shall be executed by the person in charge of, and responsible for the conduct of the business of such firm or association or body corporate and the same shall bind the firm or association, the body corporate and any officer who is in default.

Explanation. - For the purpose of this sub-regulation, the expression 'officer who is in default' shall have the same meaning as provided in sub-Section (60) of Section 2 of the Companies Act, 2013.

(8) An application for settlement of defaults related to disclosures, shall to the extent possible, be made after making the required disclosure.

Limitation (Regulation 4)

(1) An application in respect of any specified proceeding pending before the Board shall not be considered if it is made after sixty days from the date of service of the notice to show cause or supplementary notice(s) to show cause, whichever is later.

The provisions of this regulation shall not apply in the case of proceedings pending before the Tribunal or any court.

Scope of settlement proceedings (Regulation 5)

(1) No application for settlement of any specified proceedings shall be considered, if:

(a) an earlier application with regard to the same alleged default had been rejected;

(b) the audit or investigation or inspection or inquiry, if any, in respect of any cause of action, is not complete, except in case of applications involving confidentiality; or

(c) monies due under an order issued under securities laws are liable for recovery under securities laws.

(2) The Board may not settle any specified proceeding, if it is of the opinion that the alleged default, -

i. has market wide impact, or

ii. caused losses to a large number of investors, or

iii. affected the integrity of the market.

(3) Without prejudice to the generality of the foregoing provisions, for settling any specified proceeding the Board may inter alia take into account the following factors, -

(a) whether the applicant has refunded or disgorged the monies due, to the satisfaction of the Board;

(b) whether the applicant has provided an exit or purchase option to investors in compliance with securities laws, to the satisfaction of the Board;

(c) whether the applicant is in compliance with securities laws or any order or direction passed under securities laws, to the satisfaction of the Board;

(d) any other factor as may be deemed appropriate by the Board.

(4) Without prejudice to sub-regulations (1) and (3), the Board may not settle the specified proceedings where the applicant is a wilful defaulter, a fugitive economic offender or has defaulted in payment of any fees due or penalty imposed under securities laws.

(5) Nothing contained in these regulations shall be construed to restrict the right of the Panel of Whole Time Members to consider or reject any application in respect of any specified proceeding without examination by the Internal Committee or the High Powered Advisory Committee.

Rejection of application (Regulation 6)

(1) An application may also at any time be rejected on the following grounds:

(a) Where the applicant refuses to receive or respond to the communications sent by the Board;

(b) Where the applicant does not submit or delays the submission of information, document, Revised Settlement Terms, etc., as called for by the Board;

(c) Where the applicant who is required to appear, does not appear before the Internal Committee on more than one occasion;

(d) Where the applicant violates in any manner the undertaking and waivers as provided in Part-C of the Schedule-I;

(e) Where the applicant does not remit the settlement amount within the period specified in clause (a) of sub-regulation (2) of regulation 15 and/or does not abide by the undertaking and waivers;

(f) Where the applicant fails to comply with the condition precedent(s) for settlement within the time as required by the Internal Committee.

(2) The rejection under sub-regulation (1) shall be communicated to the applicant:

Provided that the applicant shall continue to be bound by the waivers given in respect of limitation or laches in respect of the initiation or continuation or restoration of any legal proceeding and the waivers given under sub-paras (d), (e), (f) and (g) of para 12 of the undertaking and waivers as provided in Part-C of the Schedule-I.

Withdrawal of application (Regulation 7)

(1) An application may be withdrawn at any time prior to the communication of the decision of the Panel of Whole Time Members under regulation 15.

(2) An applicant who withdraws an application under sub-regulation (1) shall not be permitted to make another application in respect of the same default:

Provided that, as may be recommended by the High Powered Advisory Committee, such an application may be considered subject to an increase of at least fifty percent over the settlement amount determined in accordance with Schedule-II of these Regulations. Effect of pending application on specified proceedings.

Effect of pending application on specified proceedings (Regulation 8)

(1) The filing of an application for settlement of any specified proceedings shall not affect the continuance of the proceedings save that the passing of the final order shall be kept in abeyance till the application is disposed of.

(2) Where the application is filed in case of proceedings that may be initiated against the applicant, such proceedings shall not be initiated till the application is rejected or withdrawn:

Provided that, the filing of an application shall not prohibit the initiation of any proceedings, in so far as may be deemed necessary for the purpose of issuance of interim civil and administrative directions to protect the interests of investors and to maintain the integrity of the securities markets.

Explanation - Where any proceeding is pending or to be initiated against several persons but the settlement application is filed only by one or more persons, but not all, the filing of such an application shall not affect the initiation, continuation and disposal of the proceedings against the person who has not filed the application for settlement and any adverse observations made in such proceedings against the applicant shall qua the applicant be subject to the outcome of the settlement application filed by such applicant.

Settlement terms (Regulation 9)

(1) The settlement terms may include a settlement amount and/or non-monetary terms, in accordance with the guidelines specified in Schedule-II.

(2) The non-monetary terms may include the following:

(a) Suspension or cessation of business activities for a specified period;

(b) Exit from Management;

(c) Disgorgement on account of the action or inaction of the applicant;

(d) Refraining from acting as a partner or officer or director of an intermediary or as an officer or director of a company that has a class of securities regulated by the Board, for specified periods;

(e) Cancel securities and reduce holdings where the securities are issued fraudulently, including bonus shares received on such securities, if any, and reimburse any dividends received, etc.;

(f) Lock-in of securities;

(g) Implementation of enhanced policies and procedures to prevent future securities laws violations as well as agreeing to appoint or engage an independent consultant to review internal policies, processes and procedures;

(h) Provide enhanced training and education to employees of intermediaries and securities market infrastructure institutions;

(i) Submit to enhance internal audit and reporting requirements;

(j) Restraining from accessing the securities market and/or prohibiting from buying, selling or otherwise dealing in securities, directly or indirectly and associating with the securities market in any manner for a specific period.

(3) The settlement amount, excluding the legal costs and disgorged amount, shall be credited to the Consolidated Fund of India.

(4) The application fee referred to in sub-regulation (2) of regulation 3 and the legal costs, if any, forming part of the settlement amount shall be credited to the Securities and Exchange Board of India General Fund.

Explanation. – Legal costs shall include liquidated costs, as may be determined by the Board, in respect of costs for obtaining appropriate orders from the Tribunal or Court under sub-regulation (2) of regulation 24 and include other expenses incurred by the Board in any other proceeding before any Court or Tribunal in respect of such application.

(5) The amount of profits made or losses avoided by the applicant that may be disgorged as part of the settlement terms, shall be credited to the Investor Protection and Education Fund.

Factors to be considered to arrive at the settlement terms (Regulation 10)

While arriving at the settlement terms, the factors indicated in Schedule-II may be considered, including but not limited, to the following:

(a) conduct of the applicant during the specified proceeding, investigation, inspection or audit;

(b) the role played by the applicant in case the alleged default is committed by a group of persons;

(c) nature, gravity and impact of alleged defaults;

(d) whether any other proceeding against the applicant for non-compliance of securities laws is pending or concluded;

(e) the extent of harm and/or loss to the investors' and/or gains made by the applicant;

(f) processes that have been introduced since the alleged default to minimize future defaults or lapses;

(g) compliance schedule proposed by the applicant;

(h) economic benefits accruing to any person from the non-compliance or delayed compliance;

(i) conditions which are necessary to deter future non-compliance by the same or another person;

(j) satisfaction of claim of investors regarding payment of money due to them or delivery of securities to them;

(k) any other enforcement action that has been taken against the applicant for the same violation;

(l) any other factors necessary in the facts and circumstances of the case.

High Powered Advisory Committee (Regulation 11)

(1) The Board shall constitute a High Powered Advisory Committee for consideration and recommendation of the terms of settlement.

(2) The High Powered Advisory Committee shall consist of a Judicial member who has been the Judge of the Supreme Court or a High Court and three external experts having expertise in securities market or in matters connected therewith or incidental thereto.

(3) The term of the members of the High Powered Advisory Committee shall be three years which may be extended for a further period of two years.

(4) The quorum for a meeting of the High Powered Advisory Committee shall be of three members.

Explanation. - Meeting includes meeting through audio-video electronic means or through the medium of electronic video linkage.

(5) The High Powered Advisory Committee shall conduct its meetings in the manner specified by the Board in this regard: Provided that:

(i) where any member of the High Powered Advisory Committee seeks recusal, the remaining two or more members may submit their recommendation on the terms of settlement;

(ii) where no consensus or majority may be reached, the recommendation made by the Judicial member shall be considered to be the recommendation of the High Powered Advisory Committee and in case of recusal of the Judicial member, the recommendations of the remaining two or more members shall be submitted for consideration to the Panel of Whole Time Members; and

(iii) where all or all but one of the members of the High Powered Advisory Committee recuse themselves in respect of an application, the Board may constitute another High Powered Advisory Committee.

Internal committee(s) (Regulation 12)

(1) Internal Committee(s) shall be constituted by the Board.

(2) The Internal Committee(s) shall comprise of an officer of the Board not below the rank of Chief General Manager and such other officers as may be specified by the Board.

PROCEDURE OF SETTLEMENT

Proceedings before the Internal Committee (Regulation 13)

(1) Save as otherwise provided in these regulations, an application shall be referred to an Internal Committee to examine whether the proceedings may be settled and if so to determine the settlement terms in accordance with these regulations.

(2) The Internal Committee may:

(a) call for relevant information, documents, etc., pertaining to the alleged default(s) in possession of the applicant or obtainable by the applicant;

Explanation. – Nothing in these regulations shall confer a right upon the applicant to seek information from the Board or require the Board to seek information from any other person for the purpose of relying upon it in the settlement proceedings or request the Board to permit it to present information not already disclosed in the application, which the applicant was aware of at the time of making the application or which information upon diligent enquiry being made could have become known to the applicant.

(b) call for the personal appearance of the applicant before it:

Provided that a duly authorized representative of the applicant may represent on behalf of the applicant:

Explanation. - Personal appearance under this clause includes appearance through audio-video electronic means or through the medium of electronic video linkage as may be permitted by the Internal Committee.

(ba) require the applicant to comply with certain condition precedent(s) within a specified time period for consideration of the application for settlement.

(c) permit the applicant to submit revised settlement terms within a period not exceeding fifteen working days from the date of the Internal Committee meeting.

(3) The proposed settlement terms, if any, shall be placed before the High Powered Advisory Committee.

Proceedings before the High Powered Advisory Committee (Regulation 14)

(1) The High Powered Advisory Committee shall consider the proposed settlement terms placed before it along with the following:

(a) the application, undertaking and waivers of the applicant;

(b) factors specified in regulation 10;

(c) settlement terms or revised settlement terms proposed by the applicant;

(d) any other relevant material available on record.

(2) The High Powered Advisory Committee may seek revision of the settlement terms and refer the application back to the Internal Committee.

(3) The recommendations of the High Powered Advisory Committee shall be placed before the Panel of Whole Time Members.

Action on the recommendation of High Powered Advisory Committee (Regulation 15)

(1) The Panel of Whole Time Members shall consider the recommendations of the High Powered Advisory Committee and may accept or reject the same:

Provided that where the recommendations of the High Powered Advisory Committee to settle the specified proceedings are rejected, the panel of Whole Time Members shall record reasons for rejection of the recommendations:

Provided further that where the recommendation of the High Powered Advisory Committee to settle the specified proceedings are rejected, such decision of the panel of Whole Time Members shall be communicated to the applicant.

(2) Where the Panel of Whole Time Members accepts the recommendation of the High Powered Advisory Committee to settle the specified proceedings, the applicant shall be issued a notice of demand within seven working days of the decision of the panel and the applicant shall, -

(a) remit the settlement amount forming part of the settlement terms, not later than thirty calendar days from the date of receipt of the notice of demand:

Explanation. – Remittance of settlement amount shall be done by way of payment through the dedicated payment gateway provided for the purpose.

Provided that, in no case shall such remittance be accepted after the thirtieth calendar day from the date of the receipt of the notice of demand.

(b) fulfil/undertake in writing to abide by, the other settlement terms, if any, within the time provided to the applicant.

(3) Where the Panel of Whole Time Members does not accept the recommendation of the High Powered Advisory Committee to settle the specified proceedings on the settlement terms recommended by it, the panel may return the application for re-examination of the settlement terms and thereafter the procedure as applicable in the case of an original application shall be followed by the Internal Committee and the High Powered Advisory Committee.

SUMMARY SETTLEMENT PROCEDURE

Summary settlement procedure (Regulation 16)

(1) Notwithstanding anything contained in Chapter VI, before initiating any specified proceeding, the Board may issue a notice of summary settlement in the format as specified in Part-A of Schedule-III, calling upon the noticee to file a settlement application under ChapterII and submit the settlement amount and/or furnish an undertaking in respect of other nonmonetary terms or comply with other non-monetary terms, as may be specified in the summary settlement notice in respect of the specified proceeding(s) to be initiated for the following defaults,-

i. Delayed disclosures, including filing of returns, report, document, etc.;

ii. Non-disclosure in relation to companies exclusively listed on regional stock exchanges which have exited;

iii. Disclosures not made in the specified formats;

iv. Delayed compliance of any of the requirements of law or directions issued by the Board;

v. Such other defaults as may be determined by the Board.

Provided that, the specified proceeding(s) shall not be settled under this Chapter, if in the opinion of the Board, the applicant has failed to make a full and true disclosure of facts or failed to co-operate in the required manner.

(2) Notwithstanding anything contained in the notice of settlement, the Board shall have the power to modify the enforcement action to be brought against the noticee and the notice of settlement shall not confer any right upon the noticee to seek settlement or avoid any enforcement action.

(3) The noticee may, within thirty calendar days from the date of receipt of the notice of settlement, -

(a) file a settlement application in the Form specified in Part-A of Schedule-I along with non-refundable application fee as specified in Part-B and the undertakings and waivers as specified in Part-C of Schedule-I;

(b) remit the settlement amount as specified in the notice of settlement;

(c) comply or undertake to comply with other non-monetary terms as specified in the notice of settlement, as the case may be; and

(d) seek rectification of the calculation of the settlement amount, as communicated in the notice of settlement, at the time of filing the settlement application and in all such cases, the decision of the Board shall be final and remittance shall be done within thirty calendar days from the date of receipt of the decision of the Board:

Provided that, the Board may for reasons to be recorded, grant extension of time not exceeding a further period of fifteen calendar days for filing the settlement application, remittance of the settlement amount and/or furnishing an undertaking in respect of any of the non-monetary terms or compliance with any of the non-monetary terms specified in the notice of settlement.

(4) Upon being satisfied with the remittance of settlement amount and undertaking furnished in respect of the non-monetary terms or compliance with non-monetary terms, if any as detailed in the settlement notice, the Board shall pass an order of settlement under regulation 23.

Regulation 17

Notwithstanding anything contained in these regulations, where a noticee does not file a settlement application under this Chapter or remit the settlement amount and/or comply with other non-monetary terms to the satisfaction of the Board or withdraws the settlement application at any time prior to the communication of the decision of the Board, the specified proceedings may be initiated, and such a noticee shall only be permitted to file a settlement application in respect of the proceedings pending before the Court or Tribunal, after conclusion of proceedings before the Adjudicating Officer or the Board, as the case may be.

Settlement with confidentiality (Regulation 19)

(1) An applicant seeking the benefit of confidentiality in return for admitting for the limited purpose of settlement of specified proceedings to be initiated and agreeing to provide substantial assistance in the investigation, inspection, inquiry or audit, to be initiated or ongoing, against any other person in respect of a violation of securities laws, shall fulfil the conditions of this Chapter, including –

(a) cease to participate in the violation of securities laws from the time of the disclosure of information, unless otherwise directed by the Board;

(b) provide and continue to provide complete and true disclosure of information, documents and evidence, which is in his possession or he is able to obtain, to the satisfaction of the Board in respect of the alleged contravention of the provisions of securities laws;

(c) co-operate fully, continuously and expeditiously throughout the investigation, inspection, inquiry or audit and related proceedings before the Board; and

(d) not conceal, destroy, manipulate or remove the relevant documents in any manner that may contribute to the establishment of the alleged violation.

Explanation. – Violation of securities laws in this Chapter refers to defaults other than those of disclosure and reporting requirements detailed in Schedule II.

Provided that an application made under this chapter shall be made only in cases prior to or pending investigation, inspection, inquiry or audit.

(2) Notwithstanding anything contained in this Chapter, where an applicant fails to comply with the conditions mentioned in this regulation, the Board may rely upon the information and evidence submitted by the applicant in any proceedings

(3) Without prejudice to sub-regulations (1) and (2), the Board may subject the applicant to further restrictions or conditions, as deemed fit, after considering the facts and circumstances of the case.

(4) For the purpose of seeking confidentiality, the applicant or its authorized representative may make an application containing all the relevant disclosures pertaining to the information as specified in Schedule-IV for furnishing the information and evidence relating to the commission of any violation of securities laws.

(5) Upon being satisfied the Board may assure the benefit of confidentiality and shall thereupon mark the status of the application depending upon its priority and convey the same to the applicant in writing.

(6) The Board may, for reasons to be recorded in writing, at any stage, reject the application if the information, documents or evidence is found to be incomplete or false to the knowledge of the applicant.

(7) The rejection of the application for confidentiality shall be communicated to the applicant.

Procedure (Regulation 20)

(1) The provisions of Chapters IV to VI of these regulations may be applied *mutatis mutandis* to a settlement application filed under this Chapter and a settlement order passed accordingly.

(2) The information, documents and evidence provided by the applicant under this chapter shall be submitted in the manner specified by the Board.

Confidentiality and assurance (Regulation 21)

For the purposes of providing the applicant with interim confidentiality and assurance from being proceeded with, the Board may not initiate regulatory measures when the Board has a reasonable belief that the information provided to it relates to a possible securities law violation that has occurred, is ongoing or about to occur.

Confidentiality (Regulation 22)

Notwithstanding anything contained in Chapter X, the following shall be treated as confidential, -

(a) the identity of the applicant seeking confidentiality; and

(b) the information, documents and evidence furnished by the applicant under this Chapter:

Provided that, the identity of the applicant or such information or documents or evidence may not be treated as confidential if, —

(i) the disclosure is required by law;

(ii) the applicant has agreed to such disclosure in writing; or

(iii) there has been a public disclosure by the applicant.

SETTLEMENT ORDERS

Settlement of proceedings before the Adjudicating Officer and the Board (Regulation 23)

(1) The Whole Time Member, Adjudicating Officer or the competent officer of the Board before whom the proceedings are pending, shall dispose of the respective proceedings, by an appropriate order, on the basis of the approved settlement terms.

(2) The settlement order passed under these regulations shall, contain the details of the alleged default(s), relevant provisions of the securities laws, brief facts and circumstances relevant to the alleged default, the admissions made by the applicant, if any and the settlement terms.

Settlement of the proceedings pending before the Tribunal or any court (Regulation 24)

(1) Save as otherwise provided in these regulations, the provisions with regard to settlement of specified proceedings shall *mutatis mutandis* apply to an application for settlement of any proceeding pending before the Tribunal or any court.

(2) The proposal of settlement along with the settlement terms or rejection thereof shall be placed before such Tribunal or court for appropriate orders.

Service and publication of settlement order (Regulation 25)

Settlement orders shall be served on the applicant and shall also be published on the website of the Board:

Provided that settlement orders in matters relating to the confidentiality shall not, directly or indirectly, disclose the identity of the applicant, but shall indicate the provisions of securities laws which the applicant is alleged to have violated.

Settlement Schemes (Regulation 26)

Notwithstanding anything contained in these regulations, the Board may specify a settlement scheme for any class of persons involved in respect of any similar specified defaults.

Explanation. - A settlement order issued under a Settlement scheme shall be deemed to be a settlement order under these regulations.

Effect of settlement order on third party rights or other proceedings. (Regulation 27)

(1) A settlement order under these regulations shall not be admissible as evidence in any other proceeding relating to an alleged default not covered under the settlement order nor affect the right of third parties arising out of the alleged default.

(2) Where any applicant who obtains a settlement order is also noticee along with any other person in any civil and administrative proceeding, the Adjudicating Officer or the Board while disposing proceedings against such other person may make necessary observations in respect of the applicant in so far as is necessary to prove the act of another: Provided that, unless the settlement order is

revoked, such observations shall qua the applicant be subject to the settlement order obtained by the applicant.

(3) Where any person has obtained a settlement order, which contains observations in respect of any other person for the commission of an alleged default, such an order shall not in itself be admissible as evidence against such other person.

Revocation of the settlement order (Regulation 28)

(1) If the applicant fails to comply with the settlement order or at any time after the settlement order is passed, it comes to the notice of the Board that the applicant has not made full and true disclosure or has violated the undertakings or waivers, settlement order shall stand revoked and withdrawn and the Board shall restore or initiate the proceedings, with respect to which the settlement order was passed.

(2) Whenever any settlement order is revoked, no amount paid under these regulations shall be refunded.

Confidentiality of information (Regulation 29)

(1) All information submitted and discussions held in pursuance of the settlement proceedings under these regulations shall be deemed to have been received or made in a fiduciary capacity and the same may not be released to the public, if the same prejudices the Board and/or the applicant.

(2) Where an application is rejected or withdrawn, the applicant and the Board shall not rely upon or introduce as evidence before any court or Tribunal, any proposals made or information submitted or representation made by the applicant under these regulations:

Provided that this sub-regulation shall not apply where the settlement order is revoked or withdrawn under these regulations.

Explanation. – When any fact is discovered in consequence of information received from a person in pursuance of an application, so much of such information, whether it amounts to an admission or not, as relates distinctly to the fact thereby discovered, may be proved.

SEBI Settlement Order in respect of Mansun Consultancy Private Limited & others, dated May 25, 2023

Facts of the case:

It was alleged that the Mansun Consultancy Private Limited, Mr. P R Sundar and Ms. Mangayarkarasi Sundar ("Applicants") have carried out investment advisory activities without obtaining registration of SEBI and allegedly violated the provisions of Section 12(1) of SEBI Act, 1992 read with Regulation 3 (1) of the SEBI (Investment Advisers) Regulations, 2013 ('IA Regulations'). Mr. P R Sundar and, Ms. Mangayarkarasi Sundar are the promoter directors of the said company with 50% shareholding each.

A Show Cause Notice was served on the Applicants. The SCN has inter alia alleged that Mr. P R Sundar was running the website www.prsundar.blogspot.com through which he was offering various packages for providing advisory services. The fees collected in lieu of the services were received via a payment gateway linked to the bank account of, Mansun Consultancy Pvt. Ltd. held with ICICI Bank Ltd.

On enquiry, Mansun submitted a list of recommendations provided by it for the month of January 2021. Upon analysis of a sample of such recommendations it is observed by SEBI that the aforesaid recommendations are related to purchasing / selling / dealing in securities which were communicated to the clients. Therefore, it was alleged that the recommendations provided by Mansun fall under the category of 'investment advice' as defined under Reg. 2 (1) (l) of IA Regulations.

Further, it was alleged that the Applicants have engaged in the activities of an 'investment adviser' as defined under regulation 2 (m) of IA Regulations.

Applicants have filed three (3) applications with SEBI in terms of the SEBI (Settlement Proceedings) Regulations, 2018 ("Settlement Regulations") proposing to settle the pending proceedings through a Settlement Order without admitting or denying the findings of fact and conclusions of law.

Order:

The applicants proposed the following Settlement terms:

- Settlement Amount of Rs. 15,60,000/- each i.e. a total sum of Rs. 46,80,000/- to SEBI.
- Disgorgement amount of Rs. 6,07,69,863/- including interest @12% p.a. from June 01, 2020 till the date of submission of the revised Settlement terms.
- The Applicants shall refrain from buying, selling or otherwise dealing in securities in India for a period of one (1) year from the date of passing of the Settlement Order.

Pursuant to receipt of the Settlement Applications, the High Powered Advisory Committee ('HPAC') considered the settlement terms proposed by the Applicants and recommended the case for settlement.

On the basis of the aforesaid, in exercise of the powers conferred under Section 15JB read with Section 19 of the SEBI Act and in terms of Regulations 23 read with Regulation 28 of the Settlement Regulations, SEBI ordered that the instant proceedings initiated against the Applicants are disposed of as per the terms prescribed by SEBI.

Securities and Exchange Board of India Settlement Order (Dated June 20, 2023)

In the matter of failure of systems of NSE and NCL upon occurrence of glitch on February 24, 2021

On February 24, 2021, National Stock Exchange of India Limited (hereinafter referred to as "NSE") took a decision to halt trading in all its segments. The stock exchange informed that it has multiple telecom links with two service providers and that it received communication from both the telecom service providers that there are issues with their links due to which there is an adverse impact on NSE system (hereinafter also referred to as the "glitch").

Following the incident, Sebi conducted investigations and issued show cause notices to officers of NSE.

The regulator alleged failure of NSE and NCL to monitor services of vendor in respect of its core and critical activities, to ensure systems preparedness and readiness to move operations to DRS (Disaster Recovery Site).

In the show cause notice, it also alleged failure of NSE and NCL to ensure orderly execution of trades, real time risk management of trades and market integrity, failure in IT infrastructure capacity planning and management.

While Sebi's proceedings were pending, NSE, NCL and its senior officials proposed to settle the matter with the regulator.

The National Stock Exchange (NSE) and its subsidiary NSE Clearing Ltd (NCL) have settled the trading glitch case with the Securities and Exchange Board of India (Sebi) paying a total amount of ₹72.64 crore as settlement charges.

NSE and NCL will pay Rs 49.77 crore and Rs 22.88 crore, respectively, for themselves and their employees, who will also have to undergo non-monetary punishment.

Introduction of Compounding Provisions under Competition Act, 2002

The Competition (Amendment) Act, 2023 notified on April 25, 2023 provides for compounding of offences by National Company Law Tribunal with respect to offices that are not being an offence punishable with imprisonment only or imprisonment and also with fine by inserting the following section:

"59A. Notwithstanding anything contained in the Code of Criminal Procedure, 1973, any offence punishable under this Act, not being an offence punishable with imprisonment only or imprisonment and also with fine, may either before or after the institution of any proceeding, be compounded by the Appellate Tribunal or a court before which such proceeding is pending.

On May 19, 2023, the Ministry of Corporate Affairs ('MCA') notified certain provisions of the Competition (Amendment) Act, 2023 ('Amendment Act'), to be effective from May 18, 2023, including Section 59A of Competition Act 2022.

COMPOUNDING PROVISIONS UNDER THE FOREIGN EXCHANGE MANAGEMENT ACT, 1999 (FEMA)

Penal Provisions under FEMA

Section 13 of FEMA contains the penalties for contravention of any provision of FEMA or any rule, regulation, notification, direction or order issued in exercise of the powers under it including contravention of any condition subject to which an authorization is issued by RBI.

The penalties are quite substantial and can extend up to three times of the sum involved in such contravention where the amount is quantifiable or up to Rs.2 lakhs, where the amount is not directly quantifiable and where the contravention is a continuing one, further penalty which may extend to Rs.5000 for every day after the first day during which the contravention continues.

Power to compound contravention (Section 15)

1) Any contravention under section 13 may, on an application made by the person committing such contravention, be compounded within 180 days from the date of receipt of application by the Director of Enforcement or such other officers of the Directorate of Enforcement and officers of the Reserve Bank as may be authorised in this behalf by the Central Government in such manner as may be prescribed.

2) Where a contravention has been compounded under sub-section *(1)*, no proceeding or further proceeding, as the case may be, shall be initiated or continued, as the case may be, against the committing such contravention under that section, in respect of the contravention so compounded.

Foreign Exchange (Compounding Proceedings) Rules 2000 ("Rules")

Central Government has notified the Foreign Exchange (Compounding Proceedings) Rules 2000 for the purpose of compounding of offences under section 15 of the FEMA Act, 1999. It contains the details for compounding.

Who are the Compounding Authorities/Who can Compound the Offence?

'Compounding Authority' means the persons authorised by the Central Government under sub-section (1) of section 15 of the Act, namely;

- **Officers of the Reserve Bank**: An officer of the Reserve Bank of India not below the rank of the Assistant General Manager.
- **Officers of the Enforcement Directorate (ED):** Officers of ED not below the rank of Deputy Director or Deputy Legal Adviser (DLA)

  It may be noted that section 3(a) of FEMA prescribes the provisions for the dealing in or transfer any foreign exchange or foreign security to any person not being an authorised person (commonly dubbed as Hawala transaction).

Power of Reserve Bank to compound contravention

If any Person contravenes any provisions of Foreign Exchange Management Act, 1999 except clause (a) of Section 3 of the Act.

(a) in case where the sum involved in such contravention is Rs.10 lakhs or below, by the Assistant General Manager of the Reserve Bank of India;

(b) in case where the sum involved in such contravention is more than Rs.10 lakhs but less than Rs.40 lakhs, by the Deputy General Manager of Reserve Bank of India;

(c) in case where the sum involved in the contravention is Rs. 40 lakhs or more but less than Rs.100 lakhs by the General Manager of Reserve Bank of India;

(d) in case the sum involved in such contravention is Rs.100 lakhs or more, by the Chief General Manager of the Reserve Bank of India;

Further no contravention shall be compounded unless the amount involved in such contravention is quantifiable.

Every officer specified under sub-rule (1) of rule 4 of the Reserve Bank of India shall exercise the powers to compound any contravention subject to the direction, control and supervision of the Governor of the Reserve Bank of India.

Power of Enforcement Directorate to compound contraventions –

If any Person contravenes provisions of Section 3(a) of Foreign Exchange Management Act.

(a) in case where the sum involved in such contravention is five lakhs rupees or below, by the Deputy Director of the Directorate of Enforcement;

(b) in case where the sum involved in such contravention is more than rupees five lakhs but less than rupees ten lakhs, by the Additional Director of the Directorate of Enforcement;

(c) in case where the sum involved in the contravention is rupees ten lakhs or more but less than fifty lakhs rupees by the Special Director of the Directorate of Enforcement;

(d) in case where the sum involved in the contravention is rupees fifty lakhs or more but less than one crore rupees by Special Director with Deputy Legal Adviser of the Directorate of Enforcement;

(e) in case the sum involved in such contravention is one crore rupees or more, by the Director of Enforcement with Special Director of the Enforcement Directorate.

Provided further that no contravention shall be compounded unless the amount involved in such contravention is quantifiable.

Every officer of the Directorate of Enforcement specified under sub-rule (1) of this rule shall exercise the powers to compound any contravention subject to the direction, control and supervision of the Director of Enforcement.

limit for Compounding

1. **Time Limit:** A contravention committed by any person within a period of 3 years from the date on which a similar contravention committed by him was compounded under these rules cannot be compounded.

Any second or subsequent contravention committed after the expiry of a period of 3 years from the date on which the contravention was previously compounded shall be deemed to be a first contravention and can therefore be compounded.

2. **Filing of Appeal**: No contravention shall be compounded if an appeal has been filed under section 17 or section 19 of FEMA, 1999.

Procedure for Compounding

Application is to be made to the compounding authority either suo-moto or on being advised to compound as per format given in the Foreign Exchange (Compounding Proceedings) Rules, 2000

⬇

Every application for compounding for any contravention under this rule shall be made in Form to the Director, Directorate of Enforcement, New Delhi, along with a fee of Rs.5000 by DD infavour of the Compounding Authority.

⬇

The Compounding Authority may call for any information, record or any other documents relevant to the compounding proceedings.

⬇

The Compounding Authority shall pass an order of compounding after affording an opportunity of being heard to all the concerned as expeditiously as possible as and not later than 180 days from the date of application. If the Enforcement Directorate is of the view that the proceeding initiated before it relates to a serious contravention suspected of money laundering, terror financing or affecting sovereignty and integrity of the nation, the Compounding Authority shall not proceed with the matter and shall remit the case to the appropriate Adjudicating Authority for adjudicating contravention under section 13 of FEMA.

⬇

Where any contravention is compounded before the adjudication of any contravention under section 16 of FEMA, no inquiry shall be held for adjudication of such contravention in relation to such contravention against the person in relation to whom the contravention is so compounded.

⬇

Where the compounding of any contravention is made after making of a complaint under section 16(3), such compounding shall be brought by the authority specified in rule 4 or rule 5 in writing, to the notice of the Adjudicating Authority and on such notice of the compounding of the contravention being given, the p erson in relation to whom the contravention is so compounded shall be discharged.

Factors considered while considering Compounding Application

The following indicative factors, may be taken into consideration for the purpose of passing compounding order and adjudging the quantum of sum on payment of which contravention shall be compounded:

- the amount of gain of unfair advantage, wherever quantifiable, made as a result of the contravention;
- the amount of loss caused to any authority/ agency/ exchequer as a result of the contravention;
- economic benefits accruing to the contravener from delayed compliance or compliance avoided;
- the repetitive nature of the contravention, the track record and/or history of non-compliance of the contravener;
- contravener's conduct in undertaking the transaction and in disclosure of full facts in the application and submissions made during the personal hearing; and any other factor as considered relevant and appropriate

Payment of amount compounded and certificate of compounding

The sum for which the contravention is compounded as specified in the order of compounding shall be paid by demand draft in favour of the Compounding Authority within 15 days from the date of the order of compounding of such contravention.

In case a person fails to pay the sum compounded within the time specified, he shall be deemed to have never made an application for compounding of any contravention under these rules and the provisions of the Act for contravention shall apply to him.

On realization of the sum for which contravention is compounded a certificate in this regard shall be issued subject to the specified conditions, if any, in the order.

Contents of the order of the Compounding Authority

- Every order shall specify the provisions of the Act or of the rules, directions, requisitions or orders made there under in respect of which contravention has taken place along with details of the alleged contravention.
- Every such order shall be dated and signed by the Compounding Authority under his seal.
- One copy of the order shall be supplied to the applicant and the Adjudicating Authority as the case may be.

In the matter of ***M/s Candor View India Private Limited, Compounding order dated October 30, 2018*** Reserve Bank of India, Bengaluru.

Delay in allotment of shares to the foreign investors (i.e beyond 180 days of receipt of the inward remittances), persons resident outside India, .

The applicant, M/s Candor View India Private Limited(applicant), was incorporated on December 01, 2015, under the Companies Act, 2013, as per the Certificate of Incorporation issued by the Registrar of Companies, Karnataka. The company is engaged in the business of aluminum metal & metal alloys as cash and carry wholesale trading

The applicant has filed a compounding application dated July 06, 2018, for compounding of contraventions of the provisions of the Foreign Exchange Management Act, 1999, (the FEMA) and the regulations issued there under. The contravention sought to be compounded is delay in allotment of shares to the foreign investors, persons resident outside India, beyond 180 days of receipt of the inward remittances, in terms of Paragraph 8 of Schedule I to Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000, notified vide Notification No. FEMA 20/2000- RB dated May 03, 2000, and as amended from time to time (hereinafter referred to as Notification No. FEMA 20/2000-RB).

The company received inward remittances of Rs. 4,96,321.58, and Rs. 3,678.84, amounting to Rs. 5,00,000.42, from the foreign investor in USA, on April 05, 2016, and October 13, 2016, respectively. Company allotted 50,000 equity shares for a total consideration of Rs.5,00,000.00, on May 26, 2017, to the foreign investor, which is beyond 180 days from the date of receipt of inward remittances, with prior approval of Reserve Bank of India,

The application was considered and the contraventions were compounded.

In terms of Section 13 of the FEMA, any person contravening any provision of the Act, shall be liable to a penalty up to thrice the sum involved, in such contravention upon adjudication. However, taking into account the relevant facts and circumstances of the case, a lenient view were taken on the amount for which the contravention are to be compounded and an amount of Rs. 31,500.00 (Rupees Thirty One Thousand and Five Hundred only) was imposed under Compounding

Mrs. Joyce Lynn Peters v. Reserve Bank of India and others **(Writ Petition No. 26425 of 2017, Karnataka High Court**

Facts of the Case:

1. Mrs. Joyce Lynn Peters (petitioner) pursuant to the complaint dated February 25, 2011 made by deputy director of Enforcement Directorate (“ED”), was issued a show cause notice dated April 6, 2011 (“SCN”)

alleging violation of the provisions of Section 6(3)(d) (Capital account transactions) of the FEMA read with the provisions of Foreign Exchange (Borrowing or Lending in Foreign Exchange) Regulations, 2000. After receiving the SCN, the Petitioner applied for compounding of the contravention before the Reserve Bank of India ("RBI") and the ED ("Respondents").

2. The Petitioner's application was returned by letter dated September 22, 2011 by the Respondents on the ground that compounding was not permissible when adjudicatory proceedings for contravention were being initiated. The Petitioner responded by contending that the return of said application is unsustainable as the pendency of adjudicatory proceedings cannot be a ground for declining the request for compounding.

3. Subsequently, since no decision was taken by the Respondents thereon, the Petitioner filed a writ petition before the co-ordinate bench of the Karnataka High Court (KHC). The KHC, by judgment dated November 5, 2015, permitted the Petitioner to file another application before the Respondents within two weeks and directed the Respondents to consider the same.

4. Accordingly, after some period of delay, the Petitioner filed another application before the Respondents ("Application"). The Application was also rejected by the Respondents stating that since the Petitioner had filed appeal against the adjudicatory order, Rule 11 of the Compounding Rules would come in the way of the Application being treated favourably ("Impugned Reply to Application"). Rule 11 of the Compounding Rules states that no contravention shall be compounded if an appeal has been filed under Section 17 or Section 19 of the FEMA. Aggrieved by the Impugned Reply to Application, the Petitioner filed a writ petition before the KHC challenging the Impugned Reply to Application.

Issues:

- Whether petitioner had made the application for compounding belatedly i.e., beyond the period prescribed by the Coordinate Bench of this Court...?
- Whether the pendency of appeal preferred by the contravener bars the compounding of contravention, as provided under Section 15 of the FEMA Act, 1999 Act...?
- Whether the Respondent Nos. 1 & 2 could have banked upon Rule 11 of the Compounding Rules for rejecting petitioner's application for compounding...?

Judgment:

The Karnataka High Court held that the endeavour of the Respondents to sustain the Impugned Reply to Application by relying upon Rule 11 of the Compounding Rules does not yield fruit and they are only seeking shelter under a leaking umbrella. The writ petition succeeded and a writ of certiorari was issued quashing the Impugned Reply to Application. The matter was remitted back to the Respondents for consideration afresh, in accordance with law and within a period of eight weeks.

Late Submission Fee (LSF) -An alternative to Compounding under FEMA

LSF mechanism provides for a simple process of paying a prescribed late fee to regularise reporting delays of Foreign Investment, External Commercial Borrowing and Overseas Investment transactions. Prior to introduction of LSF, the reporting person/entity (Applicant) had no choice but to go through the cumbersome process of filing a compounding application and paying the penalty for delayed reporting after the compounding order was passed, which could take up to 180 days after the submission of compounding application.

The Reserve Bank of India (RBI) for the first time introduced the concept of Late Submission Fee (LSF) vide its Notification No. FEMA 20(R)/2017-RB dated November 07, 2017 (RBI Notification), in respect of the Foreign Investment (FI) transactions undertaken on or after November 7, 2017. Thereafter, LSF was made applicable to the reporting delays concerning External Commercial Borrowings (ECB) vide RBI A.P. (DIR Series) Circular No. 17 dated January 16, 2019 (ECB Circular), and Overseas Investment (OI) vide RBI A.P. (DIR Series) Circular No. 12 dated August 22, 2022 (OI Circular).

RBI brought uniformity in imposition of LSF across functions vide circular dated September 30, 2022. Prior to the RBI Circular, although LSF was applied for all the transactions, the manner of computation of LSF was not consistent across functions (i.e. FI, ECB and OI). While LSF was applied as a percentage of the amount involved for FI reporting delays, in case of ECB reporting delays, it was applied as a fixed amount which is linked to the period of delay occurred. Further, LSF which was recently applied for OI reporting delays under the OI Directions prescribed a different method of computation depending upon the nature of reporting involved.

The following matrix shall be used henceforth for calculation of LSF, wherever applicable(as per RBI Circular dated September 30, 2022):

Sr. No.	Type of Reporting delays	LSF Amount (INR)
1.	Form ODI Part-II/ APR, FCGPR (B), FLA Returns, Form OPI, evidence of investment or any other return which does not capture flows or any other periodical reporting	7500
2.	FCGPR, FCTRS, Form ESOP, Form LLP(I), Form LLP(II), Form CN, Form DI, Form InVi, Form ODI-Part I, Form ODIPart III, Form FC, Form ECB, Form ECB-2, Revised Form ECB or any other return which captures flows or returns which capture reporting of non-fund transactions or any other transactional reporting	[7500+(0.025% × A × n)]

Notes:

a) "n" is the number of years of delayin submission rounded-upwards to the nearestmonth and expressedup to 2 decimal points.

b) "A" is the amount involvedin the delayed reporting.

c) LSF amountis per return. However, for any numberof Form ECB-2 returns, delayedsubmission for each LRN will be treated as one instance for the fixed component. Further, 'A' for any ECB-2 return will be the gross inflowor outflow (including interestand other charges), whicheveris more.

d) Maximum LSF amount will be limited to 100 per cent of 'A' and will be roundedupwards to the nearest hundred.

e) Where an advice has been issued for payment of LSF and such LSF is not paid within 30 days, such advice shall be considered as null and void and any LSF received beyond this period shall not be accepted.If the applicant subsequently approaches for payment of LSF for the same delayed reporting, the date of receipt of such application shall be treated as the reference date for the purpose of calculation of "n".

f) The facility for opting for LSF shall be available up to three years from the due date of reporting/ submission. The option of LSF shall also be available for delayed reporting/submissions under the Notification No. FEMA 120/2004-RB and earlier corresponding regulations, up to three years from the date of notification of Foreign Exchange Management (Overseas Investment) Regulations, 2022.

g) In case a person responsible for any submission or filing under the provisions of FEMA, neither makes such submission/filing within the specifiedtime nor makes such submission/filing along with LSF, such personshall be liablefor penal action under the provisions of FEMA, 1999.

As a process, once the reporting of transaction (through Single Master Form (SMF) on RBI's FIRMS portal5 for FI transactions and in physical form for ECB and OI transactions) is completed, in the event of delay in reporting, such cases shall be forwarded by AD Bank to the RBI. The RBI shall then condone the delay and issue a conditional acknowledgment subject to payment of LSF within a stipulated timeframe. LSF is levied as per the computation matrix. Final acknowledgment of reporting shall be issued only upon payment of LSF by the reporting party. The amount once paid as LSF is not refundable in any manner.

LSF payment is an additional facility for regularizing reporting delays without undergoing the compounding procedure. Hence, an option to undergo the compounding process is always available when the reporting party decides not to avail LSF facility. Importantly, the LSF applies only for the reporting delays, and contravention of any other provisions under the FEMA would still be subject to adjudication or compounding with the RBI.

NEW UNIFORMED LSF MATRIX

In order to streamline and bring uniformity, the RBI Circular introduced a new uniformed LSF matrix (as below) ("New LSF") which shall apply to all the reporting delays on or after September 30, 2022, across functions.

Sr. No	Type of Reporting delays	LSF Amount (INR)
1.	Form ODI Part-II/ APR, FCGPR (B), FLA Returns, Form OPI, evidence of investment or any other return which does not capture flows or any other periodical reporting	7500
2.	FC-GPR, FCTRS, Form ESOP, Form LLP(I), Form LLP(II), Form CN, Form DI, Form InVi, Form ODI-Part I, Form ODI-Part III, Form FC, Form ECB, Form ECB-2, Revised Form ECB or any other return which captures flows or returns which capture reporting of non-fund transactions or any other transactional reporting.	[7500 + (0.025% x A x n)]

Notes:

a. "n" is the number of years of delay in submission rounded-upwards to the nearest month and expressed up to 2 decimal points.

b. "A" is the amount involved in the delayed reporting.

MEDIATION & CONCILIATION

Pendency in Indian courts is the first issue that comes to mind when one thinks about the problems facing the Indian judiciary. Alternative dispute resolution (ADR) mechanisms like arbitration, conciliation and mediation plays a significant role in reducing the number of cases that enter the formal justice delivery system by providing redress outside it.

The word 'mediation' originated from the Latin root 'mediare' which signify 'halve'. Mediation is a voluntary, party-centered and structured negotiation process where a neutral third party assists the parties in amicably resolving their dispute by using specialized communication and negotiation techniques. In mediation, the parties retain the right to decide for themselves whether to settle a dispute and the terms of any settlement. Even though the mediator facilitates their communications and negotiations, the parties always retain control over the outcome of the dispute.

Conciliation means "the settling the disputes without litigations". It is a process in which independent person or persons are appointed by the parties with mutual consent by agreement to bring about a settlement of their dispute through consensus or by using of the similar techniques which is persuasive.

Mediation and Conciliation have gained popularity in almost all countries worldwide. In India, the conciliation process was introduced in the Industrial Disputes Act, 1947 and, later, under the Arbitration and Conciliation Act, 1996. In 1999, mediation was specifically recognized in amendments made to the Code of Civil Procedure, 1908. Ever since, courts are empowered to refer a case for resolution through mediation or conciliation at the parties' request, or if the court feels the case has elements of settlement.

The enactment of Section 89 of the CPC, 1908 marked a major step towards institutionalising ADR through its incorporation in the civil procedure . This provision empowers civil courts to refer civil disputes to, among other things, mediation, 'where it appears to the court that there exist elements of a settlement which may be acceptable to the parties.'

Mediation in India received an impetus due to the Supreme Court's judgment in the case of *Salem Advocate Bar Association v. Union of India (AIR 2005 (SC) 3353).* In this case, a Committee was constituted by the Apex Court in order to enable better implementation of Section 89 by ensuring quicker dispensation of justice. This Committee drafted the Model Rules, 2003 which served as the model for various High Courts in framing their own mediation rules.

Mediation: The term "mediation" has been defined under black law dictionary as ""*A method of non- binding dispute resolution involving a neutral third party who tries to help the disputing parties to reach a mutually agreeable solution".*

Conciliation: The term "Conciliation" has been defined under black law dictionary as "The process of adjusting or settling disputes in a friendly manner through extra judicial mean".

Difference between Mediation and Conciliation

Basis for Comparison	Mediation	Conciliation
Meaning	Mediation is a structured process. The Mediator assists the disputants to reach a negotiable settlement. The process results in signed agreement which decides the future behaviour of the parties.	Conciliator brings the disputants to the agreement through negotiation. Further, the Conciliator is appointed only after the dispute has arisen.
Participation of third party	The neutral third party has less participation in dispute redressal	The neutral party appointed has more participation in dispute redressal
Terms for settlement	In mediation, the mediator does not suggest the manner of settlement to the parties. Any settlement arrived at using either process is voluntary. No settlement can be imposed by the mediator or conciliator.	The conciliation process is similar to mediation. But the conciliator suggests terms for settlement on evaluation of the issues discussed by the parties.
Decisions	The decision of the mediator is called "settlement	The decision of the Conciliator is called "award".

Advantages of Mediation and Conciliation

The object of mediation is to offer to the litigant public, a speedy and satisfactory alternative dispute resolution process in certain types of civil cases. When the cases suitable for negotiated settlements are referred to mediation, the benefits are twofold.

- **Informal.** The process is informal and flexible; attorneys are not necessary. There are no formal rules of evidence and no witnesses.
- **Confidential.** Mediation is a confidential process. The mediators will not disclose any information revealed during the mediation. It is the process by which the parties to a dispute have closed-door discussions on a contentious issue in the presence of neutral mediator(s).
- **Quick and Inexpensive.** When parties want to get on with their business and their lives, mediation is an option to consider. Mediation generally takes less time to complete, allowing for an earlier solution than is possible through investigation.
- **Mediator:** The mediator, who is specially trained, helps the parties move from their positions, towards assessing where their interests are. Then, he helps the parties determine how the matter can be settled, examining various options. Unlike formal adjudicatory processes, the mediation need not be confined to the issues raised in the case, but can go beyond to other matters the parties want resolved. They can also agree to disagree on some issues, while resolving the rest.

Mediation and conciliation are all basically non-adjudicatory dispute resolution processes, where a neutral third party renders assistance to the parties to the dispute to reach a satisfactory settlement. The neutral third-party listens to the parties, ascertains the facts and circumstances and the nature of dispute, identifies the causes for the difference or conflict and facilitates the parties to reach an amicable settlement.

MEDIATION & CONCILIATION UNDER THE COMPANIES ACT, 2013 (SECTION 442)

The Companies Act, 2013 under section 442 provides for mediation and conciliation as viable options for dispute resolution to which the concerned parties can resort to at any stage of the proceedings between them. It provides for dispute settlement through alternate disputes resolution mechanisms. Such a mechanism provides an alternative to litigation which is a time consuming and exhausting process.

As per Section 442 of the Companies Act, 2013, the Central Government is required to maintain a panel of experts to be called as the Mediation and Conciliation Panel consisting of such number of experts having such qualifications as prescribed for mediation between the parties during the pendency of any proceedings before the Central Government or the Tribunal or the Appellate Tribunal under this Act.

Rule 3 of the Companies (Mediation and Conciliation) Rules, 2016 provides for the panel of mediators or Conciliators:

- Regional Director is empowered to prepare a panel of experts willing and eligible to be appointed as mediators or conciliators in the respective regions and such panel shall be placed on the website of the Ministry of Corporate Affairs or on any other website as may be notified by the Central Government.
- The Regional Director may invite applications from persons interested in getting empanelled as mediator or conciliator and possessing the requisite qualifications specified in Rule 4.
- A person who intends to get empanelled as mediator or conciliator and possesses the requisite qualifications is required to apply to the Regional Director in **Form MDC-1.**
- Application received as above, if rejected by the Regional Director, the Regional Director shall record the reasons in writing for the same.
- The Regional Director shall invite applications from persons interested in getting empanelled as mediator or conciliator every year during the month of February and update the Panel which shall be effective from 1st of April of every year.

Rule 4 prescribes qualifications for empanelment:	**Rule 5 disqualifications for empanelment:**
A person shall not be qualified for being empanelled as mediator or conciliator unless he:	**A person shall be disqualified for being empanelled as mediator or conciliator, if he -**
(a) has been a Judge of the Supreme Court of India ; or	(a) is an undischarged insolvent or has applied to be adjudicated as an insolvent and his application is pending;
(b) has been a Judge of a High Court ; or	(b) has been convicted for an offence which, in the opinion of the Central Government, involves moral turpitude ;
(c) has been a District and Sessions Judge ; or	(c) has been removed or dismissed from the service of the Government or the Corporation owned or controlled by the Government ;
(d) has been a Member or Registrar of a Tribunal constituted at the National level under any law for the time being in force ; or	(d) has been punished in any disciplinary proceeding, by the appropriate disciplinary authority ; or

(e) has been an officer in the Indian Corporate Law Service or Indian Legal Service with 15 years experience ; or	(e) has, in the opinion of the Central Government, such financial or other interest in the subject matter of dispute or is related to any of the parties, as is likely to affect prejudicially the discharge by him of his functions as a mediator or conciliator.
(f) is a qualified legal practitioner for not less than 10 years ; or	
(g) is or has been a professional for at least 15 years of continuous practice as Chartered Accountant or Cost Accountant or Company Secretary ; or	
(h) has been a Member or President of any State Consumer Forum ; or	
(i) is an expert in mediation or conciliation who has successfully undergone training in mediation or conciliation.	

Section 442(2) stipulates that, any of the parties to the proceedings may, at any time during the proceedings before the Central Government or the Tribunal or the Appellate Tribunal, can apply to the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, in such form along with such fees as prescribed, for referring the matter pertaining to such proceedings to the Mediation and Conciliation Panel and the Central Government or Tribunal or the Appellate Tribunal, as the case may be, shall appoint one or more experts from the panel as referred above.

The Central Government or the Tribunal or the Appellate Tribunal before which any proceeding is pending may, suo motu, refer any matter pertaining to such proceeding to such number of experts from the Mediation and Conciliation Panel as the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, deems fit.

The fee and other terms and conditions of experts of the Mediation and Conciliation Panel shall be such as prescribed.

Rule 6 stipulates conditions for application for appointment of Mediator or Conciliator –

(1) (a) Parties concern may agree on the name of the sole mediator or conciliator for mediation or conciliation between them;

(b) Where, there are two or more sets of parties and are unable to agree on a sole mediator or conciliator, the Central Government or the Tribunal or the Appellate Tribunal may ask each party to nominate the mediator or conciliator or the Central Government or the Tribunal or the Appellate Tribunal may appoint the mediator or conciliator, as may be deemed necessary for mediation or conciliation between the parties.

(2) The application to the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, for referring the matter pertaining to any proceeding pending before it for mediation or conciliation shall be in **Form MDC-2** and shall be accompanied with a fee of Rs.1000.

(3) On receipt of an application under sub-rule (2), the Central Government or the Tribunal or the Appellate Tribunal shall appoint one or more experts from the panel.

(4) The Central Government or the Tribunal or the Appellate Tribunal, as the case may be, before which any proceeding is pending may, *suo motu*, refer any matter pertaining to such proceeding to such number of experts from the Mediation and Conciliation Panel, if it deems fit in the interest of parties.

Deletion from the Panel (Rule 7)

The Regional Director may by recording reasons in writing and after giving him an opportunity of being heard, remove any person from the Panel.

Withdrawing Name from Panel (Rule 8)

Any person who intends to withdraw his name from the Mediation and Conciliation Panel may make an application to the Regional Director indicating the reasons for such withdrawal and the Regional Director shall take a decision on such application within fifteen days of receipt of such application and update the Panel accordingly.

Duty of mediator or conciliator to disclose certain facts (Rule 9)

- It shall be the duty of a mediator or conciliator to disclose to the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, about any circumstances which may give rise to a reasonable doubt as to his independence or impartiality in carrying out his functions.
- Every mediator or conciliator shall from the time of his appointment and throughout continuance of the mediation or conciliation proceedings, without any delay, disclose to the parties about existence of any circumstance as referred above.

Withdrawal of appointment (Rule 10)

- The Central Government or the Tribunal or the Appellate Tribunal as the case maybe, upon receiving any disclosure furnished by the mediator or conciliator under rule 9, or after receiving any other information from a party or other person in any proceeding which is pending and on being satisfied that such disclosures or information has raised a reasonable doubt as to the independence or impartiality of such mediator or conciliator, may withdraw his appointment and in his place, appoint any other mediator or conciliator in that proceeding .
- However, the mediator or conciliator may, offer to withdraw himself from such proceeding and request the Central Government or the Tribunal or the Appellate Tribunal as the case may be to appoint any other mediator or conciliator.

Section 442(5) prescribes that the Mediation and Conciliation Panel is required to follow such procedure as prescribed and dispose of the matter referred to it within a period of three months from the date of such reference and forward its recommendations to the Central Government or the Tribunal or the Appellate Tribunal, as the case may be.

Any party aggrieved by the recommendation of the Mediation and Conciliation Panel may file objections to the Central Government or the Tribunal or the Appellate Tribunal, as the case may be.

Procedure for disposal of matters (Rule 11)

(1) For the purposes of mediation and conciliation, the mediator or conciliator shall follow the following procedure, namely :-

The mediator shall fix the dates and the time of each mediation or conciliation session, where all parties have to be present

The mediator shall hold the session at the place decided by the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, or such other place where the parties and the mediator or conciliator jointly agree

The mediator may conduct joint or separate meetings with the parties

10 days before the session, each party shall provide to the mediator, a brief memorandum setting forth the issues to resolve and all such informations as may be requires

each party shall furnish to the mediator or conciliator such other information as may be required by him in connection with the issues to be resolved.

On basis of information provided and after consulting with both parties , shall pass the order as may be agreed by both the parties

(2) Where there is more than one mediator or conciliator, the mediator or conciliators may first concur with the party that agreed to nominate him and thereafter interact with the other mediator or conciliator, with a view to resolve the dispute.

Mediator or Conciliator not bound by the Indian Evidence Act, 1872 or the Code of Civil Procedure, 1908 (Rule 12)

The mediator or conciliator shall not be bound by the Indian Evidence Act, 1872 or the Code of Civil Procedure, 1908 while disposing the matter, but shall be guided by the principles of fairness and natural justice, having regard to the rights and obligations of the parties, usages of trade, if any, and the circumstances of the dispute.

Representation of parties (Rule 13)

- The parties shall ordinarily be present personally or through an authorised attorney at the sessions or meetings notified by the mediator or conciliator.
- The parties may be represented by an authorised person or counsel with the permission of the mediator or conciliator in such sessions or meetings and the mediator or conciliator or the Central Government or the Tribunal or the Appellate Tribunal as the case may be, shall be entitled to direct or ensure the presence of any party to appear in person.
- The party not residing in India may, with the permission of the mediator or conciliator, be represented by his or her authorised representative at the sessions or meetings.

Consequences of non-attendance of parties at sessions or meetings on due dates (Rule 14)

If a party fails to attend a session or a meeting fixed by the mediator or conciliator deliberately or wilfully for two consecutive times, the mediation or conciliation shall be deemed to have failed and mediator or conciliator shall report the matter to the Central Government or the Tribunal or the Appellate Tribunal, as the case may be.

Administrative assistance (Rule 15)

In order to facilitate the conduct of mediation or conciliation proceedings, the mediator or conciliator with the consent of the parties, may arrange for administrative assistance by a suitable institution or person.

Offer of settlement by parties (Rule 16)

- Any party to the proceeding may, "without prejudice" offer a settlement to the other party at any stage of the proceedings, with a notice to the mediator or conciliator.
- Any party to the proceeding may make a, "with prejudice" offer to the other party at any stage of the proceedings with a notice to the mediator or conciliator.

Role of Mediator or Conciliator (Rule 17)

The mediator or conciliator shall attempt to facilitate voluntary resolution of the dispute by the parties, and communicate the view of each party to the other, assist them in identifying issues, reducing misunderstandings, clarifying priorities, exploring areas of compromise and generating options in an attempt to resolve the dispute, emphasising that it is the responsibility of the parties to take decision which affect them and he shall not impose any terms of settlement on the parties :

However, on consent of both the parties, the mediator or conciliator may impose such terms and conditions on the parties for early settlement of the dispute as he may deem fit.

Parties alone responsible for taking decision (Rule 18)

The parties shall be made to understand that the mediator or conciliator facilitates in arriving a decision to resolve the dispute and that he shall not and cannot impose any settlement nor the mediator or conciliator give any assurance that the mediation or conciliation shall result in a settlement and the mediator or conciliator shall not impose any decision on the parties.

Time limit for completion of mediation or conciliation (Rule 19)

- The process for any mediation or conciliation under these rules shall be completed within a period of 3 months from the date of appointment of expert or experts from the Panel.
- On the expiry of 3 months from the date of appointment of expert from the Panel, the mediation or conciliation process shall stand terminated.
- In case of mediation or conciliation in relation to any proceeding before Tribunal or Appellate Tribunal which could not be completed within 3 months, the Tribunal or as the case may be, the Appellate Tribunal, may on the application of mediator or conciliator or any of the party to the proceedings, extend the period for mediation or conciliation by such period not exceeding 3 months.

Parties to act in good faith (Rule 20)

All the parties shall commit to participate in the proceedings in good faith with the intention to settle the dispute

Confidentiality, disclosure and inadmissibility of information (Rule 21)

(1) When a mediator or conciliator receives factual information concerning the dispute from any party, he shall disclose the substance of that information to the other party, so that the other party may have an opportunity to present such explanation as it may consider appropriate.

However, when a party gives information to the mediator or conciliator subject to a specific condition that the information may be kept confidential, the mediator or conciliator shall not disclose that information to the other party.

(2) The receipt or perusal, or preparation of records, reports or other documents by the mediator or conciliator, while serving in that capacity shall be confidential and the mediator or conciliator shall not be compelled to divulge information regarding those documents nor as to what

transpired during the mediation or conciliation before the Central Government or the Tribunal or the Appellate Tribunal or as the case may be, or any other authority or any person or group of persons.

(3) The parties shall maintain confidentiality in respect of events that transpired during the mediation and conciliation and shall not rely on or introduce the said information in other proceedings as to -

(i) views expressed by a party in the course of the mediation or conciliation proceedings ;

(ii) documents obtained during the mediation or conciliation which were expressly required to be treated as confidential or other notes, drafts or information given by the parties or the mediator or conciliator.

(iii) proposals made or views expressed by the mediator or conciliator ;

(iv) admission made by a party in the course of mediation or conciliation proceedings.

(4) There shall be no audio or video recording of the mediation or conciliation proceedings.

(5) No statement of parties or the witnesses shall be recorded by the mediator or conciliator.

Privacy (Rule 22)

The mediation or conciliation sessions or meetings shall be conducted in privacy where the persons as mentioned in rule 13 shall be entitled to represent parties but other persons may attend only with the permission of the parties and with the consent of the mediator or conciliator.

Protection of action taken in good faith (Rule 23)

No mediator or conciliator shall be held liable for anything, which is done or omitted to be done by him, in good faith during the mediation or conciliation proceedings for civil or criminal action nor shall be summoned by any party to the suit or proceeding to appear before the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, to testify regarding information received by him or action taken by him or in respect of drafts or records prepared by him or shown to him during the mediation or conciliation proceedings.

Communication between mediator or conciliator and the Central Government or the Tribunal or the Appellate Tribunal (Rule 24)

In order to preserve the confidence of parties in the Central Government or the Tribunal or the Appellate Tribunal as the case may be and the neutrality of the mediator or conciliator, there shall be no communication between the mediator or conciliator and the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, in the subject matter.

However, if any communication between the mediator or conciliator and the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, is necessary, it shall be in writing and copies of the same shall be given to the parties or the authorised representative:

Further that communication between the mediator or conciliator and the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, shall be limited to communication by the mediator or conciliator:

(i) about the failure of the party to attend ;

(ii) about the consent of the parties ;

(iii) about his assessment that the case is not suited for settlement through the mediation or conciliation;

(iv) about settlement of dispute between the parties.

Settlement agreement (Rule 25)

- Where an agreement is reached between the parties in regard to all the issues or some of the issues in the proceeding, the same shall be reduced to writing and signed by the parties and if any counsel has represented the parties, the conciliator or mediator may also obtain the signature of such counsel on the settlement agreement.
- The agreement of the parties so signed shall be submitted to the mediator or conciliator who shall, with a covering letter signed by him, forward the same to the Central Government or the Tribunal or the Appellate Tribunal, as the case may be.
- Where no agreement is reached at between the parties, before the time limit specified in rule 19, or where the mediator or conciliator is of the view that no settlement is possible, he shall report the same to the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, in writing.

Fixing date for recording settlement and passing order (Rule 26)

- The Central Government or the Tribunal or the Appellate Tribunal as the case may be, shall fix a date of hearing normally within fourteen days from the date of receipt of the report of the mediator or conciliator under rule 25 and on such date of hearing, if the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, is satisfied that the parties have settled their dispute, it shall pass an order in accordance with terms thereof.
- If the settlement disposes of only certain issues arising in the proceeding, on the basis of which any order is passed as stated in sub-rule (1), the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, shall proceed further to decide the remaining issues.

Expenses of the mediation and conciliation (Rule 27)

- At the time of referring the matter to the mediation or conciliation, the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, may fix the fee of the mediator or conciliator and as far as possible, a consolidated sum may be fixed rather than for each session or meeting.
- The expense of the mediation or conciliation including the fee of the mediator or conciliator, costs of administrative assistance and other ancillary expenses concerned, shall be borne equally by the various contesting parties or as may be otherwise directed by the Central Government or the Tribunal or the Appellate Tribunal, as the case may be.
- Each party shall bear the costs for production of witnesses on his side including experts or for production of documents.
- The mediator or conciliator may, before the commencement of the mediation or conciliation, direct the parties to deposit equal share of the probable costs of the mediation or conciliation including the fees to be paid to the mediator or conciliator.
- If any party or parties do not pay the amount referred to sub-rule (4), the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, shall on the application of the mediator or conciliator, or any party, issue appropriate directions to the concerned parties.
- The mediation or conciliation shall commence only on the deposit of amount referred to in sub-rule (4) and in case amount is not paid before such commencement, the mediation or conciliation shall be deemed to have terminated.

Ethics to be followed by Mediator or Conciliator (Rule 28)

The mediator or conciliator shall-

(a) follow and observe the rules strictly and with due diligence ;

(b) not carry on any activity or conduct which shall reasonably be considered as conduct unbecoming of a mediator or conciliator ;

(c) uphold the integrity and fairness of the mediation or conciliation process;

(d) ensure that the parties involved in the mediation or conciliation are fairly informed and have an adequate understanding of the procedural aspects of the process ;

(e) satisfy himself or herself that he or she is qualified to undertake and complete the assignment in a professional manner ;

(f) disclose any interest or relationship likely to affect impartiality or which might seek an appearance of partiality or bias ;

(g) avoid, while communicating with the parties, any impropriety or appearance of impropriety ;

(h) be faithful to the relationship of trust and confidentiality imposed in the office of mediator or conciliator ;

(i) conduct all proceedings related to the resolutions of a dispute, in accordance with the relevant applicable law ;

(j) recognise that the mediation or conciliation is based on principles of self-determination by the parties and that the mediation or conciliation process relies upon the ability of parties to reach a voluntary, undisclosed agreement ; and

(k) maintain the reasonable expectations of the parties as to confidentiality and refrain from promises or guarantees of results.

Provided that if any party finds conduct of mediator or conciliator violative of ethics laid down in this rule, the party may immediately bring it to the notice of the Regional Director.

Resort to arbitral or judicial proceedings (Rule 29)

The parties shall not initiate, during the mediation or conciliation under these rules, any arbitral or judicial proceedings in respect of a matter that is the subject-matter of the mediation or conciliation, except that a party may initiate arbitral or Judicial proceedings, where, in his, opinion, such proceedings are necessary for protecting his rights.

Matters not to be referred to the mediation or conciliation.

The following matters shall not be referred to mediation or conciliation, namely :—

- the matters relating to proceedings in respect of inspection or investigation under Chapter XIV of the Act; or the matters which relate to defaults or offences for which applications for compounding have been made by one or more parties.
- cases involving serious and specific allegations of fraud, fabrication of documents forgery, impersonation, coercion etc.
- cases involving prosecution for criminal and non-compoundable offences.
- cases which involve public interest or interest of numerous persons who are not parties before the Central Government or the Tribunal or the Appellate Tribunal as the case may be.

Whether the order of the panel will be binding upon the parties?

Rule 18 of the said Rules has specifically provides that ***"parties alone shall be responsible for taking decision"*** and the mediator or conciliator shall not impose any decision on the parties. Thus, the order of the panel shall not be binding.

Can crimes of fraud be referred to mediation or conciliation?

The crime of fraud comes under non-compoundable offence and these types of crime shall not be referred to mediation or conciliation for settlement.

As per rule 30 of Companies (Mediation and Conciliation), Rule 2016, following matters shall not be referred to mediation or conciliation, namely:—

- the matters relating to proceedings in respect of inspection or investigation under Chapter XIV of the Companies Act, 2013; or the matters which relate to defaults or offences for which applications for compounding have been made by one or more parties.
- Cases involving serious and specific allegations of fraud, fabrication of documents forgery, impersonation, coercion etc.
- Cases involving prosecution for criminal and non-compoundable offences.
- Cases which involve public interest or interest of numerous persons who are not parties before the Central Government or the Tribunal or the Appellate Tribunal as the case may be.

A Practicing Company Secretary wants to establish his practice in the field of Mediation and Conciliation. He wants to know whether he would not be eligible to be appointed as a Mediator or Conciliator as per Rule 5 of Companies (Mediation and Conciliation) Rules, 2016. Advise him.

As per Rule 4 of Companies (Mediation and Conciliation) Rules, 2016, a Company Secretary with at least 15 years of continuous practice is qualified for being empanelled as mediator or conciliator.

However, as per Rule 5 of Companies (Mediation and Conciliation) Rules, 2016, a person shall be disqualified for being empanelled as mediator or conciliator, if he-

- is an undischarged insolvent or has applied to be adjudicated as an insolvent and his application is pending;
- has been convicted for an offence which, in the opinion of the Central Government, involves moral turpitude;
- has been removed or dismissed from the service of the Government or the Corporation owned or controlled by the Government;
- has been punished in any disciplinary proceeding, by the appropriate disciplinary authority; or
- has, in the opinion of the Central Government, have such financial or other interest in the subject matter of dispute or is related to any of the parties, as it is likely to affect the discharge of his professional obligations as a mediator or conciliator.

What is a Settlement agreement as per Companies Act, 2013 and the Companies (Mediation and Conciliation) Rules?

Rule 25 of the Companies (Mediation and Conciliation) Rules, 2016 provide for Settlement agreement

- Where an agreement is reached between the parties in regard to all the issues or some of the issues in the proceeding, the same shall be reduced to writing and signed by the parties and if any counsel has represented the parties, the conciliator or mediator may also obtain the signature of such counsel on the settlement agreement.
- Submission of the Settlement agreement to the mediator or conciliator, Mediator or conciliator to forward the same alongwith covering letter to the Central Government or Tribunal or Appellate Tribunal.
- Where no agreement is reached at between the parties, before the time limit specified in rule 19, or where the mediator or conciliator is of the view that no settlement is possible, he shall report the same to the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, in writing.

LESSON ROUND-UP

- The term "Compounding" refers to the exercise of voluntarily admitting the contravention, pleading guilty and seeking redressal for the same.
- Section 441(1) starts with a non-obstante clause containing "Notwithstanding anything contained in the Code of Criminal Procedure, 1973", which overrides the provision of Code of Criminal Procedure relating to compounding of offence.
- Section 441(2) makes it clear that an offence committed by a company or its officer within a period of 3 years from the date on which a similar offence committed by it or him was compounded under this section cannot be compounded.
- Whenever an investigation against a company has been directed to be carried out and has already been initiated or when such an investigation is pending to be initiated, the power of the compounding authorities under this sub-section gets eclipsed.
- Section 13 of FEMA contains the penalties for contravention of any provision of FEMA or any rule, regulation, notification, direction or order issued in exercise of the powers under it including contravention of any condition subject to which an authorization is issued by RBI.
- The Companies Act, 2013 under section 442 provides for mediation and conciliation as viable options for dispute resolution.
- Mediation is a voluntary, party-centered and structured negotiation process where a neutral third party assists the parties in amicably resolving their dispute by using specialized communication and negotiation techniques.

GLOSSARY

Offence: any act or omission made punishable by any law for the time being in force.

Compound: to settle a matter by a money payment, in lieu of other liability.

Settlement: an official agreement that ends an argument; the act of reaching an agreement.

TEST YOURSELF

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. P is the Managing Director of AMR Limited who committed a fraud against the Company. A judicial proceeding has been initiated against P for fraud committed by him. Now P wants to settle the case through mediation or conciliation. Can P's case be referred to mediation or conciliation ?
2. Enumerate the Compounding Authorities under Companies Act, 2013. Write the procedure for compounding in brief.
3. "A Company and its officers will not be eligible for compounding again for similar offence". Elucidate.
4. Thinking Star Limited, a Public Limited Company was into manufacturing of steel and steel products. The Company wanted to expand its operations and to fund the same, it evaluated various options including bank loan, private placement, etc. However, due to a paucity of time the Company went ahead and funded its operations by issuing shares to a friend of Mr. XY, the Managing Director of the Company on private placement basis. The Company failed to comply with the provisions of the Companies Act, 2013. Mr. XY was not willing to act, unless there was any notice from the regulators. Mr. S, the Corporate Advisor to the Company suggested Mr. XY to compound the offence as it would be in the best interest of the Company.

   Under the Companies Act, 2013, where a Company seeks compounding before institution of any prosecution, whether any prosecution shall be instituted in relation to such offences either by Registrar of Companies or any person authorised by the Central Government'?

5. Discuss the objective of providing Compounding, immunity and its economic benefits.
6. 'There are monetary limits for each authority to compound the offence' — Enumerate the powers of Reserve Bank of India and Enforcement Directorate to compound contraventions.
7. Explain the meaning of Mediation and Conciliation. What is the difference between these two terms ?
8. State whether the following offences under the Companies Act, 2013 are compoundable, if yes, also mention the Compounding Authority :
   (i) Failure to comply with the provisions relating to transfer and transmission of securities.
   (ii) A Company fails to repay the deposit or part thereof or any interest thereon within the time specified or such further time as may be allowed.
   (iii) Failure to distribute dividend within thirty days.
   (iv) Contravention of provisions relating to charges.
9. ''Mediator or conciliator facilitates in arriving a decision to resolve the dispute and that he shall not and cannot impose any settlement.'' In background of this statement, explain who is responsible to take a decision under Companies (Mediation and Conciliation) Rules, 2016 and what is the time limit for completion of mediation or conciliation.

LIST OF FURTHER READINGS

- Companies Act, 2013 and Rules made thereunder
- SEBI Act, 1992
- FEMA Act, 1999

OTHER REFERENCES (Including Websites / Video Links)

- https://www.mca.gov.in/content/mca/global/en/home.html
- https://www.indiacode.nic.in/
- https://rbidocs.rbi.org.in/rdocs/CompoundingOrders/PDFs/CVIPL22112018F3CED01526714BF181FDB6A439B0CA5F.PDF

PART II

AUDIT & DUE DILIGENCE

Concepts of Various Audits

Lesson 8

KEY CONCEPTS

■ Audit Committee ■ Internal Control ■ Risk Assessment ■ Compliance Office ■ Environmental Control ■ Forensic Audit ■ Investigation Services ■ Litigation services ■ Financial Statement Fraud

Learning Objectives

To understand:

- Various fields available for Company Secretaries being multi-disciplinary professional which renders the Auditing services including financial as well as non- financial audits.
- Internal Audit as a mechanism to provide an independent and objective assessment of the effectiveness and efficiency of a company's operations, specifically its internal control structure.
- The requirement of the various audit under various rules, regulations and practices.
- The detailed coverage of each type of Audit.

Lesson Outline

REGULATORY FRAMEWORK

- The Companies Act, 2013 and rules made thereunder
- SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015
- Schedule VII to the Companies Act, 2013
- SEBI (Substantial Acquisition of Sharesand Takeovers) Regulations, 2011
- SEBI (Prohibition of Insider Trading) Regulations, 2015

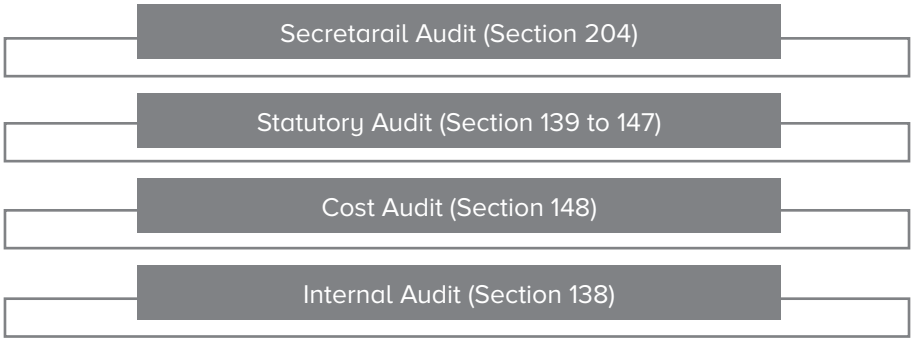
INTRODUCTION

Audit is an independent and systematic examination of statutory records, books of accounts, documents and vouchers of an organization. This is performed or conducted to ascertain how far the financial statements as well as non-financial disclosures present a true and fair view of the concern as to. Audit provides and significant assurance to the management and other stakeholders on the affairs of the company. The Auditor while conducting audit obtains evidence and formulates an opinion on the basis of his judgment which is communicated through their audit report.

> The term audit is derived from the Latin word "audire" which means to hear.

Sections 139 to 147 under chapter X of the Companies Act, 2013 along with the Companies (Audit and Auditors) Rules, 2014 contain provisions regarding audit and auditors covering the appointment, removal, resignation of auditors, eligibility, qualifications and disqualifications of auditors, remuneration of auditors, powers and duties of auditors etc. for the statutory auditors of the company. According to the section 143(12), the provision of the Section 143 i.e. power and duties of the Auditors are mutatis mutandis applicable to the cost accountant conducting cost audit under section 148 and the company secretary in practice conducting secretarial audit under section 204 of the Companies Act, 2013.

The Companies Act, 2013 contains the provisions relating to the following Audits:



Broadly, the audit can be classified in to two type of audit i.e. the Financial Audit and the Compliance Audit, the Financial Audit cover the Statutory Audit, Cost Audit and Internal Audit whereas the Compliance Audit cover the Secretarial Audit, CSR Audit, and Corporate Governance Audit, Takeover Audit, Insider trading Audit, Labour law Audit, Cyber Audit, Systems Audit, Social Audit and Forensic Audit etc. The company as a part of the internal review periodically conduct the audits of other functions of the organization like Stock Audit, HR Audit, Branch Audit, Performance Audit, IT Audit and Environment Audit etc. which helps in the development of the internal function of the company.

The above audits are considered as the emerging areas for the company secretaries and with the expertise in these areas, the company secretaries has proven themselves as the competent professional for conducting such audits. The detailed principles of the various audits are elaborated in this chapter.

CORPORATE GOVERNANCE AUDIT

Corporate governance is a strategic activity that ensures that all the necessary processes for directing and controlling a business enterprise are implemented effectively. It is about ethical conduct in business. Corporate Governance deals with conducting the affairs of a company in such a way that there is fairness to all stakeholders and that its actions benefit the greatest number of stakeholders. It is about transparency, integrity and accountability.

Recent scandals in Indian Corporates have raised questions not only about the practices adopted by companies to solicit business but also about the standards of accountability in public administration including within the government machinery and institutions.

Corporate Governance provisions under the erstwhile listing agreement popularly known as the Clause 49 requirements have been overhauled by the Companies Act 2013, recent adoptions of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("LODR Regulations"). Schedule II of the said regulations have elaborated on the Corporate Governance measures and are applicable to the entities which are listed with recognized stock exchange(s). These have aligned India's corporate governance regime with the developed countries,

Audit of corporate governance processes provides assurance to the various stakeholders that all the required governance activities have been accomplished along with identifying the governance norms has not been satisfied by the company for assisting stakeholders in making an informed decision. The Stakeholders do not like to receive surprises and audit of corporate governance activities shall ensure and effective check mechanism on the supervisory and managerial layers of a business enterprise. Corporate Governance Audit mechanism works primarily through Audit Committee and the Auditor.

Need for Corporate Governance Audit (CGA)

The audit serves as a monitoring device and is essential in corporate governance also. The auditors view management as the primary driver of corporate governance and to ensure commitment of the Board in managing the company in a transparent manner.

The history indicates that well-governed companies receive higher market valuations. Improving corporate governance will also increase capital flows to companies; from domestic and global capital; equity and debt; and from public securities markets and private capital sources even the increased customer base.

Scope of Audit of Corporate Governance Activities

1. Financial and non-financial information's and disclosures
2. Rights of stakeholders
3. Boards of directors (composition, mix, independence)
4. Control environment (accounting, controls, internal and external audit)
5. Risk management
6. Transparency and disclosure of financial information and executive compensation
7. Strategic plans, programs and guidance on social responsibilities

Role of Audit Committee

Audit Committee plays a vital role in the corporate governance of an entity. The Companies Act, 2013 and LODR regulations in respect of the constitution, terms of reference and role & responsibility of the audit committee, underline the importance of audit process and its contribution to the corporate governance process: structure of audit committee with respect to corporate governance has been defined under LODR regulations as follows:

According to Section 177 of Companies Act, 2013, the Board of Directors of the following class of companies shall constitute an Audit Committee:

(i) every listed public company; or

(ii) the Public Companies having paid up share capital of ten crore rupees or more; or

(iii) the Public Companies having turnover of one hundred crore rupees or more; or

(iv) the Public Companies which have, in aggregate, outstanding loans, debentures and deposits, exceeding fifty crore rupees.

The Audit Committee shall consist of a minimum of three directors with independent directors forming a majority. Provided that majority of members of Audit Committee including its Chairperson shall be persons with ability to read and understand, the financial statement.

Further, regulation 18 of SEBI (LODR) Regulations. 2015 that every listed entity shall constitute a qualified and independent audit committee in accordance with the terms of reference, subject to the following:

Minimum No. of Directors	● The audit committee shall have minimum three directors as members.
Requirement of IDs	● Two-thirds of the members of audit committee shall be independent directors and in case of a listed entity having outstanding SR equity shares, the audit committee shall only comprise of independent directors.
Financial Literacy	● All members of audit committee shall be financially literate and at least one member shall have accounting or related financial management expertise.
Presence of Chairperson in AGM	● The chairperson shall be an independent director and he/she shall be present at the annual general meeting to answer shareholder queries.
CS as Secretary of Audit Committee	● The company secretary shall act as the secretary of the committee.
Invitation to Executives	● The audit committee at its discretion shall invite the finance director or head of the finance function, head of internal audit and a representative of the statutory auditor and any other such executives to be present at the meetings of the committee.

Role of Audit Committee w.r.t. corporate governance has been defined under LODR Regulations as follows:

1. Oversight of the listed entity's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible;
2. Recommendation for appointment, remuneration and terms of appointment of auditors of the listed entity;
3. Approval of payment to statutory auditors for any other services rendered by the statutory auditors;
4. Reviewing, with the management, the annual financial statements and auditor's report thereon before submission to the board for approval, with particular reference to:
    a. matters required to be included in the director's responsibility statement to be included in the board's report in terms of clause (c) of sub-section (3) of Section 134 of the Companies Act, 2013;
    b. changes, if any, in accounting policies and practices and reasons for the same;
    c. major accounting entries involving estimates based on the exercise of judgment by management;
    d. significant adjustments made in the financial statements arising out of audit findings;
    e. compliance with listing and other legal requirements relating to financial statements;
    f. disclosure of any related party transactions;
    g. modified opinion(s) in the draft audit report.
5. Reviewing, with the management, the quarterly financial statements before submission to the board for approval;
6. Reviewing, with the management, the statement of uses / application of funds raised through an issue (public issue, rights issue, preferential issue, etc.), the statement of funds utilized for purposes other than those stated in the offer document / prospectus / notice and the report submitted by the monitoring agency monitoring the utilisation of proceeds of a public or rights issue, and making appropriate recommendations to the board to take up steps in this matter;
7. Reviewing and monitoring the auditor's independence and performance, and effectiveness of audit process;
8. Approval or any subsequent modification of transactions of the listed entity with related parties;
9. Scrutiny of inter-corporate loans and investments;
10. Valuation of undertakings or assets of the listed entity, wherever it is necessary;
11. Evaluation of internal financial controls and risk management systems;
12. Reviewing, with the management, performance of statutory and internal auditors, adequacy of the internal control systems;
13. Reviewing the adequacy of internal audit function, if any, including the structure of the internal audit department, staffing and seniority of the official heading the department, reporting structure coverage and frequency of internal audit;
14. Discussion with internal auditors of any significant findings and follow up there on;
15. Reviewing the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the board;

16. Discussion with statutory auditors before the audit commences, about the nature and scope of audit as well as post-audit discussion to ascertain any area of concern;
17. To look into the reasons for substantial defaults in the payment to the depositors, debenture holders, shareholders (in case of non-payment of declared dividends) and creditors;
18. To review the functioning of the whistle blower mechanism;
19. Approval of appointment of chief financial officer after assessing the qualifications, experience and background, etc. of the candidate;
20. Carrying out any other function as is mentioned in the terms of reference of the audit committee;
21. Reviewing the utilization of loans and/ or advances from/investment by the holding company in the subsidiary exceeding rupees 100 crore or 10% of the asset size of the subsidiary, whichever is lower including existing loans / advances / investments existing;
22. Consider and comment on rationale, cost-benefits and impact of schemes involving merger, demerger, amalgamation etc., on the listed entity and its shareholders.

Illustrative Checklist for Auditing Corporate Governance System in a Company

Accountability

1. Check there is separation of ownership and control.
2. Check whether executive management is accountable to Board.
3. Check whether board is accountable to shareholders.
4. Check whether there is a board / audit committee charter/ policies.
5. Check whether the independent directors have powers to play their role effectively.
6. Check whether sufficient number of meetings held, and are the meetings of sufficient length and depth to cover the agenda and provide healthy discussion of issues.
7. Check whether the auditors of the company have full access to information and authority to present their view points at board meetings.
8. Check whether the company has policies on ethical marketing practices, bribery and dishonesty, employee and customer privacy, fair employment practices, gifts, entertainment, related party transactions and conflict of interests.

Fairness

1. Check whether all shareholders, including minorities are treated equitably.
2. Check whether there are defined procedure for effective resolutions of violations.
3. Check whether the company has pricing policy and fair market practice code.

Transparency

1. Investors should be able to obtain information about the rights attached to all series and classes of shares before they purchase. Any changes in voting rights should be subject to approval by those classes of shares which are negatively affected.
2. Check whether there is a timely, accurate disclosure on all material matters, including financial and non-financial information, performance, ownership, frauds, going concern crisis and governance.
3. Check whether the company has a policy for making political contributions.

4. Check whether the company has comprehensive insider trading disclosure and compliance practices.
5. Check whether shareholders should be able to make their views known on the remuneration policy for board members and key executives. The equity component of compensation schemes for board members and employees should be subject to shareholder approval.
6. Institutional investors acting in a fiduciary capacity should disclose how they manage material conflicts of interest that may affect the exercise of key ownership rights regarding their investments.

Responsibility

1. Check whether the company has policy on stakeholder's rights, social responsibility and business sustainability requirements.
2. Check whether the board's responsibility includes review and guiding of corporate strategy, major plans of action, risk policy, annual budgets and business plans; setting performance objectives; monitoring implementation and corporate performance; and overseeing major capital expenditures, acquisitions and divestitures.

Shareholder Interests

1. Check whether shareholders should have the right to participate in, and to be sufficiently informed on, decisions concerning fundamental corporate changes such as:
   (a) amendments to the statutes, or articles of incorporation or similar governing documents of the company;
   (b) the authorisation of additional shares; and
   (c) extra-ordinary transactions, including the transfer of all or substantially all assets that in effect result in the sale of the company.
2. Check whether capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership should be disclosed.
3. There exists rules and procedures governing the acquisition of corporate control in the capital markets, and extraordinary transactions such as mergers, and sales of substantial portions of corporate assets, should be clearly articulated and disclosed so that investors understand their rights and recourse. Transactions should occur at transparent prices and under fair conditions that protect the rights of all shareholders according to their class.
4. The exercise of ownership rights by all shareholders, including institutional investors, should be facilitated.
5. Minority shareholders should be protected from abusive actions by, or in the interest of, controlling shareholders acting either directly or indirectly, and should have effective means of redress.
6. Members of the board and key executives should be required to disclose to the board whether they, directly, indirectly or on behalf of third parties, have a material interest in any transaction or matter directly affecting the corporation.

In the Corporate Governance Audit, the auditor issue the compliance certificate and summarizes his opinion and descriptive narration of areas of improvement would be provided as a part of the audit report under Clause (E) of Schedule V of the SEBI (LODR) Regulations, 2015. The Compliance certificate shall be given either the practicing company secretaries or auditors regarding compliance of conditions of corporate governance which shall be annexed with the directors' report.

CORPORATE GOVERNANCE DUE DILIGENCE – COVERAGE

The following aspects are to be analysed during corporate governance due diligence. The list provided hereunder is not an exhaustive list.

BOARD INDEPENDENCE & GOVERNANCE

(i) Board Composition

(a) Is the chairperson an executive chairperson?

(b) If chairperson is executive, does 50% or more of the board consist of independent directors?

(c) If the non-executive chairperson is a promoter of the company or is related to any promoter or person occupying management positions at the board level or at one level below the board, does 50% or more of the board consist of independent directors?

(d) If the non-executive chairperson is not a promoter of the company or is not related to any promoter or person occupying management positions at the board level or at one level below the board, does 1/3rd or more of the board consist of independent directors?

(ii) The proportion of independent directors to total number of directors.

(iii) The company has at least one woman director.

(iv) In case of top 1000 listed entities, the Board of directors has at least one independent woman director.

(v) In case of top 2000 listed entities, the board of directors has not less than six directors.

(vi) Senior/lead independent director if any, if the offices of chairperson and chief executive officer are not held by different persons.

(vii) Written policy/ procedure if any for induction of independent directors.

(viii Disclosure if any, in the annual report the basis on which independent directors are nominated on the board

(ix) Letter of appointment of non-executive directors.

(x) Maximum tenure of independent directors if any specified.

(xi) Details of separate meetings of independent directors.

(xii) Details of orientation programme /training of directors.

(xiii) Details of D&O insurance if any provided.

(xiv) Gap between resignation and appointment of independent directors.

(xv) Details of affirmative statement from each of the independent directors that they meet the criteria of independence (annual and at the time of appointment).

BOARD SYSTEMS AND PROCEDURES

(i) Details of circulation of agenda.

(ii) Details of board meetings.

(iii) Attendance in board meeting.

(iv) Details of meeting through video conferencing.

(v) List of applicable laws if any maintained by the company.

(vi) Information /certificate to the board on statutory compliances.

(vii) Communication of board decisions to various departments.

(viii) Details of written code of conduct for directors, senior management and other employees.

(ix) Policy on succession planning at senior management level (just one level below the board),

(x) Policy on action taken report

xi) Policy on reviewing the effectiveness of board and its members.

(xii) Share dealings by directors and his relatives.

BOARD COMMITTEES

(i) Names of board committees, its terms of reference, composition and meetings.

(ii) Details of chairperson of board committees.

(iii) Proportion of independent directors in audit committee.

(iv) Risk assessment process by audit committee.

(v) Process of reviewing the related party transactions by the audit committee.

(vi) Details of financial experts in the audit committee.

(vii) Communication mechanism between internal auditor, audit committee and CFO.

(viii) Details of rotation of auditors/audit partners.

(ix) Details of pending investor grievances.

TRANSPARENCY AND DISCLOSURE COMPLIANCES

(i) Details of disclosures in the Annual Report.

(ii) Disclosure on the details of remuneration paid to Board members.

(iii) Disclosure on related party transaction.

(iv) Disclosure on material cases pending against the company.

(v) Details of directors appointed or proposed to be appointed.

(vi) Means of communication.

(vii) Details of filings with Corp filing portal.

(viii) Disclosures on insider trading.

(ix) Disclosure of CEO/CFO on compliance under LODR Regulations.

(x) Compliance of Secretarial Standards issued by ICSI.

(xi) Compliance of Accounting Standard/Cost Accounting Standard (if applicable).

(xii) Details of Secretarial Audit if any.

(xiii) Adverse remarks in Audit Report, Cost Audit Report, Secretarial Audit Report.

(xiv) Disclosure of director's relationship inter-se.

(xv) Details of corporate disclosure policy.

CONSISTENT SHAREHOLDER VALUE ENHANCEMENT

(i) Growth in net-worth.

(ii) Details of dividend paid.

(iii) Dividend policy, if any.

(iv) EPS

(v) Details of public shareholdings.

(vi) Details of investor satisfaction survey, if any.

OTHER STAKEHOLDERS VALUE ENHANCEMENT

(i) Details of Vendor/Supplier/Customer Satisfaction surveys.

(ii) Personnel policy.

(iii) Policy on employee participation in management.

(iv) Policy on ESOPs

(v) Policy on prevention of sexual harassment.

(vi) Vendor Development policy.

CORPORATE SOCIAL RESPONSIBILITY

(i) Policy on CSR, if any.

(ii) CSR/Sustainability Report, if any.

(iii) Energy conservation initiatives.

(iv) Water/ waste management initiatives.

(v) Budget for CSR activities etc.

SECRETARIAL AUDIT

The Corporate sector in India is governed by various Acts and the rules, regulations made thereunder and every mode of Business has to abide by plethora of applicable laws, rules, procedures, regulations and the internal regulatory framework. Every Company, while pursuing its business activities, has to comply with the rules and regulations relating to the Companies Act, Securities laws, FEMA, Industry Specific laws and General laws like Labour laws, Competition law and Environmental and Pollution related laws and should also pursue the good governance practices.

> The term "Secretarial Audit" refers to the mechanism which is connected with the audit of the non-financial aspects of the company. It gives necessary comfort to the investors, management, regulators and other stakeholders, as to the compliance of all applicable laws by the company and certifies the existence of adequate systems and processes for ensuring compliance of laws in the company.

Secretarial Audit covers non-financial aspects of the business vis-à-vis their impact on the performance of the company and verifies compliances of applicable laws, regulations and guidelines. Nonetheless, this exercise enhances the capabilities of the management and also mitigates business and reputation risk to a great extent. It also evaluates the manner in which the affairs of a company are conducted to a great extent.

In the era of minimum government, maximum governance, the Secretarial Audit postulates for an independent verification of the records, books, papers and documents by a Company Secretary to check the compliance status of the company according to the provisions of various statutes, laws and rules & regulations and also to ensure the compliance of legal and procedural requirements and processes followed by the company.

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.

Applicability of Secretarial Audit

Section 204(1) of the Companies Act, 2013 read with Rule 9 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 provides that-

(1) Every listed company and a company belonging to other class of companies as may be prescribed1 shall annex with its Board's report made in terms of section 134(3), a secretarial audit report, given by a company secretary in practice, in such form No.MR-3.

(2) It shall be the duty of the company to give all assistance and facilities to the company secretary in practice, for auditing the secretarial and related records of the company.

(3) The Board of Directors, in their report made in terms of section 134(3), shall explain in full any qualification or observation or other remarks made by the company secretary in practice in his report under sub-section (1).

(4) If a company or any officer of the company or the company secretary in practice, contravenes the provisions of this section, the company, every officer of the company or the company secretary in practice, who is in default, shall be liable to a penalty of Rs. 2,00,000.

Explanation to this sub-rule clarifies that the paid-up share capital, turnover, or outstanding loans or borrowings as the case may be, existing on the last date of latest audited financial statement shall be taken into account.

In terms of Rule 9(1) of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, for the purposes of sub-section (1) of section 204, the other class of companies shall be as under-

(a) Every Public Company having a paid-up share capital of 50 crore rupees or more; or

(b) Every Public Company having a turnover of 250 crore rupees or more; or

(c) Every Company having outstanding loans or borrowings from banks or public financial institutions of 100 crore rupees or more.

Secretarial Audit and Secretarial Compliance Report under the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015

In view of the criticality of secretarial functions for ensuring efficient functioning of the Board, the Kotak Committee on Corporate Governance, in its report dated October 05, 2017, recommended that-

(a) Secretarial Audit to be made compulsory for all listed entities under the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("Regulations") in line with the provisions of the Companies Act, 2013.

(b) Secretarial Audit to be extended to all material unlisted Indian subsidiaries in line with the recommendations of the Committee on strengthening group oversight and improving compliance at a group level for listed entities.

Accordingly, SEBI vide circular no. CIR/CFD/CMD1/27/2019 dated February 08, 2019 notified the following provisions to be included in the SEBI (LODR) Regulations, 2015:

Regulation 24A: Secretarial Audit: Every listed entity and its material unlisted subsidiaries incorporated in India shall undertake secretarial audit and shall annex with its annual report, a secretarial audit report, given by a company secretary in practice, in such form as may be prescribed with effect from the year ended March 31, 2019.

The above provision has been substituted by the SEBI vide amendment dated 05.05.2021 which reads as under:

Regulation 24A: Every listed entity and its material unlisted subsidiaries incorporated in India shall undertake secretarial audit and shall annex a secretarial audit report given by a company secretary in practice, in such form as specified, with the annual report of the listed entity.

Every listed entity shall submit a secretarial compliance report in such form as specified, to stock exchanges, within 60 days from end of each financial year.

In order to avoid duplication, the listed entity and its unlisted material subsidiaries shall continue to use the same Form No. MR-3 as required under Companies Act, 2013 and the rules made thereunder for the purpose of compliance with Regulation 24A of SEBI (LODR) Regulations, 2015 as well.

The circular further provides that the listed entities and their material subsidiaries shall provide all such documents/information as may be sought by the PCS for the purpose of providing a certification under the Regulations and this circular.

While the Annual Secretarial Audit shall cover a broad check on compliance with all laws applicable to the entity, listed entities shall additionally, on an annual basis, require a check by the Company Secretary in Practice on compliance of all applicable SEBI Regulations and circulars / guidelines issued thereunder, consequent to which, the Company Secretary in Practice shall submit a report to the listed entity. The Annual Secretarial Compliance Report is applicable to all Listed Entities.

Purpose of Secretarial Audit

Secretarial Audit provides an effective mechanism to ensure that compliance of various legislations and regulations including the Companies Act, SEBI Law, Secretarial Standards and other corporate and economic laws applicable to the company has been diligently done. This would give necessary comfort to the Investors, Management, Regulators and Other Stakeholders.

The periodical Secretarial Audit helps to detect the instances of non-compliances and facilitates taking corrective measures well in time to avoid any further risk.

Secretarial Audit facilitates monitoring compliances with the requirements of law through a formal compliance management programme which can produce following positive results to the stakeholders of a company:

- Companies that go the extra mile with their compliance programs lay the foundation for good governance.
- Companies with an effective compliance management programme have lesser chance of being penalised, both monetarily and by way of imprisonment.
- Companies that imbibe business and personal ethics and an effective compliance management programme within their work culture often enjoy employee and customer loyalty and public respect for their brand, which can translate into better market capitalization and shareholder returns.
- Recognition for the company as a good corporate citizen.

INTERNAL AUDIT

Internal audit is a process of evaluating and assessing an organization's internal controls, risk management procedures, and governance practices. The goal of internal audit is to help organizations achieve their objectives by providing independent, objective assurance and consulting services.

Internal auditors are professionals who are responsible for conducting internal audits within an organization. They assess the effectiveness and efficiency of the organization's operations, the reliability of financial reporting, and compliance with laws and regulations. Internal auditors also identify areas of potential risk and recommend improvements to the organization's internal controls and processes.

Definition of Internal Auditing:

According to the Definition of Internal Auditing in the IIA's International Professional Practices Framework (IPPF), internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

Performed by professionals with an in-depth understanding of the business culture, systems, and processes, the internal audit activity provides assurance that internal controls in place are adequate to mitigate the risks, governance processes are effective and efficient, and organizational goals and objectives are met.

Evaluating emerging technologies. Analyzing opportunities. Examining global issues. Assessing risks, controls, ethics, quality, economy, and efficiency. Assuring that controls in place are adequate to mitigate the risks. Communicating information and opinions with clarity and accuracy. Such diversity gives internal auditors a broad perspective on the organization. And that, in turn, makes internal auditors a valuable resource to executive management and boards of directors in accomplishing overall goals and objectives, as well as in strengthening internal controls and organizational governance.

The terms "functions" and activities" used in sub-section (1) of section 138 of the Companies Act, 2013 connote a much wider scope than "Financial Audit" and "Operations Audit". Therefore, it is clearly evident that the scope of internal audit is very wide and it covers the compliance systems in companies covering all the functions of any company. Internal Audit requires an in depth understanding of the business culture, systems and processes, understanding and improvement of internal controls for effective risk management, understanding the governance structure of the organisation and ability to provide value additions for improvement in governance processes.

The internal audit may contribute in the following areas:

a) Independent review and appraisal of control systems across the organization (both financial control systems and operational areas where the organization may reap benefits).

b) Ascertainment of the extent of compliance of policies, procedures, regulations and legislations. Checking compliance management systems of an organization.

c) Facilitate good practices in management of risk. This requires systems for ascertaining, measuring, managing and where possible mitigation or dispersion of the risk.

d) Achieve savings by identifying waste, inefficiency and duplication of effort across the organization.

e) Structuring programs and activities such that company assets are safeguarded and there are internal check systems which minimize the possibility for reducing fraud / early warning signals for identifying fraud.

Class of companies Sub-section (1) of section 138 of the Companies Act, 2013 provides that such class or classes of companies as may be prescribed shall be required to appoint an internal auditor, who shall either be a chartered accountant or a cost accountant, or such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the company.

As per rule 13 of the Companies (Accounts) Rules, 2014, the following companies are required to appoint an internal auditor or a firm of internal auditors:

Criterion	**Listed Companies and producer companies**	**Unlisted Public Company**	**Every Private Company**
Paid-up Capital	Internal audit is mandatory	50 crore rupees or more*	Not Applicable
Turnover	For all listed companies, irrespective of any criterion	200 crore rupees or more*	200 crore rupees or more*
Outstanding loans and borrowing from bank and PFI		exceeding 100 crore rupees or more**	exceeding 100 crore rupees or more**
Outstanding deposits		25 crore rupees or more**	Not Applicable

* during the preceding financial year

** at any point of time during the preceding financial year.

Section 138 of the Companies Act, 2013 brought the concept of internal audit to the forefront and has widened its scope to a larger extent. Company Secretaries being Governance professionals are aptly suited to perform the role of internal auditors and accordingly recognized to be appointed as internal auditors in the companies under the provisions of Companies Act.

CORPORATE SOCIAL RESPONSIBILITY (CSR) AUDIT

Corporate Social Responsibility (CSR) includes various social and environmentally responsible guidelines, essential for companies that want to maintain a strong connection to the marketplace. Corporate Social responsibility includes the way a company treats and proactively contributes to its community, promotes fair working conditions and a non-discriminatory environment, conveys transparent and honest accounting reports, and generally earns a reputation of trust and integrity in the society where it serves.

CSR has become a mandatory part of many Companies vide introduction in Companies Act, 2013 and has changed the dynamics of CSR. An increased emphasis on governance, stricter monitoring and reporting obligations require companies to be more accountable, disciplined and strategic in their CSR approach

Applicability of CSR Spending/Committee		
Net worth of rupees five hundred crore; or	Turnover of rupees one thousand crore or more; or	Net profit of rupees five crore or more
During the immediately preceding financial year		

Section 135 of the Companies Act, 2013 provides that every company having net worth of rupees five hundred crore or more, or turnover of rupees one thousand crore or more or a net profit of rupees five crore or more during the immediately preceding financial year shall:

- constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors, out of which at least one director shall be an independent director;
  - In case, where a company is not required to appoint an independent director under sub-section (4) of section 149 of Companies Act, 2013, the company shall have in its Corporate Social Responsibility Committee two or more directors.
- adopt a CSR Policy in order to develop a sustainable CSR road map to help determine both compliance and social relevance with the Act.
- spend, in every financial year, at least 2% of its average net profits made during the three immediately preceding financial years, in pursuance of its CSR policy.

Objective of CSR Audit

Corporate Social Responsibility (CSR) audit help in measuring the actual social performance against the social objectives set by the Company. It also provides that at what level the decision making, mission statement, guiding principles, and business conduct are aligned with social responsibilities. The audit helps meeting the expectations of stakeholder groups relating to social and environmental responsibilities of the company.

Purpose of CSR Audit

- To ensure compliance with the provisions of Companies Act, 2013 with respect to constitution of the Committee, adoption of policy and appropriate spending towards CSR activities.
- To facilitate transparent monitoring mechanism and a mentor for the company's CSR activities and implementation of CSR policy.

- To evaluate internal control and governance framework.
- To assess the project life cycle.
- To conduct financial review of projects to confirm the utilization of budgets for achieving desired outcomes.

Methodology for CSR Audit

1. Review of CSR policy, CSR committee, governance structure, strategy, projects, partner identification and selection process, monitoring, evaluation and reporting.
2. Interact with beneficiaries, project team, management and other stake holders.
3. Review of beneficiary identification and selection process, budget allocation, outcomes monitoring and reporting.
4. Review of CSR expenditure, project's direct expenditure, overheads and administrative expenses, traceability and genuiness of expenditure, per beneficiary cost, reasons for inability to spend 2% of profits.

Conducting CSR Audit

The CSR audit may be conducted internally by the company or engage external agencies having expertise in CSR projects. However the companies publish periodical report on their social initiatives and through the Website. However, according to provisions of Companies Act, 2013, Companies are required to annex report on the corporate social responsibilities with the board report of the company.

Coverage of CSR Audit

The CSR audit cover the CSR activities relating to human rights, fundamental human rights, freedom of association and collective bargaining, non-discrimination, forced labor, child labor, health and safety, career development and training, environmental issues and issues relating to community development and social wellbeing. However, Schedule VII of the Companies Act, 2013 provides the list of activities which could be taken by the company as their CSR Activities. These activities cover the following:

(i) Eradicating hunger, poverty and malnutrition, promoting health care including preventive health care and sanitation including contribution to the Swach Bharat Kosh set-up by the Central Government for the promotion of sanitation and making available safe drinking water.

(ii) promoting education, including special education and employment enhancing vocation skills especially among children, women, elderly and the differently abled and livelihood enhancement projects.

(iii) promoting gender equality, empowering women, setting up homes and hostels for women and orphans; setting up old age homes, day care centres and such other facilities for senior citizens and measures for reducing inequalities faced by socially and economically backward groups.

(iv) ensuring environmental sustainability, ecological balance, protection of flora and fauna, animal welfare, agroforestry, conservation of natural resources and maintaining quality of soil, air and water including contribution to the Clean Ganga Fund set-up by the Central Government for rejuvenation of river Ganga.

(v) protection of national heritage, art and culture including restoration of buildings and sites of historical importance and works of art; setting up public libraries; promotion and development of traditional art and handicrafts.

(vi) measures for the benefit of armed forces veterans, war widows and their dependents, Central Armed Police Forces (CAPF) and Central Para Military Forces (CPMF) veterans, and their dependents including widows.

(vii) training to promote rural sports, nationally recognised sports, paralympic sports and olympic sports.

(viii) contribution to the prime minister's national relief fund or Prime Minister's Citizen Assistance and Relief in Emergency Situations Fund (PM CARES Fund) or any other fund set up by the central govt. for socio economic development and relief and welfare of the schedule caste, tribes, other backward classes, minorities and women;

(ix) (a) Contribution to incubators or research and development projects in the field of science, technology, engineering and medicine, funded by the Central Government or State Government or Public Sector Undertaking or any agency of the Central Government or State Government; and

(b) Contributions to public funded Universities; Indian Institute of Technology (IITs); National Laboratories and autonomous bodies established under Department of Atomic Energy (DAE); Department of Biotechnology (DBT); Department of Science and Technology (DST); Department of Pharmaceuticals; Ministry of Ayurveda, Yoga and Naturopathy, Unani, Siddha and Homoeopathy (AYUSH); Ministry of Electronics and Information Technology and other bodies, namely Defense Research and Development Organisation (DRDO); Indian Council of Agricultural Research (ICAR); Indian Council of Medical Research (ICMR) and Council of Scientific and Industrial Research (CSIR), engaged in conducting research in science, technology, engineering and medicine aimed at promoting Sustainable Development Goals (SDGs).

(x) rural development projects.

(xi) slum area development different.

Explanation- For the purposes of this item, the term 'slum area' shall mean any area declared as such by the Central Government or any State Government or any other competent authority under any law for the time being in force.

(xii) disaster management, including relief, rehabilitation and reconstruction activities.

Explanation- For the purpose of this item, the team 'Slum area' shall mean any area declared as such by the Central Government or any State Government any other competent out authority under any Law for the time being in force

Illustrative Checklist for Corporate Social Responsibility provisions under the Companies Act, 2013

1. Check if the constitution of CSR Committee is applicable to company.
2. If yes, whether the company has constituted CSR committee of the board consisting of three or more directors, out of which at least one director is an independent director.

   In case where a company is not required to appoint an independent director under sub-section (4) of 149, it shall have in its CSR Committee two or more directors.
3. Whether the company has CSR policy approved by the CSR Committee.
4. Whether the CSR committee has recommended list of CSR projects or programme within the purview of schedule VII.
5. Whether the monitoring process of such projects or programme has been established by the company.
6. The composition of CSR committee is disclosed in the board's report.
7. Check whether the CSR activities were under taken as per CSR policy and projects, programs or activities excludes activities undertaken in pursuance of its normal course of business
8. Corporate social responsibility committee has recommended the amount of expenditure to be incurred on the activities referred in the Corporate Social Responsibility policy.
9. The company has instituted a transparent monitoring mechanism for implementation of the CSR projects or programs or activities undertaken by the company.

10. The company has disclosed the contents of the policy in board's report and at its website, if any.
11. The board's report includes an annual report on CSR containing prescribed particulars.
12. In case the company does not spend the specified amount (i.e. at least two percent of the average net profits made during the three immediately preceding financial years), Board's report specifies the reason for not spending the amount.
13. Check if the net profits of the company are in accordance with the provisions section 198 of the Companies Act, 2013 or not.
14. In case the company has built CSR capacities of their own personnel, check whether the expenditure including expenditure on administrative overheads shall not exceed five percent of total CSR expenditure of the company in one financial year.
15. The company has complied with all other requirement of the CSR Rules.

As the CSR audit cover the various direction of the CSR policy of the company which include the planning, execution and the reviews of the CSR activities. This will help to get a clear picture of Corporate Social Responsibility practices adopted by the company. The CSR audit provide an understating of company is position in CSR and also provide an independent assurance on CSR commitment to stakeholders. The different measures of the CSR Audit Includes:

1. How the Company has identified the major socio-economic changes in the key communities caused by its presence/ operations/ major expansion programs.
2. How the company has conducted social surveys before undertaking a particular CSR activity.
3. How the company has identified the possible impact of its CSR activities on the life style of communities.
4. How the company undertakes the Impact assessment of the CSR activities.

TAKEOVER AUDIT

The Takeover audit includes the compliances relating disclosure requirements(event based /continuous disclosures), Pricing, Open offer and verification of the compliance of various stage of takeover process etc., under the provision of the Companies Act, 2013 and the SEBI (Substantial Acquisition of Shares and Take- overs) Regulations, 2011. However the takeover audit primarily includes:

Identification and categorisation	• Identify and categorises of acquirer i.e. promoter, promoter group, person in control, persons acting in concert, associates, immediate relatives etc.
Timely Disclosures	• Ensuring that the timely disclosures have been made by promoters, members of promoter group and PAC's relating to acquisition, transfer and encumbrance.
Monitoring of Promoters Holdings	• Effective monitoring of the holdings of promoters, members of promoter group and PACs and take necessary action as required.
Timely Intimation	• Ensuring that timely intimation is sent to stock exchanges in respects of transfers exempt under SEBI (SAST) Regulations, 2011.

Timely reports under SAST	● Ensuring that timely reports are filed in respect of transfers exempt under SEBI (SAST) Regulations with stock exchanges and SEBI, if applicable.
Checking timey Compliances	● Thoroughly examine the takeover regulations through checklist and timeline for compliances.

Takeover audit for a business deal may be done as:

- pre-acquisition;
- post-acquisition.

In order to provide the desired results to investors and to ensure that the business acquisition deal is executed in the most effective manner, the concept of the takeover audit has been evolved; the takeover audit furnishes a cost benefit analysis to suggest a strategic plan for the durable long term investment strategy.

A meticulous takeover audit through due diligence process helps companies take advantage of legitimate new business opportunities, while at the same time helps to minimize the risks.

A strong takeover audit cum due diligence process is censorious to ensure that the acquirer is fully aware of all aspects of the proposed business deal and provides access to vital understanding that is used to negotiate the final price.

CONSEQUENCES OF VIOLATION OF OBLIGATIONS SEBI (SAST) REGULATIONS, 2011

SEBI (SAST) Regulations, 2011 have laid down the general obligations of acquirer, target company and the manager to the open offer. For failure to carry out these obligations as well as for failure / non-compliance of other provisions of SAST Regulations, penalties have been laid down in the SEBI Act and Regulations made thereunder. These penalties *inter-alia* include:

- directing the divestment of shares acquired;
- directing the transfer of the shares / proceeds of a directed sale of shares to the investor protection and education fund;
- directing the target company / any depository not to give effect to any transfer of shares;
- directing the acquirer not to exercise any voting or other rights attached to shares acquired;
- debarring person(s) from accessing the capital market or dealing in securities;
- directing the acquirer to make an open offer at an offer price determined by SEBI in accordance with the Regulations;
- directing the acquirer not to cause, and the target company not to effect, any disposal of assets of the target company or any of its subsidiaries unless mentioned in the letter of offer;
- directing the acquirer to make an offer and pay interest on the offer price for having failed to make an offer or has delayed an open offer;
- directing the acquirer not to make an open offer or enter into a transaction that would trigger an open offer, if the acquirer has failed to make payment of the open offer consideration;
- directing the acquirer to pay interest of for delayed payment of the open offer consideration;
- directing any person to cease and desist from exercising control acquired over any target company;

- directing divestiture of such number of shares as would result in the shareholding of an acquirer and persons acting in concert with him being limited to the maximum permissible non-public shareholding limit or below.

In any proceedings as mentioned above, SEBI shall comply with principles of natural justice.

INSIDER TRADING AUDIT

The insider trading audit includes the compliances requirements (event based /continuous disclosures) under the SEBI (Prohibition of Insider Trading) Regulations, 2015 which includes:

- Initial disclosures of trades which is to be made by only the promoters, key managerial personnel, directors internally;
- Continual disclosures which is to be made by every promoter, employee or director in case value of trade exceed monetary threshold of ten lakh rupees over a calendar quarter; company to accordingly notify stock exchanges within 2 trading days;
- Submission of trading plans;
- Appointment of compliance officer;
- Pre-clearance for trading;
- Codes of fair disclosure and conduct;
- Role of the designate person;
- Manner of dealing with UPSI (unpublished price sensitive information).

Illustrative checkpoints for verification of Compliance under the SEBI (Prohibition of Insider Trading) Regulations, 2015 includes whether:

1. The company has appointed a compliance officer.
2. The company has maintained structured digital database containing the nature of unpublished price sensitive information and the names of such persons who have shared the information and also the names of such persons with whom information is shared under this regulation along with the Permanent Account Number or any other identifier authorized by law where Permanent Account Number is not available.
3. The structured digital database is preserved for a period of not less than eight years after completion of the relevant transactions and in the event of receipt of any information from the Board regarding any investigation or enforcement proceedings, the relevant information in the structured digital database shall be preserved till the completion of such proceedings.
4. The company has designated an officer to administer the code of conduct and other requirements under Insider trading regulations. (Regulation 9)
5. The Board of Directors of has formulated a code of practices and procedures for fair disclosure of unpublished price sensitive information as per Schedule A of Insider trading regulations.
6. The Code has been hosted on the website of the company and a copy of the same must be sent to the stock exchange.
7. The code of conduct has stipulated the sanctions and disciplinary actions, including wage freeze, suspension, recovery, clawback etc. and any amount collected has been remitted to the SEBI for credit to the Investor Protection and Education Fund administered by the SEBI under the SEBI Act, 1992.

8. The Company has designated a Chief Investor Relation Officer, who is also a senior officer of the company to deal with dissemination of information and disclosure of unpublished price sensitive information, as per the principles set out in Schedule A of Insider trading regulations.

9. The Company has formulated code of conduct to regulate, monitor and report trading by insiders as per Schedule B of these regulations.

10. The Company has formulated an internal code of conduct for governing dealing in securities as per the minimum standards set out in Schedule B of Insider trading regulations.

11. Every such code of practices and procedure relating to unpublished price sensitive information and every document thereto has been promptly intimated to the stock exchange where the securities are listed.

12. The trading plan has been formulated in compliance with Regulation 5. If yes, whether necessary compliances have been made.

13. The disclosures were taken from the KMPs of the Company and from those relating to trading by such person's immediate relatives, and by any other person for whom such person takes trading decisions.

14. The connected person or class of connected persons have made disclosures of holdings and trading in securities of the company in such form and at such frequency as may be determined by the company in order to monitor compliance with these regulations.

15. Code of Conduct provides for suitable protection against any discharge, termination, demotion, suspension, threats, harassment, directly or indirectly or discrimination against any employee who files a Voluntary Information Disclosure Form, irrespective of whether the information is considered or rejected by the SEBI. (Regulation 7l)

16. Every code of practices and procedures for fair disclosure of unpublished price sensitive information and every amendment thereto has been promptly intimated to the stock exchanges where the securities are listed. (Regulation 8)

17. Any action has been sanctioned by the Board for the violation/ contravention of the provisions these regulations. (Regulation 10)

18. The Compliance officer has reviewed and monitored the trading plans if any, submitted by any insider and approved the trading plan that it has not violated these regulations.

19. The Compliance officer has received undertaking or declaration from insider with respect to the trading plan, as the case may be.

20. The Compliance officer has notified the trading plan to the stock exchange(s), if any.

21. The Company maintains the record of the said disclosures as required for a minimum period of five years.

22. The Company has received the initial disclosure from every promoter, Key Managerial Personnel (KMP) and Directors with respect to the securities held by them in Company.

23. The Company receives disclosure by every person on appointment as KMP or Director or upon becoming a promoter within seven working days of such appointment or becoming promoter.

24. The Company is regular in receiving continual disclosure from the promoter, member of the promoter group, designated person and directors with respect to the number of securities acquired or disposed of within two trading days of such transaction, if such transactions exceed Rs.10,00,000 or such other value as may be specified in a calendar quarter.

25. The Company has notified the particulars of such trading to the stock exchange(s) within two trading days of receipt of the disclosure or from becoming aware of such information.

26. The Company is regular in receiving disclosures of holding & trading of securities of the company by any other connected person or class of connected persons, held or traded by them. The Company has in its discretion require this information & set out the frequency for seeking such information.

27. The Compliance officer has provided reports of trading to the Chairman of Audit Committee, if any or to the Chairman of the Board of Directors as per the frequency stipulated by the Board of Directors.

28. The Company follows Chinese wall procedures & processes as per the norms contained in the code of conduct, wherever applicable.

29. The Compliance officer determines the timing of closure of the trading window and re-opening of the trading window.

30. The Compliance officer has put in place appropriate procedure for pre-clearance of trades for designated persons.

31. The Designated Person have not entered into any contra trade as per the specified period as mentioned in the code of conduct which shall be not less than six months from the date of trade in securities of the Company.

32. The profit arises from the Contra trade, if executed inadvertently or otherwise, has been liable to be disgorged for remittance to SEBI for credit to the Investor Protection and Education Fund administered by the SEBI under the Act.

33. Any action has been initiated by SEBI against the company or any of its promoter, director, Key Managerial Personnel, officer or employee under the PIT regulations in the past or present.

34. The company or any of its promoters, director, Key Managerial Personnel, officer or employee has been convicted by SEBI with respect to Insider Trading in the past or present.

35. Any action taken against persons responsible for non- adherence with respect to formulation of code of conduct.

36. Any other prevention mode with respect to insider trading as adopted by the Company.

INDUSTRIAL AND LABOUR LAW AUDIT

Industrial and Labour law Audit is an effective tool for compliance management of labour, employment and Industrial laws. Audit helps to detect non-compliances of labour and employment laws applicable to a business and take corrective measures to avoid any unwarranted legal actions by the regulators against the business and its management. Labour Law audit is useful in promoting cordial relations between employees and employers and also lead to better governance and value creation for the business.

Labour Law Audit envisages a systematic scrutiny of records prescribed under labour legislations by a professional like Company Secretary, who shall report to the compliance and non-compliance/extent of compliance and conditions of labour in the Indian industry/business and in any commercial establishments.

Scope of Industrial and Labour Audit

The Labour Law auditor cover all labour legislations applicable to an Industry/Business or any other commercial establishment, wherein audit is being conducted by the Labour Law Auditor. Scope of labour law audit will certainly differ from business to business which is based on the nature of business, size of business, location of business and number of manpower etc.

Labour laws audit is a unique concept and differs from other compliance/audits in the country. While all other audits are based on financial implications on company/business entity, whereas the labour laws audit consideration of human values, and the rights of the workman. The scope of secretarial audit also includes examining and reporting on whether the adequate systems and processes are in place to monitor and ensure compliance required under the various industrial and labour laws.

Though the Industrial and Labour audit include the various State and Local Laws along with the central laws, However the illustrative list of the compliance requirement under the various central law has been provided below:

Factories Act, 1948

1. The Factories Act, 1948 is applicable to the company.
2. The occupier has at least fifteen days before occupying or using any premises as a factory, sent to the Chief Inspector a written notice as contained in section 7.
3. The provisions regarding registration / licence as prescribed in section 6 have been complied with.
4. The employer has appointed the manager/ occupier of the factory under the Factories Act, 1948 and sent notice to the competent authority.
5. The company has complied with provisions of:
   - "Health" measures as provided in chapter III;
   - "Safety" measures as provided in chapter IV;
   - Applicable provisions of chapter IV-A – Hazardous Processes;
   - "Welfare" measures as provided in chapter V;
   - "Working Hours" of adults as provided in chapter VI;
   - "Employment of Young Persons" as provided in chapter VII; and
   - "Annual Leave with Wages" as provided in chapter VIII.
6. Under the Factories Act, 1948 Registers, Return & Abstracts:
   - Register of Compensatory Holidays
   - Register of Adult Workers
   - Register of Leave with Wage Register
   - Muster Roll
   - Register of Accident & Dangerous Occurrences
   - Inspection Book
   - Half yearly returns (Before 15th of July & 15th of January) of every year in duplicate)
   - Accident & Dangerous Occurrences (Every Month)
   - Combined Annual Returns (Before January every year)
   - Notice of Adult workers
   - Abstract of Factories Act, 1948.

Industrial Disputes Act, 1947

1. The Industrial Disputes Act, 1947 is applicable to the company.
2. There is an industrial dispute, as defined under Section 2A of the Act.
3. The company has maintained a muster roll as required under section 25-D of the Act.

4. The Company is an industrial establishment, having one hundred or more workmen. If yes, the company has constituted Works Committee as required under Section 3 of the Act.
5. Any change in the conditions of service applicable to any workman in respect of any matter specified in the fourth schedule of the Act, has been made after giving 21 days' notice to the workmen, of such intention in Form E, as required under Section 9A of the Act, read with Rule 34.
6. The company has twenty or more workmen. If yes, the company has constituted Grievance Redressal Committee as required under Section 9-C of the Act.
7. The Company is a Public Utility Service. If yes, the lockout if any has been carried out after giving sufficient notice in Form N, as required under Section 22(3) of the Act read with rule 73.
8. The Company has complied with the conditions precedent to the retrenchment of workmen, as required under Section 25F and Section 25N, as applicable.
9. The Company maintains a muster roll for its workmen as required under Section 25-D.
10. The Company has compensated for being laid off, the workmen, whose name is in the muster rolls and has completed not less than one year of continuous service. (Section 25C)
11. The company has compensated the workmen in case of closing down of undertakings, as prescribed in section 25FFF.

The Payment of Wages Act, 1936

1. The Payment of Wages Act, 1936 is applicable to the company.
2. The payment of wages is made before:
   (a) before the expiry of the 7th day of the following month, when less than 1000 persons are employed.
   (b) before the expiry of the 10th day of the following month, when more than 1000 workers are employed.
3. The deductions made from the wages of the employee are in accordance with section 7 of the Act.
4. If any deduction has been made on account of damage or loss, show cause notice has been given to the employee.
5. In case any deduction has been made for unauthorized absence, opportunity of being heard is given.
6. The registers and records giving particulars of persons employed, the work performed by them, the wages paid to them, the deductions made from their wages and the receipts given by them are maintained and preserved for a period of 3 years or more.
7. The employer has displayed the abstract of the Act and Rules made thereunder in the manner prescribed under section 25.

The Minimum Wages Act, 1948

1. The Minimum Wages Act, 1948 is applicable to the Company.
2. The company has been paying the minimum wages as notified from time to time by the appropriate Government under the Act.
3. The company has paid wages in cash. If not, the wages in kind has been paid after following the procedure prescribed under section 11 of the Act.
4. The company follows the conditions prescribed with regard to working hours, working day under section 13 of the Act.

5. The company has paid overtime rate as prescribed under section 14 of the Act read with rule 25.
6. The company has maintained all registers and records that are required to be maintained under section 18 of the Act and rule 26.
7. The company has followed the procedure prescribed with respect to payment of undisbursed amounts due to employees, for reasons such as death, whereabouts not known etc.
8. The company has followed the procedure prescribed in rule 21 of the Minimum Wages (Central) Rules, 1950 with respect to deductions made from the wages.
9. The company has followed time and conditions of payments of wages prescribed in rule 21 of the Minimum Wages (Central) Rules, 1950.
10. Notices in prescribed Form, containing the minimum rate of wages has been displayed at the main entrance to the establishment, as specified in rule 22.

Employees' State Insurance Act, 1948

1. The Employees' State Insurance Act, 1948 is applicable to the company.
2. The factory or establishment to which the Act applies has been registered.
3. The rate of contribution of the employer and employee is in accordance with the Act. [Rule 51 of ESI (Central) Rules, 1950.]
4. The manner and time Limit for making payment of contribution is in accordance with the Act.
5. The employer has maintained the register of employees in ç.
6. Submission of returns/reports:
   (a) Annual return;
   (b) Return of contributions;
   (c) Report of accident;
   (d) Report of death of insured persons.
7. The benefits provided in Chapter V of the Act were made available to the applicable employee.

The Employees' Provident Fund and Miscellaneous Provisions Act, 1952

1. The Employees' Provident Fund and Miscellaneous Provisions Act, 1952 is applicable to the company.
2. The contributions made by the employer and the employee and payment thereof are in accordance with para 29 and 30 of the Employees' Provident Funds Scheme, 1952.
3. The employer has obtained declarations from the persons taking up the employment. (Para 34 of the scheme)
4. The employer has prepared the contribution card in Form No. 3 or 3-A as appropriate in respect of every employee in his employment.
5. The employer has sent to the Commissioner:
   (a) Consolidated return in the form specified by the commissioner.
   (b) Monthly return in prescribed Form together with declaration.
   (c) In such form as the commissioner may specify of employees leaving service of the employer during the preceding month.

(d) Inspection note book in such form as the commissioner may specify, is maintained.

(e) Accounts relating to amount contributed to the fund by the employer and by the employee have been maintained. (Para 36 of scheme)

6. The employer has furnished particulars of ownership to the Regional Commissioner. (Para 36 A of scheme)
7. The employer has forwarded the monthly abstract to the commissioner. [Para 38 (2) of scheme]
8. Consolidated annual contribution statement was sent to the commissioner. [Para 38(3) of scheme]
9. Submission of contribution card to the commissioner with a statement.
10. Any proceedings under the Act have been initiated against the Directors for recovery of dues.
11. If the Employer has created its own trust, whether the terms of trust are more beneficial than those provided under the trust.
12. The conditions imposed by PF Commissioner for the creation of Trust are satisfied.
13. The provisions relating to Employees' Pension Scheme, 1995 have been complied with.
14. The provisions relating to Employees' Deposit Linked Insurance Scheme, 1976 have been complied with.

The Payment of Bonus Act, 1965

1. The Payment of Bonus Act, 1965 is applicable to the company.
2. Computation of available surplus, allocable surplus and bonus are correctly arrived at.
3. Any amount has been deducted from bonus and if so, whether they are in accordance with the provisions of section 18.
4. Bonus is paid to the eligible employees.
5. The minimum or maximum amount of bonus paid is in accordance with section 10 or section 11, as the case may be.
6. The company has paid bonus to the employee:

   (a) Where there is a dispute regarding payment of bonus pending before any authority under section 22-within a month from the date on which the award becomes enforceable or the settlement comes into operation, in respect of such dispute;

   (b) In any other case-within a period of eight months from the close of the accounting year.

7. The company has maintained the registers as provided in rule 4.
8. The company has submitted the annual return of payment of bonus to the Inspector in Form No. D within thirty days after the expiry of the time limit prescribed in section 19.

The Payment of Gratuity Act, 1972

1. The Payment of Gratuity Act, 1972 is applicable to the company.
2. There are employees who have worked for a continuous period of 5 years or more.
3. Any gratuity has been paid to any employee. If yes, whether it has been paid within 30 days.

4. The employer has displayed a notice as provided in rule 4, specifying the name of the officer with designation who is authorised to receive notice under the Act or the rules made thereunder.
5. The employer has complied with the provisions related to nominations as specified in rule 6.
6. Gratuity of any employee has been forfeited. If yes, whether an opportunity of being heard is given?
7. The gratuity has been forfeited for the reasons as specified in the Act.
8. The employer has displayed the abstract of the Act and rules made thereunder at or near the main entrance of the establishment, as specified in rule 20.
9. The employer has obtained insurance for liability of payment of gratuity as specified in section 4A of the Act.

The Contract Labour (Regulation and Abolition) Act, 1970

1. The Contract Labour (Regulation and Abolition) Act, 1970 is applicable to the company.
2. The principal employer has obtained the certificate of registration for the establishment.
3. The appropriate Government has by a notification prohibited the employment of contract labour under section 10.
4. The contractors have obtained license from the Licensing Authority for contract labour undertaken or executed by them.
5. The contractors have got their license renewed in time.
6. The contractors are employing workmen as per license and registration certificate.
7. The number of workmen actually employed by the contractor's tallies with the number of workmen shown in the license.
8. The contractors are sending half-yearly returns in time.
9. Where the wage period is one week or more, the contractors are issuing wages slips one day prior to the disbursement of wages.
10. The principal employer maintains register of contractors.
11. The principal employer has sent annual return in to the Registering Officer.
12. The principal employer has within fifteen days of commencement or completion of each contract, submitted return to the Inspector.
13. Minimum rate of wages are being paid to the contractor labour in the presence of authorized representative of the principal employer.
14. The authorized representative of the principal employer gives a certificate to this effect at the end of the entries in the register of wage- cum- Muster Roll, as the case may be.
15. The contractors are properly depositing ESI, EPF contributions in respect of their workmen and submitting copies of the challan to the HR Department of the company.
16. The contract labour is provided the facility of rest room, canteen, wash room, first aid and other facilities.
17. The contract labour is granted leave with wages.
18. The contract labour is being paid over time at double rate.

19. The workmen engaged by the contractor are ensured benefits from ESI Scheme including issue of cards, temporary slips and are provided medical facilities.
20. The contract labour is being given contribution slips of EPF issued by the Regional Provident Commissioner.
21. The payment of wages to contract labour is being made in accordance with rule 65.
22. The leave applications and gate passes of the contract labour are being signed by the contractor and his agent.
23. The gate passes to the contract Labour are issued and signed by the company's employees.
24. The contractors are maintaining records as provided in rule 78.
25. Under the Contract Labour (Regulation & Abolition) Act, 1970.
    - Registration Certificate (Before appointing contractor)
    - Register of Contractor
    - Register of Employees employed by Contractor
    - Muster Roll, Wage Register, Over Time Register, Fine Register
    - Deduction Register, Advance Register (contractor)
    - Notice regarding rates of wages
    - Display of the Act & Rules
    - Half yearly return by contractor
    - Annual Return by Principle Employer (before 15th Feb)

The Maternity Benefit Act, 1961

1. The Maternity Benefit Act, 1961 is applicable to the company.
2. The employer has knowingly employed a woman in any establishment during the six weeks immediately following the day of her delivery, miscarriage or medical termination of her pregnancy.
3. Any pregnant woman has made any request not to give her any work which is of an arduous nature or which involves long hours of standing, etc. during the period of one month immediately preceding the period of six weeks, before the date of her expected delivery.
4. Any woman employee is entitled for maternity benefit, medical bonus and nursing break and if yes, whether payment has been made and nursing break was allowed in accordance with the Act.
5. The employer exhibited the abstract of the provisions of the Act and the rules made thereunder in accordance with section 19 of the Act.
6. Whether the employer has maintained muster rolls, registers and records as prescribed, if any, by the appropriate Government.
7. Whether the employer has submitted annual return in the form prescribed, if any, by the appropriate Government.

The Child and Adolescent Labour (Prohibition and Regulation) Act, 1986

1. The Child and Adolescent Labour (Prohibition and Regulation) Act, 1986 is applicable to the company.

2. The occupier has sent notice to Inspector as per section 9 when a child is employed or permitted to work.
3. The employer has employed any child labour in occupations set forth in Part-A or Process set forth in Part-B of the Schedule to the Act.
4. The employer has maintained the register in Form No. A in respect of children employed or permitted to work as specified in section 11.
5. The occupier has displayed notice containing abstract of sections 3 and 14 as specified in section

The Industrial Employment (Standing Orders) Act, 1946

1. The Industrial Employment (Standing Orders) Act, 1946 is applicable to the company.
2. One hundred or more workmen are employed, or were employed on any day of the preceding twelve months.
3. The industrial establishment has submitted to the Certifying Officer, five copies of the draft Standing Orders proposed by it for adoption in the establishment.
4. The text of the Standing Orders as finally certified has been prominently posted by the company in English and in the language understood by the majority of workmen on special boards to be maintained for the purpose.
5. The industrial establishment has modified the Standing Orders on agreement between the employer and the workmen or a trade union or other representative body of the workmen.
6. Any workman was suspended by the industrial establishment pending investigation or inquiry into complaints or charges of misconduct.
7. The industrial establishment has paid any subsistence allowance to any suspended employee.

The Employees' Compensation Act, 1923

1. The Employees' Compensation Act, 1923 is applicable to the company.
2. Any personal injury is caused to an employee by an accident arising out of or in the course of employment. If yes, the company has paid compensation as prescribed under Section 4 of the Act.
3. The company has maintained notice book in its premises, for reporting notice of accidents as prescribed in Section 10(3) of the Act.
4. The company has reported of fatal accident or serious bodily injuries in prescribed Form to the Commissioner, as prescribed in section 10-B read with Rule 11 of the rules.
5. The company has deposited compensation with the Commissioner in respect of the workman whose injury has resulted in death and has furnished statement in Form No. A, OR In other cases company shall furnish statement in Form 'AA', as prescribed in section 8(1) read with rule 6(1). (As Applicable)
6. The company has furnished a statement in Form 'D', while depositing compensation, as required under section 8(2) read with rule 9.
7. The company has sent a return as to compensation paid during the previous year. (As specified by the State Government in respective state law)
8. On settlement of compensation amount in between company and workman, company executed a memorandum of agreement with the workman in Form No. K, L or M, as the case, may be and submitted such agreement along with an application to register it to the Commissioner, as prescribed in rule 48.

9. The provisions for reservation of apprentice training places for SC/ST/OBC have been made in designated trades.

10. The contract of apprenticeship was sent by the employer to the apprenticeship advisor/entered on the port-site within 7 days for verification & registration.

Equal Remuneration Act, 1976

1. Equal Remuneration Act, 1976 is applicable to the Company.

2. Payment of equal remuneration has been made to all for same work or work of similar nature and there is no discrimination between men and women while recruiting or subsequent to recruitment, promotion etc. (As per Section 4 read with section 5)

3. The company has maintained register in relation to workers in Form No. D as required under rule 6.

The Employment Exchange (Compulsory Notification of Vacancies) Act, 1959

1. The Employment Exchange (Compulsory Notification of Vacancies) Act, 1959 is applicable to the company.

2. The company has notified the vacancies to employment exchanges, as prescribed in section 4 of the Act read with rule 5.

3. The company has furnished quarterly returns, biennial return to local employment exchange as prescribed in rule 6.

CYBER AUDIT

Cyber security is an attempt to minimising any risk of financial loss, disruption or damage to the reputation of an organisation that may arises from the failure of its information technology systems. The objective of the cyber audit is to provide an assessment of the operating effectiveness of cyber security policies and procedures, identify, protect, detect, respond and recover processes and activities to the board. The Cyber audit program generally covers sub-processes such as asset management, awareness training, data security, resource planning, recover planning and communications, in order to identify internal control and regulatory deficiencies that could put the organization at risk.

The security and control issues which deals under cyber security audits includes:

1. Protection of sensitive data and intellectual property

2. Protection of networks to which multiple information resource are connected

3. Responsibility and accountability for the device and information contained in it.

Scope of a cyber-security audit includes

1	● Data security policies relating to the network, database and applications in place
2	● Data loss prevention measures deployed
3	● Effective network access controls implemented

4 ● Detection/prevention systems deployed

5 ● Security controls established (physical and logical)

6 ● Incident response program implemented.

Dimension of the Cyber Security Audit Process

Management

Management of the Company ultimately owns the risk decisions made for the organization. Therefore, it has a vested interest in ensuring that cyber security controls exist and are operating effectively. Decisions are typically made based on guidance received during the risk management processes, for taking appropriate decisions.

Risk Management

Risk assessments are typically made based on guidance by the Cyber security officer at an organization and enterprise management make decisions, employing risk management processes. The objective in any risk assessment is twofold. First, it is critical to communicate the state of the risk so that it is easy to understand and be clear on the level of risk involved. Secondly and just as significantly the ways in which to address that risk must be identified as well. This provides both problem and solution, and mitigates the negative impact of that risk to an enterprise. The risk landscape is ever-changing. It is important to have defined processes, trained and competent cyber security resources, and a governance framework to ensure that appropriate actions are carried out by enterprise leadership and managed effectively to address current and emerging threats.

Internal Audit

Internal auditors and risk management professionals have key roles to play, as does enterprise management. Cyber Auditing is a security measure not an inconvenience. It is critical to protecting an enterprise in today's global digital economy. The internal audit department plays a vital role in cyber security auditing in many organizations, and often has a dotted-line reporting relationship to the audit committee to ensure an independent view is being communicated at the board level of the enterprise. Audit helps enterprises with the challenges of managing cyber threats, by providing an objective evaluation of the controls and making recommendations to improve them as well as assisting the senior management and the board of directors understand and respond to cyber risks. Organizations, especially within the public sector, also contract for the services of external auditors to provide independent assurance of the financial and operational controls primarily to ensure the controls design is effective and the needs of the organization are being met.

Illustrative checkpoint on the Cyber Security Audit

Personnel Security

1. Whether the staff wears ID badges?
2. Whether it is a current picture part of the ID badge?
3. Are authorized access levels and type (employee, contractor, visitor) identified on the Badge?
4. Whether the credentials of external contractors are checked?
5. Whether the company has policies addressing background checks for employees and contractors?
6. Whether the Company has a process for effectively cutting off access to facilities and information systems when an employee/contractor terminates employment?

Physical Security

1. Whether the Company has policies and procedures that address allowing authorized and limiting unauthorized physical access to electronic information systems and the facilities in which they are housed?
2. Whether the Company's policies and procedures specify the methods used to control physical access to your secure areas, such as door locks, access control systems, security officers, or video monitoring?
3. Whether the access to the computing area is controlled (single point, reception or security desk, sign-in/ sign-out log, temporary/visitor badges)?

Account and Password Management

1. Whether the Company has policies and standards covering electronic authentication, authorization, and access control of personnel and resources to your information systems, applications and data?
2. Whether the Company ensures that only authorized personnel have access to the computers?
3. Whether the Company requires and enforces appropriate passwords?
4. Are your passwords secure (not easy to guess, regularly changed, no use of temporary or default passwords)?

Confidentiality of Data

1. Whether the Company is exercising responsibilities to protect sensitive data under their control?
2. Whether the most valuable or sensitive data encrypted?
3. Whether the Company has a policy for identifying the retention of information (both hard and soft copies)?

Compliance and Audit

1. Whether the Company reviews and revises the security documents, such as: policies, standards, procedures, and guidelines, on a regular basis?
2. Whether the Company audits the processes and procedures for compliance with established policies and standards?
3. Whether the Company test the disaster plans on a regular basis?
4. Does management regularly review lists of individuals with physical access to sensitive facilities or electronic access to information systems.

ENVIRONMENTAL AUDIT

According to Section 2(a) of the Environmental Protection Act, 1986, 'Environment' includes Water, air and land. The inter-relationship which exists among and between, (i) water, air, land, and (ii) human beings, other living creatures, plants, microorganisms and property.

Environmental audit in general term reflect various types of evaluations intended to verify the environmental compliance and management system implementation gaps, along with related corrective actions and it has a wide variety of meanings. Environmental Audit refers to verification and assessment of environmental measures in an organisation.

Objectives of environmental audit are to evaluate the efficacy of the utilization of resources of man, machine, materials, and to identify the areas of environmental risks and liabilities and weaknesses of management

system and problems in compliance of the directives of the regulatory agencies and control the generation of pollutants and / or waste.

An environmental audit from a financial perspective is conducted to ensure that public funds were spent efficiently and for their intended purposes. During an audit of financial statements related to environmental matters, the following issues will merit special attention:

- Initiatives to prevent, abate, or remedy damage to environment;
- Conservation of renewable and non-renewable resources; (Mentioned in Director's Report)
- Consequences of violating environment laws, rules and regulations;
- Consequences of vicarious liability imposed by the government, courts etc.

There are generally two different types of environmental audits: Compliance audits and Management systems audits. As the name implies, these audits are intended to review the site's/company's legal compliance status in an operational context. Compliance audits generally begin with determining the applicable compliance requirements against which the operations will be assessed. This tends to include Central Laws, state laws, and local Laws, Rules and Regulations.

1. Environmental Compliance audits

Compliance audit with respect to environmental issues will relate to providing assurance that governmental and private company's activities are conducted in accordance with the relevant laws, rules, notifications, regulations and standards as also policies and strategies. The audit have limited scope which is pre-defined under various legislations. Further the Audits are also focused on operational aspects of a company/site, rather than the contamination status of the real property. The following law covered under the environmental compliance audit:

Air Pollution

1. The Indian Boilers Act, 1923.
2. The Motor Vehicles Act, 1988.
3. The Mines and Minerals (Development and Regulation) Act, 1957.
4. The Factories Act, 1948.
5. The Industries (Development and Regulation) Act, 1951.
6. The Air (Prevention and Control of Pollution) Act, 1981.

Water Pollution

7. The River Boards Act, 1956.
8. The Merchant Shipping (Amendment) Act, 1970.
9. The Water (Prevention and Control of Pollution) Act, 1974.

Radiation

10. The Atomic Energy Act, 1962.

Pesticides

11. The Poison Act, 1919.
12. The Factories Act, 1948.
13. The Insecticides Act, 1968.

Miscellaneous

14. The Indian Forest Act, 1927.
15. The Ancient Monuments and Archaeological Sites and Remains Act, 1958.
16. The Wildlife (Protection) Act, 1972.
17. The Urban Land (Ceiling and Regulation) Repeal Act, 1999.
18. The Forest (Conservation) Act, 1980.
19. The Environment (Protection) Act, 1986.
20. The Public Liability Insurance Act, 1991.

2. Environmental Management Systems Audit

ISO 14001 is a voluntary international standard for environmental management systems ("EMS"). An EMS meeting the requirements of ISO 14001:2015 is a management tool enabling an organization of any size or type to:

1. Identify and control the environmental impact of its activities, products or services;
2. Improve its environmental performance continually, and
3. Implement a systematic approach to setting environmental objectives and targets, to achieving these and to demonstrating that they have been achieved.

ISO 14001 is an environment management system standard published by International Organisation for standardization in the year 1996 and later updated in the year 2005. It provides highly effective, globally accepted framework for establishing and continually improving the effectiveness of environmental management. Implementation of ISO 14001 may bring with it both reductions in environmental risk and environmental costs.

The International Organization of Standardization (ISO) defines an environmental management system as "part of the management system used to manage environmental aspects, fulfil compliance obligations, and address risks and opportunities." The framework in the ISO 14001 standard can be used within a plan-do-check-act (PDCA) approach to continuous improvement.

ISO 14001:2015 should be used by any organization that wishes to set up, improve, or maintain an environmental management system to conform to its established environmental policy and requirements. The requirements of the standard can be incorporated into any environmental management system, the extent to which is determined by several factors including the organization's industry, environmental policy, products and service offerings, and location.

Question: Which of the following is not "Environment" as per Environmental Protection Act, 1986?

Options: (A) Water (B) Human Beings (C) Air (D) Buildings

Answer: (B)

At the highest level, ISO 14001:2015 covers the Context of the organization, Leadership, Planning, Support, Operation, Performance evaluation Improvement with regard to environmental management systems:

Process of Environment Audit

1. Understanding the industrial activity and Pre-audit or planning stage

Collection of background information about the entity, definition of objectives and scope of audit, formation of audit team and development of audit plan and protocols.

2. On-site or Field Audit

Communicate the objectives of the audit to key faculties and schedule necessary meetings and interviews, identify areas of concern, site / facility inspection, evidence / records / document review, staff interviews, initial review of findings.

3. Assessing the impact and post-audit

Final evaluation of findings, submit preliminary report with type and magnitude of impact on the environment, get approval of management, introduce the findings to the auditees, submit final environment audit report along with short/ long term acceptability.

4. Follow up or review

Verify the action taken on audit findings and recommendations.

Checklist on Environment Audit

A. Environment Policy

1. Whether the company have defined and documented its environmental policy.
2. Whether such policy is based on significant environmental aspects and corporate policy.
3. Whether such policy is appropriate to the organization's activities and their potential environmental impacts and regulatory requirements.
4. Does the policy include commitments to:
   - Continual improvement;
   - Prevention of pollution;
   - Comply with environmental legislation and other requirements.
5. Does the policy provide a framework for setting environmental objectives and targets.
6. Is the policy documented, implemented, maintained and communicated to all persons working for or on behalf of the organization.
7. Is the policy available is freely available to public.

Question: .....is a voluntary international standard for Environmental Management Systems ("EMS").

Options: (A) ISO 14001 (B) ISO 15002 (C) ISO 12501 (D) 12901

Answer: (A)

B. Environment Aspects

1. Whether a procedure been established, implemented and maintained to identify the environmental aspects of its current and relevant past activities.
2. Whether aspects related to potential significant environmental aspects been considered in establishing and implementing the EMS.
3. Whether aspects having legal and/or regulatory reporting, monitoring or operational requirements been identified as "significant" aspects.
4. Are the following environmental aspects considered in sufficient detail:
   - Air emission
   - Wastewater effluent
   - Waste management
   - Soil pollution

- Raw material and natural resource usage
- Hazardous and toxic material
- Impact on well-being (e.g. noise, smell, heat, landscape, protection)
- Utility, energy and resource.

5. Other environmental specific issues on site such as housekeeping, storage, areas, piping.
6. Are the following operational aspects considered:
   - Normal operating conditions
   - Abnormal operating conditions (e.g. start up and shut down conditions, maintenance, incidents)
   - Development of new or modified processes, products or services.
7. Actual and potential emergency conditions and accidents.
8. Have significant aspects been identified.

C. Legal and Other Requirements

1. Has a procedure been developed and implemented to identify applicable regulatory, legal and other requirements.
2. Are current copies of all applicable regulatory and other requirements accessible to personnel as necessary.
3. Have all further agreements the organization needs to fulfil been integrated in the procedure:
   - Business related agreements
   - Agreements with public authorities.
4. Guideline other than legal requirements (e.g. company policy, industry codes and practices, etc.)
5. Are the following licenses, permits and approvals available to demonstrate full legal compliance:
   - Licenses of waste collectors
   - Air emission permits
   - Wastewater discharge permits
   - Permits and licenses related to dangerous goods
   - Environmental fees, e.g. wastewater discharge fee
   - Registration at authorities (e.g. wastewater discharge, air emission inspection).

INFORMATION SYSTEMS AUDIT

Information systems auditing or systems audit is an ongoing process of evaluating controls, collecting and evaluating evidence to determine whether a computer system safeguards assets, maintains data integrity, allows organizational goals to be achieved effectively, and uses resources efficiently. Thus, information systems auditing supports traditional audit objectives; attest objectives (those of the external auditor) that focus on asset safeguarding and data integrity, and management objectives (those of the internal auditor) that encompass not only attest objectives but also effectiveness and efficiency objectives.

An information systems audit performed in an organisation is a comprehensive examination of a given targeted system. The audit consists of an evaluation of the components which comprise that system, with examination and testing in the following areas:

- High-level systems architecture review
- Business process mapping (e.g. determining information systems dependency with respect to user business processes)
- End user identity management (e.g. authentication mechanisms, password standards, roles limiting or granting systems functionality)
- Operating systems configurations (e.g. services hardening)
- Application security controls
- Database access controls (e.g. database configuration, account access to the database, roles defined in the database)
- Anti-virus/Anti-malware controls
- Network controls (e.g. running configurations on switches and routers, use of Access control lists, and firewall rules)
- Logging and auditing systems and processes
- IT privileged access control (e.g. System Administrator or root access)
- IT processes in support of the system (e.g. user account reviews, change management)
- Backup/Restore procedures.

During the System audit, the auditors are required to understand and evaluate the overall control environment. The control environment reflects the overall attitude of, awareness of, and actions by the board of directors, management, and others concerning the importance of internal controls in the enterprise.

General objectives of System Auditing	
1	Validation of the organizational aspects and administration of the information service function.
2	Validation of the controls of the system development life cycle.
3	Validation of access controls to installations, terminals, libraries, etc.
4	Automation of internal auditing activities.
5	Internal training.
6	Training members of the information service function department.

CHECKLIST ON SYSTEMS AUDIT

A. Management Controls

1. Security Policy and Standards

1. Whether the organization has a Security Policy?
2. If a security policy exists, it needs to be examined for adequacy in proportion to the risk.

2. Constitution of Steering Committee

The formulation and implementation of a sound security policy should be a team effort, brought into effect by a committee in which there is at least one member of the Board of Directors apart from the Chief Information Officer (CIO)and user HoDs.

3. Business Continuity Planning

The Auditor should examine all such possibilities by which the availability of Computer Systems is threatened with temporary or permanent breakdown. In sensitive areas, even proofing against mob violence/terrorist strikes should be kept in view.

4. Systems Development Methodology

The documentation should be properly cross-indexed. The effect of a change made in the system should be well understood and thorough testing should be done and documented. The System Auditor should get necessary evidence and comment on the lack of proper adherence to procedure.

B. Operational Controls

1. Monitoring physical assets

1. Whether monitoring of physical assets are done in regular intervals?
2. Any discrepancy in the data collected and the current data of physical assets are addressed immediately or not?

2. Ensure adequate environmental controls:

1. Whether proper facilities of Air-conditioning (dust, temperature & humidity controls), Power Conditioning (Online UPS functioning all the time with backups, proper earthing) are timely reviewed?
2. Whether the cable connections/electronic points are functioning properly or not is reviewed on regular intervals?

C. Organizational Controls

1. Whether the roles, responsibilities and duties of User Departments and IT Department are defined?
2. The CIO should have three reportees– one for taking care of the development team, one for ensuring Information System / IT Centre security and another for managing the facilities (i.e., operations and maintenance of hardware), OS, database administration, vendor management, service providers etc.

D. Application Controls

Whether each of the Computer Systems and subsystems must have its own set of controls for Inputs, processing & outputs. Processing controls should also ensure checks for legal compliance.

FEW MANDATORY AUDITS UNDER SEBI

Circular No. & Date	Particulars	Purpose of Audit
CIR/CDMRD/DEICE/01/2015 dated November 16, 2015	Annual System Audit, Business Continuity Plan (BCP) and Disaster Recovery (DR)	Any events of disaster will disrupt trading systems adversely, thereby impacting the market integrity and the confidence of investors. Exchanges should therefore have robust Busin ess Continuity Plan (BCP) and Disaster Recovery (DR) to ensure continuity of operations.
SEBI/HO/CDMRD/DEICE/ CIR/P/2016/70 August 11, 2016	Annual System Audit of Stock Brokers / Trading Members of National Commodity Derivatives Exchanges	SEBI vide Circular No. CIR/MRD/ DMS/34/2013, dated November 06, 2013, has prescribed stock broker system audit framework and mandated Stock Exchanges to ensure conduct of system audit of its members as per the prescribed framework and monitor the same. It was decided to make the provisions of the aforesaid circular applicable to the Brokers/ Trading Members of the National Commodity Derivatives Exchanges.
SEBI/HO/IMD/DF2 CIR/P/2019/57 dated April 11, 2019	System Audit framework for Mutual Funds / Asset Management Companies (AMCs)	Considering the importance of systems audit in technology driven asset management activity and to enhance and standardize the systems audit
SEBI/HO/MRD1/ICC1/ CIR/P/2020/03 January 07, 2020	Annual System Audit of Market Infrastructure Institutions (MII)	The Systems Audit Report including compliance with SEBI circulars/ guidelines and exceptional observation format along with compliance status of previous year observations shall be placed before the Governing Board of the MII and then the report along with the comments of the Management of the MII shall be communicated to SEBI within a month of completion of audit. Further, along with the audit report, MIIs are advised to submit a declaration from the MD / CEO certifying the security and integrity of their IT Systems.

FORENSIC AUDIT

Forensic Audit is a dynamic and strategic tool in combating corruption, financial crimes and frauds through investigations and resolving allegations of fraud and embezzlement. It may be conducted to determine negligence. Forensic is the application of science to crime concerns. Forensic science is science applied to legal matters especially criminal matters.

> "Forensic" means suitable for use in the court of law. The examination a company's financial records to derive evidence which can f used in a court of law is a Forensic Audit. It includes the use of accounting, auditing and investigative skills to assist in the legal matters

Forensic audits are highly specialized, and the work requires detailed knowledge of fraud investigation techniques and the legal framework. Forensic accountants are trained to look beyond the numbers and has necessary skills and experience to accept the work. Highly specialized and the work requires detailed knowledge of fraud investigation techniques and the legal framework (civil, criminal laws and human psychology) and to identify substance over form when dealing with an issue.

A forensic auditor is required to have specialist training so that he can understand the legal framework and also has the knowledge of forensic audit techniques. He should also have the expertise in the use of IT tools and techniques that facilitate data recovery and analysis.

A forensic audit, also known as forensic accounting, refers to the application of accounting methods for detection and gathering evidence of frauds, embezzlement, or any other such white-collar crime. It is the application of accounting skills to legal questions.

Forensic audit is done in two-phases:

1. **Investigation Services –** At first the auditor begins with an investigation; looking into the accounts and statement, and identifying defects in it. It then moves on to find ways to deal with such defects, which is a reactionary function.

2. **Litigation Services –** It is entirely possible the frauds detected be resolved within the company itself. However, there are times when they need to be resolved through legal channels. During such situations, forensic auditors give litigation support to the advocates. Their advice and consultation about the legalities of commercial disputes are very essential. Moreover, they also provide research assistance by giving relevant documents and facts to support a legal claim, and also help decide the extent of damage that is required. They are also called up by the Court as an expert witness for further investigation.

Areas of Forensic Audit					
Criminal investigations	Professional negligence cases	Fraud investigation and risk / control reviews	Arbitration cases	Settlement of insurance claims	Dispute settlement

PURPOSE OF FORENSIC AUDIT

I. Corruption

In Forensic audit, while investigating fraud, auditor would look out for:

Conflicts of interest – When fraudster used his/her influence for personal gains detrimental to company. For example, if a manager allows and approves inaccurate expenses of employee with whom he has personal relations. Even though the manager is not benefitted from this approval but he is likely to receive personal benefits after making such inappropriate approvals.

Bribery – As the name suggest offering money to get things done or influence a situation one's favour would be bribery.

Extortion – In above example, if someone demands money so as to award Tender to other party then it would amount to extortion.

II. Asset Misappropriation

This is the most common and prevalent fraud carried out by fraudsters. Misappropriation of cash, raising fake invoices, payments

Example: A driver uses the office car for his personal holiday trip is said to misappropriate the Asset.

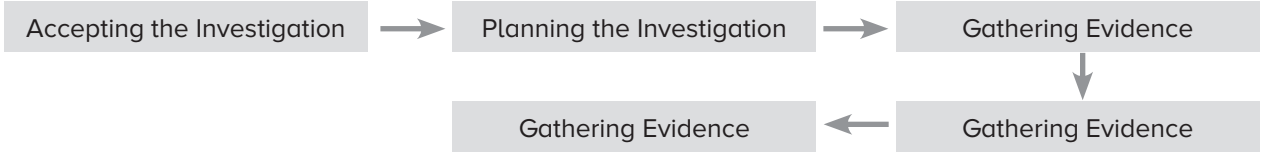
made to non-existing suppliers or employees, misuse of assets or theft of Inventory are few examples of such asset misappropriation.

III. Financial statement fraud

Companies get into such type of frauds so as to show a better performance of the company than what it is actually. This is done so as improve liquidity or ensure top management keep earning the bonuses or due to market pressure on performance.

Some examples of such frauds are – Intentional forgery of accounting records; omitting transactions – either revenue or expense transactions, non-disclosures of relevant details from the financial statements; or not applying the requisite financial reporting standards.

Procedure of Forensic Auditing Investigation



Step 1 – Accepting the Investigation

A forensic audit is always assigned to an independent firm/group of investigators in order to conduct an unbiased and truthful audit and investigation. Thus, when such a firm receives an invitation to conduct an audit, their first step is to understand the business, Identify possible frauds that could exist and determine whether or not they have the necessary tools, skills and expertise to go forward with such an investigation. They need to do an assessment of their own training and knowledge of fraud detection and legal framework. Only when they are satisfied with such considerations, can they go ahead and accept the investigation.

Step 2 – Planning the Investigation

Planning the investigation is the key step in a forensic audit. The auditor(s) must carefully ascertain the goal of the audit so being conducted, and to carefully determine the procedure to achieve it, through the use of effective tools and techniques. Before planning the investigation, they should catalog possible fraud symptoms,

Symptoms of Fraud

- Delayed submission of returns information etc.;
- Delayed remittances into Bank;
- Delay or non-preparation of Bank reconciliation statements;
- Lifestyle of promoters/directors and key employees ;
- Continued internal control lapses and not following norms of corporate governance.

Internal Indicators

- Delay in finalisation of accounts;
- Frequent changes in Accounting Policies;
- Continuing Losses;
- Over drawl of loans or advances;
- Higher cost per unit of production;
- High amount of losses or wastage shown in *books* v/s *Norms*;
- High investment in group companies;
- Profit not supported by increased cash availability.

They should also be clear on the final categories of the report, which are as follows,

- Identifying the type of fraud that has been operating, how long it has been operating for, and how the fraud has been concealed;
- Identifying the fraudster(s) involved;
- Quantifying the financial loss suffered by the client;
- Gathering evidence to be used in court proceedings;
- Providing advice to prevent the recurrence of the fraud.

Illustrative Checklist on Forensic Audit

- Whether the fraud detected is at the management level or employee level?
- What was the reason or motive behind the fraud?
- How is the internal check on cash transactions, raising of invoices etc.?
- Who is responsible for the checking if all the things are in order in regular intervals?
- What is the nature of fraud – corruption, assets misappropriation or financial misstatement?
- Whether the entries passed are properly reflected in the balance sheet without any omission?
- Whether IT returns are filed every year properly?
- Whether bank entries are reconciled on regular basis? Whether bank statements do not have any discrepancy.

Fraud Triangle and Fraud Risk

A fraud triangle is a tool used in forensic auditing that explains three interrelated elements that assist the commission of fraud- Pressure (motive), opportunity (ability to carry out the fraud) and rationalization (justification of dishonest intentions). Fraud risk is the vulnerability a company/organisation has to those who are capable of overcoming the three elements in the fraud triangle. Fraud risk assessment is the identification of fraud risks that exist in the company/organisation. The planning involves the formulation of techniques and procedures that align with the fraud risk and fraud risk management.

Planning also includes the identification of the best way/mode to gather evidence. Thus, it is necessary that ample research should be done regarding certain investigative, analytical, and technology-based techniques, and also related legal process, with regard to the outcome of such investigation.

Step 3 – Gathering Evidence

In forensic auditing specific procedures are carried out in order to produce evidence. Audit techniques and procedures are used to identify and to gather evidence to prove, for example, how long have fraudulent activities existed and carried out in the organization, and how it was conducted and concealed by the perpetrators. In order to continue, it is pertinent that the planning stage has been thoroughly understood by the investigating team, who are skilled in collecting the necessary evidence. It is also important to keep clear sequence of custody until the evidence is presented in court. A logical flow of evidence helps in understanding the fraud and evidence presented in a better manner. If the same is not done then the evidence can be challenged in court, or the court would not admit it.

The investigators can use the following techniques to gather evidence or data about symptoms, testing controls to gather evidence which identifies the weaknesses, which allowed the fraud to be perpetrated.

- **Analytical Procedure:** Using analytical procedures to compare trends over time or to provide comparatives between different segments of the business applying computer-assisted audit

techniques, for example, to identify the timing and location of relevant details being altered in the computer system.

- **Discussions and Interviews:** Discussions and interviews with employees.
- **Substantive Techniques:** Substantive techniques such as reconciliations, cash counts and reviews of documentation.
- **Forensic Data Analysis (FDA):** FDA is the technology used to conduct fraud investigations; the process by which evidence is gathered, summarized and compared with existing different sets of data. The aim here is to detect any anomalies in the data and identify the pattern of such anomalies to indicate fraudulent activity.

Step 4 – Reporting

The reporting stage is the most obvious element in a forensic audit. After investigating and gathering evidence, the investigating team is expected to give a report of the findings of the investigation, and also the summary of the evidence and conclusion about the loss suffered due to the fraud. It should also include the plan of the fraud itself, and how it unfolded, basically the whole trail of events, and suggestions to prevent such fraud in the future.

Step 5 – Court Proceedings

The last stage expands over those audits that lead to legal proceedings. Here the auditors will give litigation support to the Company/Regulators. The auditors are called to Court, and also included in the advocacy process. The understanding here is that they are called in because of their skill and expertise in commercial issues and their legal process. It is important that they lay down the facts and findings in an understandable and objective manner for everyone to comprehend so that the desired action can be taken up. They need to simplify the complex accounting processes and issues for others to understand the evidence and its implications.

FORENSIC AUDIT REPORT

Forensic Audit Report is statement of observation gathered & considered while proving conclusive evidence. It is a medium through which an auditor expresses his opinion under audit after the forensic audit investigation is completed.

Illustrative table of contents of a Forensic Audit Report include the following points:

1. Executive Summary
2. Origin of the audit
3. Audit Objective
4. Proposed Audit Outputs
5. Audit Implementation approach
6. Risk Analysis
7. Internal Environment Risk: Customers, product and Competitors; Financial Management; Human Resource Management; Information Technology; Business processes
8. External Environment Risk: Economy and market situation; political and legal scenario; Technology in the sector
9. Audit Process
10. Preliminary understanding of scope and incident coverage
11. Collect evidence

12. Conduct Interviews
13. Analyse findings
14. Validate inferences and conclusions
15. Evidence of risk events
16. Conflicts of interest; Bribery; Extortion; Theft; Fraudulent transactions; inventory frauds; misuse of assets; financial statement frauds
17. Audit recommendations
18. Logical framework approach
19. Preconditions and risks
20. Governance on recommendation implementation
21. Stakeholders
22. Budget considerations

SOCIAL AUDIT

A social audit is a way of measuring, understanding, reporting and ultimately improving an organization's social and ethical performance. A social audit helps to narrow gaps between vision/goal and reality, between efficiency and effectiveness. It is a technique to understand, measure, verify, report on and to improve the social performance of the organization.

Social auditing creates an impact upon governance. It values the voice of stakeholders, including marginalized/ poor groups whose voices are rarely heard. Social auditing is taken up for the purpose of enhancing local governance, particularly for strengthening accountability and transparency in local bodies.

Social audit is a process of reviewing official records and determining whether state reported expenditures reflect the actual money spent on the ground. A social audit is a formal review of a company's endeavors in social responsibility.

The key difference between development and social audit is that a social audit focuses on the neglected issue of social impacts, while a development audit has a broader focus including environment and economic issues, such as the efficiency of a project or programme.

A social audit is an official evaluation of an organization's involvement in social responsibility projects or endeavors. For example, a local family store makes a clothing donation to a local church that has a homeless shelter for women and children. The store makes a similar donation three times a year. This is something that a social audit might uncover. Factors examined by a social audit include records of charitable contributions, volunteer events, efficient utilization of energy, transparency, work environment, and employees' wages.

Implications of Social Audit		
Social auditing creates an impact upon governance. It values the voice of stakeholders, including marginalized/poor groups whose voices are rarely heard.	Social auditing is taken up for the purpose of enhancing local governance, particularly for strengthening accountability and transparency in local bodies.	Social Audit makes it sure that in democracy, the powers of decision makers should be used as far as possible with the consent and understanding of all concerned.

Objectives of Social audit

1. Assessing the physical and financial gaps between needs and resources available for local development.
2. Creating awareness among beneficiaries and providers of local social and productive services.
3. Increasing efficacy and effectiveness of local development programmes.
4. Scrutiny of various policy decisions, keeping in view stakeholder interests and priorities, particularly of rural poor.
5. Estimation of the opportunity cost for stakeholders of not getting timely access to public services.
6. Provision of information needed to improve the effectiveness of programs designed to enhance community development.

Rights of Social Auditor to be effective

1. seek clarifications from the implementing agency about any decision-making, activity, scheme, income and expenditure incurred by the agency;
2. consider and scrutinize existing schemes and local activities of the agency; and
3. access registers and documents relating to all development activities undertaken by the implementing agency or by any other government department.

This requires transparency in the decision-making and activities of the implementing agencies. In a way, social audit includes measures for enhancing transparency by enforcing the right to information in the planning and implementation of local development activities.

A social audit looks at factors such as a company's record of charitable giving, volunteer activity, energy use, transparency, work environment, and worker pay and benefits to evaluate what kind of social and environmental impact a company is having in the locations where it operates.

SOCIAL AUDIT- COVERAGE

A social audit examines issues regarding internal practices or policies and how they affect the identified society. The activities included tend to pertain to the concepts of social responsibility. This can include activities affecting the financial stability of a region, any environmental impact resulting from standard operations and issues of transparency in reporting.

There is no standard regarding what must be considered as the society during the audit. This allows a business to expand or contract the scope based on its goals. While one company may wish to understand the impact it

has on a small-scale society, such as a particular city, others may choose to expand the range to include an entire state, country or the world as a whole.

Regulation 91E of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, mandates Social Audit of Social Enterprise engaged in the activities specified under regulation 292E (2) (a) of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018.

Use of Social Audit Findings

As a social audit is completely voluntary, the results of the audit are not required to be released to the general public or any regulatory agency. While positive results may be voluntarily disclosed, negative results may be kept internal and used to identify potential improvements that can make the results of the next social audit more favorable. For example, if a company found that the examined society did not believe it was adequately involved in charitable activities within the community, the company might choose to increase efforts in this area in the hopes of improving public perception.

Implementation of Social Audit

1. **Empowerment of people:** Social audit is most effective when the actual beneficiaries of an activity are involved in it. However, people can only get involved in the process when they are given appropriate authority and rights. To this end, the 73rd amendment of the constitution has empowered the Gram Sabha to conduct social audit. This is relevant only in the villages. In the cities, the Right to Information Act empowers the people to inspect public records.
2. **Proper Documentation:** Everything right from the requirement gathering to planning to implementation must be properly documented. Some of the documents that should be made mandatory are:
   - Applications, tenders, and proposals.
   - Financial statements, income - expense statements.
   - Registers of workers.
   - Inspection reports.
3. **Accessibility of Documents:** Merely generating documents is useless if they are not easily accessible. In this information age, all the documents must be put on line.
4. **Punitive Action:** The final and most important provision, about which nothing is being done yet is to have punitive actions for non-conformance of the process of social audit. Unless there is legal punishment, there will be no incentive for the people in authority to implement the processes in a fair manner.

Steps for Social Audit

- Clarity of purpose and goal of the local elected body.
- Identify stakeholders with a focus on their specific roles and duties. Social auditing aims to ensure a say for all stakeholders. It is particularly important that marginalized social groups, which are normally excluded, have a say on local development issues and activities and have their views on the actual performance of local elected bodies.
- Definition of performance indicators which must be understood and accepted by all. Indicator data must be collected by stakeholders on a regular basis.
- Regular meetings to review and discuss data/information on performance indicators.
- Follow-up of social audit meeting with the panchayat body reviewing stakeholders' actions, activities and viewpoints, making commitments on changes and agreeing on future action as recommended by the stakeholders.

- Establishment of a group of trusted local people including elderly people, teachers and others who are committed and independent, to be involved in the verification and to judge if the decisions based upon social audit have been implemented.
- The findings of the social audit should be shared with all local stakeholders. This encourages transparency and accountability. A report of the social audit meeting should be distributed for Gram Panchayat auditing. In addition, key decisions should be written on walls and boards and communicated orally.

Checklist on Social Audit

- Whether the company has well defined policies for development of the society especially the poorand rural people?
- Whether on regular basis the scrutiny of fulfillment of the policy is done?
- Whether the physical and financial gaps between needs and resources available for local development are assessed on regular intervals?
- Whether the voice of the minority shareholders are considered?
- Are necessary actions taken over them?

ICSI SOCIAL AUDIT STANDARDS

The Institute of Company Secretaries of India has approved the ICSI Social Audit Standards covering all the sixteen areas of activities listed by the Regulatory Authorities, where a Social Enterprise can operate to be eligible to register on the Social Stock Exchanges.

The Institute formulated the ICSI Social Audit Standards to provide guidance for conducting a Social Audit of Social Enterprises engaged in any of the activities as enumerated under Regulation 292E(2)(a) of SEBI (ICDR), Regulations, 2018.

The history of Social Stock Exchange (SSE) is not longer than a decade. It's a novel social and economic phenomenon. The object of introduction of SSE is to attract social investors to participate in financing Social Enterprise. SSE serves as a mediator between social enterprises that need funding and investors who are willing to invest their money for social causes. Thus, SSE provides a platform for trading of securities of Social Enterprise. Securities and Exchange Board of India (SEBI) with a view to improve visibility and knowledge, among stakeholders like investors, promoters, directors, officers of the Social Enterprise, regulators, government authorities, financial institutions, banks, creditors and common public, vide regulation 91E of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 introduced the concept of Social Audit.

Objectives

The main object of Social Audit is to ascertain the impact made by the Social Enterprise through its activities, intervention, programs or projects implemented during the reporting period. It will also analyse whether the implemented activities, intervention, programs or projects has addressed the challenges set at the implementation stage or those mentioned in the fund-raising documents. The impact report aims to highlight the positive impact made to the target area, unintended negative impact and gap between desired object and actual impact made by the Social Enterprise during the reporting period. The main objects of Social Audit are as follows:

- Assessing the impact made by the Social Enterprise through implementation of activities, intervention, programs or projects;
- Verifying the authenticity and validity of implementation of projects;
- To identify and report the gap between desired object and actual impact made by the Social Enterprise;

- Assessing the nature, intensity and duration of impact of the project;
- Evaluating the cost and efficiency of the projects/ interventions being carried out by the Social Enterprise;
- Evaluating the unintended effects and how to use the experience from the running projects to improve the design of future projects;
- Verifying whether all the statutory requirements are fulfilled or not.

Scope

Different projects may have a very different list of social issues. The Social Auditor is to exercise his own technical judgement to determine which issues should be subject to inquiry. The minimum issues which must be addressed by the Social Auditor are enumerated as under:

- Will the project significantly impact the economic, environment and social condition of the local community?
- Will there be a significant change in the general access that the communities have to natural resources, such as drinking water and energy?
- Does the local community have effective governance mechanisms to deal with the long-term effects of the project?
- Are there groups (indigenous groups, women, ethnic minorities, LGBTQIA+ and so on) who will be differentially impacted by the project?
- Will the project increase or decrease the demand for services, such as education or health?
- Will the project produce any population or demographic movement, such as the change in size of the communities affected by the project?

Above questions can help the auditor and the Enterprise to determine the extent of the impact, as well as any unmanageable social obstacles ahead of the project. This allows for the anticipation of any adverse significant social effects of the infrastructure and for avoiding, minimizing, or offsetting them.

Mandatory nature of framework and Standards

These Social Audit Standards are applicable to all Social Auditors empanelled with the ICSI Institute of Social Auditors who undertake the Social Audit assignment as per the relevant provisions of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 and other relevant provisions notified from time to time. The Standards are formulated for the effective assessment of impact made by the Social Enterprises through the projects identified and the eligibility criteria as notified by SEBI vide Regulation 292E (2) (a) of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018.

Eligibility Criteria

As per Regulation 292E (2) (a) of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018, in order to establish the primacy of its social intent, such Social Enterprise shall meet the following eligibility criteria: -

i. Eradicating hunger, poverty, malnutrition and inequality;

ii. Promoting health care including mental healthcare, sanitation and making available safe drinking water;

iii. Promoting education, employability and livelihoods;

iv. Promoting gender equality, empowerment of women and LGBTQIA+ communities;

v. Ensuring environmental sustainability, addressing climate change including mitigation and adaptation, forest and wildlife conservation;

vi. Protection of national heritage, art and culture;

vii. Training to promote rural sports, nationally recognised sports, Paralympic sports and Olympic sports;

viii. Supporting incubators of Social Enterprises;

ix. Supporting other platforms that strengthen the non-profit ecosystem in fundraising and capacity building;

x. Promoting livelihoods for rural and urban poor including enhancing income of small and marginal farmers and workers in the non-farm sector;

xi. Slum area development, affordable housing and other interventions to build sustainable and resilient cities;

xii. Disaster management, including relief, rehabilitation and reconstruction activities;

xiii. Promotion of financial inclusion;

xiv. Facilitating access to land and property assets for disadvantaged communities;

xv. Bridging the digital divide in internet and mobile phone access, addressing issues of misinformation and data protection;

xvi. Promoting welfare of migrants and displaced persons.

Social Audit Standards for other items, if any, identified by the SEBI or Government of India from time to time, will be notified as and when the items are notified by the SEBI or Government of India.

The Social Auditors empanelled under IISA shall maintain and preserve the records and evidences collected in the course of Social Audit for a minimum period of eight (8) years from the date of the respective Social Impact Assessment Report.

Benefits and Advantages of Social Audit

- *Financial data on social activities/ programs/ interventions:* Social Audit assesses the source of funding, its utilisation and appropriate reporting to the Governing Body of the Social Enterprise.
- *Encourage for social performance:* Social Audit assesses the impact of the activities undertaken and brings the social point of view to the attention of the management, and thus encourages the Social Enterprise to perform better.
- *Improve relationships with Stakeholders:* By Implementing the auditors' recommended improvements, it helps the Social Enterprise to meet stakeholder expectations, enabling it to build a good relationship with them in the long term.
- *Comparison of different activities:* The Social Audit provides data for comparing effectiveness of different types of social welfare programmes undertaken and this further enables to assess which activity has better social impact.
- *Enhances Social Reputation:* Social Audit helps the organization to build up the image and reputation of the organization in the minds of the public.
- *Sense of Social Responsibility among Shareholders and Community as a whole:* Social Audit helps shareholders as well as other stakeholders realize the importance of socially beneficial programmes and extend their cooperation to the Social Enterprise's programmes of social welfare and development.

List of ICSI Social Audit Standards.

Sl. No.	Social Audit Standards
1	Social Audit Standard on eradicating hunger, poverty, malnutrition and inequality (ICSI SAS-01)
2	Social Audit Standard on promoting health care including mental healthcare, sanitation and making available safe drinking water (ICSI SAS-02)
3	Social Audit Standard on promoting education, employability and livelihoods (ICSI SAS-03)
4	Social Audit Standard on promoting gender equality, empowerment of women and LGBTQIA+ communities (ICSI SAS-04)
5	Social Audit Standard on ensuring environmental sustainability, addressing climate change including mitigation and adaptation, forest and wildlife conservation (ICSI SAS-05)
6	Social Audit Standard on protection of national heritage, art and culture (ICSI SAS-06)
7	Social Audit Standard on training to promote rural sports, nationally recognised sports, Paralympic sports and Olympic sports (ICSI SAS- 07)
8	Social Audit Standard on supporting incubators of Social Enterprises (ICSI SAS-08)
9	Social Audit Standard on supporting other platforms that strengthen the non-profit ecosystem in fundraising and capacity building (ICSI SAS-09)
10	Social Audit Standard on promoting livelihoods for rural and urban poor including enhancing income of small and marginal farmers and workers in the non-farm sector (ICSI SAS-10)
11	Social Audit Standard on slum area development, affordable housing and other interventions to build sustainable and resilient cities (ICSI SAS-11)
12	Social Audit Standard on disaster management, including relief, rehabilitation and reconstruction activities (ICSI SAS-12)
13	Social Audit Standard on promotion of financial inclusion (ICSI SAS- 13)
14	Social Audit Standard on facilitating access to land and property assets for disadvantaged communities (ICSI SAS-14)
15	Social Audit Standard on bridging the digital divide in internet and mobile phone access, addressing issues of misinformation and data protection (ICSI SAS-15)
16	Social Audit Standard on promoting welfare of migrants and displaced persons (ICSI SAS-16)

(The details of the standards are available at https://www.icsi.edu/media/webmodules/ICSI_Social_Audit_Standards.pdf)

ICSI AUDITING STANDARDS – AN OVERVIEW

The Companies Act, 2013 has introduced the concept of Secretarial Audit (Audit) for Bigger Companies in order to have third party professional assurance in the areas of governance, compliances and disclosures by the companies. A Practicing Company Secretary (PCS) who is holding Certificate of Practice (CoP) have been casted an exclusive responsibility to undertake such audit of companies.

Company Secretaries have been authorized first time undertake and perform Auditing function under the Companies Act. PCS is required to provide his "Secretarial Audit Report" (Audit Report) in form MR-3 pursuant to the provisions of Section 204(1) of Companies Act, 2013 and Rule 9 of the Companies (Appointment & Remuneration Personnel) Rules 2014 to the members of the Company.

PCS has also been casted a duty to detect and report the frauds in the Companies while performing the duties as Auditor. Initially, a lot of challenges was there in conducting audits and in developing auditing acumen and undertaking the function of detection of frauds.

Accordingly, ICSI has taken initiatives in the area of Auditing and to strengthen the auditing acumen and detection abilities of PCS it was decided to develop the auditing techniques and tools to undertake secretarial audits of other companies.

The ICSI has setup an Auditing Standards Board for laying down the foundations of Company Secretaries Auditing Standards (CSAS) in India and for inculcation of best auditing practices among its members, and issued CSAS-1 to CSAS-4 effective from it 1st April, 2021.

Observance of ICSI auditing for standards by PCS, will lead to good governance, compliance and transparency among the companies. It will also help the PCS to comply with its important function of detection and reporting of frauds.

The Council of the Institute of Company Secretaries of India (ICSI) has approved the issuance of four ICSI Auditing Standards. The Standards are required to be observed by the Company Secretaries undertaking Audits. The Standards seek to promote best auditing practices, uniformity and consistency while conducting audits. The four Standards namely:

CSAS-1: Auditing Standard on Audit Engagement which lays down the Auditor's role and responsibilities with respect to an Audit Engagement and the process of entering into an understanding/agreement with the Appointing Authority for the purpose of audit.

CSAS-2: Auditing Standard on Audit Process and Documentation which lays down the responsibilities and duties of the Auditor with respect to Audit Process in conducting audit and maintaining proper audit records.

CSAS-3: Auditing Standard on Forming of Opinion covers the basis and manner for forming Auditor's opinion on subject matter of the audit.

CSAS-4: Auditing Standard on Secretarial Audit covers the basis and manner for carrying out the Secretarial Audit.

However, the developments arising due to the spread of Covid-19 pandemic, the mandatory applicability of ICSI Auditing Standards CSAS-1 to CSAS-4 is extended for Audit Engagements accepted by the Auditor on or after 1st April, 202

These Standards are effective and recommendatory for Audit Engagements accepted by the Auditor on or after 1st July, 2019 and mandatory for Audit Engagements accepted by the Auditor on or after 1st April, 2021. Upcoming lessons are focusing on the CSAS-1 to CSAS-4.

LESSON ROUND-UP

- Audit of corporate governance processes provides assurance to the various stakeholders that all the required governance activities have been accomplished and which governance norms has not been satisfied by the company for assisting stakeholders in making an informed decision.
- Corporate Social Responsibility (CSR) audit help in measuring the actual social performance against the social objectives set by the Company.
- According to Section 2(a) of the Environmental Protection Act, 1986, 'Environment' includes a) Water, air and land b) The inter-relationship which exists among and between, (i) water, air, land, and (ii) human beings, other living creatures, plants, microorganisms and property.
- Forensic Audit is a dynamic and strategic tool in combating corruption, financial crimes and frauds through investigations and resolving allegations of fraud and embezzlement.
- A fraud triangle is a tool used in forensic auditing that explains three interrelated elements that assist the commission of fraud- Pressure (motive), opportunity (ability to carry out the fraud) and rationalization (justification of dishonest intentions).
- A social audit is a way of measuring, understanding, reporting and ultimately improving an organization's social and ethical performance. A social audit helps to narrow gaps between vision/ goal and reality, between efficiency and effectiveness.

- The audit can be classified in to two type of audit i.e. the Financial Audit and the Compliance Audit, the Financial Audit cover the Statutory Audit, Cost Audit and Internal Audit whereas the Compliance Audit cover the Secretarial Audit, CSR Audit, and Corporate Governance Audit, Take over Audit, Insider trading Audit, Labour law Audit, Cyber Audit, System Audit, Social Audit and Forensic Audit, Related Party Audit etc.
- Internal Audit is performed by professionals with an in-depth understanding of the business culture, systems, and processes. Internal audit activity provides assurance that internal controls in place are adequate to mitigate the risks, governance processes are effective and efficient, and organizational goals and objectives are met.
- Internal audit play a very important role in risk management, corporate governance and internal control.

GLOSSARY

Forensic Audit : Forensic Audit is a dynamic and strategic tool in combating corruption, financial crimes and frauds through investigations and resolving allegations of fraud and embezzlement.

Social Audit : A social audit is a way of measuring, understanding, reporting and ultimately improving an organization's social and ethical performance.

Investor Protection and Education Fund : Investor Protection and Education Fund administered by the SEBI under the SEBI Act, 1992.

Industrial Dispute : Means any dispute or difference between employers and employers, or between employers and workmen, or between workmen and workmen, which is connected with the employment or non-employment or the terms of employment or with the conditions of labour, of any person.

ISO 14001 : ISO 14001 is a voluntary international standard for environmental management systems ("EMS").

Forensic auditing : As new area of auditing to detect the frauds in companies that suspected fraudulent transactions.

CSAS : The Council of the Institute of Company Secretaries of India (ICSI) has approved the issuance of four ICSI Auditing Standards. The Standards are required to be observed by the Company Secretaries undertaking Audits. They are called CSAS.

TEST YOURSELF

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation)

1. Comment on the close relationship between Corporate Governance and SEBI (LODR) Regulations & Companies Act, 2013.
2. What is the purpose of CSR Audit?
3. Discuss the scope of Takeover Audit.
4. Discuss the scope and benefits of Industrial and Labour Audit.
5. What is Cyber Audit and write down its objectives?
6. Discuss the current scenario of Environment Laws in India.
7. Describe the System audit controls evaluation process
8. Forensic audit is unlike other audits. Comment.

9. What do you understand by Social Audit? State the implications of Social Audit.
10. Explain internal audit and its, objectives and scope.
11. Explain the role of internal audit in corporate governance, risk management and internal control.
12. The object of forensic auditing is to relate the findings of audit by examining and gathering legally
13. Rahul has recently started as a Company Secretary in Practice. He has got an assignment of internal audit. Advise Rahul about internal audit and its stepwise approach.
14. The Board of Directors of ABC Ltd. has received a letter from a whistle blow alleging insider trading by few members amongst the Senior Management. The Board has appointed you to perform the insider trading audit. Explain the essential factors enabling review and reporting of insider trading audit.
15. How monitoring and evaluation of effectiveness of the Organisation's Risk Management Process is carried out through internal audit ? Describe.
16. "Audit as a monitoring device is essential in corporate governance also". Substantiate the statement.

LIST OF FURTHER READINGS

- The Companies Act, 2013 rules made there under.
- SEBI Manual
- ICSI Manual on Secretarial Audit
- ICSI Guidance Note on Secretarial Audit
- Regulations, Circulars, Notifications etc. Issued by SEBI
- Handbook on Internal Audit of Operations of Depository Participants.

OTHER REFERENCES (Including Websites / Video Links)

- https://www.mca.gov.in/content/mca/global/en/home.html
- https://www.sebi.gov.in
- https://www.indiacode.nic.in
- https://www.iiaindia.co/images/PDF/Certification-Candidate-Handbook.pdf298

Audit Engagement

Lesson 9

KEY CONCEPTS

■ Conflict of Interest ■ Confidentiality ■ Preconditions of accepting professional engagement ■ Audit Engagement ■ CSAS-1 ■ Appointing Authority ■ Auditing Standard

Learning Objectives

To understand:

- The meaning of audit engagement offer and acceptance of audit engagement.
- The procedures and authority for appointment of Auditors.
- Various requirement of laws and the point which should be considered while taking up the audit engagement by any professional.
- What are the factors to be considered while charging audit audit fees and expenses.
- What are the types of audits which may be undertaken by company secretaries under various statutes.
- The concept of conflict of interest and substantial conflict of interest.

Lesson Outline

REGULATORY FRAMEWORK

- Section 92, 138, 139, 141, 142, 149, 178, 179, 204 of Companies Act, 2013.
- Schedule I and II of Companies Secretaries Act, 1980.
- CSAS – 1 on Auditing Standard on Audit Engagement

MEANING OF AUDIT ENGAGEMENT

An audit engagement is an arrangement wherein an auditor perform an audit of the transaction of the auditee for which he has been engaged by the auditee. The audit engagement is a contractual arrangement by way of the Audit Engagement letter between the auditee and the auditor.

ICSI issued CSAS-1 – Auditing Standard on Audit Engagement effective from 1st April, 2021, which defines:

"Audit Engagement" means detailed terms of reference of appointment including scope of audit, remuneration and limiting conditions, if any."

Question: *CSAS-1 is mandatory for audit engagements accepted on or after.....*

Answer: *April 01, 2021.*

Question: *What is the scope of CSAS-1 and what does it deal with?*

Answer: *CSAS-1 is applicable to the Auditor undertaking Audit Engagement under any statute. The Standard deals with the Auditor's role and responsibilities with respect to an Audit Engagement and the process of entering into an understanding/agreement with the Appointing Authority for the purpose of audit.*

Offer and acceptance of the Audit Engagement

The offer for the audit engagement may be initiated either by the Auditee or by the auditor. However it is necessary that the engagement are accepted by the auditors and the auditor fulfils the various criteria for acting as an auditor prescribed in the various applicable laws. For example in case of the statutory audit the auditor shall fulfil the eligibility criteria as prescribed under section 141 of the Companies Act, 2013.

An auditor may be appointed either as a result of one to one communication between the auditor and the Management or through a tendering process followed by the Management.

CASE STUDY

Offer:

PQS Company, a trading company, is looking to engage an internal auditor for the financial year 2022-2023. The company sends an email to ABC & Associates (Practicing Company Secretaries Firm), outlining the scope of the audit, the timeframe for completion, the audit fee, and any other terms and conditions that are relevant.

"We would like to engage your services to conduct an internal audit for the financial year 2022-2023. The audit should cover all aspects of our Internal control effectiveness; Statutory, procedures and control compliance; Implementation of recommendations; Corporate governance; Systems development; Process improvement; and Value for money and Best Value. The audit should be completed within four months of engagement. We are willing to pay a fee of INR 5,00,000 for this engagement. Please let us know if you are willing to accept this engagement, and if so, we can proceed with the necessary paperwork."

Acceptance:

ABC & Associates (Practicing Company Secretaries Firm) reviews the offer and responds with an acceptance that includes any additional terms or conditions they may have.

"Thank you for offering us this internal audit engagement. We are pleased to accept this engagement under the terms outlined in your email. In addition, we would like to include a clause that states that any findings from the audit will be presented before the audit commitee. We will also require access to all financial records and documentation related to this engagement. If this is agreeable to you, we can proceed with the necessary paperwork."

Once both parties have agreed to the terms of the engagement, they can proceed with the necessary paperwork, such as an engagement letter.

In case the auditor is to be appointed by the management on one to one basis, following steps should be taken care by the auditor:

Step 1

- Selection or screening of prospective auditee based on following risk / assessment:

Client acceptance and engagement risk e.g. highly leveraged client, habitually litigant client, in the media for wrong reason, pledging of shares by the promoter group, PE involvement.

Performance Risk – capacity, resources etc

Engagement Contract Risk

Reputation Risk

Commercials

Step 2

- Communicating his willingness to take up the audit assignment.

Step 3

- Conducting a pre- engagement meeting with the management.

The meeting may inter-alia include discussion about the terms of engagement, to discuss about the terms of engagement, prior year audit results, appropriateness of reporting framework, understanding business and environment including internal control system, design & operation, audit process, periodicity of audit, determining nature and conflict of interest, prior year audit findings and conclusions, appropriateness of reporting framework, understanding Auditee's business operations and environment including internal control system, commercial terms of the audit and the timelines and milestones, if any, for conducting the Audit and submission of the Audit Report. Auditor shall disclose in the pre-engagement meeting conflict of interest, if any, with the Auditee. The Auditor shall be under Confidentiality obligation with respect to the information obtained during the pre-engagement meeting.

Step 4	● Signing the engagement letter with the Management and issuance of certificate by auditor before accepting an audit.

In case where the appointment of auditor is through a tendering process by the management:

Step 1	Pre-bid meeting with the management to discuss upon various aspects of the tender, scope of work terms of engagement, prior year audit results, appropriateness of reporting framework, understanding business and environment including internal control system, design & operation, audit process, periodicity of audit determining nature and conflict of interest etc.
Step 2	Submission of technical bid as per the requirements of the tender document of the management.
Step 3	Signing the engagement letter with the management.
Step 4	Certificate by auditor before accepting an audit.

The Auditor shall furnish a certificate to the Appointing Authority that:

(a) The number of audits are within the ceiling prescribed by the ICSI as specified in para 2 of CSAS 1.

(b) No substantial conflict of interest as defined in para 3 of CSAS-1 exists with the Auditee.

(c) There is no restriction to render the professional services under ICSI Guidelines.

(d) He is not debarred to undertake such audit under any law or under the disciplinary mechanism of the ICSI.

Preconditions of accepting/continuing any professional engagement

Prior to acceptance of any Audit engagement, the auditor, in order to establish whether the preconditions for accepting professional assignment are present, the auditor should check that:

(a) Whether the reporting framework as required in the preparation, performance of audit, review of the secretarial/ non-financial statements is acceptable; and

(b) Whether the management is in agreement to acknowledge and understands its responsibility relating to:

  (i) Preparation of the secretarial/ non-financial statements in accordance with the applicable reporting framework, including their fair presentation;

  (ii) Development of internal control/systems/procedure to enable the preparation of secretarial/ non-financial statements which are free from material misstatement, whether due to fraud or error; and

  (iii) Providing:

    (a) Access to all information of which management is aware that is relevant to the preparation/ audit/ review etc. of the secretarial/ non-financial statements such as records, documentation and other matters;

    (b) Additional information that the auditor may request from management for the relevant purpose; and

(c) Unrestricted access to persons within the company from whom the auditor determines it necessary to obtain audit evidence.

Limitation on scope prior to Engagement Acceptance

If management or appointing authority impose a limitation on the scope of the auditor's work in the terms of a proposed audit engagement such that the auditor believes the limitation will result in the auditor disclaiming an opinion on the Secretarial records/non-financial statements, the auditor shall not accept such a limited engagement as an audit engagement, unless required by law or regulation to do so.

Other factors affecting Engagement Acceptance

If the preconditions for an audit/professional assignment are not present, the auditor should discuss the matter with management. Unless required by law or regulation to do so, the auditor should not accept the proposed audit engagement:

(a) If the auditor assesses that the reporting framework to be applied in the preparation of the secretarial records/ non-financial statements is unacceptable, or

(b) If the agreement has not been concluded.

(c) Reference to the expected form and content of any reports and a statement that there may be circumstances in which a report may differ from its expected form and content.

If any law or regulation prescribes sufficient detail of the terms of the engagement referred to above, there is no need to record them in a written agreement, except for the fact that such law or regulation applies and that management acknowledges and understands its responsibilities.

Criteria for declining and withdrawing from an Engagement

Based on the evaluation of client information and the following factors, the auditor should determine and document the conditions beyond which it would be prudent to decline, or withdraw from an engagement:

(a) Client's status/information that is likely to impact adversely on the independence of the firm.

(b) Ability of the firm to provide appropriate service to the client, considering needs for technical skills, knowledge of the industry and personnel.

(c) Consider circumstances which would cause the firm to regard the engagement as one requiring special attention or presenting unusual risks.

APPOINTING AUTHORITY

The appointing authority means the person who is appointing the Auditors of the company. The Auditee under the Statute could be a company or any other form of entity. Appointing Authority will depend upon the type of the Auditee. In case the Auditee is a company, the Appointing Authority would be the Board of company or members of the company, as the case may be, as the case may be, and in other cases, it would be the persons who have been entrusted with the responsibility of governance and compliances of the Auditee. Further, the Appointing Authority may also include Court, Tribunal or Regulator or any officer thereof.

CASE LAW

In the matter of *Kingston Cotton Mill Co. (No. 2) [1896] 2 Ch. 279*, the case involved a dispute between the shareholders and the directors of a company over the appointment of an auditor. The shareholders had passed a resolution to appoint an auditor, but the directors refused to comply with the resolution. The honourable court held that the shareholders of a company have the right to appoint an auditor, and that the directors of the company cannot interfere with this right.

ICSI auditing standard CSAS-1 (Auditing Standard on Audit Engagement) effective from 1st April, 2021, defines: "Appointing Authority" means any person having authority to appoint the Auditor.

"Auditee" means a person subject to audit.

Under the provision of the Section 139 of the Companies Act, 2013, it has been specifically provided that the first statutory auditor shall be appointed by the Board of Directors of the company within 30 days of the incorporation of the company, however, subsequent auditors shall be appointed upon the recommendation of the board or the audit committee of the company, if any, by the members at the general meeting of the company.

For example, to conduct audit of the function and activities of the company in case of Secretarial Audit under Section 204 of Companies Act, 2013 or Clause 24A of the SEBI (LODR) Regulations, 2015 and Internal Audit under Section 138 of Companies Act, 2013, the Appointing Authority would be the Board of the Company. It may be noted that the internal auditor may or may not be the employee of the company.In case where the tribunal/ official liquidator by exercising his power, appointed the auditor, the tribunal/ official liquidator is considered as the appointing authority.

In case where the law specifically provides for the appointing authority and the appointing authority may authorize such person to sign the engagement letter, however instances where the law has not provided, the person who signs the engagement letter in official capacity can be considered as the appointing authority.

In case, the Auditee is under Corporate Insolvency Resolution Process, the Appointing Authority shall be the Resolution Professional.

In case of Audit of Depository Participants, the Appointing Authority may depend upon the type of Auditee, e.g. if the Depositary Participant is a company then the Appointing Authority will be the Board or in case of an LLP it could be the designated partner or any other partner as may be authorised to appoint the Auditor.

Similarly, in case of Internal Audit of Stock Brokers, Internal Audit of Investment Advisors, Internal Audit of Portfolio Managers, Internal Audit of Credit Rating Agencies and Internal Audit of Research Analysts, the Appointing Authority would depend upon the type of Auditee.

Types of appointing authorities	
First statutory auditor of the Company	Board of Directors or members in EGM
Statutory Auditor	Members in AGM
Secretarial Auditor	Board of Directors
Internal Auditors	Board of Directors
Auditee is under Corporate Insolvency Resolution Process	Resolution Professional
Tribunal/ official liquidator by exercising his power	Tribunal/Official Liquidator
Audit of Depository Participants	Director /Designated etc. partner depends on nature of Organisation
Internal Audit of Stock Brokers	Depends upon the type of auditee

CASE STUDY

Sun Moon Limited is a listed company and operates in the manufacturing sector. In January 2023, the company received a notice from the Securities and Exchange Board of India (SEBI) stating that Sun Moon Limited had failed to comply with several provisions of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015. The SEBI notice also required the company to appoint a practicing company secretary to conduct a secretarial audit of its records and submit a report to SEBI.

The board of directors of Sun Moon Limited have decided to appoint a M/S RR & Associates (Practicing Company Secretaries Firm) to conduct the secretarial audit and passed the Board resolution in their meeting.

However, Mr. Abhinav (shareholder) of the company challenged the appointment of the secretarial auditor in court, stating that the board did not have the authority to appoint the auditor and that the appointment should have been made by SEBI. The matter was reffered to court.

The court examined the provisions of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, and found that the regulations did not specify who had the authority to appoint a secretarial auditor. However, the court noted that the regulations required the secretarial auditor to be appointed by the company to conduct the audit.

Based on these findings, the court ruled that the board of directors of Sun Moon Limited had the authority to appoint the secretarial auditor, and that the appointment was valid. The secretarial audit was conducted, and the report was submitted to SEBI. Sun Moon Limited took corrective measures to rectify the non-compliances identified during the audit.

Terms and Conditions of Audit engagement

The objective and scope of every audit is dependent on the four corners of the terms and conditions which also include the scope of audit as agreed by and between the auditee and the auditors of the company. This requires the specific attention of the auditors and auditee on the following points:

- The objective and purpose of the audit;
- The responsibilities of the auditor;
- The responsibilities of management/ Auditee;
- The audit risk;
- The audit limitation;
- The audit plan.

This is essential that the auditor as well as the auditee should agree upon the terms of audit engagement and documented the same in the audit engagement letter or other suitable form of written agreement which can be referred on any conflict arising during the course of audit.

In case of instances where due to change in the governing laws the amended law should be considered in the performance on the audit, however, any request in the change of the terms of audit engagement should be considered by the auditor on its merit and shall be properly documented by the auditors.

AUDIT FEE & EXPENSES

Audit fee which is to be charge by the auditor depends on several factors, which includes:

- Size of the organization;
- Nature of business;
- Internal Controls systems & Technology adopted;
- Scope of audit;
- Frequency of audit etc.

Audit fees should be a fair reflection of the value of the work performed for the auditee, taking into account the above mentioned factors. However, the Audit services should not be offered or rendered under an arrangement whereby no fee will be charged unless specified findings or results are obtained, or where the fee is otherwise contingent upon the findings or results of such services, and fees should not be regarded as being contingent if fixed by a court or other public authority. Also the charge or accept a fee for professional work on a percentage basis is not advisable except where that course is authorized by statute or has been approved by a member body as generally accepted practice for certain work.

Auditors should not accept a very low level of fee as a result of competing for business. Also not to enter in to price competition and deplored in the profession, as it could impair the auditors' independence and deteriorate

the quality of the auditing service. However, charging a lower fee than has previously been charged by another auditor for similar work is not restricted in any law.

In case of Statutory Auditors, Section 142 of the Companies Act, 2013 provides that the remuneration to the Auditors shall be fixed in the general meeting of the company, also the auditor can claim the expenses incurred by him in connection with the audit of the company.

Similarly, In case of the Secretarial Audit and the Internal Audit, the Audit fee shall be decided by the Audit committee or by the board of the company.

CASE STUDY

In Re *R. Swarup Reddy Vs. M.N Pratap Reddy, NCLAT New Delhi, Company Appeal (AT) Nos. 77 & 121 Of 2018,* in this matter CLB appointed Independent auditors for auditing books of account the company. Auditors completed their work and claimed fees of Rs. 36.16 lakh. The director company stated that fees claimed by auditors was on higher side and at best they were entitled for a fees of Rs. 8 lakh.

The Court observed that said auditors had not only done audit but also did investigation, particularly with reference to related party transactions entered at instance of appellant with its two sister companies for period from 1-4-2007 to 31-3-2014. Further, amount claimed by said auditors was supported by number of days spent and composition of people working on assignment. It was also observed that appellant had paid nearly Rs. 62 lakh for auditing of sister concerns for same period. Therefore, fees claimed by auditors were reasonable. Court was justified in directing the company to remit to said auditors entire claimed amount.

The clause pertaining to Audit fees and expenses in the Audit Engagement Letter may be reflected as:

> *"V. Commercial Terms*
>
> *Audit fees for the F.Y. 20XX-XX is fixed at Rs. XXXXXXX plus applicable taxes. Fees will be billed as the work progresses.*
>
> *Out–of-pocket expenses by the Auditor shall be reimbursed on actual basis".*

AUDITING STANDARD ON AUDIT ENGAGEMENT (CSAS-1)

ICSI Guidance Note on Audit Engagement

The Auditing Standard on Audit Engagement (CSAS-1) is applicable to the Practicing Company Secretaries (PCS) as defined in the Company Secretaries Act, 1980, who undertake the audit assignment envisaged under the Companies Act, 2013 or Securities and Exchange Board of India Act, 1992 or any other law prevailing in India.

CSAS-1 is not applicable for Audits entrusted on a voluntary basis by the Auditee to the Auditor. However, adherence to the Standard is recommended in respect of Audits entrusted on voluntary basis also.

In case of appointment by Court, Tribunal or Regulatory Authority, CSAS-1 shall apply to the extent possible, since the manner of appointment and terms of engagement in such cases shall be as per the directions of the Court, Tribunal or Regulatory Authority.

Following is an illustrative list of Audits which may be undertaken by a Company Secretary under various Statutes:

Type of Audit	Act/Regulation	Section/ Regulation	Auditee
Secretarial Audit	Companies Act, 2013	204	Company
Secretarial Audit	SEBI (LODR) Regulations, 2015	24A	Listed Entities

Type of Audit	Act/Regulation	Section/ Regulation	Auditee
Internal Audit	Companies Act, 2013	138	Company
Audit of Depository Participants	SEBI (Depositories and Participants) Regulations 2018 read with SEBI circular no. SEBI/HO/ MRD/ DOP2-DSA2/ CIR/P/2019/22 dated January 23, 2019	76	Sole Proprietorship, Partnership Firm, LLP, Company
Internal Audit of Stock Brokers	SEBI (Stock and sub-broker) Regulations, 1993	SEBI circular no. MIRSD/ DPSIII/ Cir-26/ 08	Sole Proprietorship, HUF, Partnership Firm, LLP, Company
Internal Audit of Investment Advisors	SEBI (Investment Advisors) Regulations, 2013	19(3)	Sole Proprietorship, Partnership Firm, LLP, Company
Internal Audit of Portfolio Managers	SEBI (Portfolio Managers)Regulations, 1993	SEBI circular no. IMD/ PMS/CIR/1/21727/ 03 dated November 18, 2003	Body Corporate
Internal Audit of Credit Rating Agencies	SEBI (Credit Rating Agencies) Regulations 1999	SEBI circular no.MRD/ CRA/CIR-01/2010 dated January 06, 2010	Public Financial Institution, Scheduled Commercial Bank, Foreign Bank operating in India with RBI approval, Foreign Credit Rating Agency recognised by or under any law, Company, Body Corporate
Internal Audit of Research Analysts	SEBI (Research Analysts) Regulation, 2014	25(3)	Sole, Proprietorship, Partnership Firm, LLP, Company

While auditing under any of the statutes, the Auditors are required to examine the Records, documents and information from the Auditee to express an independent opinion. Therefore, it becomes very important to understand the scope of audit.

The CSAS-1 deals with the Auditor's responsibilities while agreeing to the terms of Audit Engagement and entering into an agreement with the Management or those charged with governance. This includes principal contents of an Audit Engagement Letter and also the duties and responsibilities of the Auditor and the Auditee in case of a change in terms of engagement, if any.

New Audit Engagement – Covers an audit being conducted first time and therefore the appointment of the Auditor is an initial appointment. It will also cover the situations where the audit for the previous period was conducted by another Auditor.

Recurring Audit Engagement – Covers the situation where the Auditor had conducted the audit for the previous period and is requested to conduct the audit for the subsequent period as well. In such a case, the Auditor should obtain fresh Audit Engagement Letter if the period of engagement has expired, including revised terms if the circumstances so require Auditor shall adhere to the Standard even if the Audit Engagement is a continuing one.

Changes in terms of Audit Engagement – Whenever there is a change in the terms of Audit Engagement in the middle of an ongoing audit, the Auditor shall adhere to the Standard and initiate a revised Engagement Letter in terms of this Standard.

Definitions:

"Auditor" means a member of the ICSI who holds a valid Certificate of Practice under Section 2(2) of the Company Secretaries Act, 1980. It includes a firm or Limited Liability Partnership (LLP) registered with ICSI and whose partners are members of the ICSI.

The term "Management" includes Board of Directors and persons who have been entrusted with the responsibility of governance and compliances of the Auditee like In case of Companies.

The term "persons who have been entrusted with the responsibility of governance and compliances of the Auditee" include the Key Managerial Personnel as defined under Section 2(51) of the Companies Act, 2013 and senior

As per Section 2(51) of Companies Act, 2013: "Key Managerial Personnel", in relation to a company, means –

(i) the Chief Executive Officer or the Managing Director or the Manager;
(ii) the Company Secretary;
(iii) the whole-time Director;
(iv) the Chief Financial Officer;
(v) such other officer, not more than one level below the directors who is in whole-time employment, designated as Key Managerial Personnel by the Board; and
(vi) such other officer as may be prescribed.

As per Regulation 16(1)(d) of SEBI (LODR) Regulations, 2015 : "Senior Management" shall mean officers/ personnel of the listed entity who are members of its core management team excluding board of directors and normally this shall comprise all members of Management one level below the Chief Executive Officer/Managing Director/ whole time Director/ Manager (including Chief Executive Officer/Manager, in case they are not part of the board) and shall specifically include Company Secretary and Chief Financial Officer:

Explanation to Section 178 of the Companies Act, 2013, describes that "Senior Management'' means personnel of the company who are members of its core Management team excluding Board of Directors comprising all members of Management one level below the Executive Directors, including the functional heads.

In case of Auditee other than companies, the term "persons who have been entrusted with the responsibility of governance and compliances of the Auditee" shall include any person or employee of the Auditee as may be authorised. For example, in case of an LLP, Management includes the partners or designated partners or any officer of the LLP entrusted with such responsibility.

In case of a Proprietorship, Management means the proprietor or any officer authorised by him.

"Predecessor or Previous Auditor" means an Auditor who has conducted the most recent audit assignment of the Auditee and submitted report thereon prior to the incumbent Auditor or was engaged but did not complete the audit assignment due to his resignation, termination or otherwise. An Auditor who has completed the assignment and has not been reappointed or an Auditor who had been appointed but has not completed the assignment due to resignation, termination or otherwise, shall be deemed to be a "Predecessor or Previous Auditor" for the same assignment.

AUDIT ENGAGEMENT PROCESS

Pre-Engagement Meeting

Before accepting the Audit Engagement, the Auditor should have a pre-engagement meeting with the Auditee. The meeting may inter-alia include discussion about the terms of engagement, prior year audit findings and conclusions, appropriateness of reporting framework, understanding Auditee's business operations and environment including internal control system, commercial terms of the audit and the timelines and milestones, if any, for conducting the Audit and submission of the Audit Report. Auditor shall disclose in the pre-engagement meeting conflict of interest, if any, with the Auditee.

The Auditor shall be under Confidentiality obligation with respect to the information obtained during the pre-engagement meeting.

Appointment

The appointment of Auditor shall be made in the manner prescribed in the applicable laws, act, rules, regulations, standards and guidelines and in case no such manner has been prescribed, such appointment shall be made in the manner determined by the Appointing Authority.

Before accepting an audit, the Auditor shall furnish a certificate to the Appointing Authority that:

(a) The number of audits are within the ceiling prescribed by the ICSI as specified in para 2 of CSAS 1.

(b) No substantial conflict of interest as defined in para 3 of CSAS-1 exists with the Auditee.

Illustration:

Section 179(3)(k) of Companies Act, 2013 read with Rule 8(4) of Companies (Meeting of Board and its Powers) Rules, 2014 requires that the Internal Auditor and Secretarial Auditor of the company shall be appointed by passing a resolution at a duly convened meeting of the Board.

Therefore, the appointment of Internal Auditor/Secretarial Auditor cannot be made by passing a resolution by circulation.

Further, the said appointment cannot be made by Key Managerial Personnel or Senior Management, even if authorised by the Board in this regard.

(c) There is no restriction to render the professional services under ICSI Guidelines.

(d) He is not debarred to undertake such audit under any law or under the disciplinary mechanism of the ICSI.

A Specimen Eligibility Certificate is placed at Annexure A.

The Auditor shall obtain an Audit Engagement Letter along with a copy of the resolution, if any, passed by the Appointing Authority and shall provide acceptance to the Appointing Authority.

The Auditor may give his acceptance to undertake the audit either on the copy of the Audit Engagement letter or through a separate letter. The acceptance may also be communicated through an email.

Audit engagement letter

The engagement letter provides the opportunity to detail the scope of the Audit Engagement and to define the responsibilities between the Auditor and the Auditee.

It is in interest of both the management and the auditor that the auditor should get an audit engagement letter before the commencement of the audit to help avoid misunderstandings with respect to the terms of engagement. In some entities, however, the objective and scope of an audit and the responsibilities of management and of the auditor may be sufficiently established by law, in that case, the engagement letter may

give a reference to the fact that relevant law or regulation applies and that management acknowledges and understands its responsibilities for preparation and maintenance of records and for devising proper systems to ensure compliance with the provisions of applicable laws and regulations.

It should be reviewed every year to ensure that it is up to date but does not need to be reissued every year unless there are changes to the terms of the engagement. The auditor shall obtain a new engagement letter if the scope or context of the assignment changes after initial appointment.

It documents the terms of Audit Engagement agreed between the Auditor and the Appointing Authority with reference to scope of audit, responsibilities of Auditor and Auditee, remuneration and limiting conditions, if any.

The Audit Engagement Letter shall *inter alia* include:

a. The objective and scope of the audit;

b. The responsibilities of the Auditor and the Auditee;

c. Written representations provided and/or to be provided by the Management to the Auditor, including particulars of the Predecessor or Previous Auditor;

d. The period within which the audit report shall be submitted by the Auditor, along with milestones, if any;

e. The commercial terms regarding audit fees and reimbursement of out of pocket expenses in connection with the audit; and f. Limitations of audit, if any.

Where the objective and scope of the audit and responsibilities of the Management and of the Auditor have been established by law, the Audit Engagement Letter shall give a reference to the provisions of the relevant law along with a statement that the Management acknowledges and understands its responsibilities for preparation and maintenance of records and for devising proper systems to ensure compliance with the provisions of applicable laws, act, rules, regulations and standards for the time being in force.

The Auditor shall agree upon the terms of Audit Engagement with the Appointing Authority which shall be documented in an Audit Engagement letter.

The Responsibilities of Auditor *inter alia* include the following:

- To take up the audit as per the terms of the engagement.
- To depute personnel who have the knowledge of the laws under which the audit is being carried out, subject to his overall supervision.
- To observe and ensure observance of highest standards of ethics and maintain utmost professionalism at all times by the employees, staff and other team members involved in the Audit and persons engaged by him to provide advice or assistance for the conduct of audit.
- To maintain and ensure confidentiality by the employees, staff and other team members involved in the audit and persons engaged by him to provide advice or assistance for the conduct of audit.
- To not trade in securities relating to which unpublished price sensitive information has come to his/her knowledge during the course of audit, which responsibility shall extend to the employees, staff and other team members involved in the audit and persons engaged by him to provide advice or assistance for the conduct of audit also.

Responsibilities of Auditee *inter alia* include:

- To provide access to premises of the Auditee and timely access to Records, documents, legal opinions, show cause notices, inspection reports and other information, explanations and reports as may be necessary in connection with the audit.
- To identify and depute a responsible official to timely provide relevant documents, information and explanations required by the Auditor.

- To provide written Management representations, if any, to the Auditor during the course of audit, which shall provide the Auditor a substantive evidence of important assertions and the Management's primary responsibility for the assertions and its accuracy.
- To provide details of the Predecessor or Previous Auditor, so as to enable proposed Auditor to communicate with the Predecessor or Previous Auditor.

Audit remuneration and expenses may depend on several factors including:

— Size of the organisation;
— Location of business and its branches;
— Type of company (Listed/Unlisted);
— Sector to which company belongs;
— Nature of business;
— Internal control mechanism;
— Scope of Audit Engagement;
— Frequency of audit, whether monthly, quarterly, yearly;
— Type of audit, whether sole, joint or concurrent audit;
— The experience of the Auditor in conducting audits;
— Estimated man-hours required to complete the assignment;
— Guidance/Advisory issued by the ICSI, if any;
— Any other term or a combination of any of the above.

Audit fees should be a fair reflection of the value of the work performed for the Auditee, considering the above factors. Quantum of fees, billing arrangement and terms of payment shall be mentioned in the Audit Engagement letter.

The Audit fee shall not be contingent upon findings or results of the audit. However, fees shall not be regarded as being contingent if fixed by a court or other public authority.

The Auditor is not permitted to pay a commission to obtain an audit nor shall he accept a commission for referral of an Auditee to a third party. He shall not accept a commission for the referral of the products or services of others.

As per Clause 2 of Schedule I of the Company Secretaries Act, 1980: A Company Secretary in Practice shall be deemed to be guilty of professional misconduct, if he pays or allows or agrees to pay or allow, directly or indirectly, any share, commission or brokerage in the fees or profits of his professional work to any person, other than a member of the Institute or a partner or a retired partner or the legal representative of a deceased partner.

As per Clause 9 of Schedule I of the Company Secretaries Act, 1980: A Company Secretary in Practice shall be deemed to be guilty of professional misconduct, if he charges or offers to charge, accepts or offers to accept, in respect of any professional employment, fees which are based on a percentage of profits or which are contingent upon the findings, or result of such employment, except as permitted under any regulation made under this Act.

Auditor should include a statement in the Audit Engagement Letter that because of inherent limitations of an audit, inherent limitations of internal control, an unavoidable risk exists that some material non-compliance may not be detected, even though the audit is properly planned and performed in accordance with the applicable Auditing Standards.

Audit Engagement Letter should also specify that arrangements concerning the involvement of third party and experts in some aspects of the Audit.

If the Appointing Authority has imposed a limitation on the scope of the Auditor's work in the terms of engagement and the Auditor believes that such limitation will result in lower level of assurance than what is required under law, the Auditor shall not accept such an engagement, unless required by law or regulation to do so.

Specimen Audit Engagement Letter is placed at Annexure B.

Communication to Previous Auditor

As a measure of the professional etiquettes, while taking up the any audit engagement, the auditors shall give intimation to the previous auditor, intimating his engagement as auditors of the company. The term predecessor or previous auditor can be defined as an auditor who has conducted the most recent audit assignment of the Auditee of the same nature and submitted report thereon prior to the incumbent auditor or was engaged but did not complete the audit assignment due to his resignation, termination or otherwise.

CASE LAW

In Re, *Ssay & Associates v. Institute of Chartered Accountants of India, HC of Delhi W.P. NO. 7674*, it was held that there is no requirement for an auditor to secure a no objection certificate from previous auditor as only requirement is that auditor, who accepts position as an auditor, must communicate with previous auditor about same.

In case whenever a practicing company secretary is appointed as secretarial auditor in place of the existing secretarial auditor, he should communicate the appointment to the earlier incumbent in writing.

Illustration

Mr. P was appointed as the Secretarial Auditor of ABC Ltd. for the F.Y. 2019-20. However, during the course of audit, he intimated the Appointing Authority his inability to complete the audit of ABC Ltd. and therefore cannot give audit report thereon. ABC Ltd. accepted the request of Mr. P and approached Mr. Q to become the secretarial Auditor for F.Y. 2019-20.

In such case, Mr. Q has to first communicate to the Predecessor Auditor i.e. Mr. P of his intention to accept the secretarial audit assignment of ABC Ltd. and wait for 7 days from the date of intimation to Mr. P, before accepting the secretarial audit of ABC Ltd. for F.Y. 2019-20.

There should be an effective communication with the Predecessor or Previous Auditor, if any. Auditor should communicate with the Predecessor or Previous Auditor in such manner as to retain positive evidence of the delivery of the communication. Communication by a letter sent by Registered Acknowledgement Due or by courier or by hand against the written Acknowledgement or through an email would be in the normal course provide such evidence. The Auditor shall wait for a period of 7 days from the date of communication before accepting the audit.

In case any information is provided by the Predecessor Auditor, the Successor Auditor shall take cognizance of the same. The information obtained from the Predecessor may be useful in undertaking the audit. Such information shall remain confidential.

CASE STUDY

XYZ Limited is a listed company and recently hired a new secretarial auditor firm (M/s AA & Associates) to replace the previous auditor firm (M/s BB & Associates), who had been serving the company for two years. The M/s AA & Associates was made responsible for ensuring compliance with various regulations and guidelines and preparing audit report.

Challenge:

The primary challenge faced by XYZ Limited was to smoothly execute the transition of responsibilities between new and old auditors to communicate effectively with the M/s BB & Associates. This was crucial, as the new auditor would need access to all previous records, reports, and other information related to the company's secretarial audit.

Solution:

To address this challenge, the company's management decided to set up a meeting between the M/s AA & Associates and the M/s BB & Associates. During the meeting, the new auditor would have the opportunity to ask any questions, clarify any doubts, and obtain access to all relevant records and reports.

Results:

The communication between the previous secretarial auditor and the new auditor was successful as a written communication in form of email has been made by M/s AA & Associates to previous auditor, and the M/s AA & Associates was able to obtain all necessary information to perform their duties effectively. The information provided by the previous auditor was extremely useful, as it helped the new auditor to identify any areas of concern and address them promptly.

The Council of the Institute of Company Secretaries of India has resolved that it shall be mandatory for every Company Secretary in Practice, before accepting any of the following assignments, to communicate to the previous incumbent, in terms of terms of clause (8) of part I of the First Schedule to the Company Secretaries Act, 1980:

(i) Signing of Annual Return in Form MGT-7 under Section 92(1) of the Companies Act, 2013 and rule 11(1) of the Companies (Management and Administration) Rules, 2014.

(ii) Certification of Annual Return in Form MGT-8 under Section 92(2) of the Companies Act, 2013 and rule 11(2) of the Companies (Management and Administration) Rules, 2014.

(iii) Issuance of Secretarial Audit Report in terms of Section 204 of the Companies Act, 2013.

(iv) Issue of Secretarial Audit Report to material unlisted subsidiaries of Listed entities (whose equity shares are listed) under Regulation 24A of SEBI (LODR) Regulations, 2015.

(v) Issue of Annual Secretarial Compliance Report to Listed entities (whose equity shares are listed) under Regulations 24A of SEBI (LODR) Regulations, 2015.

(vi) Certification under SEBI (Listing Obligations & Disclosure Requirements) Regulations, 2015 that none of the directors on the board of the company have been debarred or disqualified from being appointed or continuing as directors of companies by the Board/ Ministry of Corporate Affairs or any such statutory authority under Schedule V, Part C, Clause (10)(i).

(vii) Certification under Regulation 40(9) of SEBI (LODR) Regulations, 2015 certifying that all certificates have been issued within thirty days of the date of lodgement for transfer, sub-division, consolidation, renewal, exchange or endorsement of calls/ allotment monies.

(viii) Conduct of Internal Audit of Operations of the Depository Participants registered with NSDL & CDSL under the provisions of the Depositories Act, 1996 read with SEBI (Depositories and Participants) Regulations,1996.

(ix) Certificate of Reconciliation of Share Capital Audit Vide Circular No. D & CC/FITTC/CIR-16/2002 Dated December 31st 2002 (Amended Vide Circular No. CIR/ MRD/DP/30/2010 Dated 06-09-2010) Issued By SEBI.

(x) Acting as Compliance Auditor under Third Party Certification/ Audit Scheme (Amendment), 2018 in the State of Haryana.

(xi) Issuance of Audit Report as provided under Regulation 76 the SEBI (Depositories and Participants) Regulations, 2018, by the unlisted public companies, to be submitted on a half-yearly basis to the

ROC, under whose jurisdiction the registered office of the company is situated, under the provisions of the Rule 9A(8) of the Companies (Prospectus & Allotment of Securities) Rules, 2014.

(xii) Diligence Reporting for Banks in case of multiple banking/consortium lending arrangements in terms of the circular issued by RBI.

(xiii) Conduct of Internal Audit of Depositary Participants.

(xiv) Conduct of Internal Audit of stock brokers/sub brokers under SCRA, 1956 and Rules and Regulations made thereunder.

Question: *Is communication to previous auditor required?*

Answer: *Yes, the Auditor shall communicate in writing to the predecessor or previous auditor, if any before accepting the audit engagement.*

Further, Council of ICSI has prescribed the following format to be issued by Company Secretaries under Clause 8 of the First Schedule of the Company Secretaries Act, 1980:

CS.....

Address .....

Dear Sir / Madam,

Sub.: Intimation in terms of Clause 8 of the First Schedule to the Company Secretaries Act, 1980.

I, CS ..... /We, M/s....., Company Secretary in Practice / Firm of Company Secretaries have been approached by the Management of M/s..... Limited to..... (list of professional services) for the FY ..... vide their letter No. ..... dated ..... We understand that earlier the abovementioned professional services were being rendered by your goodself/ firm to M/s. ..... Limited during the Financial Year .....

I / We request you to kindly take this communication as an intimation to be given to the previous incumbent in terms of Clause 8 of the First Schedule to the Company Secretaries Act, 1980.

Regards, CS .....

Membership No.ACS ..... / FCS .....

CoP No.....

For & Co./ & Associates, Company Secretaries

Firm Unique Code .....

Date: .....

Place: .....

Limits on Audit Engagements

An auditor shall not accept audit engagement beyond the limits of number of audits, if any, as may be specified under applicable laws or any other body governing such profession. Violation of the limits by the auditor may attract disciplinary actions against the auditor.

The fact that because of the inherent limitations of an audit, together with the inherent limitations of internal control, there is an unavoidable risk that some material misstatements or material non-compliances may not be detected, even though the audit is properly planned and performed in accordance with the applicable auditing standard.

To uphold the quality of services rendered by members of the Institute, the Institute has issued the following guidelines:

Guidelines	Guidelines Issued at
Limits for the issue of Secretarial Audit Reports: ● 10 Secretarial Audits per partner/ PCS, and ● an additional limit of 5 Secretarial Audits per partner/PCS in case the unit is peer reviewed. The limits will be applicable for the Secretarial Audit Reports issued for the FY2016-17 onwards)	235th meeting of the Council held on 11th February, 2016
Number of Annual Secretarial Compliance Reports to be issued by PCS are 5 (five) reports individually / per partner in each financial year w.e.f. 1st April, 2020 and an additional limit of 5 (five) ASCR individually/ per partner in case the unit has been Peer Reviewed.	260th meeting of the Council held on 4-5 May, 2019
In case of the following, Secretarial Audit/ Secretarial Compliance Report to be done by Peer Reviewed Units only: ● Top 100 companies as per market capitalization w.e.f April 1, 2020 ● Top 500 companies as per market capitalization w.e.f April 1, 2021 ● All listed companies w.e.f April 1, 2022 ● All companies w.e.f April 1, 2023	259th meeting of the Council held on 16th March, 2019

Test Yourself

Question: *Can an Auditor accept any number of audits?*

Answer: *The Auditors hall accept audit engagements within the limits of number of audits, if any, as may be under any law or by ICSI from time to time.*

CONFLICT OF INTEREST

CSAS-1 (Auditing Standard on Audit Engagement) effective from 1st April, 2021, defines: "Conflict of Interest" as: The Auditor shall not have any substantial conflict of interest with the Auditee. Any conflict of interest, other than substantial conflict of interest, must be disclosed by the Auditor before accepting the Audit Engagement or as soon as the Auditor becomes aware of the same, as the case may be.

The term conflict of interest term is defined below. It is expected that the Auditor shall not have any conflict of interest with the Auditee. If the Auditor has any such interest, it is the duty of the Auditor to disclose such interest/ conflict of interest to the Auditee before accepting the Audit Engagement.

The conflict of interest with the Auditee explained below shall not be construed as a substantial conflict of interest:

- Auditor holding not more than 2% paid up share capital or shares of nominal value of Rs. 50,000, which ever is lower or more than 2% voting power.
- Auditor indebted to the Auditee for an amount not exceeding Rs. 5,00,000.

- Auditor was in employment of the Auditee more than 2 year ago

  In above cases, the Auditor shall be eligible for undertaking the Audit Engagement only if he discloses such fact in writing before accepting the Audit Engagement or as soon as he becomes aware of the same, as the case may be.

  In following cases, it shall be construed that the Auditor has a substantial conflict of interest with that of the Auditee and he shall not accept any Audit Engagement from the Auditee.

- Auditor holding not more than 2% paid up share capital or shares of nominal value of Rs. 50,000 or holding not more than 2% voting power.
- Auditor indebted to the Auditee for an amount not exceeding or equal to Rs. 5,00,000 indebtedness that may seriously impair the independence of the Auditor, irrespective of the amount.
- Auditor was in employment of the Auditee more than 2 year ago.

In above mentioned cases, the Auditor is debarred from accepting such Audit Engagement.

Test Yourself

Question: *Can an auditor accept Audit engagement even if there is conflict of interest?*

Answer: *Yes. The Auditor can accept audit engagement where there is conflict of interest with the Auditee by making disclosure before accepting audit engagement or on becoming aware of such conflict. However in case of substantial conflict of interest Auditor cannot accept Audit engagement.*

Explanation

Substantial Conflict of Interest means:

Holding of more than 2% in the paid up share capital or shares of nominal value of rupees fifty thousand, whichever is lower or more than 2% voting power, as the case may be, by the Auditor singly or along with partners, spouse, parent, sibling, and child of such person or of the spouse, any of whom is dependent financially on such person.

Before accepting the audit, the Auditor shall disclose that there is no conflict of interest of ownership as specified in this Standard or prescribed in any law, act, rules and regulations under which the audit is being carried on.

Where there exists a substantial conflict of interest in the Auditee organisation, the Auditor cannot accept the Audit Engagement.

The limit of holding of more than 2% in the paid-up share capital or shares of nominal value of rupees fifty thousand, whichever is lower or more than 2% voting power shall be applied based on combined holding of the Auditor along with partners, spouse, parent, sibling, and child of such person or of the spouse, any of whom is dependent financially on such person.

Illustration 1

Mr. A, Mr. B and Mr. C are partners in ABC, LLP, a firm of Practicing Company Secretaries. Mr. B holds 1% paid-up share capital in a company XYZ Ltd. Wife and daughter of Mr. A, who are financially dependent on him hold 1% paid-up share capital in XYZ Ltd. each.

Mr. A has been offered the Secretarial Audit of XYZ Ltd.

In this case, Mr. A is not directly holding any interest in XYZ Ltd. However according to para 3.1 of CSAS-1, Mr. A is having a substantial conflict of interest in XYZ. Ltd. as the aggregate value of paid-up share capital held by his wife, daughter and partner in XYZ Ltd. is 3%. Hence, he is not eligible to become Secretarial Auditor of XYZ Ltd.

Illustration 2

Mr. A, Mr. B and Mr. C are partners in ABC, LLP, a firm of Practicing Company Secretaries . Mr. A holds 1% paid-up share capital in a company XYZ Ltd. and Mr. B holds shares of nominal value of Rs. 60,000 in XYZ Ltd.

Mr. A has been offered the Secretarial Audit of XYZ Ltd.

In this case, though Mr. A holds only 1% of the paid up share capital in XYZ Ltd. But according to para 3.1 of CSAS-1, he is having a substantial conflict of interest in XYZ. Ltd. as his partner Mr. B is having a share capital of nominal value of more than Rs.50,000 in XYZ Ltd. and therefore Mr. A is not eligible to become Secretarial Auditor of XYZ Ltd

Illustration 3

Mr. A, Mr. B and Mr. C are partners in ABC, LLP, a firm of Practicing Company Secretaries. Mr. A & Mr. B each holds 0.5% paid-up share capital in a company XYZ Ltd. Nominal value of such shares held by each of them is Rs. 20,000. Mr. A has been offered the Secretarial Audit of XYZ Ltd.

In this case, though Mr. A is having a conflict of interest in XYZ Ltd. The same will not be considered as a substantial conflict of interest. Therefore, Mr. A can accept the Secretarial Audit of XYZ Ltd. In this case he shall disclose to the Appointing Authority the fact that he has a conflict of interest with the company, but the same is not substantial conflict of interest in accordance with CSAS-1.

Illustration 4

Mr. A, Mr. B and Mr. C are partners in ABC, LLP, a firm of Practicing Company Secretaries. Mr. A holds 1% of the paid-up share capital in company XYZ Ltd. Nominal value of such shares is Rs. 60,000. The market value of the shares held by Mr. A is Rs. 40,000. Mr. A has been offered the Secretarial Audit of XYZ Ltd.

In this case, there will be a substantial conflict of interest between Mr. A and the company XYZ Ltd. as the nominal value of shares held by Mr. A is more than Rs. 50,000, therefore he cannot accept the Secretarial Audit of XYZ Ltd. The market value of the shares is irrelevant while deciding the conflict of interest based on ownership in accordance with CSAS-1.

Illustration 5

Mr. A, Mr. B and Mr. C are partners in ABC, LLP, a firm of Practicing Company Secretaries. Mr. A holds 1% of the paid-up share capital in company XYZ Ltd. Nominal value of such shares is Rs. 60,000. XYZ Ltd. wants to give its Internal Audit assignment to ABC, LLP.

In this case, there exists a substantial conflict of interest of ABC, LLP with the company XYZ Ltd. due to the fact that one of the partners of the LLP is holding shares of a nominal value of more than Rs. 50,000 in XYZ Ltd. Therefore, it will not be eligible to undertake the internal audit assignment of XYZ Ltd. as per CSAS-1.

Indebtedness of the Auditor for an amount exceeding rupees five lakh other than that arising out of ordinary course of business of the Auditee:

Provided that any indebtedness that may seriously impair his independence shall also be considered as substantial conflict of interest.

Before accepting the audit the Auditor shall disclose that there is no conflict of financial interest as specified in this standard or prescribed law under which the audit is carried on.

The limit of rupees five lakh as specified shall be applicable to the combined indebtedness of the audit firm including indebtedness by the partners in their individual capacity.

The term "ordinary course of business" has not been defined. An assessment of whether a transaction is in "ordinary course of business" can be subjective and may vary on case-to- case basis.

For example, a banking company which in ordinary course of business provides loan or gives guarantees/ securities for the due repayment of any loan and in respect of such loans an interest is charged at a rate not less than the prevailing lending rate , may extend loan to its Auditor as per the terms and conditions of the company and such loan shall not be treated as conflict of financial interest.

Illustration 1

Mr. A is a Practicing Company Secretary. He has taken a personal loan of Rs. 5,00,000 from a XYZ LLP wherein Mr. B, who is the designated partner is friend of Mr. A. The payment of such loan is still outstanding in full. Mr. A has been offered to undertake the Internal Audit of XYZ, LLP.

In the given case, Mr. A has a conflict of interest in XYZ LLP, but it doesn't debar Mr. A from undertaking the Internal Audit of XYZ LLP. Mr. A shall disclose the fact to the Appointing Authority before accepting such Audit.

Illustration 2

Mr. A is a Practicing Company Secretary. He had taken a personal loan of Rs. 5,00,000 from XYZ Ltd. wherein his uncle is Managing Director. Mr. A has been offered to undertake the Secretarial Audit of XYZ Ltd.

In the given case, Mr. A has conflict of interest with the Auditee, as the amount of indebtedness is Rs. 5,00,000, but the same is not considered as substantial conflict of interest. In this case, he is required to make disclosure of the fact to Appointing Authority.

Illustration 3

Mr. P is a Practicing Company Secretary and is offered to conduct the Secretarial Audit of ABC Ltd. Mr. P is indebted to the Director of the company for an amount Rs. 6,00,000. Whether he can accept the Secretarial Audit Engagement of ABC Ltd.

In the given case, Mr. P has a substantial conflict of interest in ABC Ltd. And therefore he can't accept the secretarial audit assignment.

Illustration 4

Mr. A is a Practicing Company Secretary. He had taken a personal loan of Rs. 25,00,000 from XYZ Ltd.. He has used such loan towards purchase of his house which has been mortgaged with XYZ Ltd. Due to some financial crisis, Mr. A has not been able to repay any amount towards the loan since past 2 years. Mr. A has been offered to undertake the Secretarial Audit of XYZ Ltd.

The circumstances of the case suggest that indebtedness of Mr. A towards XYZ Ltd. is such that , if he accepts the Audit of XYZ Ltd., it may substantially impair the independence of Mr. A while forming an opinion on the basis of his audit findings and therefore considered as substantial conflict of interest . Therefore in this case, Mr. A shall be debarred from accepting the Secretarial Audit assignment of XYZ Ltd.

Where an Auditor was in employment of the Auditee, its holding or subsidiary company and 2 (two) years have not lapsed from the date of cessation of employment, the same shall be considered as substantial conflict of interest.

A PCS or member/partner of a PCS firm cannot undertake the audit of that undertaking where the member was in employment prior to holding the Certificate of Practice, unless two years have lapsed from the date

of cessation of employment. The PCS shall disclose the fact that two years have not lapsed from the date of cessation of his employment to the Auditee.

Holding and Subsidiary company shall have the same meaning as defined under section 2 (46) and 2(87) of the Companies Act, 2013.

Illustration 1

Mr. A was the Company Secretary of PQR Ltd. from 1st October, 2015 till 31st May, 2018. He left the job w.e.f. 31st May, 2018 and joined in ABC and Associates (CS Firm) as a partner. On 1st January 2020, ABC and Associates has been offered to conduct Secretarial Audit of ST Ltd. for the F.Y. 2020-21. ST Ltd. is the wholly owned subsidiary of PQR Ltd.

According to para 3 of CSAS-1, Mr. A or ABC and Associates, in which he is a partner cannot undertake any audit assignment in PQR Ltd. and/or its holding or subsidiary companies till 31st may, 2020, i.e. two years from the date of cessation of his employment in PQR Ltd. Therefore, ABC and associates cannot undertake the Secretarial Audit assignment of ST Ltd. for the F.Y. 2020-21.

Illustration 2

Mr. A was the Company Secretary of PQR Ltd. from 1st October, 2015 till 31st May, 2018. He left the job w.e.f. 31st May, 2018 and joined ABC and Associates (CS Firm) as an employee. On 1st January 2020, ABC and Associates has been offered to conduct Secretarial Audit of ST Ltd. for the F.Y. 2020 -21. ST Ltd. is the wholly owned subsidiary of PQR Ltd.

Since Mr. A has joined ABC and Associates in the capacity of an employee, ABC and associates can undertake the Secretarial Audit assignment of ST. Ltd. for the F.Y. 2020-21.

Effect of Substantial Interest

The Company Secretaries Act, 1980 (the Second Schedule, Part I, paragraph 4) makes it an act of misconduct for a Company Secretary to express an opinion on any report or statement of a business or enterprise in which he or his firm or a partner of his firm has a substantial interest, unless he discloses the interest also in his report. Such restriction will put the stakeholders on guard against any possibility of an impairment of the independence of the professional signing the report.

The Companies Act, 2013 does not define the phrase "substantial interest". This should be left to the judgment and discretion of the professional to determine the extent of interest which would affect his independence. He would be well advised to satisfy himself that the decision in this regard is such as would be taken as reasonable by an objective third party in the circumstances of the case. The professional must take care to see that he does not get into situations where there could be a conflict of interest and duty.

A practicing professional in practice may face a conflict of interest situation while performing a professional service. A conflict of interest creates a threat to objectivity and may create threats to the other fundamental principles. Such threats may be created when:

- The professional provides a professional service related to a particular matter for two or more clients whose interests with respect to that matter are in conflict; or
- The interests of the professional with respect to a particular matter and the interests of the client for whom the professional provides a professional service related to that matter are in conflict.

An auditor shall not allow a conflict of interest to compromise professional judgment. Examples of situations in which conflicts of interest may arise include:

Transaction advisory service	Providing a transaction advisory service to a client seeking to acquire an audit client of the firm, where the firm has obtained confidential information during the course of the audit that may be relevant to the transaction.
Auditing competitive clients	Auditing two clients at the same time who are competing to acquire the same company where the audit report might be relevant to the parties' competitive positions.
Auditing clients in legal dispute	Taking audit assignment of two clients regarding the same matter, who are in a legal dispute with each other.
Audit report for Licensor and Licensee	Providing an audit report for a licensor on royalties due under a license agreement when at the same time advising the licensee of the correctness of the amounts payable.

When identifying and evaluating the interests and relationships that might create a conflict of interest and implementing safeguards, when necessary, to eliminate or reduce any threat to compliance with the fundamental principles to an acceptable level, the auditor shall exercise professional judgment and take into account whether a reasonable and informed third party, weighing all the specific facts and circumstances available to the auditor at the time, would be likely to conclude that compliance with the fundamental principles is not compromised.

When addressing conflicts of interest, including making disclosures or sharing information within the firm or network and seeking guidance of third parties, the auditor shall remain alert to the fundamental principle of confidentiality.

If the threat created by a conflict of interest is not at an acceptable level, the auditor shall apply safeguards to eliminate the threat or reduce it to an acceptable level. If safeguards cannot reduce the threat to an acceptable level, the auditor shall decline to perform the audit; or shall terminate relevant relationships or dispose of relevant interests to eliminate the threat or reduce it to an acceptable level.

Before accepting a new client relationship, engagement, or business relationship, an auditor shall take reasonable steps to identify circumstances that might create a conflict of interest, including identification of:

1. The nature of the relevant interests and relationships between the parties involved; and
2. The nature of the service and its implication for relevant parties.

It is expected that the Auditor shall not have any conflict of interest with the Auditee. If the Auditor has any such interest, it is the duty of the Auditor to disclose such interest/ conflict of interest to the Auditee before accepting the Audit Engagement.

CONFIDENTIALITY

The Auditors of a company while performing the audit assignment access the various confidential information of the company and it is most required for the auditors to maintain the confidentiality of the auditee information. The principle of confidentiality imposes an obligation on the auditor to refrain from:

Disclosing information	Disclosing information acquired as a result of professional relationships without proper and specific authority or unless there is a legal or professional right or duty to disclose; and
Using information for personal advantage	Using information acquired as a result of professional relationships to their personal advantage or the advantage of third parties.
Inadvertent disclosures	An auditor should maintain confidentiality even in a social environment. The auditor should be alert to the possibility of inadvertent disclosure, particularly in circumstances involving long association with a business associate or a relative.
Information disclosed by a Prospective client	An auditor should also maintain confidentiality of information disclosed by a prospective client or employer.
Confidentiality within the firm	An auditor should also consider the need to maintain confidentiality of information within the firm or employing organization.
Control of Staff	An auditor should take all reasonable steps to ensure that staff under the auditor's control and persons from whom advice and assistance is obtained respect the auditor's duty of confidentiality.

Clause (1) of Part I of the Second Schedule to the Company Secretaries Act, 1980 provides that a Company Secretary in practice shall be deemed to be guilty of professional misconduct, if the member – "discloses information acquired in the course of professional engagement to any person other than the Auditee so engaging him, without the consent of the Auditee, or otherwise than as required by any law for the time being in force."

The word 'information' here implies any information which is not available in public domain.

During the course of audit, Auditor receives, verifies and inspects various audit documents, evidence, representation etc. to form an opinion or to give a report. These may be confidential and privileged information that remain in possession of the Auditor and shall not be disclosed without the express authority of the Auditee.

Herein the term proper and specific authority implies the Appointing Authority or any other person or committee as may be entrusted by the Appointing Authority to look after the conduct of Audit. It is the inherent duty of the Auditor to maintain the confidentiality of any information about the Auditee or his business that came to his knowledge as a result of performing the audit work. However, if permitted by the Auditee, Auditor may disclose or share such information with any other person as may be specifically allowed by Auditee. Since there may be different types of Auditee, the authority to give such permission to the Auditor may be different in each case. For example, in case of a company, the Secretarial Auditor is appointed by the Board and therefore it may be authorised by the Board whether the Auditor can disclose any confidential information to anyone. In another case, it may be possible that the Board has authorised a director in this regard to give such authorities and permissions to the Auditor and therefore that director will become the specific authority. Likewise in case of an LLP, it may be a designated partner or any other person as may be authorised by the LLP in this regard.

An Auditor shall maintain confidentiality even in a social environment. The Auditor shall be alert to the possibility of inadvertent disclosure, particularly in circumstances involving long association with a business associate or a relative or friends etc.

However, if the Auditor gives any reference of the audit evidence or documents while forming the opinion in the audit report, it will be deemed to be the disclosure of information under the legal obligation or in the performance of the duty.

If during the course of audit and forming opinion, the Auditor uses the decisions of the judicial authority, it will not be treated as use or sharing of confidential information.

The Auditor shall educate his employees, staff and other team members about the importance of the confidentiality of the information available to them during the course of audit. The Auditor shall ensure that reasonable procedures have been followed to maintain the confidentiality of the information. The Auditor shall also take a duly signed Non Disclosure Agreement (NDA) from such personnel who may have access to such confidential information.

The Auditor shall also ensure that reasonable procedures and safeguards are being followed to prevent unauthorised access to such confidential information.

CHANGES IN TERMS OF ENGAGEMENT

The Auditor shall not agree to a change in the terms of the Audit Engagement where there is no reasonable justification for doing so.

If the terms of the Audit Engagement are changed, the Auditor and the Appointing Authority shall agree on the new terms of the engagement by way of a supplementary/revised engagement letter or any other suitable form in writing.

A request from the Appointing Authority to change the terms of Audit Engagement may result from a change in circumstances affecting the need for the service or a restriction on the scope of Audit Engagement, whether imposed by Management or caused by other circumstances. The Auditor shall consider the justification given for the request, particularly the implication of a restriction on the scope of the Audit Engagement.

A change in circumstances that affects the Auditee's requirements may be considered a reasonable basis for requesting a change in the Audit Engagement.

A change may not be considered reasonable if it appears that the change relates to information that is incorrect, incomplete or otherwise unsatisfactory. For example, where the Auditor is unable to obtain sufficient appropriate audit evidence regarding labour law compliance by the company and the Appointing Authority asks for the Audit Engagement to be changed to a review engagement to avoid a modified opinion or a disclaimer of opinion.

With mutual consent the terms of the Audit Engagement may be changed. When such changes are there, the Auditor shall obtain the supplementary/revised engagement letter with a justification for the change and it shall be duly signed by the Appointing Authority. The impact of such change on the level of assurance shall be ascertained before accepting the same. If such change is likely to result in a lower level of assurance, then the Auditor may accept such change only if such change can adequately be covered by way of modified report.

However, the Auditor should take the following precautions while accepting the change:

(1) The Auditor should not agree to a change in the terms of the Audit Engagement which restricts the scope of audit provided under any statutes.

(2) If the term of the Audit Engagement is changed when it is expected that Auditor may have to issue a modified report, such type of changes should be resisted.

(3) Any request to change to avoid or circumvent unfavorable Auditor's report is also unjustified and should not be accepted.

(4) If the terms of the Audit Engagement are changed before the completion of the audit, the Auditor should not disregard the evidences obtained prior to the change in scope of audit.

Test Yourself

Question: *Can terms of audit engagement be changed?*

Answer: *As per Para 5.1 of CSAS-1, unless there is reasonable justification for doing so, the auditor shall not agree to change the terms of Audit Engagement. Further, if before completion of the assignment, the Auditor is requested by the Appointing Authority to change the scope of engagement, resulting in a lower level of assurance, the Auditor shall consider the appropriateness of carrying out the same.*

Annexure A

Specimen Certificate of Eligibility as Secretarial Auditor

Date:

To

The Board of Directors, Dear Sir,

Sub: Proposed Appointment as Secretarial Auditor

I/We thank you for your communication dated ..... 2019 seeking my/our consent to act as the Secretarial Auditor of your company for the financial year ..... I/We give my/ our consent for being appointed as Secretarial Auditor of the company.

I/we hereby confirm that:

1. I am/we are eligible for appointment and not disqualified for appointment as per the Companies Secretaries Act, 1980 and rules and regulations made thereunder and ICSI Auditing Standards;
2. The proposed appointment is within the limits, if any laid down by ICSI;
3. I/We do not have any substantial conflict of interest in terms of ICSI Auditing Standard on Audit Engagement (CSAS 1);
4. I/We do not have any conflict of interest in terms of ICSI Auditing Standard on Audit Engagement (CSAS 1) Or

I/We do have conflict of interest other than substantial conflict of interest which are as below :

Thanking you,

Yours sincerely,

Annexure B

Specimen Audit Engagement Letter

To,

ABC & Associates (name of Audit firm)

Company Secretaries (Address)

Dear Sir,

This engagement letter is provided in connection with (type of audit) of XYZ Ltd.

I. Scope of work

The scope of the Audit shall include ..... (For example, in case of Secretarial Audit , the scope of audit shall be as specified in Section 204 of the Companies Act, 2013)

II. Responsibilities of Auditor

The Auditor shall carry out the audit with utmost integrity in terms of this Audit Engagement Letter adhering to the highest level of ethics and standards. The Audit shall be conducted in accordance of the requirements of the ..... Act.

III. Duties of Auditee

Auditee acknowledges its responsibility for maintenance of Records and compliances under the applicable laws, acts, rules and regulations.

Auditee acknowledges its responsibility to provide the Auditor access to Records and documents of the Auditee, reports of third party and information as may be sought by the Auditor. The Auditee shall be responsible for the correctness and appropriateness of the Records, documents and information of the Auditee.

IV. Timeline

The Auditor shall submit the Audit Report for the F.Y. 20XX-XX within ..... days of the end of the financial year.

Auditor may also submit a quarterly/half-yearly review report in which the audit observations of the Auditor made during the quarter for timely redressal.

V. Commercial Terms

Audit fees for the F.Y. 20XX-XX is fixed at Rs. XXXXXXX plus applicable taxes. Fees will be billed as the work progresses.

Out–of-pocket expenses by the Auditor shall be reimbursed on actual basis.

VI. Confidentiality

The Auditor shall not disclose the information obtained during the course of Audit without proper and specific authority or unless there is a legal obligation or duty to disclose.

VII. Indemnity

During and after the term of this Engagement, both Parties agree to protect, indemnify, defend and hold harmless other Party, and to extent required from time to time non defaulting party, its officers, agents, and employees, from and against any and all expenses, damages, claims , suits, losses, actions, judgments, liabilities, and costs whatsoever (including legal fees on a full indemnity basis) arising out of, connected with, or resulting from, defaulting Party's negligence, misrepresentation or the breach of any obligations to be performed by the other party and/or its representatives under this Engagement. In no event will either party's liability towards otherparty arising from the terms of this Engagement exceed the total sum of fees paid under this Engagement.

VIII. Any other term as may be agreed between the Auditor and the Auditee, if any

For XYZ Limited

Date

Place Director Director

LESSON ROUND-UP

- The audit engagement may be initiated either by the Auditee or by the auditor. However it is necessary that the engagement is accepted by the auditors.
- The auditor may be appointed by the management on one to one basis, or through a tendering process by the management.

- In case where the practicing company secretary is appointed as Secretarial Auditor in place of the existing Secretarial Auditor, he should communicate the appointment to the earlier incumbent in writing, in view of the provisions of clause (8) of Part I of the First Schedule to the Company Secretaries Act, 1980.
- A conflict of interest creates a threat to objectivity of the audit and may create threats to the other fundamental principles, hence the auditor should maintain his Independence or avoid such situation of conflict of Interest.
- The principle of confidentiality imposes an obligation on the auditors to maintain confidentiality of the auditee information.
- It is in interest of both the management and the auditor that the auditor should get an audit engagement letter before the commencement of the audit to help avoid misunderstandings with respect to the terms of engagement.
- The CSAS-1 deals with the Auditor's responsibilities while agreeing to the terms of Audit Engagement and entering into an agreement with the Management or those charged with governance. This includes principal contents of an Audit Engagement Letter and also the duties and responsibilities of the Auditor and the Auditee in case of a change in terms of engagement, if any.
- Before accepting the Audit Engagement, the Auditor should have a pre-engagement meeting with the Auditee. The meeting may inter-alia include discussion about the terms of engagement, prior year audit findings and conclusions, appropriateness of reporting framework, understanding Auditee's business operations and environment including internal control system, commercial terms of the audit and the timelines and milestones, if any, for conducting the Audit and submission of the Audit Report.
- As a measure of the professional etiquettes, while taking up the any audit engagement, the auditors shall give intimation to the previous auditor, intimating his engagement as auditors of the company.
- A request from the Appointing Authority to change the terms of Audit Engagement may result from a change in circumstances affecting the need for the service or a restriction on the scope of Audit Engagement, whether imposed by Management or caused by other circumstances.

GLOSSARY

Document : It includes summons, notice, requisition, order, declaration, form and register, whether issued, sent or kept in pursuance of this Act or under any other law for the time being in force or otherwise, maintained on paper or in electronic form;

Expert : It includes an engineer, a valuer, a chartered accountant, a company secretary, a cost accountant and any other person who has the power or authority to issue a certificate in pursuance of any law for the time being in force.

Officer : It includes any director, manager or key managerial personnel or any person in accordance with whose directions or instructions the Board of Directors or any one or more of the directors is or are accustomed to act.

Total voting power : It is in relation to any matter, means the total number of votes which may be cast in regard to that matter on a poll at a meeting of a company if all the members thereof or their proxies having a right to vote on that matter are present at the meeting and cast their votes.

Professional and Other Misconduct : For the purpose of Company Secretaries Act, 1980 "Professional or other misconduct" shall be deemed to include any act or omission provided in any of the schedules.

Appointing Authority under CSAS : It means any person having authority to appoint the Auditor.

Auditing Engagement : It means detailed terms of reference of appointment including scope of audit, remuneration and limiting conditions, if any.

Auditee : It means a person subject to audit.

Auditor under CSAS : It means a Company Secretary who is deemed to be in practice under sub-section (2) of Section 2 of the Company Secretaries Act, 1980 and includes a firm or Limited Liability Partnership (LLP) registered with ICSI, undertaking the Audit.

Management : It includes Board of Directors and persons who have been entrusted with the responsibility of governance and compliances of the Auditee.

TEST YOURSELF

(These are meant for recapitulation only, Answer to these questions are not to be submitted for evaluation)

1. In the Audit engagement process the acceptance of the Audit Engagement by the professional is mandatory, Comment.
2. What is the scope of CSAS-1 and what does it deal with?
3. Write the examples where an auditor is assumed to have interested in the auditee's business or enterprise.
4. Draft an Audit engagement letter for the Secretarial Auditor.
5. What is the meaning of Confidentiality, Why it is necessary for the auditor to maintain confidentiality.
6. What documents are required at the time of audit engagement?
7. What is substantial conflict of interest?
8. The Board of Directors of ATP Ltd. authorized its one of the Directors X to appoint Secretarial Auditor of the Company. Can X do so as per the provisions of the Companies Act, 2013 ? Also explain pre-engagement meeting in the Audit Engagement Process.
9. X, Y and Z are three partners in JK LLP, a firm of Practicing Company Secretaries. X holds 1% paid-up share capital in ABC Ltd. Y holds shares of nominal value of Rs. 70,000/- in ABC Ltd. Referring the provisions relating to ICSI Auditing Standards, advise whether JK LLP can be engaged for the Secretarial Audit of ABC Ltd.

LIST OF FURTHER READINGS

- Companies Act, 2013 alongwith rules made thereunder
- SEBI (LODR) Regulations, 2015
- Company Secretaries Auditing Standards
- Guidance Note on CSAS
- Articles published by Professionals

OTHER REFERENCES (Including Websites / Video Links)

- https://www.icsi.edu/auditing-standard/
- https://www.icsi.edu/media/webmodules/Guidance_Notes_on_ICSI%20AS_Book_05-6-2021.pdf
- https://en.wikisource.org/wiki/Re_Kingston_Cotton_Mill_Company_(No.2)_(1896)

Audit Principles and Techniques

Lesson 10

KEY CONCEPTS

■ Audit Techniques ■ Risk Assessment ■ Confirmation ■ Internal Control System ■ Enquiry ■ Sampling ■ External Expert's opinion ■ Audit Trials ■ Audit Findings

Learning Objectives

To understand:

- The Audit Principles as generally accepted rules which are commonly applicable for every type of Audit.
- How the Audit Techniques stand for the methods that are adopted by an auditor to obtain audit evidence and performance of the audit as per the scope of the audit.
- Various techniques of auditing which may be applied by the auditor under different circumstances of audit.
- There are five core testing methods that auditors use to confirm the facts and answers that a business wants to attain during an audit.
- To know about how Audit sampling is an investigative tool.
- Internal controls are rules and procedures established by a company to ensure business continuity, prevent fraud, and preserve the integrity and accuracy of financial reporting.

Lesson Outline

- Introduction
- Audit Techniques, Examination and its Process
- Enquiry
- Confirmation
- Sampling
- Compliance test of Internal Control System
- Substantive Checking
- Verification of documents/ records
- Creation of Audit Trails
- Analysis of Audit findings
- Lesson Round-Up
- Glossary
- Test Yourself
- List of Further Readings
- Other References (Including Websites / Video Links)

MEANING OF AUDITING

Auditing evaluate a company's internal controls, including its corporate governance and accounting processes. These types of audits ensure compliance with laws and regulations and help to maintain accurate and timely financial reporting and data collection. Internal auditors are hired by companies who work on behalf of their management teams. These audits also provide management with the tools necessary to attain operational efficiency by identifying problems and correcting lapses before they are discovered in an external audit. The individual assuming up the liability of the cycle is called an 'Auditor'.

In this procedure, it is checked on the off chance that the business is running productively or not. Auditing is a significant procedure for the organization, the financial backers, the public authority, investors, creditors, and so on. They especially depend on review reports to settle on significant business decisions.

FUNDAMENTAL PRINCIPLES GOVERNING AN AUDIT

There are nine essential rules that administer the method of auditing. It rattles off the roles and obligations of the evaluator or auditor and his overall set of accepted rules while conducting an audit or review.

A. **Integrity, Independence and Objectivity:**

The inspector must be truthful and straightforward while during the inspection process; he can't be inclining toward the association. He should stay free from every kind of biasness all through the entire cycle, and his trustworthiness should not permit any negligence.

Another significant rule is autonomy or independence, and the examiner can't have any interest in the association he is inspecting, which permits him to be autonomous and fair-minded consistently.

> **Integrity** – being trustworthy, straightforward, honest, fair and candid; complying with the spirit as well as the letter of applicable ethical principles, laws and regulations; behaving so as to maintain the public's trust in the auditing profession; and respecting confidentiality except where disclosure is in the public interest or is required to adhere to legal and professional responsibilities.
>
> **Objectivity** – acting and making decisions and judgements impartially, fairly and on merit (having regard to all considerations relevant to the task in hand but no other), without discrimination, bias, or compromise because of commercial or personal self-interest, conflicts of interest or the undue influence of others, and having given due consideration to the best available evidence.
>
> **Independence** – freedom from conditions and relationships which, in the context of an engagement, would compromise the integrity or objectivity of the firm or covered persons.

B. **Confidentiality:**

The auditor comes across a great deal of sensitive monetary data of the association. It is significant that he regards the classified genre of such data and archives.

He can't uncover any delicate data to any outsider except if it is a necessity by law. What's more, he should likewise be extremely cautious with archives, authentications, and so forth that the association shares with him.

C. **Skill and Competence:**

The examiner should be capable and prepared in the strategies of auditing, for example, he should be qualified as an examiner. Furthermore, as an expert, he should be aware and upgrade on the latest changes, declarations, rules, and so forth.

In the event that is important, he can go through preparing and prepare to keep up to date with the new accounting and auditing methodology. For instance, after GST was presented, auditors needed to refresh their insight.

D. **Work Performed by Others:**

The extent of an audit on occasion can be extremely immense. So an auditor can utilise his representatives, delegates, and others who work under him.

Be that as it may, the reviewer will keep on being completely liable for the work done by these individuals working for him. So the evaluator should cautiously oversee and audit such work and be sensibly certain of the precision of such work.

E. **Documentation:**

Much of the time, the examiner keeps a review notepad, a review or audit plan, and an evaluating document or an audit file. It is significant the auditor tracks significant reports for his review work, as it is proof of the work the evaluator has completed. Also, the customer is leaned to these reports and records, assuming he wishes to examine the work.

F. **Planning:**

A review plan permits the inspector to arrange his work and empowers him to be more proficient and ideal. Each review plan is distinctive as it must be redone as indicated by the type of association, the sort of business they lead, the extent of the review, the productivity of the inside controls, and so forth.

G. **Audit Evidence:**

The auditor should gather sufficient proof to help him in his last assessment. This assortment of such proof is finished by substantive and consistency systems. There are two origins of this proof – inward or internal and outer or external. Likewise, external resources of proof are, in every case, more dependable.

H. **Accounting Systems and Internal Controls:**

The inspector needs to guarantee that the records of the association are exact and address a valid and reasonable image of the monetary status of the organisation. Likewise, the examiner should guarantee that all material data has been recorded in the accounting records. Testing the inside controls framework is likewise significant as it decides something very similar.

I. **Audit Conclusions and Reporting:**

After the examiner gathers all proof, he should now shape his viewpoint based on the accompanying standards:

- All applicable bookkeeping guidelines were applied consistently.
- Budget reports are consistent with all guidelines and legal prerequisites.
- All material data has been revealed.

CASE STUDIES

Materiality:

An auditor is conducting an audit of a company's financial statements. The auditor determines that a certain error in the financial statements is immaterial and does not need to be corrected. However, the error is later discovered to be material and the company faces legal action as a result. This case highlights the importance of properly assessing materiality and the potential consequences of misjudging it.

Risk Assessment:

An auditor is conducting an audit of a manufacturing company. During the risk assessment process, the auditor identifies a significant risk related to inventory management. The auditor then designs audit procedures to test the controls related to inventory management and discovers that there are significant weaknesses in the company's internal controls. This case highlights the importance of proper risk assessment and the need to design appropriate audit procedures based on the identified risks.

Lehman Brothers:

Lehman Brothers' bankruptcy in 2008 is another example of the failure of audit principles and techniques. The company's financial statements did not accurately reflect its true financial position, and its auditors failed to identify the risks associated with the company's mortgage-backed securities.

AUDIT TECHNIQUES

Audit techniques are the methods and procedures used by auditors to obtain sufficient and appropriate audit evidence to support their audit opinion. Here are some common audit techniques used by auditors:

1. **Examination of Record :-**

   This technique is commonly used by the auditors, the inspection of books and documents is made to verity the validity of data.

2. **Inquiry :-**

   The auditor can also use the technique of inquiry. He can get the information from resource persons inside or outside the enterprise.

3. **Sampling :-**

   Auditor can select few items from whole accounting information. This technique enables the auditor to obtain and evaluate the evidence of some characteristics of the whole class. It is helpful in forming the conclusion.

4. **Confirmation :-**

   To ensure the accuracy of the data auditor can collect the information from the debtor. Confirmation is response to an inquiry to prove certain data recorded in the books.

5. **Compliance :-**

   To check the arithmetical accuracy of accounting record, the balancing accounts can be compared with the vouchers to test the reliability of data.

6. **Compliance Test :-**

   These tests are designed to check the effectiveness and compliance of internal control. In obtaining the audit evidence, auditor is concerned with the existence of effective internal control.

7. **Use of Computer Techniques :-**

   There are large number of audit techniques like audit software, test packs and mapping which can be used by the auditor to test the accuracy of the data.

8. **Substantive Test :-**

   There are designed to obtain evidence that data produced by accounting system is accurate or not.

It has two kinds :

a) Test of detail transaction.

b) Test of significant ratios and trends.

9. Dependence on Experts and Auditors :-

The auditor has to rely on the internal and other auditors to complete his work. He has also to rely on other experts like lawyers, engineers and doctors for their expert opinion about the business.

10. Analytical Review :-

It consists of studying significant ratios, trends and investigating different changes. This review procedure is based on the expectations of relationship among the past and present data.

These are just a few of the many audit techniques that auditors may use to obtain sufficient and appropriate audit evidence. The selection of techniques depends on the auditor's judgment and the nature of the entity being audited.

CASE STUDY

A case study on Audit Techniques:

ABC Corporation is a manufacturing company that produces and sells widgets. The Company has recently undergone a change in management, and the new CEO has expressed concerns about the accuracy of the financial statements prepared by the previous management team. The company has engaged an independent auditor to perform an audit of its financial statements.

The auditor begins the audit by performing an initial assessment of the company's internal controls. The auditor reviews the company's accounting policies and procedures, interviews key personnel, and performs walkthroughs of the accounting system to identify any weaknesses or deficiencies in the internal control system.

Based on the initial assessment, the auditor decides to use a combination of audit techniques to obtain sufficient and appropriate evidence to support the audit opinion.

First, the auditor decides to perform analytical procedures. The auditor compares the company's current year financial statements to the prior year financial statements to identify any significant changes or trends. The auditor also performs ratio analysis to assess the company's liquidity, profitability, and financial stability.

Next, the auditor decides to use sampling. The auditor selects a sample of sales transactions from the company's sales ledger and tests them to verify that the sales were properly recorded in the accounting records. The auditor also selects a sample of inventory items and performs a physical count to ensure that the inventory quantities and values are accurately reflected in the financial statements.

The auditor also decides to use computer-assisted audit techniques (CAATs). The auditor uses data analysis software to scan the company's accounting records for any anomalies or trends that may indicate errors or fraud. The auditor also uses the software to test the completeness and accuracy of the inventory and accounts payable balances.

Throughout the audit process, the auditor maintains open communication with the company's management team and informs them of any findings or concerns. At the conclusion of the audit, the auditor issues an audit opinion based on the evidence obtained through the various audit techniques used.

In this case study, the auditor used a combination of audit techniques to obtain sufficient and appropriate evidence to support the audit opinion. The auditor's use of analytical procedures, sampling, and computer-assisted audit techniques helped to identify any potential risks or concerns in the financial statements, which allowed the company to address these issues and improve its financial reporting process.

PRELIMINARY PREPARATION

Preliminary preparation is an essential step in the audit process. It involves planning and preparing for the audit to ensure that the audit is conducted effectively and efficiently. Here are some of the activities that auditors typically undertake during the preliminary preparation phase:

1. **Understanding the entity:** The auditor needs to obtain a good understanding of the entity's business operations, industry, and environment. This includes understanding the entity's organizational structure, key personnel, accounting policies and procedures, and risk management processes.
2. **Assessing risk:** The auditor needs to assess the risks associated with the entity's business operations and financial reporting. This includes identifying the risks of material misstatement, evaluating the effectiveness of internal controls, and determining the materiality threshold for the audit.
3. **Developing an audit plan:** The auditor needs to develop an audit plan that outlines the scope and objectives of the audit, the audit approach, the timeline, and the budget for the audit. The audit plan should be based on the understanding of the entity and the risks identified.
4. **Assigning audit team members:** The auditor needs to assign audit team members based on their experience, skills, and knowledge of the entity's business operations and industry.
5. **Communicating with the entity:** The auditor needs to communicate with the entity's management team to discuss the audit plan, obtain necessary information, and establish a timeline for the audit. This includes obtaining a representation letter from the entity's management team.
6. **Developing audit programs:** The auditor needs to develop audit programs that outline the specific audit procedures to be performed during the audit. The audit programs should be based on the audit plan and the risks identified.
7. **Establishing an audit file:** The auditor needs to establish an audit file to document the audit plan, the audit programs, and the evidence obtained during the audit.

After the preparation of the audit manual the detailed audit programme should be prepared by the audit team, the audit programme should contain the role of team members in the performance of the chosen audit procedures.

CASE STUDY

XYZ Limited is a small manufacturing company that produces and sells widgets. The company has engaged an independent auditor to conduct an audit of its financial statements. The auditor begins by conducting preliminary preparation activities to ensure that the audit is conducted effectively and efficiently.

The auditor obtains a good understanding of XYZ Limited's business operations, industry, and environment. This includes understanding the Company's organizational structure, key personnel, accounting policies and procedures, and risk management processes. The auditor also assesses the Company's financial performance and identifies any unusual or complex transactions. The auditor assesses the risks associated with XYZ Company's business operations and financial reporting. This includes identifying the risks of material misstatement, evaluating the effectiveness of internal controls, and determining the materiality threshold for the audit.

Based on the assessment, the auditor determines the scope of the audit and the audit approach to be taken. The auditor develops an audit plan that outlines the scope and objectives of the audit, the audit approach, the timeline, and the budget for the audit. The audit plan is based on the understanding of the company and the risks identified. The auditor also consults with the company's management team to obtain their input on the audit plan and to establish a timeline for the audit. The auditor assigns audit team members based on their experience, skills, and knowledge of XYZ Limited's business operations and industry. The auditor communicates with the company's management team to discuss the audit plan, obtain necessary

information, and establish a timeline for the audit. The auditor also obtains a representation letter from the company's management team. The auditor develops audit programs that outline the specific audit procedures to be performed during the audit. The audit programs are based on the audit plan and the risks identified. The auditor also ensures that the audit programs are updated to reflect any changes in the audit plan or risks identified during the audit. The auditor establishes an audit file to document the audit plan, the audit programs, and the evidence obtained during the audit. The audit file is organized to facilitate the review of the audit work by the auditor's supervisor or peer reviewers.

By conducting these preliminary preparation activities, the auditor is able to plan and execute the audit effectively and efficiently. The auditor's understanding of XYZ Company's business operations, industry, and environment, along with the assessment of risks, enables the auditor to develop an appropriate audit plan and select the appropriate audit procedures to obtain sufficient and appropriate audit evidence.

QUESTIONNAIRE

Questionnaire is a comprehensive series of questions concerning internal control. This is the most widely used from for collecting information about the existence, operation and efficiency of internal control in an organisation. An important advantage of the questionnaire approach is that the oversight or omission of significant internal control review procedures is less likely to occur with this method. With a proper questionnaire, all internal control evaluation can be completed at one time or in sections. The review can more easily be made on an internal basis. The questionnaire form also provides an orderly means of disclosing control defects. It is the general practice to review the internal control system annually and record the review the detail. In the questionnaire, generally questions are so framed that a 'Yes' answer denotes satisfactory position and a 'No' answer suggests weakness.

Provision is made for an explanation or further details of 'No' answers. In respect of questions not relevant to the business, 'Not applicable' reply is given. The questionnaire is annually issued to the client and the client is requested to get it filled by the concerned executives and employees. If on a perusal of the answers, inconsistencies or apparent incongruities are noticed, the matter is further discussed by auditors with the client for a clear picture and accordingly the auditor prepares a report of deficiencies and recommendation for improvements.

Problem

As a Practicing Company Secretary, you have been appointed for conducting Secretarial Audit of XYZ Ltd. Prepare Questionnaire for the company including the questions relating to Related Party Transactions, Insider Trading, non-appointment of KMPs, CSR Remuneration of Directors. Assume necessary facts.

A questionnaire can be a useful tool for auditors to gather information from the auditee (the organization being audited) in order to gain a better understanding of the organization's operations, processes, and risks.

Here are certain points to be kept in mind as to how a questionnaire may be used in an audit:

1. **Planning the audit:** The auditor reviews the auditee's documentation and identifies areas of potential risk. The auditor then designs a questionnaire that is tailored to the specific risks and issues identified.
2. **Administering the questionnaire:** The questionnaire is sent to the auditee to complete. The auditee is given a deadline to complete and return the questionnaire.
3. **Analyzing the responses:** The auditor analyzes the responses to the questionnaire to identify areas of concern and potential risk. The responses can also help the auditor to identify areas where additional information or documentation is needed.
4. **Conducting follow-up interviews:** Based on the responses to the questionnaire, the auditor may conduct follow-up interviews with key personnel to gather additional information and clarify any areas of concern.

5. **Reporting the findings:** The auditor prepares a report that summarizes the findings of the audit, including any areas of concern identified through the questionnaire and follow-up interviews.

Using a questionnaire in an audit can be a useful way for auditors to gather information in a standardized and systematic manner. However, it is important for the auditor to design the questionnaire carefully and to ensure that it is tailored to the specific risks and issues identified in the audit planning process. The auditor should also follow up with key personnel to gather additional information and to ensure that the responses to the questionnaire are accurate and complete.

CASE STUDY

XYZ Company Ltd is a manufacturing company that specializes in producing high-tech electronics. The company has recently experienced a decline in sales and profits, and the management team has requested an audit to identify the root cause of the problem. The auditor decides to use a questionnaire to gather information from the auditee (the company) to gain a better understanding of the company's operations, processes, and risks.

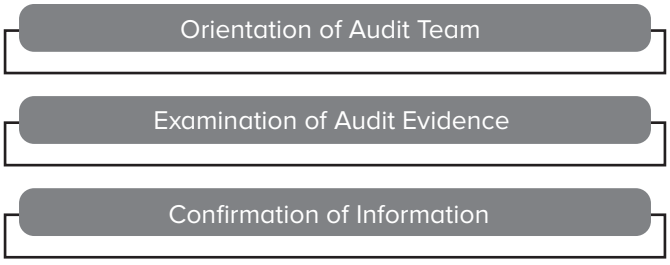
1. **Designing the questionnaire:** The auditor designs a questionnaire that is tailored to the specific risks and issues identified in the audit planning process. The questionnaire includes questions about the company's sales and marketing strategies, production processes, supply chain management, financial management, and risk management practices.
2. **Administering the questionnaire:** The questionnaire is sent to key personnel within the company, including the sales and marketing team, the production team, the supply chain management team, and the finance team. The auditee is given a deadline to complete and return the questionnaire.
3. **Analyzing the responses:** The auditor analyzes the responses to the questionnaire to identify areas of concern and potential risk. The responses reveal that the company has been experiencing quality control issues in its production processes, which has resulted in a high rate of defective products. The auditor also identifies weaknesses in the company's supply chain management practices, including inadequate supplier vetting and a lack of contingency planning.
4. **Conducting follow-up interviews:** Based on the responses to the questionnaire, the auditor conducts follow-up interviews with key personnel to gather additional information and clarify any areas of concern. The auditor also requests additional documentation to support the auditee's responses to the questionnaire.
5. **Reporting the findings:** The auditor prepares a report that summarizes the findings of the audit, including the areas of concern identified through the questionnaire and follow-up interviews. The report includes recommendations for improvement in the company's production processes and supply chain management practices.

Using a questionnaire in the audit of XYZ Company Ltd allowed the auditor to gather information in a standardized and systematic manner. The questionnaire revealed important information about the company's quality control issues and weaknesses in its supply chain management practices. The findings from the questionnaire and follow-up interviews were used to develop recommendations for improvement, which the company can use to address the root cause of the decline in sales and profits.

INTERACTION THROUGH INTERVIEWS

The main purposes for an interview in context of an audit are orientation, examination and confirmation. An interview can have one or two of these purposes, but normally not all three at the same time.

Orientation is normally part of the audit team's learning process during the planning phase. It aims at exploring and giving an overview of a specific area or function, e.g., by asking for presentations of activities, explanations of formal or informal networks or interpretation of documents (reports, instructions or, budgets). The objective could be to identify possible audit subjects or to find out about other available sources of information, such as key persons or documentation.



Examination aims at more specific issues with a view to establishing new information, often to be used as audit evidence. In some cases, such information has not been previously recorded at all but is embodied in the interviewee through personal experiences, particular references, opinions, etc. In other cases, the knowledge can be retrieved for example by (joint) interpretation of internal documents, reports or records.

It should be noted that evidence obtained from interviews often needs to be corroborated, i.e. supported by evidence from other data collection methods.

Confirmation, finally, often goes together with either orientation or examination, but deserves to be mentioned as a separate purpose because of its fundamental importance. Confirmation, by definition, is typically based on information that has already been gathered. However, in this context the information can also be gathered and confirmed simultaneously. Not least in the planning phase, it is important to have basic conditions and facts explicitly confirmed by stakeholders. However, in the execution phase there might also be a need to confirm facts and findings. If data is incorrectly understood, the quality of the whole audit may suffer and a lot of work may be in vain.

The interview techniques can be gainfully used in a structured or unstructured manner to elicit information form the entity both in the planning as well as execution phase. The Auditor can use the interview mode to obtain both qualitative and quantitative information.

The aim in the planning phase is to develop a comprehensive and correct understanding of the audited activity or the auditee's business in order to facilitate the identification of significant audit issues, there is therefore a need to get orientation as well as confirmation. An interview can very well be justified by a combination of these purposes. Orientation requires a more unstructured approach, with the auditor having maximum flexibility where necessary to explore themes that have not previously been considered and to deeply probe the responses that are given. In this phase, the auditor generally does not have a prior hypotheses or deep knowledge of the project or activity. Confirmation, on the other hand, needs a fairly structured approach in order to have important facts and conditions verified.

In the execution phase of the audit, when the objective is often a more focused examination of an area, in order to capture simple, factual data, to document or clarify certain points or to test hypotheses, interviews will typically have a more structured form. The aim is often to obtain evidence (documents, opinions and ideas) that relate to the audit's objectives, to confirm facts and to collaborate data from other sources. The auditor has a firm grasp of the issues he wants to cover and should know in advance what type of data he wants.

AUDIT PROGRAMME

Most of the time audit is conducted by a team instead of just an individual. If business is small or if there is not much to be done then it might be possible to conduct the whole engagement easily by an individual. But usually amount of work, time constraints and other factors require the audit engagement to be conducted by more than one person. In order to properly assign work to each individual and what is required to be done by whom there must be some kind of instructions set and work profile, otherwise, more than one member might be auditing the same area or in other case some areas may be left completely unaudited. To ensure efficient and effective conduct of audit assignment, audit programmes or audit programmes are used.

Audit programme contains step by step instructions to be carried out by team members i.e. it is simply a list of audit procedures to be executed by team members. Even though audit programme sets out the whole

agenda for every member of the team but the main users are the audit executives for whom it acts as a direction to be followed. The main purpose of audit programme is that every material area has been audited appropriately and sufficient appropriate audit evidence has been obtained in respect of every important areas of audit.

Audit programmes are prepared on the basis of audit plan usually by the auditor who is signing the Audit Report of the company. But sometimes, auditors have a basic audit programme and the same is used by the auditor after making some modifications to it to make it according the audit engagement in hand. Mostly it is in the form of a checklist which can be used by the Audit executives to make sure every required procedure has been implemented. This can also help in monitoring the work of Audit executives in specific or assistants in general.

Audit programmes may be laid down in advance for the whole year for some aspects of the audit which auditor expects to be audited after regular intervals of time or when needed. For understandability and convenience, audit programmes are written for each audit area separately and then assigned to specific team members.

An audit programme is a set of instructions which are to be followed for proper execution of audit. After the development of audit plan a detailed written audit programme containing the various steps and procedures shall be required. The audit programme contains the measures that are generally employed to determine what, and how much evidence must be collected and evaluated. It also lays down the responsibilities for the whole audit team for carrying out different tasks.

The prepared audit program may be revised if needed in accordance with the prevailing circumstances. An audit program largely depends on the size of the organization and other relevant factors. Minimum essential work to be done is Standard Programme and rest is according to circumstances. There is no standard audit programme applicable for all situations. Audit programme is documented in the Audit Working Papers, which are the official record that contains the planning and execution of the audit agreement.

Difference between Audit Plan and Audit Programme

Audit Plan	Audit Programme
Audit Plan lays down the audit strategies to be followed for conducting an audit such as identifying the areas where special audit consideration and skills may be necessary, obtain the knowledge of business etc.	Audit programme is an outline of how the audit is to be done, who is to do what work and within what time
Plans should be made to cover the following among other things: (i) Acquiring knowledge of accounting systems, policies and internal control procedures (ii) Establishing the expected degree of reliance to be paced on the internal control (iii) Determining the nature, timing and extent of the audit procedures to be performed (iv) Co-ordinating the work to be done	It lays down the following audit procedure to be followed: (i) Evaluation process (ii) Ascertaining accuracy (iii) Verification of Document (iv) Scrutiny of supporting Documents (v) Checking of overall disclosure and presentation of all items in the audit completion. (vi) Preparation and submission of audit report.

IDENTIFICATION OF APPLICABLE LAWS

In India, Every mode of business needs to obey various laws, rules, regulations, orders etc. depending on the manner of doing business, business activities and areas of doing business. Sometimes, this may include laws from multiple countries and sometimes such laws have conflicting requirements on each other. In such

situations, the best approach is to work with legal team or with an expert to create an outline of all the regulations and contractual obligations. Identify which requirements may impact the organization and discuss the results with management to determine and development of suitable measures which are sufficient for compliance.

Further, the identification of the compliance requirements under applicable laws is just one part of the auditor, but for the management of the company it is necessary to make sure there is sufficient evidence that the company is compliant with each and every one of them. For ensuring the compliance of the applicable laws the company:

Inventory of Applicable Laws	● should have a documented inventory of every applicable law, regulation, contractual obligation and any other form of compliance requirement which needs to comply;
Publishing Compliance Policy	● should publish its compliance policy which should be supported by standards, procedures, and guidelines;
Communication	● should exchange emails with legal\compliance team, functional heads, compliance officers and others with information on compliance obligations and skills (e.g. Privacy, Procurement, HR, Finance, IT) concerning compliance matters in the information security context;
Agendas Minutes etc.	● should share related agendas, minutes or notes of meetings with those people on related matters;
Internal Reports on Compliance	● should place Internal reports concerning applicable compliance obligations, ideally with evidence that management is actively engaged in assessing the extent to which compliance is needed and aware of the risks of non-compliance;
Compliance Assessment	● should conduct Compliance assessment\review\audit reports, noting the content, form, distribution, status.

For an auditor and the company it is required to identify the applicable legal requirement of act, regulation but should also identify the sections applicable under such regulation.

Further, the legal compliance for a holding company/subsidiary company/joint venture company with diverse operations, the compliance requirement will vary from operation to operation based on the nature of the operations and the locations of the different operation and also based on the applicable legal instruments, and the applicable sections of the relevant laws referred in those legal instruments. The diverse operation and different geographical location may create a complexity in compliance.

Dealing with the amendment in the laws is another concern in fulfilling compliance requirement, which requires that the company should keep up to date information on the compliance requirement with an information of the changes in the laws and regulations. Further, the legal team of the company should continuously communicate the effect of such changes on the Company, its holding, subsidiary, Joint Venture Company or any of the geographical area where the company operates.

Some of the regulators like MCA, RBI, SEBI, on time to time issue the Master Circulars, and Master Direction, Removal of Difficulties Order etc., which helps in identifying and figure out the actual requirement of the law which needs to be complied with.

CREATION OF MASTER CHECKLIST

The Audit is not a process of the collecting data and checking the checkbox, it is the postmortem of the affairs of the company, the data and evidence collected during the execution of the audit shall be independently reviewed by the auditor and submit its report to the shareholders. Unless the auditor independently reviews the facts & data, the auditor is not able to give his independent opinion.

The truth is that collecting data and checking the box is just not good enough. The mere existence of a control chart does not ensure the compliance and equate to sustained, significant process improvement and complete the audit.

In general, an audit checklist can be divided in to the following headings according to their significance in the audit scope.

1. **Entity operation and organizations:** This checklist contains the matters relating to:
   - Product manufactured/ service delivered/ operation performed by the company
   - Statutory status basis for these operations
   - Objects of the company as per the memorandum of association
   - Capital structure of the company and funding status
   - Details of the promoters and directors of the company
   - Details of subsidiaries, joint ventures and associate companies
   - Transactions with the related parties
   - Material changes took place during the audit period
   - Recipient of the products/services of the company
   - Details of the key managerial personnel
   - Details of the functional head responsible for audit
   - Details of the audit committee and its term of references

– Details of the geographical location where the company operates

– Audit observations of the previous year's etc.

2. Financial & Non-financial Reporting Requirement

The company's financial statement, directors' report, annual return, websites, filing with the regulators are the primary source of information about the company. The financial statements are the focus of financial audit, the audit team should familiarize itself with the format of financial statement which needs to the submitted to the regulators. This checklist generally covers the points relating to changes in laws, regulations, accounting standards, accounting rules or accounting policies since the last audit, new heads of accounts introduced since the last audit, changes in the format of accounts or any such item which require exercising of judgement or estimation.

In case of the non-financial disclosures and reporting requirement the audit team should have the detailed requirements under legal and regulatory framework along with the procedural requirements of the same. The auditor should check the limits, eligibility, criteria etc. on the various dates to understand the compliance requirement.

3. Legal and Regulatory requirement

The legal and regulatory requirement of every company differs according to the nature and status of the company, its business activity, area of operation, geographical location etc. depending on the relevant central, state and local laws, rules & regulations. It is the most important for the auditor to have the detailed compliance requirement applicable to the company and such checklist should cover the section wise compliance requirement highlighting the amendment during the audit period.

4. Matter of Shareholder and public interest

The audit team should identify the extent of the shareholder and public interest in the company's activities and the financial statement. The factors which might indicate such interest includes the public deposit, loan and advances dividend, corporate social responsibility, small shareholders interest, high level of comment in media etc.

5. Review of Control Environment

The control environment comprises the conditions under which the various process of the entity are designed, implemented and functions and based on that the audit team should seek to arrive at a conclusion as to whether the control environment is reliable and justifiable in accordance with the size and operations of the company. After the review of the control systems, the auditor determines the specific component increase or decrease, the effectiveness of some or all application systems and controls. If based on the understanding of the control environment, the audit team has fundamental doubts about the effectiveness of the prevailing systems and controls, the same should be reported to the entity and should be kept in mind while carrying the audit. The checklist shall contain the checkpoints relating to management characteristic, philosophy, operation style and commitment, accurate disclosures and reporting, along with:

– The operating environment and culture

– Management commitment to designing and maintaining reliable accounting systems

– The ability of management to control the operations

– The organizational structure of the entity

– Methods of assigning authority and responsibility

– Supervision and monitoring

– Senior management control methods.

Test Yourself:
As a Practising Company Secretary, prepare a master checklist for Secretarial Audit for a Listed Company engaged in the Business of Manufacturing automobiles with a Paid up capital of Rs. 5000 Crore.

WORKING PAPERS AND MAINTENANCE OF WORK SHEET

Working Papers

Audit working papers are the outcome of the documentation process. Working papers are the record of various audit procedures performed, audit evidence obtained, allocation of work between audit team members etc. Audit working papers are the documents and evidence that an auditor collects and retains with himself during the audit.

In the working papers document the auditor's conclusions and the reasons as to why those conclusions were reached should be documented. The disposition of each audit finding identified during the audit and its related corrective action should be documented.

Audit working papers are the documents prepared or obtained by the auditors and retained by him in connection with the audit. Audit working papers are used to support the audit work done in order to provide assurance that the audit was performed in accordance with the applicable standards. Working papers include all the evidence gathered by auditor indicating what work has been done by him and the procedure he has followed in verifying a particular asset or a liability and also provide information that whether:

- audit was properly planned;
- audit was carried out;
- audit was adequately supervised;
- the appropriate review was undertaken;
- the evidence is sufficient and appropriate to support the audit opinion.

Working papers should be completed throughout the audit and working papers should be economical to prepare and to review. It is easy to include every scrap of information and every form into the working papers. However, the working papers then become a confused mixture of data that is difficult to assimilate and use.

Working papers should be complete and concise, they should be considered as a usable record of work performed. Auditors should include in their working papers only what is essential; and, they should ensure that each work paper included serves a purpose that relates to an audit procedure. Working papers which are created during the audit and later determined to be unnecessary should be deleted/removed. The working papers may include:

(a) Planning documents and audit programs.

(b) Internal control questionnaires, flowcharts, checklists and narratives.

(c) Notes and minutes resulting from interviews.

(d) Organizational data, such as charts with job descriptions, process chart.

(e) Copies of important documents.

(f) Information about operating and financial policies.

(g) Results of control evaluations.

(h) Letters of confirmation and representation.

(i) Analysis and test of transactions, processes.

(j) Results of analytical review procedures.

(k) Audit reports and management responses.

(l) Audit correspondence that documents the audit conclusions reached.

Scanned Documents as working papers

Scanned documents should include a reference to the source and the purpose of the document which is relevant to understand or appreciating the actual audit work performed. Such information needs to be included only when it is not provided elsewhere in the working papers.

Tick marks

Tick marks do not need to be standardized throughout the set of working papers, but must be consistent throughout a particular work paper. Tick mark explanations must be a part of the working paper or included in a separate tick mark legend work paper.

Cross Referencing

Working papers should be prepared using the appropriate cross referencing. A cross reference from the Audit Procedures to the primary working paper provides a reference to where the work was performed. It is not necessary to cross refer all work papers to the Audit Procedures - only the primary work paper should be cross referred. The primary work paper will then contain cross-references to other, supporting working papers, which provide additional information regarding the audit procedures performed, results and conclusions reached.

Cross-references should be used to refer information useful in more than one place or to other relevant information including the source of information, composition of summary totals, or other documents or examples of transactions. To encourage conciseness, documents/information only single copy of the working papers should be placed in working file for cross referencing.

Question: Which of the following is not a benefit of Cross referencing ?

Options: (A) Time saving (B) Cost saving (C) Conciseness (D) All information in one document

Answer: (D)

Cross referencing is an audit technique used to compare and match data from different sources to ensure accuracy and completeness

Question arise that whether the working papers are the property of the client or auditor. Whether the client can demand custody of such working papers?

Answer: – Working papers are the record of various audit procedures performed, audit evidence obtained, allocation of work between audit team members etc. Audit working papers are the documents and evidence that an auditor collects and retains with himself during the audit. Thus, the audit working papers are the property of auditor and not of the client. No, client cannot demand custody of such working papers. The auditor may on his discretion make portions of or extracts of working papers available to his client. But the client cannot ask the auditor for the custody of working papers.

CASE STUDY

An auditor is conducting an audit of a company's financial statements. As part of the audit, the auditor is reviewing the company's bank statements to ensure that all transactions are accurately recorded in the company's financial records. The auditor notices a payment of Rs 10 Lacs to a vendor that does not match any of the vendor payments recorded in the company's accounting system.

To investigate this discrepancy, the auditor uses cross referencing to compare the bank statement with the company's accounting records. The auditor identifies the check number on the bank statement and searches for it in the company's check register. The auditor finds that the check was issued to a different vendor for a different purpose than the one recorded on the bank statement.

The auditor then reviews the company's invoices and purchase orders to determine if there were any other payments made to the vendor listed on the bank statement. The auditor discovers that the vendor did provide services to the company, but the payment was not recorded in the accounting system.

Based on these findings, the auditor concludes that the payment was made to the vendor for services rendered and that the payment should be recorded in the company's financial statements. The auditor then makes the necessary adjustments to the financial statements to reflect the correct amount of the payment.

In this case, cross referencing helped the auditor to identify a discrepancy between the bank statement and the accounting records, and to investigate the cause of the discrepancy. By comparing and matching data from different sources, the auditor was able to ensure the accuracy and completeness of the financial statements, and to identify any errors or omissions that needed to be corrected.

Standard Working papers

A standard set of working papers will include at least the following documents:

(a) **General File:** The General File contains key information through the various phases of the audit including planning (audit objectives, planning comments including etc.), reporting process, audit programs and comments for the next audit. The General File will include the draft and final reports. Audit responses will also be included in the file.

(b) **Work paper File:** This file should contain the detailed audit procedures and detailed audit working papers. Detailed audit procedures provide detailed audit steps of the audit work to be performed during fieldwork that will achieve the specific audit objectives outlined in the audit program.

(c) **Future Audit Considerations:** Auditors are encouraged to develop and document future audit ideas during the course of their work. These should be included in the "Comments for next audit" section of the general file.

General file provides almost all the relevant information at one place.

Work paper file can direct the Audit in right direction and may ensure the completion of work with in timelines.

Comments for next audit can improve the quality of work by Auditors.

Working papers are the connecting link between the client's records and the audited records. These provide permanent historical record. These also serve as a great guide to the staff to whom the work of audit has been assigned after the previous year audit. These would come to the help of the auditor in future in case the client files a suit against the auditor's negligence. The working papers are the property of the auditor and the client cannot ask the auditor for their custody. However it is the duty of the auditor to maintain confidentiality of the client information. Further, if audit working papers are disclosed then it may amount to professional misconduct.

Types of Working Papers

The auditor's working papers are divided into two parts:

(i) Permanent File

The permanent file usually contains documents and matters of continuing importance of clients' business

which will be required for more than one audit. The data in these files are the information, which is of continuous interest and relevant to succeeding audits. Data in this file can include the following:

A. Statutory Documents

B. The rules and regulations of the company :

(a) Memorandum of Association.

(b) Articles of Association.

(c) Certificate of Incorporation/Commencement of Business.

(d) Registration documents under various statutory bodies.

C. Copies of documents of continuing importance and relevance to the auditor:

(a) Letter of engagement and Board Resolution for appointment of the auditor.

(b) Record of communication with the retiring auditor.

(c) Royalty Agreement/Technical collaboration.

(d) Copies of important legal documents/contracts.

D. Addresses of the registered office and business -The Company's registered office address and all other units/premises, with a short description of the work carried on at such places.

E. An organization chart - Details of all departments and sub-divisions thereof showing hierarchy of management.

F. List of books and records with location - List of books and records maintained by the company and place of their location. Names, positions, specimens of signatures and initials of persons responsible for books and document should also be included.

G. An outline history of the organization.

H. Analysis of significant ratios and trends.

I. Internal Controls - Notes on internal control with Details of study & evaluation of internal controls in the form of narrative record, questionnaires or flow charts etc.

J. The business structure within a group and associated companies - List of all holding, subsidiary and associate companies.

K. Company's advisors - list of the company's advisors such as bankers, merchant bankers, stockbrokers, solicitors, valuers, insurance brokers etc.

(ii) Current Audit File

These file contains information relating to the audit of the current period. Information included in the current file should be information for the period under audit. The indicative list of current file can be as follows:

A. Appointment letter for the Current Year, along with the defined scope of Audit;

B. Extracts of important board/management meetings;

C. List of responsible persons with their designation and contact details;

D. Secretarial Audit Report/Financial Audit Report for current year as well as previous year;

E. Actions initiated by company towards Secretarial Auditor's observations and suggestions in previous years reports;

F. Audit Plan/Audit Program;

G. Current year's Secretarial Records ;

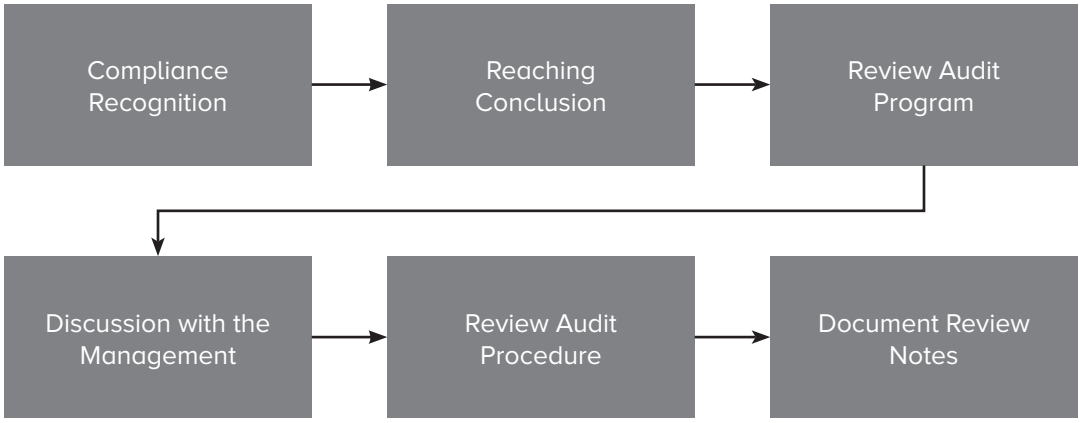
H. Communications with the company/management team;

I. Letters of representations, confirmations received from company;

J. Audit review points and highlights of analysis.

Working paper Review

The auditor should review all working papers to determine whether they are relevant and have a useful purpose, evidence the audit work performed and sufficiently support the audit findings. In addition, the auditor should ensure the conclusions reached were reasonable and valid, and that the office working paper standards were followed. The auditor should review all audit review notes to be certain that all notes have been resolved within the working papers. Documentation obtained and not relevant to the audit should be returned/destroyed upon the completion of the audit. The review will consist of:



(a) Determining compliance with working paper guidelines.

(b) Reviewing the audit program that outlines the major objectives of the audit, and ensure that the procedures accomplish the objective(s).

(c) Reviewing the audit procedures and the referenced working papers to ensure the working papers support the procedures performed and all procedures have been completed.

(d) Determine that the working papers adequately are documented and the conclusions reached in the report.

(e) Ensuring that all findings prepared have been discussed with the appropriate member of management, and that the disposition of the audit concerned is documented.

(f) Documenting review notes.

Filing and Protection of Working papers

All working papers that are considered confidential, are the property of the Auditor, and are to be kept under adequate control. Working papers often contain sensitive information or data that must be protected from unauthorized use or review.

Working papers in process also need to be controlled by the Auditor. While conducting field work away from the Auditor's office, the auditors should control the working papers to ensure that information is neither removed, nor substituted nor altered.

Retention Policy

All working papers pertaining to an audit belong to the Auditor. All such data is to be kept by the Auditor and is subject to the retention requirements as required by law.

IDENTIFICATION OF THE EVENT AND CORPORATE ACTIONS

During the Audit planning stage the auditors should go through the various filings with statutory bodies etc. to understanding the company affairs, the following points considered as events/information on which the auditor should specifically verify the compliance required under applicable laws.

1. Acquisition(s) (including agreement to acquire), Scheme of Arrangement (amalgamation/ merger/ demerger/ restructuring), or sale or disposal of any unit(s), division(s) or subsidiary of the Company or any other restructuring.
2. Issuance or forfeiture of securities, split or consolidation of shares, buyback of securities, any restriction on transferability of securities or alteration in terms or structure of existing securities including forfeiture, reissue of forfeited securities, alteration of calls, redemption of securities etc.
3. Revision in Rating(s).
4. Outcome of Meetings of the board of director relating to :
   - dividends and/or cash bonuses recommended or declared or the decision to pass any dividend and the date on which dividend shall be paid/dispatched;
   - any cancellation of dividend with reasons thereof;
   - the decision on buyback of securities;
   - the decision with respect to fund raising proposed to be undertaken;
   - increase in capital by issue of bonus shares through capitalization including the date on which such bonus shares shall be credited/dispatched;
   - reissue of forfeited shares or securities, or the issue of shares or securities held in reserve for future issue or the creation in any form or manner of new shares or securities or any other rights, privileges or benefits to subscribe to;
   - short particulars of any other alterations of capital, including calls;
   - financial results;
   - decision on voluntary delisting by the listed entity from stock exchange(s).
5. Agreements (viz. shareholder agreement(s), joint venture agreement(s), family settlement agreement(s) impacting management and control of the Company, agreement(s)/treaty(ies)/contract(s) with media companies) which are binding and not in normal course of business, revision(s) or amendment(s) and termination(s) thereof.
6. Fraud/defaults by promoter or key managerial personnel or by Company or arrest of key managerial personnel or promoter.
7. Change in directors, key managerial personnel (Managing Director, Chief Executive Officer, Chief Financial Officer , Company Secretary etc.), Auditor and Compliance Officer.
8. Appointment or discontinuation of share transfer agent.
9. Corporate debt restructuring.
10. One time settlement with a bank.

11. Reference to IBC, 2016 and winding-up petition filed by any party/creditors.
12. Issuance of Notices, call letters, resolutions and circulars sent to shareholders, debenture holders or creditors or any class of them or advertised in the media by the Company.
13. Proceedings of Annual and extraordinary general meetings.
14. Amendments to memorandum and articles of association.
15. Commencement or any postponement in the date of commencement of commercial production or commercial operations of any unit/division.
16. Change in the general character or nature of business brought about by arrangements for strategic, technical, manufacturing, or marketing tie-up, adoption of new lines of business or closure of operations of any unit/ division (entirety or piecemeal).
17. Capacity addition or product launch.
18. Awarding, bagging/receiving, amendment or termination of awarded/bagged orders/contracts not in the normal course of business.
19. Agreements (viz. loan agreement(s) (as a borrower) or any other agreement(s) which are binding and not in normal course of business) and revision(s) or amendment(s) or termination(s) thereof.
20. Disruption of operations of any one or more units or division of the Company due to natural calamity (earthquake, flood, fire etc.), force majeure or events such as strikes, lockouts etc.
21. Effect(s) arising out of change in the regulatory framework applicable to the Company.
22. Litigation(s)/dispute(s)/regulatory action(s) with impact.
23. Fraud/defaults etc. by directors (other than key managerial personnel) or employees of Company.
24. Options to purchase securities including any ESOP/ESPS Scheme.
25. Giving of guarantees or indemnity or becoming a surety for any third party.
26. Granting, withdrawal, surrender, cancellation or suspension of key licenses or regulatory approvals.
27. Any other information/event viz. major development that is likely to affect business, e.g. emergence of new technologies, expiry of patents, any change of accounting policy that may have a significant impact on the accounts, etc. and brief details thereof and any other information which is exclusively known to the Company and which may be necessary to enable the holders of securities of the Company to appraise its position and to avoid the establishment of a false market in such securities.

Question: Which of the following can not be considered as an event for Corporate Action?

Option: (A) Corporate debt restructuring (B) Reference to IBC (C) Amendment to MOA (D) Prosecution of Member in a Fraud case.

Answer: (D)

TESTING METHODS USED DURING AUDIT PROCEDURES

There are five core testing methods that auditors use to confirm the facts and answers that a business wants to attain during an audit. The nature of these test methods focuses on everything from asking probing questions to inspecting documents and re-performing calculations.

Each testing method helps the auditor issue a well-informed opinion, based on evidence. Further, it provides the auditor with the information needed to provide qualified conclusions, whether the business is operating optimally, and managing risks properly.

These are the five types of testing methods used during audits.

- Inquiry
- Observation
- Examination or Inspection of Evidence
- Re-performance
- Computer Assisted Audit Technique (CAAT)

Inquiry

Inquiry is a fairly straightforward testing method, using interview-style questioning with the point of contact for certain controls. Because the quality of the information gained from inquiry depends on the accuracy and truthfulness of the interviewee, it is considered a weaker form of evidence. With the inquiry method, auditors ask questions of the organization's managers, accountants and any other key staff to help determine some relevant information. The auditor may ask about business processes and the appropriate recording of financial transactions to make sure the company is doing everything possible to avoid risks.

One example of inquiry commonly used is asking the business owner how the company's financial and data security records are stored. The auditor takes the responses into account—but does not accept the answers alone as confirmation—to establish additional testing criteria since this method is often used in conjunction with other, more reliable methods.

Observation

Another simple, basic and effective testing method involves an auditor's observation of tasks, procedures and conditions. This testing method is most often used when there is no documentation of the operation of a control.

Traditionally, observation has been performed on-site during the evidence-gather phase of a SOC audit. For example, management at an audited organization may state that certain noted records have been appropriately secured in a locked drawer. Then, in order to verify that certain stated records have been securely stored in locked cabinets, the auditor will watch an employee unlock the specified drawer during normal daily activities and take out the records.

Observation, even done remotely, can ensure that a company has an air conditioning system capable of keeping their servers cool by checking the thermostat in the equipment room. Or, for example, we can observe the configuration of IT systems to make sure that requirements are met.

Examination or Inspection of Evidence

This testing method helps auditors determine whether manual controls are being consistently performed and properly documented. Inspection can be used to verify the implementation of control measures, and to test certain attributes of policies and procedures.

For example, an auditor may check to make sure that backups are scheduled to run on a regular basis or that data classification controls. In these cases, the auditor can use inspection to verify that the control has been designed and is operating effectively. He or she will check to see if forms are being filled out correctly. Examination of evidence also includes the review of written documentation and records that might include visitor logs, employee manuals and system databases.

Re-performance

Re-performance is used when inquiry, observation, and physical examination and inspection have failed to provide the requisite assurance that a control is operating effectively. It's also the method that is used least frequently in the field. Re-performance requires the auditor to manually execute the control in question, such as re-performing a calculation that is usually automated. The auditor can leverage work done by an internal auditor and documented in work papers, so that only a sample of the work needs to be re-tested to verify.

The re-performance method is helpful in decreasing the workload for auditors and determining whether automated controls are operating effectively. It is the strongest type of testing to highlight the operating effectiveness of a control.

Computer-Assisted Audit Technique (CAAT)

The CAAT method of testing is often used to analyze large volumes of data or a sample of compiled data. Using special software, CAAT testing runs a script over a ledger, spreadsheet, or an entire database, to spot trends, irregularities, and potentially fraudulent entries.

AUDIT SAMPLING

Audit sampling is an investigative tool in which less than 100% of the total items within the population of items are selected to be audited. It is an auditing technique that provides supporting evidence that allows auditors to issue audit opinions without having to audit every single item and transaction.

Purpose of Audit Sampling

No matter what kind of audit is being performed – internal, external, or government – audit sampling needs to be used so that auditors can complete their audits without wasting resources in checking every single item. The objectives of audit sampling are as follows:

- Gather enough evidence to conclude an audit opinion
- Reduce the number of resources used
- Provide the basis for auditors to issue a conclusive audit opinion
- Detect any errors or fraud that can occur
- Prove that auditors have completed their audit fully in accordance with auditing standards
- Used as a tool for investigating
- Audit Sampling Importance.

When auditing financial statements, it is not feasible to audit and check every single item within the financial statements. It will be very costly and will take a lot of resources and time to do so.

Audit sampling enables auditors to make conclusions and express fair opinions based on predetermined objectives without having to check all of the items within financial statements. The auditors will only verify selected items, and through sampling, can infer their opinion on the entire population of items.

There are two forms of sampling:

1. **Statistical audit sampling**

   Statistical audit sampling involves a sampling approach where the auditor utilizes statistical methods such as random sampling to select items to be verified. Random sampling is used when there are many items or transactions on record.

   Consider a company with more than 100 inventory transactions on its records. Using statistical sampling is recommended due to the high number of transactions.

   For example, with statistical sampling, ten items are selected from the total population randomly. Every single item within the 100 has an equal probability of being selected and tested for accuracy as a result. Again, it benefits auditors since they can still make an audit opinion but do not have to check all 100 transactions.

2. Non-statistical audit sampling

In contrast to statistical audit sampling, non-statistical audit sampling items are not chosen randomly. Instead, they are chosen based on the auditor's judgment, and the result of the testing from the selections is not used to infer the conclusion for the entire population.

In the example earlier, ten inventory transactions can be used to infer the opinion on all 100 transactions. In non-statistical audit sampling, the auditors may choose to select items based on criteria such as:

The value of items (e.g., items greater than Rs 10 lacs)

Items with specific information (e.g., items related to a certain company)

CASE STUDY

An external auditor was engaged to conduct an audit of a manufacturing company's financial statements. As part of the audit, the auditor used statistical sampling techniques to select a sample of transactions to test for accuracy and completeness.

The auditor used a combination of random sampling and systematic sampling to select the sample. The sample was selected from the company's sales and purchases transactions, as these transactions were considered to be material and had a high risk of misstatement.

After selecting the sample, the auditor examined the transactions to verify their accuracy and completeness. The auditor found that a few of the transactions in the sample were not properly documented, and there were some discrepancies in the amounts recorded in the company's records compared to the supporting documents.

Based on the results of the sample, the auditor projected the findings to the entire population of sales and purchases transactions and concluded that there were material misstatements in the financial statements. The auditor then communicated the findings to the company's management and recommended adjustments to the financial statements.

The management of the company agreed with the auditor's findings and made the necessary adjustments to the financial statements. The auditor then issued an unqualified opinion on the financial statements, indicating that the financial statements were fairly presented in all material respects.

This case study demonstrates the importance of audit sampling in conducting an effective audit. By using statistical sampling techniques, the auditor was able to select a representative sample of transactions and test them for accuracy and completeness. The results of the sample allowed the auditor to draw conclusions about the entire population of transactions and detect material misstatements in the financial statements.

TESTS OF INTERNAL CONTROLS

Internal controls are rules and procedures established by a company to ensure business continuity, prevent fraud, and preserve the integrity and accuracy of financial reporting. A test of internal controls is an evaluation of the existing controls, either as part of an official audit or in preparation for an audit, to see if the controls are in place and identify weaknesses.

The purpose of internal controls testing is to see if the controls are properly detecting or preventing material errors or purposeful misstatement in financial reports.

Although control audits cannot completely detect all fraud, auditors can use controls testing to test operational controls for gaps, which can significantly reduce risk. Testing reveals what situation the company is in:

If controls are found to be effective, control risk is low.

If controls are identified as vulnerable or ineffective, control risk is high. Auditors may need to perform additional tests or take further actions, as specified by the relevant regulation or compliance standard.

Purpose of Internal Controls Testing

There are two primary purposes for internal controls testing:

1. **Shortening the audit process –** if a controls test shows that internal controls are effective, and are able to prevent errors or fraud in financial statements, this can eliminate the need for additional audit actions.
2. **Providing additional audit evidence** to demonstrate compliance, in situations where individual substantive procedures cannot provide sufficient evidence on their own.

Types of Audit Tests of Internal Controls

As discussed earlier about testing methods used during audit procedures. There are below types of internal control tests, each one is progressive and more comprehensive:

1. **Inquiry—**auditors ask managers and employees about the controls they are implementing. This is usually combined with more reliable testing methods—controls objectives or criteria should never rely only on an inquiry.
2. **Observation—**auditors observe activities and operations to see how controls are implemented. This is useful in cases where there is no documentation on how to operate the control unit. For example, if there is no formal procedure to ensure security cameras are installed, the auditor can simply observe if there are security cameras at the facility.
3. **Examination or inspection—**auditors determine if controls are really operational, using existing documentation and logs. For example, a test of controls can involve visiting a secured facility and ensuring that doors are locked and equipped with access control devices.
4. **Re-performance—**the previous three methods cannot fully guarantee the effective operation of the control. Re-performance involves the auditors actually trying to perform the control to see if it is effective. For example, the audit can run backups and try to restore the system to normal operation, or manually perform a financial calculation to ensure it is correct.
5. **Computer-aided audit tools (CAAT)—**auditors use technology to analyze large amounts of data automatically. A simple CAAT can be a spreadsheet, but there are specialized tools available that can test various types of internal controls. Most CAAT solutions are focused on export based, point in time sample testing across a complete inventory of all transactions.

CASE STUDY

An external auditor was engaged to conduct an audit of a retail company's financial statements. As part of the audit, the auditor reviewed the company's internal controls to assess their effectiveness in preventing and detecting errors and fraud.

The auditor found that the company had several weaknesses in its internal controls. Specifically, the company lacked proper segregation of duties, which meant that a single employee had control over several critical functions, including approving and recording transactions, and reconciling accounts.

The company also had inadequate documentation of transactions and did not have policies and procedures in place to ensure that transactions were properly authorized and recorded. In addition, the company did not perform regular physical inventory counts to ensure that inventory was accurately recorded in the financial statements.

As a result of these weaknesses, the auditor was unable to rely on the company's internal controls to support the accuracy and completeness of the financial statements. The auditor communicated the weaknesses to the company's management and recommended improvements to the internal controls.

The management of the company agreed with the auditor's findings and took corrective action to strengthen the internal controls. The company implemented a new policy of segregation of duties, ensuring that critical functions were assigned to different employees. The company also established policies and procedures for authorizing and recording transactions and performed regular physical inventory counts.

The auditor then re-assessed the internal controls and found that the improvements made by the company were effective in addressing the weaknesses identified in the audit. The auditor was then able to rely on the internal controls to support the accuracy and completeness of the financial statements.

This case study highlights the importance of strong internal controls in preventing and detecting errors and fraud in financial reporting. By identifying weaknesses in the internal controls and recommending improvements, the auditor helped the company to strengthen its financial reporting processes and provide accurate and reliable financial statements.

SUBSTANTIVE TESTING

Substantive testing is an auditing technique that checks for any errors or material misstatements in a company's accounts, financial statements or supporting documents. When a company claims that their financial records are accurate, complete and valid, substantive testing supports this claim as evidence that there are no errors. This traditional auditing method also helps an auditor to form an overall opinion about the company's financial statements. Substantive testing includes a wide variety of different auditing procedures and tests that an auditor can use depending on the situation.

Who does substantive testing?

Either a company's internal audit staff or hired external auditors can conduct substantive testing for a company. Using the company's internal audit staff may provide confirmation for whether their internal record systems are performing correctly. If the internal record systems are not performing properly, the internal audit staff can improve the system or eliminate the problem, so the company performs better in the next audit. Internal auditors typically conduct substantive testing at regular intervals throughout the year. External auditors often get hired to conduct substantive testing once a year, usually at the end of the year.

How do substantive tests work?

Here are the steps elucidating how substantive auditing works:

1. **A company makes assertions**

   A company's management team makes implicit or explicit claims about their financial situation, and these auditing assertions get presented to an auditor. There are five general categories of assertions that companies make during audits, which are:

   Occurrence or existence: This assertion states that financial statements listing assets, liabilities and shareholder equity exist when the accounting period is over.

   Disclosure and presentation: This is an assertion that the financial statements will include and present all financial information and financial disclosures in a clear manner that auditors can easily understand.

   Obligations and rights: This assertion states that the company has usage rights or ownership of all the assets listed in the financial statements and that all liabilities belong to the company, not a third party.

   Accuracy or valuation: This assertion states that all the calculations in the financial statements are accurate, classified appropriately and based on a proper valuation of balances, liabilities and assets.

   Completeness: An assertion that the financial statements include and present all the required items, transactions and inventory, including third parties with temporary possession.

2. **The auditor creates a plan**

   The auditor creates a structured audit plan for the company based on the assertions. The auditor identifies which auditing processes, including substantive tests, will best determine any errors or misstatements in the assertions. Categories of auditing processes that auditors can choose include analytical procedures, inquiry and confirmation, inspection, observation and recalculation. For example, to evaluate fixed assets, an auditor could observe a procedure and then analyze the paper records for accuracy.

   There are three general activities that an auditor includes in their audit plan for substantive testing, which are:

   - Examine physical adjustments and journal entries the company made while the company prepared the financial statements.
   - Match the underlying accounting records with the company's financial statements and their supporting documents.
   - Test the different classes of account balances, transactions and disclosures.

3. **An auditor shares audit results with a company**

   The auditor writes an official report listing any errors or material misstatements that the audit found, shares the report with management and requests further audit testing if it's warranted. The auditor also provides their overall opinion about the company's financial statements.

What happens when substantive testing finds an error?

If an auditor finds any errors in a company's financial statements or the supporting documents, the auditor may require the company to do further audit testing. The auditor writes a management letter with a summary of the errors they found and shares the letter with the company and the audit committee. Usually, there are only errors or misstatements if:

- External auditors don't detect an error during audit procedures, which is called detection risk.
- Internal auditors or the internal record systems don't identify or fix an error, which is called control risk.
- The company or auditor doesn't detect initial errors when the financial process and reporting begin.

Examples of substantive testing

Each substantive procedure should have enough documentation that it allows for collection, review and repetition. The documentation should be thorough enough that more than one auditor can independently test for accuracy and come to the same conclusion. Here is a list of common substantive auditing procedures and tests that auditors do:

- Verify that approved dividends exist by reviewing board minutes from the board of directors;
- Confirm that the balances in accounts payable are correct by contacting suppliers;
- Confirm that the balances in accounts receivable are correct by contacting customers;
- Check that assets obtained from a business combination have fair values assigned to them by confirming with experts;
- Watch the physical inventory count as it happens for each ending period;

- Test ending cash balances by issuing a bank confirmation;
- Contact lenders to confirm that loan balances are correct;
- Take fixed asset records and physically match them to fixed assets;
- Use inventory valuation calculations to confirm if inventory is valid;
- Recalculate the calculations that were already made by the client;
- Re-perform a company's procedures to make sure they perform as planned;
- Confirm loan balances are correct by contacting lenders;
- Test end cash balances by getting bank confirmation.

AUDIT TRAILS

The audit can be done internally by the company itself to make sure that the books have been maintained correctly. They can bring in an external auditor to go through the records to find anything amiss. The auditor usually also provides a report with their own analysis and suggestions about the company's status. There is also a government audit where governments can look into a company's records to check for mismanagement of funds or tax evasions. This is why an audit trail is helpful. It is useful to trace all events right from transactions entered into the books of accounts to all the changes such as alteration, deletion, etc. that may take place.

Audit trail rule for businesses using accounting software from 1st April,2023. The Ministry of Company Affairs through its notification issued on 24th March, 2021, relating to Audit Trail and the same is applicable on all companies *(except Proprietorship concerns, Partnership firms and Limited Liability Partnership)*.

According to the same notification,businesses that fall under the purview of MCA and use accounting software for maintaining books of accounts should have an audit trail feature. The accounting software used by such businesses should create an edit log of each and every transaction with changes made in the books of accounts. The software should capture the date details when such changes (edits) are made and ensure the edit trail cannot be disabled.

In simple words, the expectation is to maintain the edit log of every transition right from recording to tracking the changes that may take place.

According to the recent notification, the new audit trail rule in accounting software will now be implemented from 1st April,2023. This was originally planned for 2021 and but later the effective date was moved to 1s April,2022. Now, it is postponed to 1st April, 2023.

Rule 3 (Manner of Books of Account to be Kept in Electronic Mode) of the Companies (Accounts) Rules, 2014, species that for the financial year commencing on or after the 1st day of April, 2023, every company which uses accounting software for maintaining its books of account, shall use only such accounting software which has a feature of recording audit trail of each and every transaction, creating an edit log of each change made in books of account along with the date when such changes were made and ensuring that the audit trail cannot be disabled.

How does audit trail work?

Audit trails must have a few key details to provide comprehensive information about a transaction. To get these details at an enterprise level, however, a certain audit trail framework must be set up. Every access made to the accounts and records of the company should be tracked. Every edit made to any information must be recorded with the name of the person who did it and the time it was done. If any information was deleted, that also should be recorded.

Following are the key financial details to track as part of the audit trail:

- Any changes involved in the transaction
- The person who partook in the transaction
- The time at which the transaction took place
- The time at which the modification or edit took place
- Example of audit trail.

Accounting software provides the ideal example for audit trails. Once you enter a transaction in the software, the software will maintain a record of it. Any further edits made to the details, such as a change in the amount or change in the name against which the entry is made, will also be tracked by the software along with the user who made the changes and the time it was changed. Even if some transaction were to be deleted, the software will track that as well and keep the record of everything since the original entry was made.

This means that every transaction can be checked from its entry to its deletion. Basically, Audit trail based on Triple 'W' Approach i.e. When, Who What! 1. => when changes were made i.e, Date and Time (Time Stamp) 2. => who made those changes i.e., User ID 3. => what data was changed i.e., transaction reference; success/failure

What is the purpose of an audit trail?

The main reason for documenting everything that a company or its employees do is to have a record that can be revisited if the need arises. In case of any discrepancy, you have a pathway that can lead to the erring or fraudulent transaction which is causing the discrepancy. The trail is basically a way to ensure that there are no gaps in data that may lead to a blind spot, making it impossible to determine the cause of the error. It also enables the company to locate external breaches and interference. It is also a mandatory requirement for notified companies to stay compliant.

What are the benefits of an audit trail?

The MCA audit trail system requires companies to maintain electronic records of all transactions and to provide access to these records to the MCA and other regulatory authorities upon request. The system also requires companies to maintain a detailed audit trail of all changes made to electronic records, including the date, time, and person making the change.

The MCA audit trail system has several benefits, including:

1. **Increased transparency:** The audit trail system provides a detailed record of all transactions, making it easier for regulators and stakeholders to monitor the activities of companies and to detect any irregularities.
2. **Improved accuracy:** By requiring companies to maintain accurate electronic records, the audit trail system helps to prevent errors and omissions in financial reporting.
3. **Greater accountability:** The audit trail system holds companies and their employees accountable for their actions by providing a detailed record of all changes made to electronic records.
4. **Enhanced regulatory compliance:** The audit trail system helps to ensure that companies comply with various laws and regulations related to corporate governance and financial reporting.
5. **Foolproof :** There is also the advantage of proving that the company books are clean and in a healthy state which gives a big boost in the valuation of the company as well as generating funds through loans or by raising capital.

Overall, the MCA audit trail system is a powerful tool for improving transparency and accountability in corporate reporting and for preventing fraud and misconduct. By requiring companies to maintain accurate electronic

records and providing a detailed audit trail of all changes, the system helps to promote good corporate governance and to protect the interests of stakeholders.

CASE STUDY

An auditor was conducting an audit of a large manufacturing company in India. As part of the audit, the auditor reviewed the electronic records maintained by the company, as required by the Audit Trail system implemented by the MCA.

During the review, the auditor noticed that there were several entries in the electronic records that did not match the company's financial statements. The auditor also observed that there were multiple changes made to the electronic records, but there was no documentation explaining the reasons for the changes.

To investigate the discrepancies, the auditor used the Audit Trail system to review the changes made to the electronic records. The system provided a detailed record of all changes, including the date, time, and person making the change. The auditor also reviewed the company's financial statements to identify the source of the discrepancies.

The auditor found that the company had understated its revenues by recording them in a different financial year than when they were actually earned. The auditor also discovered that there were several unauthorized changes made to the electronic records to conceal the irregularities.

The auditor reported the findings to the company's management and recommended that the discrepancies be corrected and the electronic records be updated accordingly. The company's management cooperated with the auditor and took corrective action to address the issues identified.

As a result of the audit, the company improved its internal controls and financial reporting processes to prevent similar issues in the future. The Audit Trail system implemented by the MCA was instrumental in uncovering the irregularities and ensuring that the company took corrective action.

This case study demonstrates the importance of the Audit Trail system implemented by the MCA in promoting transparency and accountability in corporate reporting and detecting financial irregularities. The system provides a powerful tool for auditors to identify discrepancies in electronic records and to investigate the causes of those discrepancies. It also helps to promote good corporate governance and protect the interests of stakeholders.

ANALYSIS OF AUDIT FINDINGS

Audit finding means a written summary of all instances of non-conformance with the requisite provisions, and all areas of concern identified during the course of the audit that, in the Consultant Auditor's judgement, merits further review or evaluation.

The lead auditor will then take the completed audit report and review the contents with the affected department head. Upon acceptance by the department head, the final audit report should then be signed by the department head verifying acceptance and responsibility for any change(s) required.

Determine Plan of Action

The entire reason for conducting internal management system audits is to verify conformance and continually improve on the management system. Therefore, it is extremely important that all identified non-conformances are corrected in a timely manner.

Some companies place all audited non-conformances into their corrective/preventive action process for tracking purposes. Others place only critical non-conformances into the corrective/preventive action process. Regardless of the mechanics of tracking the identified audited non-conformances, it is imperative that corrective action is taken.

Once the corrective action is in place, the auditors should review the actions taken and verify the root cause was identified properly and resolved. An accept or reject decision can then be rendered for the change action.

If acceptable, no further action is required, and the issue is considered resolved. If unacceptable, the department head must complete a new root cause analysis, develop a new action plan, and put the new action plan into place. The auditors will now review the new action plan and make a determination of acceptance or rejection.

CASE STUDY

An auditor is conducting an audit of a bank. The auditor uses statistical sampling to test a sample of loan transactions. The auditor discovers that there are several instances where the bank has not properly assessed the creditworthiness of the borrowers. This case highlights the importance of using appropriate sampling techniques to ensure that audit evidence is representative of the population being tested.

An external auditor was engaged to conduct an audit of a technology company's financial statements. As part of the audit, the auditor performed a series of tests on the company's revenue recognition policies and procedures.

During the audit, the auditor found that the company had recognized revenue prematurely for a number of contracts. Specifically, the company had recognized revenue before it had fully delivered the goods or services to the customer, or before it had received full payment from the customer.

The auditor also found that the company had not properly documented the terms of the contracts, making it difficult to determine the correct revenue recognition policies to apply.

As a result of these findings, the auditor communicated the issues to the company's management and recommended adjustments to the financial statements. The management of the company agreed with the auditor's findings and made the necessary adjustments to the financial statements.

The auditor then issued a modified opinion on the financial statements, indicating that there were material misstatements due to premature revenue recognition. The auditor also issued a management letter, outlining the weaknesses in the company's revenue recognition policies and procedures, and recommending improvements.

The management of the company took corrective action to improve the revenue recognition policies and procedures. The company implemented a new system to document the terms of contracts and trained employees on the proper revenue recognition policies to apply.

In the subsequent year, the auditor performed follow-up procedures to test the effectiveness of the improvements made by the company. The auditor found that the improvements were effective in addressing the weaknesses identified in the audit, and the auditor was able to issue an unqualified opinion on the financial statements.

This case study highlights the importance of audit findings in identifying weaknesses in financial reporting processes. By communicating the findings and recommendations to the company's management, the auditor helped the company to make necessary adjustments and improvements to strengthen its financial reporting processes and provide accurate and reliable financial statements.

LESSON ROUND-UP

- Auditing evaluate a company's internal controls, including its corporate governance and accounting processes. These types of audits ensure compliance with laws and regulations and help to maintain accurate and timely financial reporting and data collection.
- There are nine essential rules that administer the method of auditing. 1. Integrity, Independence, and Objectivity. 2. Confidentiality. 3. Skill and Competence. 4. Work Performed by Others. 5. Documentation 6. Planning. 7. Audit Evidence. 8. Accounting Systems and Internal Controls. 9. Audit Conclusions and Reporting

- Techniques of auditing means the procedure and method which is adopted by the auditor in checking the accounts.
- There are five core testing methods that auditors use to confirm the facts and answers that a business wants to attain during an audit. The nature of these test methods focuses on everything from asking probing questions to inspecting documents and re-performing calculations. 1. Inquiry 2. Observation 3. Examination or Inspection of Evidence 4. Re-performance 5. Computer Assisted Audit Technique (CAAT)
- Audit sampling is an investigative tool in which less than 100% of the total items within the population of items are selected to be audited. It is an auditing technique that provides supporting evidence that allows auditors to issue audit opinions without having to audit every single item and transaction.
- Substantive testing is an auditing technique that checks for any errors or material misstatements in a company's accounts, financial statements or supporting documents. When a company claims that their financial records are accurate, complete and valid, substantive testing supports this claim as evidence that there are no errors.
- Audit finding means a written summary of all instances of non-conformance with the requisite provisions, and all areas of concern identified during the course of the audit that, in the Consultant Auditor's judgement, merits further review or evaluation.

GLOSSARY

Auditing Techniques: The Audit techniques stand for the methods that are adopted by an auditor to obtain audit evidence and performance of the Audit as per the scope of the audit.

Audit Planning: The Audit plan, describes the processes and activities that are to be carried out in connection with a particular audit and for the improving the quality of audit.

Documents: Documents includes board resolutions, agenda and minutes, notices, registers, cash books and accounting records, procedure manuals, reports etc.

Confirmation: Confirmation is a type of inquiry and involves obtaining, independently of the auditable entity, a reply from a third party with regard to some particular information. For example, confirmation of balances from the banks.

Audit Plan: A description and schedule of audits to be performed over a certain period of time (typically three years); includes areas to be audited, type and scope of work, and high-level objectives.

Audit Program: Policies and procedures that govern the audit process.

Governance: Processes and structures implemented to communicate, manage, and monitor organizational activities.

Internal Audit: The process of providing independent assurance that an organization's risk management, governance, and internal control processes are operating effectively.

Mitigation Actions: The necessary steps, or action items, to reduce the likelihood and/or impact of a potential risk.

Risk: A potential event or action that would have an adverse effect on the organization.

Workpapers: Documents that summarize and record all the activities and evidence obtained during an audit or investigation.

TEST YOURSELF

(These are meant for recapitulation only, Answer to these questions are not to be submitted for evaluation)

1. List down various Audit Techniques.
2. Define testing Methods used during audit procedures.
3. What is Audit Sampling? What is the purpose of Audit Sampling?
4. What is substantive Checking? How does sunstantive testing work?
5. Explain Audit trials. What are benefits of Audit Trials?

LIST OF FURTHER READINGS

- Company Secretaries Auditing Standards
- ICSI Guidance Note on CSAS
- Articles published by Professionals in Chartered Secretary.

OTHER REFERENCES (Including Websites / Video Links)

- https://www.icsi.edu/auditing-standard/

Audit Process and Documentation

Lesson 11

KEY CONCEPTS

■ Audit Process ■ Audit Planning ■ Risk Assessment ■ Audit Evidence ■ Audit Check list ■ Documentation

Learning Objectives

To understand:

- An audit should be seen as an aid to the organisation concerned in ensuring that its operations are conducted in compliance with the provisions of the applicable legislations.
- The Audit process that has three components i.e. Audit Planning, Audit Execution, and Audit Reporting.
- Audit documentations is extremely necessary to avoid the duplication of the work, forming of audit opinion and for future and cross references.
- The manner of Documentation of the Audit records.

Lesson Outline

REGULATORY FRAMEWORK

- CSAS-2, Auditing Statndard on Audit Process and Documentation

INTRODUCTION

The Auditor must plan and perform audit procedures to obtain sufficient and appropriate audit evidence to have a reasonable basis for Auditor's opinion. Sufficiency is the measure of the quantity of audit evidence and depends on various factors including internal controls systems and risk involved. As the risk increases, the amount of evidence that the Auditor should obtain also increases. However, as the quality of the evidence increases, the need for additional corroborating evidence decreases. Increase in the quantum of poor quality of evidences cannot compensate for the requirement of sufficiency of evidence.

Appropriateness is the measure of the quality of audit evidence, i.e. its relevance and reliability. To be appropriate, audit evidence must be relevant and reliable in providing support for the conclusions on which the Auditor's opinion is based.

Auditing Standard on Audit Process and Documentation (CSAS-2)

This Auditing Standard CSAS-2 is applicable to the Auditor undertaking Audit under any statute. The Standard deals with responsibilities and duties of the Auditor with respect to Audit Process in conducting audit and maintaining proper audit documents.

The objective of the Standard is to prescribe principles for an Auditor:

(i) to conduct audit as per the specified audit process;

(ii) to maintain documentation that provide:

  (a) sufficient and appropriate record to form the basis for the Auditor's Report; and

  (b) evidence that the audit was planned and performed in accordance with the applicable Auditing Standards and statutory requirements.

The Standard is effective and recommendatory for Audit Engagements accepted by the Auditor on or after 1st July, 2019 and mandatory for Audit Engagements accepted by the Auditor on or after 1st April, 2021.

For the purpose of Auditing Standards (CSAS) issued by the Institute of Company Secretaries of India ('ICSI'), the following terms shall have the meaning attributed as below, unless specified otherwise :

(1) "Audit Documents" means the working papers prepared or records obtained by the Auditor in connection with the audit.

Working papers include the audit plan, letters of representation and/or confirmation, abstracts of Auditee's documents, records kept by the Auditor of the procedures applied, the tests performed, the information obtained, analyses and the conclusions reached in the process of audit. The audit documents may be in physical and/or electronic mode.

Test Yourself

Question: What are audit documents?

Answer: The Standards define audit documents as the working papers prepared or records obtained by the Auditor in connection with the audit.

(2) "Audit Evidence" refers to relevant information and documents gathered in the course of the audit for arriving at the conclusion on which the Auditor's opinion is based.

The audit evidence is fundamental and important part in the audit process. The auditors need audit evidence to form and conclude their audit opinion. The sources of the audit evidence may be internal to the auditee or from external sources. These may include the company's record, data, disclosures in financial statements, company's website, website of various Govt. authorities like SEBI, Stock Exchange, etc.

Test Yourself

Question: What is Audit Evidence?

Answer: Audit Evidence refers to relevant information and documents gathered in the course of the audit for arriving at the conclusion on which the Auditor's opinion is based.

(3) "Management" as defined in CSAS-1.

"Management" includes Board of Directors and persons who have been entrusted with the responsibility of governance and compliances of the Auditee.

Test Yourself

Question 1: What is the scope of CSAS-2 and what does it deal with?

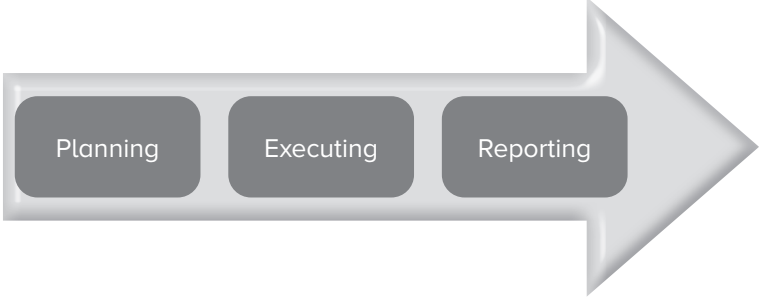
Answer: CSAS-2 is applicable to the auditor who is undertaking audit under any statute and deals with responsibilities and duties of auditor with respect to Audit Process in conducting audit and maintaining proper audit documents.

Question 2: Is CSAS-2 mandatory?

Answer: CSAS-2 is mandatory for audit engagements accepted by an auditor on or after April 01, 2021.

OVERVIEW OF THE AUDIT PROCESS

The audit process can be broadly grouped in three phases:



Audit Planning: For an effective audit, a timely, well thought out and well executed planning efforts is essential. The Auditor should obtain and update his understanding of the company, its activities, operation's and control environment in the company. The Audit planning consists of the following actions:

1. Understanding the company;
2. Establishing audit objectives and scope;
3. Determining Materiality;

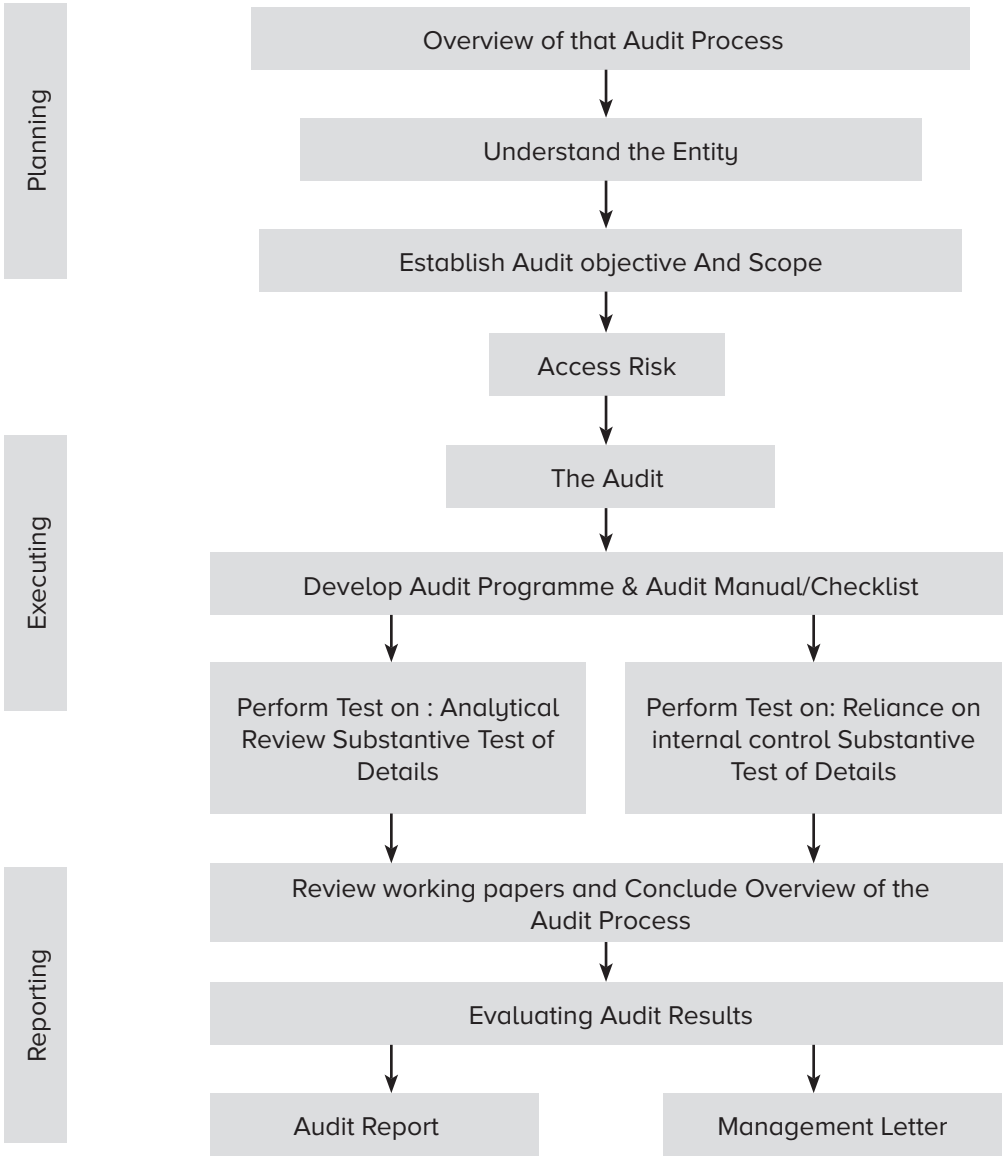
4. Assessment of Risk;
5. Preparation of Audit plan;
6. Preparation of detailed Audit Programme.

Execution of Audit: The effective Audit Execution is based on the Audit plan and the efficiency of the Audit team. However the Execution of the Audit covers the following actions:

1. Sampling of various transactions or items;
2. Sampling for testing of controls;
3. Identification of events;
4. Performing controls testing procedures;
5. Performing analytical procedures;
6. Sampling for substantive test of details;
7. Performing substantive test of details;
8. Review of working papers;
9. Management discussion on draft Report.

Reporting: In the reporting phase, the auditor covers evaluation of audit results, deriving conclusion, forming of opinion and prepare the audit report.

1	Understanding the Auditee and its operation
2	Understanding the legal requirements and Applicability of Law, Rules and Regulations
3	Overview and Assessment, Internal Control Mechanism and Identification of Material Event and Risk Areas
4	Risk Assessment considering the existing Internal Control Mechanism
5	Deciding the Audit Approach considering Reliance on the Internal Control and Procedures to be Adopted for Audit
6	Identification of the Audit Evidences
7	Designing the detailed Audit Procedure for various Transactions & Events based on the Materiality, Value and Nature
8	Perform Audit Procedures
9	Audit Conclusions based on the Audit Evidence
10	Forming of Opinion



AUDIT PLANNING

The audit plan, describes the processes and activities that are to be carried out in connection with a particular audit and for the improving the quality of audit. Accordingly, an auditor should plan an audit so that it is performed in an effective manner within the defined scope. The audit planning should also include overall audit strategy for the audit.

"The Auditor shall make audit plan to conduct audit as per the terms of Audit Engagement".

The Audit Plan is a comprehensive report of scheduled audits by process or location. The purpose of the plan is to define the audit work to be completed in fiscal year and enables to focus on important areas under review. The Audit plan is dynamic in nature and is to be designed based on organization's need.

Illustration:

An internal audit plan is a document defining the scope, coverage and resources, including time, required for an internal audit over a defined period. The internal auditor should, in consultation with those charged with governance, including the audit committee, develop and document a plan for each internal audit engagement to help him to conduct the engagement in an efficient and timely manner. Adequate planning ensures that appropriate attention is devoted to significant areas of audit, potential problems are identified, and that the skills and time of the staff are appropriately utilized.

Audit plan is very crucial and should be designed with due care. Audit plan addresses the specifics of what, where, who, when and how: Such as- What are the audit objectives?; Where will the audit be done?; Whether there will be audit visits to other locations of the company?; When will the audit(s) occur?; Who constitute the audit team?; How will the audit be done? etc.

The Auditor should prepare an audit plan, which shall include detailed layout for conducting audit procedures, timing, sample sizes, basis of selection of sample, etc.

The basic purpose of an audit plan is:

- to develop an audit process which ensures that sufficient and appropriate evidence is gathered to support the audit opinion;
- the audit should be planned in a manner which ensures that the audit is carried out in an efficient and effective way in a timely manner;
- the audit plan should be documented and kept as audit working paper;
- the audit planning process should be framed on a thorough understanding of the Auditee, its business, sector in which it functions and its operation;
- to determine the materiality for the audit.

Audit planning means establishing and developing an overall audit process, including but not limited to:

- Identification of broad audit areas;
- Seeking previous audit findings and observations from the Management and the Predecessor or Previous Auditor, in case of change of Auditor;
- Determination of subject matters and audit areas requiring special attention, when considered necessary;
- Risk Assessment and Materiality;
- Audit technique;
- Allocation of audit resources for the audit; and
- Preparation of audit schedule.

The audit approach may be a reliance or systems-based approach where the preliminary assessment has shown that controls are robust and proper procedures have been followed; or a substantive approach where the preliminary assessment shows controls to be poor, or where testing shows that the controls have not operated continuously and effectively during the period being audited, or where controls (even if deemed to be good or excellent) are not tested (whether due to lack of resources, expertise, etc.)

Materiality, together with the Auditor's assessment of inherent risks and the Auditor's preliminary assessment of internal controls, provide the basis for the appropriate audit approach. The combined assessment of inherent risk and evaluation of internal control helps to determine the nature and extent of the audit procedures to be designed and performed.

The audit shall be planned in a manner which ensures that qualitative audit is carried out in an efficient, effective and timely manner. Audit planning shall ensure that appropriate attention is accorded to crucial areas of audit and significant issues are identified in a timely manner.

Test Yourself

Question: Whether preparation of Audit Plan is mandatory?

Answer: The Auditor shall make audit plan to conduct audit as per the terms of Audit Engagement.

Essentials of Audit Planning

The Audit planning helps to develop an audit approach which will ensure that sufficient appropriate evidence is gathered to support the audit opinion in the most cost effective manner. For a successful audit plan, the following points should be considered by auditor:

- Ensuring the quality of Audit:The Audit should be planned in such manner, which ensures the high quality of audit in economic, efficient, and effective way and in a timely manner.
- Documented Audit Plan: The Audit plan should be documented and should be kept with the audit working papers.
- Clubbing of inter related steps: The Inter related steps and events should be clubbed together.
- Finalization type of Audit Plan: The elements of an audit plan may be similar for different auditee entities. However, the actual contents may differ from auditee to auditee enterprise, and on nature, type & objective of the audit or authentication assignment.
- Independent review of Audit Plan : The audit plan should be reviewed by the experienced auditor, normally not engaged on the assignment. Their experience may be useful to modify the audit plan to meet the audit objectives more vigorously.
- Flexibility: The audit plan should be flexible enough to accommodate modifications which may be necessary and should be carried out with the approval of team leader.
- Reaching conclusion: Auditing involves the collection and analysis of facts and data sufficient to reach reliable and valid conclusions about the subject of the audit.
- Training and communication to Audit Staff: The Auditing staff should be made familiar of the quality control policies and procedures of the firm. The hierarchy, responsibility & authority for decision making needs to be clearly defined and understood by the audit staff.

CASE STUDY

Secretarial Auditor Engagement and Audit Planning in case of Sun Moon Ltd.

- **Engagement of Secretarial Auditor**

Sun Moon Ltd by receiving consent letter and passing Board resolution has appointed secretarial auditor M/s J J & Associates (Practicing Company Secretaries Firm)

Intimation to earlier Incumbent

M/s J J & Associates (Practicing Company Secretaries Firm) is appointed as Secretarial Auditor in place of the existing Secretarial Auditor Mr. ABC, M/s J J & Associates shall intimate the appointment to the earlier incumbent in writing.

- **Acceptance of Appointment**

An appointment letter to be issued by the Sun Moon Ltd to M/s J J & Associates along with a copy of the board resolution. Accordingly, the M/s J J & Associates shall confirm acceptance/Rejection (as the case may be) of appointment in writing.

- **Preliminary Discussions/Surveys**

It is important to have relevant information about the company. The secretarial auditor is expected to take an overview of the operations of the company and interact with the personnel involved to know about the nature of the business. He may opt for surveys for generating information about the company.

- **Preliminary Meeting**

The preliminary meeting with the senior management and the administrative staff involved in the audit will give a fair idea of what is expected and the manner in which audit activities are to be undertaken. In the meeting the preliminary questionnaire and the initial observations of the secretarial auditor may be put forth and discussed. At this stage time frame of the audit should be determined and finalized. The secretarial auditor shall at this stage discuss the scope and objectives of the audit, gather information on important processes, evaluate existing controls, and plan the audit steps.

- **Finalization of Audit Plan and Briefing the Staff**

For an efficient and effective audit report it is important to work out an action plan. The work plan involves briefing the audit staff as to allotment of work, fieldwork responsibilities and other roles. The audit plan should comprehensively outline the fieldwork and usage of auditing tools. The review of controls helps the auditor determine the areas of highest risk and design tests to be performed in the fieldwork section. It is essential that the audit work plan is in adherence strictly with the timelines.

- **Testing, Interviews and Analysis**

The secretarial auditor may use a variety of tools and technology to gather information about the company's operations. It is during this stage that the Secretarial Auditor determines whether the controls identified during the preliminary review are operating properly and in the manner described by the Company. Fieldwork typically consists of interviewing with staff of the company whether formally or informally, reviewing procedure manuals, processes, testing and analysing compliance with applicable policies and procedures and laws, rules, regulations, and assessing the adequacy of controls. This is a crucial stage which relates to significant findings which the secretarial auditor uses while preparing the draft audit report.

- **Working Papers**

Working papers are a vital tool of the audit profession. They are the support of the audit opinion. They connect the management's records and financials to the auditor's opinion. They are comprehensive and serve many functions.

- **Preliminary Report/Audit Summary for Discussions**

The detailed commentary describing the findings and recommended solutions shall be summarised and presented for initial discussions with the management for their insights and clarity. Upon completion of the fieldwork, the auditor to summarize the audit findings, conclusions, and recommendations necessary in the form of the audit report.

- **Audit Report Submission**

The auditor shall prepare the final report based on the field work and working papers to present the audit findings and discuss recommendations for improvements, if any. The Final report shall contain the opinion on the statutory compliances examined by the auditor and shall state whether in his opinion the Company is carrying out / not carrying out due compliances of the applicable provisions of the various corporate laws. A final meeting shall be an opportunity for the management and the auditor to discuss various aspects of the audit report and review management responses. This is an opportunity to discuss how the audit went and any remaining issues to be scrutinized. The final report shall be provided with or without qualifications.

- **Review of audit plan**

As part of Secretarial Audit's self-evaluation program, the secretarial auditor after the completion of the audit work plan shall investigate into the details of how did the audit plan work out, assess the odds and take corrective measures for future audits.

Developing the Audit Plan

The Auditor establishes the overall audit strategy, which sets out the scope, timing and direction of the audit and guides the development of the more detailed audit plan which should include the following:

1. Introduction – a short introduction about the audit;
2. Audit field – A description of the audit field, including the regulatory framework for the audit where relevant and recent significant changes and developments that may affect the audit;
3. Audit objectives – The audit objectives depend on the type of audit to be conducted;
4. Audit coverage – The audit coverage periods to be covered and locations to be visited; control systems to be tested and sample to be audited;
5. Materiality – Identification of materiality in terms of value, nature and context;
6. Risks – A preliminary assessment of risks (e.g. changes in the regulatory environment or internal control systems and evaluation of inherent and control risk);
7. Audit approach – The audit approach, including the audit procedures to be carried out in order to provide the necessary audit evidence. This identifies the extent of planned reliance on control systems and the extent of substantive procedures;
8. Organisation – Organisation of audit work: resources (including recourse to the work of other Auditor and experts), timetable (including the reporting objectives of the audit), documentation in electronic audit support system.

The Auditor shall adhere to the audit plan. The audit plan may be modified, if circumstances so warrant. The audit plan should be documented in audit file, including significant changes made during the course of the audit and the reasons for such changes. The audit plan should be updated and modified as may be necessary during the course of the audit, whether due to unexpected events, changes in conditions or audit evidence obtained. This may have an impact on the planned nature, extent and timing of planned audit procedures. Updation of audit plan may be carried out in the circumstances such as change in business plan, changes in the regulatory environment, changes in management, etc.

The Auditor shall plan the audit with professional scepticism so that it is possible to exercise professional judgment in an objective manner. The application of professional scepticism enhances the effectiveness of applied audit procedures and reduces the risk and possibility that the Auditor will reach an inappropriate conclusion when evaluating the results of audit procedures.

CASE STUDY:

*Audit Plan & Process of Case Western Reserve Office of Internal Audit Services

A key function of the Office of Internal Audit Services is to understand, audit, and report to management on how that risk is being managed. Knowing what areas to audit and where to commit resources is an integral part of managing the internal audit function.

To identify areas of potential risk, each year the Office of Internal Audit Services performs a thorough risk assessment of all university management centers, operating units, and significant departments. From this assessment, an Audit Plan is developed and presented to the Audit Committee for approval.

Step 1: Planning

The auditor will review prior audits in your area and professional literature. The auditor will also research applicable policies and statutes and prepare a basic audit program to follow.

Step 2: Notification

The Office of Internal Audit Services will notify the appropriate departments regarding the upcoming audit and its purpose, at which time an opening meeting will be scheduled.

Step 3: Opening Meeting

This meeting will include management and any administrative personnel involved in the audit. The audit's purpose and objective will be discussed as well as the audit program. The audit program may be adjusted based on information obtained during this meeting.

Step 4: Fieldwork

This step includes the testing to be performed as well as interviews with appropriate department personnel.

Step 5: Report Drafting

After the fieldwork is completed, a report is drafted. The report includes such areas as the objective and scope of the audit, relevant background, and the findings and recommendations for correction or improvement.

Step 6: Management Response

A draft audit report will be submitted to the management of the audited area for their review and responses to the recommendations. Management responses should include their action plan for correction.

Step 7: Closing Meeting

This meeting is held with department management. The audit report and management responses will be reviewed and discussed. This is the time for questions and clarifications. Results of other audit procedures not discussed in the final report will be communicated at this meeting.

Step 8: Final Audit Report Distribution

After the closing meeting, the final audit report with management responses is distributed to department personnel involved in the audit, the President, Chief Financial Officer, and CWRU's external accounting firm.

Step 9: Follow-up

Approximately six months after the audit report is issued, the Office of Internal Audit Services will perform a follow-up review. The purpose of this review is to conclude whether or not the corrective actions were implemented.

**Source: https://case.edu/auditservices/about/customer-service*

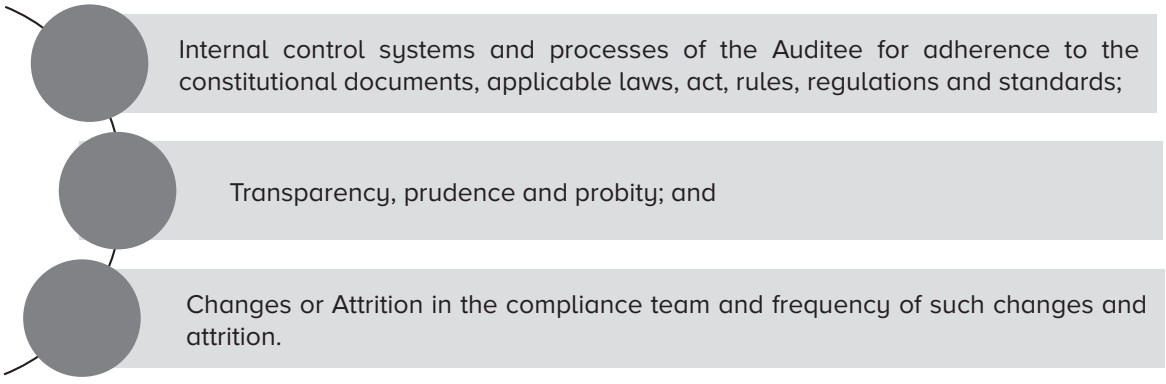
RISK ASSESSMENT

Risk: A risk is defined as 'threat or possibility that an action or event will adversely or beneficially affect an organization's ability to achieve its objectives'.

Risk Assessment: a systematic process of evaluating the potential risks that may be involved in a projected activity or undertaking.

As per CSAS-2 para 2, Risk assessment of the Auditee with respect to and connected/relevant to the Audit Engagement shall be done considering industrial & business environment, organisational structure and compliance requirements. The industrial & business environment includes the regulatory changes & judicial orders, compliance and disclosure requirements, etc.

The Auditor shall evaluate high risk areas and activities of the Auditee relating to:



The Auditor shall endeavor to make assessment of risk and shall identify critical and high risk areas; the risk assessment by Auditor can be made:

- by considering the underlying risk assessed by Management or internal and/or specific expert/ agencies and analysis thereof;
- by reviewing policies and procedures put in place to mitigate risk;
- by having insight into the objectives, key performance indicators, risks and control measures, holding meetings with key executives of the Auditee.

CASE STUDY

Materiality & Risk Assessment

You have been working as a partner in M/s ABC & Associates for six years. M/s ABC & Associates is a medium-sized Practicing Company Secretaries Firm. The firm provides secretarial auditing and internal auditing services. Furthermore, M/s ABC & Associates provides services in the areas such as corporate laws, securities laws & capital market and corporate governance. Most of the clients are in the processed food industry.

M/s ABC & Associates has a Client Acceptance Policy that sets out principles to determine whether to accept a new client or a new engagement. These principles are fundamental to maintaining quality, managing risk, protecting the firm and meeting regulatory requirements.

As part of the client acceptance process, M/s ABC & Associates carefully considers the risk characteristics of a prospective client and conducts several due diligence procedures. Before M/s ABC & Associates accepts a new engagement or client, M/s ABC & Associates determines if it can commit sufficient resources to deliver a high quality audit. The approval process is rigorous, and no new audit engagement may be accepted without the approval of M/s ABC & Associates Managing Partner. M/s ABC & Associates dedicates significant time and resources to the strict implementation of their client acceptance policy. All prospective audit engagements are classified as either 'High Risk', 'Moderate Risk' or 'Low Risk'.

M/s ABC & Associates has set up a team to prepare a recommendation to the Managing Partner for every client acceptance decision in FY 2023-2024.

The managing partner of M/s ABC & Associates met the chairman of the audit committee of a company called 'XYZ Ltd' in the last week of March 2023. The chairman indicated that the company has decided to change its current secretarial auditor.

For new engagements, the CSAS-1 require that the potential new auditor communicates with the predecessor auditor about the audit engagement.

DETERMINING MATERIALITY

1. Identify business risks for the processed food service sector;
2. Identify and evaluate the factors important in assessing an audit client's business risk and the risk of material misstatement;
3. Identify and understand the implications of key inherent and business risks associated with a new client;
4. Determine planning materiality for an audit client;
5. Provide support for your materiality decisions.

After you have accepted XYZ LTD as a new client, you are provided with the financial statement of last three years for the purpose of risk assessment.

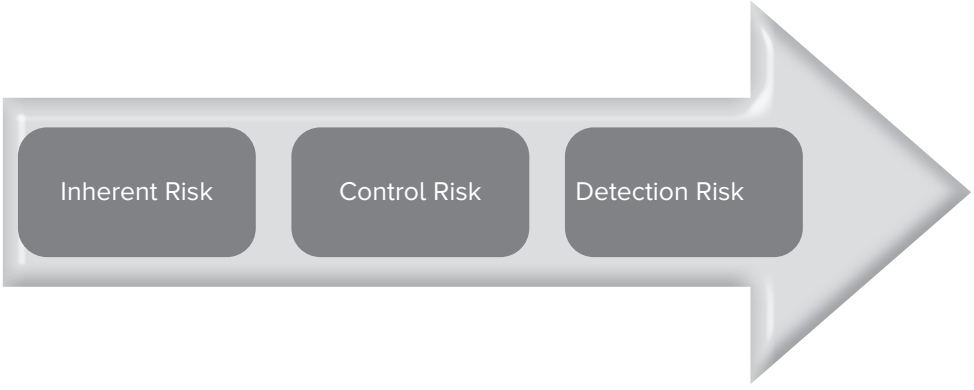
Test Yourself

Question: Is risk assessment required to be done for audits?

Answer: Yes. Risk assessment of auditee with respect to the audit shall be done considering industrial and business environment, organisational structure and compliance requirements.

Auditing risk means that an auditor accepts/presumes some level of uncertainty in performing the audit work, which means that the auditor accepts the risk that the audit opinion given by the auditor might be wrong. Only a very small degree of audit risk would be acceptable as otherwise the audit process may lose its purpose.

The audit risk has three components



Inherent Risk: Inherent risk is the susceptibility of a class of transaction to misstatement that could be material, individually or when aggregated with misstatements in other transaction, assuming that there were no related internal controls. For example, Genuineness of the related party transactions.

Control Risk: Control Risk is the risk that a misstatement that could occur in an class of transactions and that could be material individually or when aggregated with misstatement on other transaction, will not be prevented or detected and corrected on a timely basis by the internal control systems. For example, delay in the filing of forms.

Detection Risk: Detection Risk is the risk that an auditor's substantive audit procedures will not detect a misstatement that exist in class of transactions that could be material, individually or when aggregated with misstatement on other transaction. For example, while certification of e-form, the auditor has overlooked the compliance of the Secretarial Standards.

The auditor should maintain the high level of the assurance/confidence while expressing the audit opinion, and this is the most important steps in the audit planning to ensure that the audit team will gather competent, relevant and reasonable audit evidence at minimum cost.

There is an inverse relationship between materiality and the level of audit risk that is, the higher the materiality level, the lower the audit risk and vice versa. Auditor should take note of the inverse relationship between materiality and audit risk when determining the nature, timing and extent of audit procedures.

Risk Assessment Process Overview:

Identify Key Risks	Evaluate Risks	Prioritize Identified Risks	Develop and refine internal Audit Plan
Gather information on each department's risks based on: ● Financial significance ● FTEs ● Directional change; reorganizations, turnover ● Past internal audits ● Survey elected officials ● Interviews ● COSO's ERM PESTLE areas: (Political, Economic, Social, Technological, Legal Compliance, Environmental) Capital, People, Process, and Technology. Consolidate results and review for common themes.	Score departments based on inherent risks identified and those risks identified through analysis and interviews. Assess and prioritize key risks by control objective based on vulnerabilities, likelihood, and impact of a negative event.	Map high-risk prioritized departments and identified risks to control objectives Prioritize other risks Identified. Define high-level scope of internal audit projects based on prioritized risks. Develop preliminary Internal Audit Plan based on key risks identified and feedback from management.	Validate Internal Audit Plan internally. Present Internal Audit Plan to Audit Committee. Review and adjust Internal Audit Plan throughout the year.

Source: https://reciprocity.com/blog/risk-assessment-and-internal-controls/

***Sample Internal Audit Risk Assessment Questionnaire**

Please submit the following along with your responses, if applicable:

a. Risk Assessment completed during the last year:

b. Organizational Chart :

c. Any reviews conducted in the area of responsibility either internally or by external auditors and/or consultants. Please provide a copy of any report with results of the review:

1. Based on the goals and objectives of the unit, what obstacles do you face that could affect or keep you from achieving your goals and objectives (e.g. resources, priority of project, support from management)?
    a. Strategic – Goals
    b. Financial – Assets
    c. Operational – Processes
    d. Compliance – Laws & Regulations
    e. Reputational – Public Image
2. What recent events have occurred in this unit (e.g. new degrees, centers, change in management, turnover of staff)?
3. What are some of the areas of risk that your unit is facing? In other words, what exposures do you have that could potentially pose a threat or disruption to your research/business/ academic programs? What keeps you up at night when you think of what "could" go wrong? Consider the various areas including but not limited to financial risks, human resources, technological, students, legal and regulatory compliance, public relations or political risk, changes in units (reorganization, turnover).
4. What do you have in place to manage and deal with these risks?
5. What is the worst thing that has already happened in your unit?
6. How do you measure your performance? Have you obtained the desired outcome in recent years?
7. What other units do you depend on to achieve your objectives? Do you feel you receive the information and support you need from these units? If not, please explain why and the difficulties you have encountered
8. Who are your key stakeholders or external constituents (e.g. donors, legislatures?)
9. Are there any particular areas within your unit or on campus which you currently have a concern about? If so, please explain. Please describe or list any areas or concerns that you would like reviewed by Internal Audit.
10. What unique systems do you have and how critical are they to the functioning of your unit? Have you had any performance issues? Who supports these systems? Do you have any systems that contain confidential or critical information such as student, or employee information (eg. social security numbers, etc.)
11. Describe or List any areas in which you are aware of fraud and abuse and the nature of the fraud and abuse.
12. How can Internal Audit meet the expectations of your unit? Do you feel comfortable calling Internal Audit with a problem or concern?

Please list any other comments, questions or concerns.

** Source: https://www.template.net/business/assessment/internal-audit-risk-assessment-templates/*

INFORMATION ABOUT THE AUDITEE

As per CSAS-2 para 3, the Auditor shall obtain sufficient information about the Auditee that is relevant for conduct of audit and forming an opinion and its expression.

It should *inter-alia* cover the following details:

- Nature of the business of the Auditee;
- Sector in which the Auditee operates and how Government / Regulatory policies have evolved specific to such sector;
- Size of the business of the Auditee including geographical locations;
- Organisation structures including Directors and KMPs;
- Corporate structure, associates, joint ventures, subsidiaries;
- Laws applicable to business of the Auditee;
- Registrations and permissions obtained;
- Court & regulatory orders enforced;
- Media Reports.

AUDIT CHECK-LISTS

As per CSAS-4 para 4, the Auditor shall use systematic and comprehensive audit checklists for carrying out the audit and to verify the compliance requirements.

The Auditor shall compile and validate the checklists for use in the audit process on the basis of information gathered about the Auditee and scope of the audit. It is a useful tool to ensure that no compliance point is missed or omitted while conducting audit. The Audit checklist should provide structure and continuity to an audit. Checklists provide a means of communication and a place to record data for use for future reference.

Ideally audit checklists should:

- promote overall planning and timelines of the audit;

- ensure comprehensive, consistent and focussed audit approach;
- avoid duplication of data verification and information;
- ensure that audit scope is being followed;
- serve as a memory aid and provide a repository for notes collected during the audit process.

Audit checklists should be developed to provide assistance to the audit process and should be reviewed and updated from time to time to meet the scope of audit and its effectiveness. Audit team should be trained in the use of a particular checklist and be shown how to use it to obtain optimal information.

Illustration: Audit Findings are expressed in the following manner on the audit checklist:

- Non - conformty (major)
- Non - conformty (minor)
- Opportunity for improvement

Classification	Non-compliance with	Typical form	Reaction of the audited unit
Non-conformity (major)	Binding requirements that must be observed by the audited unit (laws, official regulaions, other external requirements, customer requirements etc.)	● Systematic and relevant systematic deviations ● Accumulation of minor non-Conformities ● Relevant impact on occupational safety, health, environment, nearby areas or finances ● Relevant legal consequences are to be expected	● Immediate action ● Corrective action ● Cause analysis ● Deadline ● Responsible person ● Follow up
Non-conformity (minor)		● lndividual or minor cases and/or minor deviations ● Minor impact on occupational safety, health, environment, nearby areas or finances ● Minor legal consequences are to be expected	● Corrective action ● Cause analysis ● Deadline ● Responsible person ● Follow up
Opportunity for improvement	Best practices	● The binding requirements are observed ● There are no immediately recognizable negative effects ● Possible improvement of processes, procedure, effectiveness, efficiency	● Evaluation and feedback on further action

Source: https://www.template.net/business/checklist-templates/internal-audit-checklist/

COLLECTION AND VERIFICATION OF AUDIT EVIDENCE (CSAS-2 PARA 5)

The Auditor shall verify compliance with applicable laws, act, rules, regulations and standards. Deviation, if any, shall be recorded. The Auditor shall satisfy himself about compliance of the Auditee with the applicable laws, rules and regulations. If any deviation is observed, then the appropriate noting of the same shall be made.

The Auditor shall obtain complete, relevant and necessary evidence to support the opinion. Audit evidence is obtained using a variety of techniques such as the following:

1. **Documents/Records Scrutiny**

   This is predominant mode of obtaining audit evidence and involves scrutiny of a wide variety of documents e.g. board resolutions, agenda and minutes, notices, registers, records, procedure manuals, reports, etc. In auditing, it is often not possible, due to limited resources, to check every document or record. The Auditor, wherever necessary, may choose to sample a statistical representative number of documented results, such as monitoring big data or incident reports. An appropriate sampling method will manage any uncertainty to an acceptable level.

2. **Testing, Interviews and Analysis**

   The Auditor should determine whether the controls identified during the preliminary review are operating properly and in manner described by the Auditee. Fieldwork typically consists of interviewing the staff of the Auditee whether formally or informally, reviewing procedure manuals and processes, testing and analyzing compliance with applicable policies and procedures and laws, rules, regulations and assessing the adequacy of controls. This exercise may result in significant findings, which the Auditor should consider while preparing the audit report.

3. **Questionnaires**

   This involves seeking information from relevant persons within the Auditee through issue of a formal questionnaire to elicit further information and gather relevant audit evidence.

4. **Third Party Confirmation**

   Third party confirmation is a type of inquiry and involves obtaining, independently of the Auditee, a reply from a third party with regard to some particular information – for example Registrar and Transfer Agents or other third party agencies.

5. **Analytical Procedures**

   Analytical procedures involve comparing data, or investigating fluctuations or relationships that appear inconsistent in various records.

Test Yourself

Question: Is audit evidence necessary to support in formation of opinions?

Answer: Yes. the auditor shall obtain complete, relevant and necessary evidence to support the opinions. Further, the Auditor shall keep gathering and evaluating evidence until he is satisfied that sufficient and appropriate evidence exists to provide a basis for formation of the Audit Opinion.

The process of gathering and evaluating evidence shall continue until the Auditor is satisfied that sufficient and appropriate evidence exists to provide a basis for formation of the Audit Opinion.

Audit evidence collected through above mentioned audit procedures is to be evaluated against the relevant, already identified criteria. This involves consideration of evidence collected vis-a-vis the subject matter information, as well as the written responses obtained from responsible officers of the Auditee under the scope of audit.

THIRD PARTY CONFIRMATION

The Auditor shall obtain confirmations from third party(ies), wherever required, with respect to information which is related to such party(ies).

Third party confirmation is a type of inquiry and involves obtaining, independently of the Auditee, a reply from a third party with regard to some particular information – for example Registrar and Transfer Agents or other third party agencies.

During the course of audit, if circumstances warrant, the Auditor shall obtain the information from the third parties. In such cases, a written request should be made to obtain the information. An external confirmation is audit evidence obtained as a direct written response to the Auditor from a third party in paper form, or through electronic or other medium. Requesting external confirmations is a commonly used audit procedure in an audit. It can be useful in obtaining audit evidence about significant transactions outside the normal course of business, and related party transactions.

Circumstances may exist where it may be difficult to obtain responses to external confirmation requests. The auditor should plan alternative or additional procedures.

Test Yourself

Question: Is third party confirmation relevant during the course of audit?

Answer: The Auditor shall obtain confirmations from third party(ies), wherever required, with respect to information which is related to such party(ies). During the course of audit, if circumstances warrant, the Auditor shall obtain the information from the third parties. In such cases, a written request should be made to obtain the information.

ANALYSIS OF AUDIT EVIDENCE

The Auditor shall evaluate the Audit Evidence to arrive at the conclusion. The Auditor shall verify compliance with applicable laws, rules and regulations and highlight deviations, if any. Further, the Auditor has to obtain competent, relevant and reasonable evidence to support his judgment as well as conclusions relating to the audit.

The evidence gathering and evaluation is a simultaneous, systematic and an interactive process and involves:

- Gathering evidence by performing appropriate audit procedures;
- Evaluating the evidence obtained as to its sufficiency (quantity) and appropriateness (quality);
- Re-assessing risk and gathering further evidence as necessary.

The evidence gathering and evaluation process should continue until the Auditor is satisfied that sufficient and appropriate evidence exists to provide a basis for the Auditor's conclusion. Audit evidence should be evaluated against the identified criteria. This involves consideration of evidence collected vis-à- vis the subject matter information as well as the written responses obtained from responsible officers of the Auditee. Auditor should check that the audit evidence is relevant and reliable.

While evaluating evidence, if the Auditor finds that Audit Evidence is conflicting, the Auditor shall assess the extent and credibility of conflicting evidence in order to reach a conclusion or collect more evidence to resolve the conflict.

After evaluating the evidence and considering its materiality, the Auditor should decide how best to conclude in the light of the evidence collected, which would be the supporting key documents and arrive at audit conclusions. While evaluating evidence, Auditor can find that audit evidence is conflicting i.e. while some evidence supports the subject matter information other evidences seem to contradict it. In such circumstances, the Auditor needs to assess the extent and credibility of conflicting evidence, undertake alternate audit procedure to corroborate the evidences in hand for forming an appropriate opinion.

Test Yourself

Question: What shall the auditor do in case the evidence is found to be conflicting?

Answer: While evaluating evidence, if the Auditor finds that Audit Evidence is conflicting, the Auditor shall assess the extent and credibility of conflicting evidence in order to reach a Conclusion or collect more evidence to resolve the conflict.

CASE LAW

In the matter of *Price Waterhouse & Co. Vs. Securities & Exchange Board of India Securities Appellate Tribunal Mumbai Appeal No. 6 of 2018*, it was held that there must be evidence to show that there was fabrication, falsification and fudging of the books of account of SCSL by the appellants and that the said fabrication, etc. was done with intent, knowledge, connivance and collusion with the management in order to play a fraud on the shareholders/investors. The evidence must be apparent and glaring and not on the basis of preponderance of probabilities. There must be direct evidence of falsification and fabrication of the books of account

DOCUMENTATION

The Auditor shall adequately document the Audit Evidence in working papers, including the basis and extent of planning, work performed and the findings of audit.

The word "document" is used to refer to a written or printed paper that bears the original, official, or legal form of something and can be used to furnish decisive evidence or information. "Documentation" refers to the act or an instance of the supplying of documents or supporting references or records.

Documentation of audit evidence supports audit conclusions and confirms that the audit was carried out in accordance with scope of audit.

The Audit documentation is important for several reasons including:

- Confirm and support the Auditor's opinion and reports;
- Increase the efficiency and effectiveness of the audit;
- Serve as a source of information for preparing reports and or answering any enquiries from the Auditee or from any other party;
- Serve as evidence of the Auditor's compliance with applicable standards;
- Facilitate planning and supervision;
- Help the Auditor's professional development;
- Help to ensure that delegated work has been satisfactorily performed;
- Provide evidence of work done for future reference;
- The user of the audit report rely upon the audit report with proper documentation;
- It confirms that the Auditor's report is in conformity with the applicable laws, rules, regulations and standards, etc.

The Audit Documents shall contain sufficient information to enable an Auditor, having no previous connection with the audit, to ascertain from such documents the significant findings and conclusions of the Auditor. Audit documents should be comprehensive, understandable with ease and contain all the significant information related to the scope covered under the audit.

According to the *Public Company Accounting Oversight Board (PCAOB): Audit documentation should be prepared in sufficient detail to provide a clear understanding of its purpose, source, and the conclusions reached. Also, the documentation should be appropriately organized to provide a clear link to the significant findings or issues. Examples of audit documentation include memoranda, confirmations, correspondence, schedules, audit programs, and letters of representation. Audit documentation may be in the form of paper, electronic files

*The Public Company Accounting Oversight Board (PCAOB) is a nonprofit corporation established to oversee the audits of public companies. The PCAOB also oversees the audits of brokers and dealers registered with the U.S. Securities and Exchange Commission (SEC).

Source: https://pcaobus.org/oversight/standards/archived-standards/pre-reorganized-auditing-standards-interpretations/details/Auditing_Standard_3#:~:text=Audit%20documentation%20should%20be%20prepared,the%20significant%20findings%20or%20issues.

Audit Documentation shall take place throughout the audit process. Working papers shall be complete and appropriately detailed to provide a clear trail of the audit. Audit Documents shall be properly indexed, referenced with and supplemented by the set of working papers.

CASE LAW

In *Re V. Shankar Vs. Securities and Exchange Board of India SAT Appeal No. 283 Of 2022,* it was held that the Company secretary, as part of his duty and responsibility is only required to authenticate contents indicated in balance sheet or in offer document and is not required to go into veracity of buy back offer document and its legal compliances before authenticating such document and, therefore, company secretary could not be held guilty of making false or misleading open offer which had been approved by board of directors of company.

Some of the broad characteristics of Audit Documentation are set out below :

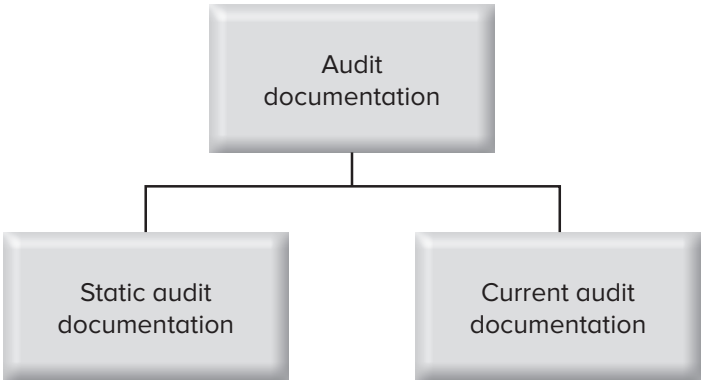
Completeness and accuracy	● Provide support to audit conclusions
Clarity and conciseness	● Facilitates understanding the entire audit process without need for any supplementary examination.
Legibility and neatness	● Applies particularly to photocopies
Ease of reference	● Working papers may be organised in volumes in a manner that facilitates easy reference
Relevance	● Working papers should be restricted to matters, which are important, pertinent and useful for the intended purpose
Ease of review	● Working papers should contain cross references to audit plan, discussion papers, audit observations, field audit report and the compliance audit report, as the case may be, to enable Auditor to link the working papers to audit findings and conclusions
Complete audit trail of analysis	● Working papers should provide a complete trail of the audit procedures performed, evidence that were gathered and evaluated, audit findings and conclusions that were drawn.

Test Yourself:

Question: What is the importance of audit documentation?

Answer: The Auditor shall adequately document the Audit Evidence in working papers, including the basis and extent of planning, work performed and the findings of audit. Documentation of audit evidence supports audit conclusions and confirms that the audit was carried out in accordance with scope of audit.

Audit documentation may be divided into two categories:



- ✓ Auditor appointment letter
- ✓ Record of communication with the previous Auditor and his resignation letter
- ✓ Information pertaining to the legal aspects of the Auditee
- ✓ Constitutional Documents - MOA, AOA, LLP Agreement, JV Agreement, Share Purchase Agreement etc.
- ✓ Complete details of the management
- ✓ Copies of audited financial statements of the previous years
- ✓ Details of holding, subsidiary, associate companies and joint ventures.

- ✓ Evidence that the work performed was supervised and reviewed
- ✓ Audit review points and highlights
- ✓ Major weakness in the internal control systems
- ✓ Confirmations, if sought, received from the Auditee
- ✓ Communication with the third parties
- ✓ Evidence of the audit planning process

Documentation of discussions held with management related to significant matters, where written record is not available:

Relevant discussions with the Management should be recorded and documented. The Confirmations, if sought, received from the Auditee should be taken on record. Documentation of audit evidence supports audit conclusions and confirms that the audit was carried out in accordance with the scope of the audit. The Auditor should adequately document the audit evidence, including the basis and extent of planning, work performed and the findings of audit.

What does the significant matters mean?

Significant Matters: Judging the significance of a matter requires an objective analysis of the facts and circumstances. Significant matters include, Matters that give rise to significant risks; Circumstances that cause the auditor significant difficulty in applying necessary audit procedures and Findings that could result in a modification to the auditor's report.

Source: https://www.ifac.org/system/files/downloads/2008_Auditing_Handbook_A075_ISA_230.pdf

Test Yourself:

Question 1: When shall the audit documentation take place?

Answer: The Audit documentation, shall take place throughout the audit process. Working papers shall be complete and appropriately detailed to provide a clear trail of the audit. Audit Documentation shall be properly indexed, referenced with and supplemented by the set of working papers.

Question 2: Whether discussion with management should also be documented?

Answer: Yes. the Auditor shall also document discussion with the management with respect to significant matters in respect of which written record is not available.

RECORD KEEPING AND RETENTION

The Auditor shall establish policies and procedures for retention of Audit Documents. A well established policies and procedures should be in place for the documentation. Audit Documentation is essential for the following purposes:

- To comply with legal duties and requirements, either statutory or regulatory;
- To avoid liability, the improper destruction or alteration of documents in a litigation situation;
- To support or oppose a position in an investigation or litigation;
- To protect from unnecessary expense and time during discovery;
- To maintain control over discovery and e-discovery; and
- To keep documents confidential and avoid leakage to attackers or competitors.

The Audit Documents shall be collated for records within a period of 45 days from the date of signing of Auditor's Report. The documents should be maintained in a manner which is safe, secure and retrievable as and when required.

The Audit Documents shall be maintained in physical or electronic form and retained for a period of 8 years from the date of signing of Auditor's Report.

Test Yourself:

Question 1: Within how many days shall the audit documents be collated for records?

Answer: The audit documents shall be collated for records within a period of 45 days from the date of signing of Auditor's Report.

Question 2: For how long the Audit documents are required to be maintained?

Answer: The Audit Documents should be maintained in physical or electronic form and retained for a period of 8 years from the date of signing of Auditor's Report.

LESSON ROUND-UP

- Sufficiency is the measure of the quantity of audit evidence and depends on various factors including internal controls systems and risk involved.
- Appropriateness is the measure of the quality of audit evidence, i.e. its relevance and reliability.

- This Auditing Standard CSAS-2 is applicable to the Auditor undertaking Audit under any statute. The Standard deals with responsibilities and duties of the Auditor with respect to Audit Process in conducting audit and maintaining proper audit documents.
- The working paper file contains the documents relating to the work performed by the auditor.
- The audit evidence is fundamental and important part in the audit process. The auditors need audit evidence to form and conclude their audit opinion
- The audit plan, describes the processes and activities that are to be carried out in connection with a particular audit and for the improving the quality of audit.
- Risk assessment of the Auditee with respect to and connected/relevant to the Audit Engagement shall be done considering industrial & business environment, organisational structure and compliance requirements.
- The Auditor shall obtain sufficient information about the Auditee that is relevant for conduct of audit and forming an opinion and its expression.
- The Auditor shall use systematic and comprehensive audit checklists for carrying out the audit and to verify the compliance requirements.
- The Auditor shall verify compliance with applicable laws, act, rules, regulations and standards. Deviation, if any, shall be recorded.
- The Auditor shall obtain confirmations from third party(ies), wherever required, with respect to information which is related to such party(ies).
- The Auditor shall evaluate the Audit Evidence to arrive at the conclusion. The Auditor shall verify compliance with applicable laws, rules and regulations and highlight deviations, if any. Further, the Auditor has to obtain competent, relevant and reasonable evidence to support his judgment as well as conclusions relating to the audit.

GLOSSARY

Audit Documents : Audit Documents means the working papers prepared or records obtained by the Auditor in connection with the audit.

Audit Evidence : Audit Evidence refers to relevant information and documents gathered in the course of the audit for arriving at the conclusion on which the Auditor's opinion is based.

Management : Management as defined in CSAS-1.

TEST YOURSELF

(These are meant for recapitulation only, Answer to these questions are not to be submitted for evaluation)

1. 'The audit process can be broadly grouped in three phases'. Prepare a note to substantiate the statement.
2. The interview is the most reliable source for obtaining the information for the auditor. Comment
3. ''The audit checklist assists auditors in conducting a thorough, systematic and consistent audit.'' Briefly highlight the benefits of checklist.
4. The Audit documentation is important for several reasons. Explain.
5. The Auditor shall evaluate the Audit Evidence to arrive at the conclusion. The Auditor shall verify compliance with applicable laws, rules and regulations and highlight deviations, if any. Elucidate.

LIST OF FURTHER READINGS
● Company Secretaries Auditing Standards ● Guidance Note on CSAS-2 ● Articles published by Professionals ● ICSI FAQ on CSAS-2

OTHER REFERENCES (Including Websites / Video Links)
● https://www.icsi.edu/auditing-standard/

Forming an Opinion & Reporting

Lesson 12

KEY CONCEPTS

■ Audit Evidence ■ Reporting with Qualification ■ Unqualified Opinion ■ Modified Opinion ■ Qualified Opinion ■ Adverse Opinion ■ Disclaimer of Opinion ■ Emphasis of Matter

Learning Objectives

To understand:

- The need to form an opinion on the affairs of the company to state whether they are in accordance with the applicable laws or not in any audit.
- The principles and procedure relating to preparing audit report.
- How an auditor should form his opinion on considering all material respects, in accordance with the applicable reporting framework and the requirement of the audit.
- Various forms of Audit opinion and its relevance under the audit report.

Lesson Outline

REGULATORY FRAMEWORK

- CSAS 3: Auditing Standard on forming of opinion.

INTRODUCTION TO PROCESS OF FORMING AN OPINION

The audit is performed by an Auditor who is independent to the company which is being audited and the critical part in auditing is the forming of opinion i.e. views of the auditors, which shall be based on the fact, records and verifications made by him during the performance of the audit. This requires auditors to have knowledge of the basic principles of forming an audit opinion and should have expertise in application of knowledge while forming opinion. *(In Re Bhikubhai Vithlabhai Patel and Others Vs. State of Gujarat and others, Gujarat High Court Mis Civil Appeal for review no, 3165 of 2006,* it was held that the existence of relevant material is a precondition to the formation of opinion. The formation of opinion, though subjective, must be based on material disclosing that a necessity had arisen.)

Upon the performance of the audit and conclusion thereof, the auditor is required to submit a report stating that the affairs of the company are carried out in the fair manner and are free from material misstatement.

However, the content of the opinion should clearly indicate whether it is unmodified or modified and if modified, whether it is modified as adverse or disclaimer of opinion. The auditor should form his opinion on considering all material aspects, in accordance with the applicable reporting framework and the requirement of the audit and after obtaining reasonable assurance about whether the affairs of the company relating to the scope of audit as a whole are free from material misstatement or not.

In particular, the auditor shall evaluate whether, in view of the requirements of the applicable reporting framework:

(a) The Company has adequately disclosed all relevant information about its affairs;

(b) The Company has followed all procedures as required under the applicable laws;

(c) The Company is in compliance with the applicable laws;

(d) The Company is consistent with the applicable reporting framework;

(e) The information presented by the company is relevant, reliable, comparable, and understandable; and

(f) The company has provided adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information.

Auditing Standard on Forming of opinion (CSAS-3)

The Auditing Standard on Forming of opinion (CSAS-3), formulated by Auditing Standards Board (ASB) of the Institute of Company Secretaries of India (ICSI) and issued by the Council of the ICSI, is effective from 1st July, 2019 on a recommendatory basis and shall be mandatory with effect from 1st April, 2021.

This Auditing Standard on Forming of opinion is applicable to the Auditor undertaking Audit under any statute. The Standard deals with basis and manner for forming Auditor's opinion on subject matter of the audit. This standard aims to promote consistency in opinion forming and reporting thereof to enable users of the report to identify the audit findings.

Objective

The objective of the Standard is to enable the Auditor to lay down the basis and manner for evaluation of the conclusions drawn from the Audit Evidence obtained and express the opinion through written report.

The objective is to standardise the process of analysis and evaluation of audit conclusions made during the audit process to form an opinion and express it in writing. The Standard lays down the principles that need to be applied while forming an opinion and expression thereof.

The evaluation under CSAS-2 refers to the evaluation of Audit Evidence to reach a conclusion, whereas this Standard deals with evaluation of conclusion(s) reached during audit process. This Standard also deals with the manner in which the opinion formed by the Auditor will be expressed in writing and circumstances and manner to disclaim the opinion and the reporting format.

FORMS OF OPINION

Unqualified / Unmodified Opinion

The auditor shall report an unqualified opinion if the affairs of the company are found to be free from material misstatements. In addition, an unqualified opinion is given over the existence and effectiveness internal controls of an entity if the management has claimed responsibility for its establishment and maintenance, and the auditor has performed fieldwork to test its effectiveness.

An unqualified opinion contains no reservations concerning the company. This is also known as a "clean" opinion, meaning that the affairs of the company are presented fairly.

The Auditor should express an unmodified opinion when based on Audit Evidence, the Auditor concludes that:

(a) there is due compliance with the applicable law in terms of timelines and process; and

(b) the records as relevant for the audit verified by him as a whole are free from misstatement and maintained in accordance with applicable laws.

"Records" include:

(i) Memorandum and Articles of Association, byelaws or any other constitutional documents;

(ii) Minutes, returns, forms, index and Registers;

(iii) Books and papers include books of accounts, deeds, vouchers;

(iv) Agreements, Memorandum of Understanding;

(v) Other documents maintained by the Auditee either in physical or electronic form; and

(vi) Correspondence.

Generally the Records means the Records for the audit period, however if an opinion forming warrants the review of prior period Records, the same may also be considered as Records. Further, the Records means the Records of an Auditee, however if an opinion forming warrants the Records of regulators, authorities and third parties may also be considered as Records

(c) the auditor concludes that the information on the affairs of the company in all material respects, are in accordance with the applicable reporting framework.

Para 4.1 of the of CSAS -3 Provides that -

The Auditor shall express an unmodified opinion when based on Audit Evidence, the Auditor concludes that:

(a) there is due compliance with the applicable laws in terms of timelines and process; and

(b) the records as relevant for the audit verified by him as a whole are free from misstatement and maintained in accordance with applicable laws.

Misstatement

"Misstatement" means any information or statement which is false, incorrect, incomplete, misleading or misrepresents, omits or suppresses a material fact.

Misstatement means when any written statement is found to be false, incorrect, incomplete, misleading, or which misrepresents or omits or suppresses any material fact from the given meaning of the stated sentence or paragraph or otherwise from the whole document, which in turn fails to portray a clear, true and fair meaning of the titled subject and ultimately purpose of the given statement is not attained or understood in its correct sense.

Causes of misstatement may include :

(a) an inaccuracy in gathering or processing data or information;

(b) an omission of a disclosure;

(c) an incorrect or clear misinterpretation of the facts; or

(d) Management's judgments that the Auditor considers unreasonable.

For Example:

1. XYZ an Auditee company has stated in its Annual Report that company has complied with all applicable regulations of SEBI during the Financial Years whereas the material non-compliances were not reported which impacts the Goodwill of the company, which can mislead the investors.

2. Company undertook a material related party transactions but it is not disclosed in the company's Annual Report.

An unmodified opinion is an audit report that has been issued with no reservations or qualifications regarding the state of compliances of all the applicable laws, rules and regulations of the Auditee's business activities, documents, or statements etc. In this opinion, the Auditor follows a standard opinion format to state that all the statements, documents or other business procedures are a fair representation of the condition of the Auditee's business, and in accordance with the applicable Laws.

In order to form unmodified opinion, Auditor shall conclude as to whether he has obtained reasonable assurance about whether the documents, books or statements as a whole are free from material misstatement, whether due to fraud or error.

An unmodified opinion is formed when based on all the Audit Evidences the Auditor states that there is due compliance of all the applicable laws, or any other law for the time being in force, or any rule or regulation in terms of timelines and process.

Compliance in terms of timelines: Compliance in terms of timelines implies that when the adherence of the applicable laws, act, rules or regulations are made within the specified time limits as provided in the law for the particular task or completing any business procedure etc.

Example: As per law the due date of filing the Annual Returns, i.e., Form MGT-7 of the company with Registrar of Companies is given as sixty days from the date of Annual General Meeting of the company and company has also filed the said return within the prescribed limit of 60 days, that means company has adhered to the applicable laws properly and within the given timelines.

Compliance in terms of process: Compliance in terms of process means that, when the business activities, say documentation, or any other transaction has been made, complying with the applicable laws and as per the procedure or process given for performing that activity/procedure or transaction etc. The process of doing or performing the task as per the given procedure in the applicable laws is known to be compliances made in "in terms of process".

Example: If a company is required to shift its registered office from one place to another within same state and RoC, the a whole set of procedures given in Companies Act, 2013 is required to be followed e.g. conducting a Board Meeting for approval of shifting of Registered office, intimation to Registrar of Companies in Form INC-22 along with various documents as attachment within 15 days of passing the Board Resolution.

Modified Opinion

Modifications to the Opinion:

The Auditor should express modified opinion when the Auditor concludes that:

(a) based on the Audit Evidence obtained, there is non-compliance with the applicable laws in terms of timelines or process; or

CASE STUDY

ABC Ltd. is a listed company on BSE India. The company has appointed M/s YY & Associates as secretarial auditor for the FY 2021-2022. M/s YY & Associates had issued audit report in Form MR-3. The audit report stated observations as below:

During the period under review the Company has complied with the provisions of the Act, Rules, Regulations, Guidelines, Standards, etc. mentioned above except to the extent as mentioned below:

S.No	Relevant Provision for Compliance Requirement	Observations
1	*Regulation 17 read with Regulation 25 of Securities Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulation, 2015 and Section 149(3) of the Companies Act, 2013 read with The Companies (Appointment and Qualification of directors) Rules, 2014*	*The Composition of the Board of Directors was not in compliance with the regulations from 27.12.2021 till 15.03.2022. The Company has rectified the Non- Compliance w.e.f. 16.03.2022.*
2	*Regulation 18 of Securities Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulation, 2015*	*The Composition of the Audit Committee was not in pursuance to the Regulations and the same has been rectified on 15.10.2021.*
3	*Regulation 21 of Securities Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulation, 2015*	*The Risk Management Committee of the company comprised of 50% of the members who were board of directors of the company which was not in pursuance to the Regulations however the same had been rectified on 01.10.2021.*
4	*Section 203 of The Companies Act, 2013 read with The Companies (Appointment and Remuneration) Rules, 2014*	*The Company had Group Chief Financial Officer, however did not have Chief Financial Officer (CFO) of the company till 31.05.2021.* *The Appointment of Chief Financial Officer (CFO) was made w.e.f. 01.06.2021.*

(b) based on the Audit Evidence obtained, the records as a whole are not free from misstatement; or are not maintained in accordance with applicable laws; or

(c) he is unable to obtain sufficient and appropriate Audit Evidence to conclude that there is due compliance with the applicable laws in terms of timelines and process; or

(d) he is unable to obtain sufficient and appropriate Audit Evidence to conclude that the records as a whole are free from misstatement; or are maintained in accordance with applicable laws.

CASE STUDY

Adjudication Order in respect *of CHD Developers Ltd. and 3 others in the matter of CHD Developers Ltd. (Adjudication Order: Order/MC/VS/2021-22/13557-13560)*, in this matter SEBI initiated adjudication proceedings against CHD Developers Ltd for violations of the SEBI LODR Regulations in respect of disclosure of material false information under the LODR Regulations in relation to the opinion of its Auditor.

Based on audit procedures performed and management explanations provided, the Auditors had submitted a qualified opinion in their Report to the financial statements of the company and did not receive any explanation or evidence from the Company with respect to progress on the qualification made. Instead, the report issued on June 29, 2019 had declared that the Auditors had given an unmodified opinion.

It was observed that as the company failed to disclose its audited financial results as well as the statement of impact of audit qualifications (for audit report with modified opinion) within the stipulated period of 60 days from the end of the financial year, it has violated the provisions of SEBI LODR Regulations. Taking into account the facts and circumstances of this matter, the AO imposed penalty to the company and its officers.

If the information prepared in accordance with the requirements of a fair presentation framework is not sufficient and relevant enough so as to allow achieving of a fair presentation, the auditor should discuss the matter with management and, depending on the requirements of the applicable reporting framework and how the matter is resolved, should determine whether it is necessary to modify the opinion in the auditor's report. In case the auditor expresses a modified opinion or disclaims an opinion, the text of the opinion shall be either in italics or bold letters.

The Board of Directors, in their report made in terms of sub-section (3) of section 134, shall explain in full any qualification or observation or other remarks made by the company secretary in practice in his report.

CASE STUDY

ABC Ltd. is a listed company on BSE India. The company has appointed M/s YY & Associates as secretarial auditor for the FY 2021-2022. M/s YY & Associates had issued audit report in Form MR-3. The audit report stated observations. Consequently, directors also furnished explanations to the remarks as below:

Secretarial auditors' observation(s) in secretarial audit report and directors' explanation thereto –

i. In respect of observation that the composition of the board of directors was not in compliance with Regulation 17 and 25 of the Listing Regulations and Section 149(3) of the Companies Act, 2013 and that the composition of Audit Committee was not in compliance with Regulation 18 of the Listing Regulations.

   It is clarified that considering the stressed situation of the Company, it was difficult to find suitable persons as Independent Directors and with the appointment of new independent directors (including one woman independent director), the Company is compliant with Regulation 17 and 25 of the Listing Regulations and Section 149(3) of the Companies Act, 2013 with effect from March 16, 2022. Further, due to resignation of two independent directors who were also Audit Committee members, the composition of Audit Committee was not in compliance of Regulation 18 of the Listing Regulations for a period from September 27, 2021 till October 14, 2021. With reconstitution of Audit Committee w.e.f. October 15, 2021, this non-compliance has been rectified.

ii. In respect of observation that the Risk Management Committee of the Company comprised of 50% of the members who were directors of the Company which was not in compliance of Regulation 21 of the Listing Regulations.

   It is clarified that 50% of the members were directors only, however as a stricter compliance, the composition of the Risk Management Committee further stands rectified w.e.f October 1, 2021.

iii.	In respect of observation pertaining to non-appointment of Chief Financial Officer (CFO) in compliance with Section 203(4) of the Companies Act, 2013. It is clarified that the Company all along had a Group Chief Financial Officer. The Company appointed CFO w.e.f. June 1, 2021 and accordingly the same stands rectified.

The modification on Opinion can be in any one of the following three categories depending upon the nature and severity/ extremity of the matter under consideration:

Defining the level of severity is always a subject matter which varies according to the case to case basis and require a judgemental skill in the forming of opinion. The above three categories of the modified opinion can be further elaborated as under:

Qualified Opinion

An Opinion can be considered as a qualified opinion when the auditor specifically provides the additional paragraph or points out the specific instances where the company has failed to do compliance as required under the law, or provides reasons for the not issuing the unqualified report on the affairs of the company.

Adverse Opinion

An Opinion can be considered as an adverse opinion, which is considered as the out of track opinion, wherein the auditor concluded that the affairs of the company are not in line with its objectives, government rules, and the company has neglected and grossly misstated its records.

An adverse opinion may be an indicator of fraud, and public entities that receive an adverse opinion are forced to take corrective measures.

Disclaimer of Opinion

Instances, where the auditor is unable to access the records of the company on any grounds such as geographical reasons, regulatory, natural calamity or could not complete the audit due to absence of requisite records or insufficient co-operation from management, the auditor issues a disclaimer of opinion. Such opinion is an indication that no opinion was formed by the auditors and the Auditor was not able to conclude that the affairs of the company are conducted in true and fair manner, such disclaimer of opinion is not considered as an opinion itself.

Whenever the Auditor expresses a modified opinion or disclaims an opinion, the text of the opinion shall be either in italics or bold letters.

When the Auditor expresses a modified opinion, the Auditor shall state in opinion paragraph that, in Auditor's opinion, because of the significance of the matter(s) described in the basis for modified opinion paragraph and then continue with the opinion and describe reasons in the basis for modified opinion paragraph.

When the Auditor disclaims an opinion, he shall state in the opinion paragraph that the opinion is disclaimed because of the matter(s) described in the basis for disclaimer of opinion paragraph and then continue with the opinion and describe reasons in the basis for disclaimer of opinion paragraph.

Emphasis of Matter

Emphasis of matter (EOM) is included in the audit report to seek the attention of the reader, to make the reader aware about the specific instances which are not in the general course of business. Such matters can have the

positive as well as negative impact on the affairs of the company in future. The purpose of an EOM paragraph is to draw the users' attention to a matter already disclosed but the auditor believes that, it is fundamental to their understanding and should be a part of the report.

The following are examples of the matters which should be considered as emphasis of matter:

Legal Uncertainity	• an uncertainty relating to the future outcome of exceptional litigation or regulatory action
Litigation certainity	• when there is uncertainty about exceptional future events, pending litigations
New Technoloy	• adoption of new technology
Changes in regulatory environment	• recent changes in the regulatory environment
Major Catastrophe	• when a major catastrophe has had a major effect on the financial position
Early Application of new AS	• early application (where permitted) of a new accounting standard (for example, a new International Financial Reporting Standard) that has a pervasive effect on the financial statements in advance of its effective date

Ideally, such matters should be the part of the Directors Report or the Management Discussion and Analysis report prepared by the company. If the same is not disclosed by the company in the Directors report or in Management Discussion and Analysis Report, the auditor may opt to place the same in the Auditor's Report.

MATERIALITY

Materiality is a concept or convention within auditing and accounting relating to the importance/significance of an amount, transaction, or discrepancy in the records of the company. The objective of an audit of financial statements is to enable the auditor to express an opinion whether the financial statements are prepared, in all material respects, in conformity with an identified financial reporting framework such as Generally Accepted Accounting Principles (GAAP).

The assessment of what is material is a matter of professional judgement. Materiality can be defined as the magnitude of an omission or misstatement of information that, in the light of surrounding circumstances, makes it probable that the judgement of a reasonable person relying on the information would have been changed or influenced by the said omission or misstatement.

The auditor has to ensure that material items are properly and distinctly disclosed by the company. It is very important for

Example: The risk that a particular account balance or class of transactions could be misstated by an extremely large amount might be very low but the risk that it could be misstated by an extremely small amount might be very high.

the auditor to constantly judge whether a particular item is material or not. There is an inverse relationship between materiality and the degree of audit risk. The higher the materiality level, the lower the audit risk and vice versa.

> Materiality is the threshold above which missing or incorrect information is considered to have an impact on the decision making of the Auditor. Information is considered as material if its omission or misstatement could influence the opinion of the Auditor. Materiality can also be construed in terms of net impact.

The Auditor shall consider materiality while forming his opinion and adhere to:

1. The principle of **completeness** that requires the Auditor to consider all relevant Audit Evidence before issuing a report;
2. The principle of **objectivity** that requires the Auditor to apply professional judgement and professional skepticis minor dertoen sure that all reports are factually correctand that findings or conclusions are presented in a relevant and appropriate manner;
3. The principle of **timeliness** that implies preparing the report in due time; and
4. The principle of a **contradictory process** that implies checking the accuracy of facts and incorporating responses from concerned persons.

As the concept of Materiality is applied by the Auditor both in planning and performing the audit, and forming the opinion. Materiality consists of both quantitative and qualitative factors.

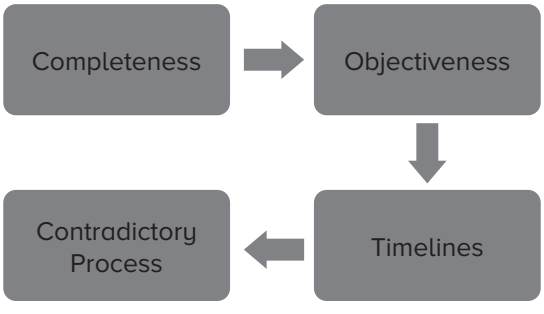
Determining Materiality is a matter of professional judgement and depends on the Auditor's interpretation of the user's needs. A matter can be judged material if knowledge of it is likely to influence the decisions of the intended users. Materiality is a relative concept. In practice, Auditors evaluate materiality on a standalone basis. What is material for one Auditee may not reach the Materiality threshold for another. Materiality is a matter of professional judgement of the Auditor and its teams' experience.

As mentioned above, materiality is important while conducting the audit process and also while forming the audit opinion based upon the evaluation of conclusions drawn on the basis of the audit process. The parameters for application of Materiality could be different in forming of audit opinion when compared to application of Materiality while evaluating the Audit Evidences in accordance with CSAS-2. While CSAS-2 deals with collection and evaluation of Audit Evidence to draw conclusions, CSAS-3 deals with evaluation of such conclusions to form the opinion.

PROCESS FOR FORMING OF OPINION

Forming of Opinion based on the audit observations is an important part of any audit, as through this process the outcome of audit are presented in the form of Audit Report to the intended users. Audit *inter alia* involves reporting compliance of or deviations from the applicable laws.

Principles for Auditors for forming opinion



The Auditor shall consider Materiality while forming his opinion and adhere to:

(a) The principle of **completeness** that requires the Auditor to consider all relevant Audit Evidence before issuing a report;

It requires that the Auditor should gather sufficient and appropriate Audit Evidences to provide the basis for the conclusion or opinion. An Auditor may collect evidences regarding accuracy, completeness and validity of data. Through compliance procedure, Auditor may collect evidences regarding internal control system as used in the Auditee's organisation.

Auditor should not be selective in using the available evidence before forming opinion. Auditor cannot use the evidence that supports his surmises and discard other evidence. Auditor should use all the available evidence available to him, and only discard the contradictory information, if any, after applying principle of contradiction process.

(b) The principle of **objectivity** that requires the Auditor to apply professional judgement and skepticism in order to ensure that all reports are factually correct and that findings or conclusions are presented in a relevant and appropriate manner;

The Auditor must remain objective throughout the whole process, such that his integrity must not allow any malpractice in the audit process. Objectivity is essential for any professional person exercising professional judgement. Objectivity is the state of mind which has regard to all considerations relevant to the task in hand but no other. It is sometimes described as 'Independence of Mind'.

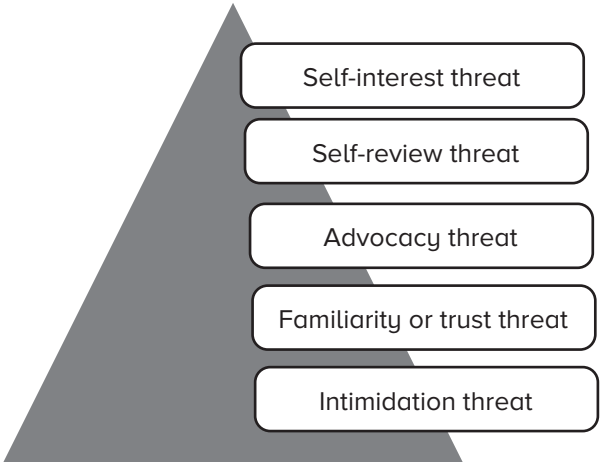
The need for objectivity is particularly evident in the case of the Auditor for carrying out an audit or some other reporting roles where their professional opinions can affect rights between parties and the decisions they take.

Professional skepticism is considered as corner stone of good auditing. Professional skepticism requires an Auditor to have an enquiring mind. Whatever documents and information are produced before the Auditor by Management/ Auditee should not be relied on the face of it. An Auditor should see to it that documents and information are reasonable, appropriate, inconsonance with attending circumstances and knowledge of the Auditor from other sources as well. Auditor must obtain sufficient evidence from Auditee to support what Auditee says.

Threats to objectivity

Threats to objectivity can arise in a number of ways, some general in nature and some related to the specific circumstances of an assignment or role. Auditor should identify the threats and consider them in the light of the environment in which he is working; he should also take into account the safeguards which assist them to withstand threats and risks to their objectivity.

The easiest way of avoiding such threats would be for Auditor to decline to act in any circumstances where the slightest threat to objectivity might exist. Threats to objectivity might include the following:



Self-interest threat - A threat to the Auditor's objectivity stemming from a financial or other self-interest conflict. This could arise, for example, from a direct or indirect interest in Auditee or from a fear of losing an audit work.

Illustration:

The M/s ABC & Associates engaged its audit team for conducting audit of XYZ Ltd. However, the audit team has not received its audit fees from XYZ Ltd for its audit. In this case, the audit team may consider to issue a favorable audit report so that the company is able to secure a loan to settle the fees outstanding for their audit.

Self-review threat - The apparent difficulty of maintaining objectivity and conducting what is effectively a self-review, if any product or judgement of a previous audit assignment or a non-audit assignment needs to be challenged or re-evaluated in reaching audit conclusions.

Advocacy threat - There is an apparent threat to the Auditor's objectivity, if he becomes an advocate for (or against) the Auditee's position in any adversarial proceedings or situations. Whenever the Auditor takes a strongly proactive stance on the Auditee's behalf, this may appear to be incompatible with the special objectivity that audit requires.

Illustration:

The auditor is assisting in selling XYZ Pvt Ltd and he is also serving as the auditor for the company. In this scenario, the auditor may issue a favorable report to increase the sale price of XYZ Pvt Ltd.

Familiarity or trust threat - A threat that the Auditor may become over-influenced by the personality and qualities of the Directors and Management, and consequently too sympathetic to their interest.

Alternatively, the Auditor may become too trusting of Management representations so as to be inadequately rigorous in his testing of them - because he knows the Auditee too well or the issue too well or for some similar reason.

Illustration:

XYZ Pvt Ltd has been audited by M/s ABC & Associates for over 8 years and the audit partner of the firm regularly plays badminton with the CEO and CFO of XYZ Pvt Ltd. Then in this case, the audit partner of Ms/ ABC & Associates may have become too familiar with the client and, thus, lack objectivity in their work.

Intimidation threat - The possibility that the Auditor may become intimidated by threat, by dominating personality, or by other pressures, actual or feared, by a director or manager or by some other party.

Illustration:

XYZ Pvt Ltd is unhappy with the conclusions and qualifications made by M/s ABC & Associates in the audit report and sensitized to switch auditors next year. XYZ Pvt Ltd is the biggest client of the M/s ABC & Associates.

In this case, the auditor's independence may be compromised, as XYZ Pvt Ltd is the biggest client of M/s ABC & Associates and they do not want to lose such a client. Therefore, the auditor may issue a report that calms XYZ Pvt Ltd.

Each of the above threats may arise either in relation to the Auditor's own person or in relation to a connected person such as a member of his family or a partner or a person who is close to him for some other reason, such as past or present association or obligation or indebtedness.

Auditors should always consider the use of safeguards and procedures which may negate or reduce threats.

An exhaustive list of countervailing factors is not possible, but Auditors should strive to develop the following characteristics in their audit firms, wherever possible to provide safeguards against these threats:

- Auditors should behave with integrity in all their professional and business relationships and to strive for objectivity in all professional and business judgements. These factors rank highly in the qualities that Auditors have to demonstrate the same. They should therefore be well used to setting personal views and inclinations aside.
- Within every audit firm there should be strong peer pressure towards integrity. Reliance on one another's integrity should be the essential force which permits partners to entrust their public reputation and personal liability to each other.
- Audit Firms of all sizes should establish strong internal procedures and controls over the work of individual Auditors, so that difficult and sensitive judgements are reinforced by the collective views of other Auditors, thereby also reducing the possibility of litigation.

(c) The principle of **timeliness** that implies preparing the report in due time;

Auditor must adhere to timeline agreed at the time of engagement for issuing the report and milestones to be achieved, if any. Deviations, from agreed timeline must be recorded with reason for such deviation.

(d) The principle of a **contradictory process** that implies checking the accuracy of facts and incorporating responses from concerned persons.

When two contradictory facts emerge on same subject matter of audit, Auditor must strive to find additional evidence/material which supports or negates one of the facts. This process of finding additional evidence/material must continue till one of the facts is eliminated. In case Auditor is unable to find further evidence/material and contradiction continues to persist, Auditor should bring out that fact clearly in his report and if circumstances warrants, disclaim opinion on that particular subject matter.

The Principle of contradictory process also implies checking the accuracy of facts with the Auditee and incorporating responses from responsible officials as appropriate. The Auditor should consider relevant evidential matter regardless of whether it appears to corroborate or to contradict the assertions. Thus, during the conduct of an audit, the Auditor should consider all relevant evidential matter even though it might contradict or be inconsistent with other conclusions.

Audit documentation must contain information or data relating to significant findings or issues that are inconsistent with the Auditor's final conclusions on the relevant matter.

After completing the audit procedures the Auditor reviews the Audit Evidence in order to draw a conclusion, issue an opinion or describe the findings.

The Auditor should evaluate whether the evidence obtained is sufficient and appropriate so as to reduce audit risk to an acceptably low level. The evaluation includes considerations of evidence that both supports and seems to contradict the audit report, conclusion or opinion on compliance/non-compliance. The evaluation further includes considerations of Materiality. After evaluating the sufficiency and appropriateness of evidence to determine the assurance level of the audit, the Auditor should consider which conclusion is appropriate in light of the evidence obtained. After evaluation, Auditors need to weigh the extent and credibility of conflicting evidence in order to reach a conclusion or collect more evidence to resolve the conflict in such situations, Auditors need to weigh the extent and credibility of conflicting evidence in order to reach a conclusion or collect more evidence to resolve the conflict.

Audit conclusion should clearly bring out the nature and extent of non-compliance, cause of such non-compliance, its Materiality and also the effect of non-compliance, if possible. The audit conclusions in case of regularity issues should also indicate whether non-compliance is a solitary one-off case, or wide spread systemic issue in the Auditee.

1. Judgement, Clarification and Conflicting Interpretation

While forming an Audit opinion the Auditor may consider or refer the decided case laws or judgements, clarifications issued, opinions formed in similar type of audits while framing the final audit opinion.

Judgements

For example, while interpreting the issue of loans given by the Auditee company in terms of Section 185, the Auditor may refer to the decided case laws in this respect, e.g in *Dr. Fredie Ardeshir Mehta v. Union of India,* the terms "indirectly" and "loans", has been explained as below :

- The word **"indirectly"** means providing loan through agencies or any other medium but does not include converting anything which does not qualify to be loan or loan represented by book debt or security or guarantee into loan, any loan represented by book debt or guarantee or security.
- The word **"Loan"** was defined by the court as a thing lent; something the use of which is allowed for a time, on the understanding that it shall be returned or an equivalent given; esp., a sum of money lent on these conditions and usually with interest. The essential requirement of a loan is the advance of money (or of some article) upon the understanding that it shall be returned, and it may or may not carry interest.
- The phrase **"any loan represented by book debt"** is inserted in order to plug the loophole used in the case of "Dr. Fredie Ardeshir Mehta v. Union of India" where court took the view that book debt can't be treated as loan and since the earlier Section 295 of Companies Act, 1956 does not explicitly include the phrase "any loan represented by book debt" hence any kind of credit facility extended by company to directors will not cover under the "Loan to director".

Therefore, while auditing, the Auditor may refer to the interpreted words given in court judgements so as to interpret the meaning of the legal terms correctly and in their true sense and can frame the opinion accordingly and accurately.

Clarifications in respect of forming the audit opinion implies that in case the true or clear sense of law cannot be interpreted by the Auditor or if it was so interpreted, then contradictory interpretations amongst various Auditors or professionals seem to exist; in such a case Auditor may refer to the clarifications issued by various authorities e.g. Ministry of Corporate Affairs, Institute of Company Secretaries of India, CBDT, or any other Govt. body etc., to frame a reliable and accurate opinion.

Opinions formed by other Auditors,in similar types of Audits may also be referred by the Auditor to form a judgement and frame its opinion. Similar type of Audit may also depend on nature of business, transactions occurred and operation of scale of Auditee, etc.

Conflicting Interpretations may be sorted out by again referring to the decided judgements, clarifications issued by the Govt. Authorities, Regulators, etc.

2. Role of Precedence and Practices

Precedence and Practice in context of Auditing implies that Auditor shall evaluate on the basis of general or ongoing practices or procedures that whether the Records maintained, statements prepared in all material respects, in accordance with the requirements of the applicable laws, rules and regulations. This evaluation shall include consideration of the qualitative aspects of the Auditee's compliance practices, including indicators of possible bias in Management's judgements.

The Practices and precedence used by Auditor for forming the Audit opinion may be as per the historical perspective i.e., methods used hitherto or generally used methods or practices or procedures be implemented for framing the opinion. Like, one of the method involves selecting a sample size of total work and activities of a firm for conducting the audit process, which simultaneously depends upon the firm's size, operation of work and no. of branches, etc., or another practice includes having an unbiased approach while conducting the audit process in order to frame the honest and unbiased opinion.

LIMITATION

If, after accepting the Audit Engagement, the Appointing Authority imposes a limitation on the scope of the Audit which, in the opinion of the Auditor, is likely to result in the need to express a modified opinion or to disclaim an opinion, the Auditor shall request the Appointing Authority to remove the limitation.

If the Appointing Authority refuses or fails to remove the limitation, the Auditor shall communicate the matter to the Management and determine whether it is possible to perform alternative procedure to obtain sufficient and appropriate Audit Evidence.

If the Auditor is unable to obtain sufficient and appropriate Audit Evidence, the Auditor shall determine the implications as follows:

(a) If the Auditor concludes that the possible effects of unavailable Audit Evidence could be non-material, the Auditor shall modify the opinion; or

(b) If the Auditor concludes that the possible effects of unavailable Audit Evidence could be material, the Auditor shall express disclaimer of opinion.

Limitation on the scope of audit means when the Auditor appointed for performing the Audit will not be able to obtain appropriate or complete Audit Evidences due to the restrictions or limitations imposed on the process of Audit which ultimately affects the Auditor's opinion.

The Auditor's inability to obtain sufficient and appropriate Audit Evidence (also referred to as a limitation on the scope of the audit) may arise from:

(a) Circumstances beyond the control of the Auditee;

(b) Circumstances relating to the nature or timing of the Auditor's work;

(c) Limitations imposed by Management.

An inability to perform a specific procedure does not constitute a scope limitation if the Auditor can obtain sufficient appropriate Audit Evidence by performing alternative procedures. Limitations imposed by Management may have other implications for the Audit, e.g. for the Auditor's assessment of fraud risks.

If after obtaining the Audit engagement, the Appointing Authority imposes a limitation on the scope of Audit, which is likely to affect the Auditor's opinion, the Auditor shall request the Authority to remove the limitation. If Management refuses the Auditor's request to remove a limitation that Management has imposed on the scope of the audit, the Auditor should communicate the matter with those charged with governance. When a limitation on the scope of the audit imposed by Management is not removed, the Auditor should determine whether it is possible to perform alternative procedures to obtain sufficient appropriate Audit Evidence on which to base an unmodified opinion. If the Auditor is unable to obtain sufficient appropriate Audit Evidence, the Auditor should determine the implications as follows:

- if the possible effects of the scope limitation are material but not pervasive to the business procedures, documents, or underlying transactions, the Auditor should modify the opinion;
- if the possible effects of the scope limitation are both material and pervasive to the compliance of laws, rules and regulations or underlying transactions or other business procedures/activities so that a qualification of the opinion would be inadequate to communicate the gravity of the situation, the Auditor should disclaim an opinion.

THIRD PARTY REPORT OR OPINION

Sometimes due to circumstances like geographical constraints or want of expertise on any specific subject matter an Auditor may be required to rely on the Third Party reports. The Third Party reports may be arranged by the Auditee or Auditor directly. Third Party Report or Opinion is used as one of the external source of obtaining the Audit Evidences that would help in building the strong and quality Audit Opinion.

"Third Party" means any person who does not have a direct connection with the audit but whose inputs or opinion might influence the audit conclusion and includes an expert. Third party may include any person who has given inputs and opinion of the expert relevant for forming an opinion.

The Auditor shall adhere to the following while forming an opinion based on Third party reports or opinions:

(a) The Auditor shall indicate the fact of use of Third party report or opinion and shall also record the circumstances necessitating the use of Third party report or opinion;

(b) The Auditor shall indicate the fact if Third party report or opinion is provided by the Auditee;

(c) The Auditor shall consider the important findings/observation of Third party;

(d) The Auditor shall, if necessary and feasible, carry out a supplemental test to check veracity of the Third party report or opinion.

While using the work of Third Party, the Auditor should:

Consider the independence and objectivity of the Third Party;

- Take account of the Third Party's professional competence for the specific audit;
- Consider the scope of the Third Party's work;
- Determine the cost-effectiveness of using such work;
- Perform procedures too btain sufficient appropriate Audit Evidence that the work of the Third Party is adequate in the context of the specific audit (which may require access to the Third Party's working papers); and
- Consider the significant findings of the other Auditor when analysing and interpreting the results of that work. Where these findings are significant to the opinion, Auditor should discuss these findings with the Third Party and consider whether it is necessary to carry out additional audit testing him.
- When using the work of Third Party, Auditor should carefully consider that, the Third Party may only recognise a duty of care to the addressee of the audit report.

MANAGEMENT REPRESENTATION LETTER

The auditor may obtain a management representation letter from the auditee company on matters which are not capable of direct verification by the Auditor. The letter may be signed by Managing Director/Company Secretary/Senior Management who would normally have authority to issue the same. Suggested format of the management representation letter is provided below. The format may be adopted with changes, depending on the circumstances and facts governing every audit. The Auditor can use this letter of representation as part of his audit evidence.

However, it is advised to exercise all possible care, reasonable skill & due diligence. Adequate enquiries should be made in respect of matters which are capable of direct verification. Mere getting certification or written representation from management may defeat the purpose of the audit.

Specimen Management Representation Letter for Secretarial Audit

Note: *The following letter is a general guidance. Representation made by management may vary from one entity to another and from one year to another. It should be adopted in the light of individual requirements and circumstances.*

M/s ABC & CO, Date:

Company Secretaries,

ZYZ Road, India

Dear Sir,

This representation letter is provided in connection with your audit of the Secretarial Records maintained under The Companies Act, 2013 (the Act) and the rules made thereunder; (ii) The Securities Contracts (Regulation) Act, 1956 ('SCRA') and the rules made thereunder; (iii) The Depositories Act, 1996 and the Regulations and Bye-laws framed thereunder; (iv) Foreign Exchange Management Act, 1999 and the rules and regulations made

thereunder to the extent of Foreign Direct Investment, Overseas Direct Investment and External Commercial Borrowings; The Regulations and Guidelines prescribed under the Securities and Exchange Board of India Act, 1992 ('SEBI Act') and other applicable laws including labour laws like Factories Act, Payment of Gratuity Act etc for the year ended on 31st March, 20 ..... Environmental Laws and Competition Laws for the purpose required in it. We the undersigned acknowledge our responsibility for maintaining the Secretarial records referred above and confirm, to the best of our knowledge and belief, the following representations:

Company Law

1. The Company has maintained books of accounts as required under Section 128 of the companies Act, 2013.
2. The Company has complied with all the provisions of the Secretarial Standards.
3. The Company has complied with all the provisions of Companies Act, 2013 relating to Statutory Audit/ Cost Audit/Internal Audit.
4. No request for transfer or transmission of shares have been received by the company during the year other than as recorded.
5. Statutory Registers were kept open for public inspection during working hours on all working days.
6. Notice of Board meetings were duly sent to all the Directors.
7. Notes and notes to agenda were duly sent to all the Directors.
8. No resolutions were passed by way of circulation during the year under review other than those recorded in the minutes.
9. The views of all the dissenting Directors (if any) on important matters have been captured and recorded in the minute.
10. The venue and time of Board meeting was finalized with the consultation of all board members.
11. Draft minutes and final minutes were properly sent to all the Directors.
12. Company has not obtained any secured loan from any financial institution/banks other than those mentioned in the register of charges.
13. Notice of annual general meeting has been duly sent to all the members, Directors, Statutory Auditor and Secretarial Auditors.
14. No show cause notice has been received by the company under the Acts referred above or any other laws applicable on the company.
15. There are no pending litigation and claims other than those reported in the Financial Statements - balance sheet by way of contingent liability.

16 No event other than reported to you specifically has occurred during the year which has a major bearing on the company's affairs in pursuance of the laws, rules, regulations, guidelines, standards, etc. referred to above. We have provided to you all relevant information and have given access to all data and records.

17. The company has altered the memorandum/articles of Association and have recorded the alterations in all copies of the Memorandum/Articles of Association.
18. Wherever the Share Certificates were issued in the physical form, they were issued in accordance with the provisions of the Companies Act, 2013 and the rules thereunder.
19. .....

Securities Laws

1. All price sensitive Information was furnished to the stock exchanges from time to time.
2. All investors complains directly received by the company are recorded on the same date of receipt.

3. The Company has complied with provision of SEBI (LODR) Regulations, 2015.
4. .....

Specific Applicable Laws

Labour Laws

1. All the premises and establishments have been registered with the appropriate authorities.
2. The Company has not employed any child labour/bonded labour in any of its establishments.
3. The company is ensuring the compliance of PF/ESI and other social security measures with respect to the contract employees. One of the responsible officers of the company carries out the survey regarding the compliance of this.
4. The company has held its internal complaints committee meeting regularly under POSH.
5. .....

Environmental Laws

1. The Company is not discharging the contaminated water at the public drains/rivers. The company has efficient water treatment plants at its factory premises (if applicable).
2. The company has been disposing the hazardous waste as per applicable rules. Competition Law.

Competition Law

List of other laws generally applicable to the company. We are attaching herewith the list of laws:

1. Applicable specifically to the Company.
2. Other Laws applicable to the Company

Date: [For XYZ Limited]

Place: Director

Opinion obtained by Management

In the certain situations, upon the qualifying remarks of the auditors, the management of the company may submit its replies which may be supported by the opinion provided by the third party. In such cases the reliance on such opinion should be made by the auditor based on his professional judgement and the company may provide the explanation on such qualifications in the Directors report.

Upon consideration of the information produced by the company as audit evidence, the auditor should evaluate whether the information is sufficient and appropriate for purposes of the audit by performing procedures to:

(a) Test the accuracy and completeness of the information, or test the controls over the accuracy and completeness of that information; and

(b) Evaluate whether the information is sufficiently precise and detailed for the purposes of the audit.

Exit Conference

While concluding the audit, the auditor should conduct a meeting with the management of the company or with the group supervisory officers. The audit observations should preferably be shared with such officials beforehand for providing the opportunity to discuss the audit findings and to clarify any point relating to audit and audit observations.

EVALUATION OF AUDIT EVIDENCE AND FORMING OPINION

The Audit evidence plays a significant role in forming of Opinion. Based on such evidence the auditors form their opinion in the report, accordingly the auditor should obtain competent, relevant and reasonable evidence to support his judgement and conclusions.

The competent evidence is information which is quantitatively sufficient and appropriate to achieve the auditing results and is qualitatively impartial to inspire confidence and reliability.

The Reliable audit evidence is evidence that is impartial. The reliability of audit evidence is dependent upon its nature, its source and the method used to obtain it. While collecting the audit evidence the auditor should consider the below:

Reliability of Documentary Evidence	● Documentary evidence is more reliable than oral evidence.
Evidence on Direct Personal Knowledge	● Evidence of which the auditor has direct personal knowledge is the most reliable evidence.
Evidence from External Source	● Independent evidence obtained from external sources is more reliable than internal evidence, if that evidence is truly Independent and complete.
Reliability of Visual Evidence	● Visual evidence is highly reliable for conforming the existence of assets, but not their ownership value.
Examining figures less reliable	● Drawing conclusions solely through examining relationship between figures in the account (analytic Review) is less reliable evidence.
Oral Evidence Least reliable	● Oral evidence must be considered as the least reliable, whenever feasible, auditor should attempt to obtain documentary confirmation of oral evidence.
Reliability of information generated within entity	● The reliability of information generated within the auditee entity is a function of the reliability of internal control systems within the entity.
Photocopies less reliable	● Photocopies are less reliable than the originals, the source of photocopies should be identified by noting the source and as far as possible the photocopies should be certified.
Accepted Evidences	● Evidence, which is accepted by the auditee entity, is always reliable.
Gain increased assurance	● The auditor may gain increased assurance when audit evidence obtained from different source is consistent.

Sharing draft report with management with category of risk involved with each remark and qualification

After the exit meeting and the completion of the audit procedures, the auditor should prepare an executive summary of audit findings. The summary explains the key audit issues, the category of risk, their resolution, agreed adjustments. After discussing the executive summary the audit certificate should be signed by the auditor and by the management or person authorized by the management of the company.

The executive summary is a high-level summary, which explains audit findings, while it is a concise document; it should contain sufficient information to stand alone as a summary of the evidence which supports audit team's conclusion on the appropriate form of audit certificate. The executive summary should include:

(i) a summary of the auditee's operations and purpose;

(ii) a summary of the regularly framework within which the auditee operates;

(iii) an explanation of the audit approach and the balance between test of controls and substantive procedures;

(iv) a summary of the key risk identified;

(v) a commentary on key balances;

(vi) a commentary on the accounting policies and significant account areas;

(vii) a summary of the result of audit procedures;

(viii) details of areas where difficult questions of principle or judgement were involved;

(ix) matters brought forward from previous year audit;

(x) a summary of other important matters for attention;

(xi) outstanding matters, for example, outstanding reappointment orders or letter authorizing agreed amendments to the financial statement;

(xii) a summary of matters carried forward to the next years audit; and

(xiii) a conclusion on the appropriate form of audit certificate.

The report should clearly mention the process name; significant findings with respect to the criteria; analysis of the consequences of the findings; and recommendations of the auditor. Each observation should be supported by a set of facts and each recommendation to the management should be supported by a business reasons for implementation.

Further, the replies on the auditor's observations and recommendations/comments of the management of the Auditee's company should be obtained and should be recorded in the audit file. Also, in case where the auditor opinion is other than the unmodified opinion, the full rationale should be given in the executive summary.

Different stages of communication and discussion should be as under:

1. **Preliminary Draft:** At the conclusion of fieldwork, the auditor should draft the report and present it to the entity's management for auditee's comments.

2 **Exit Meeting:** The auditor should discuss with the management the findings, observations, recommendations and text of draft and obtain their comment on the draft, achieve consensus and reach an agreement on the audit findings.

3. **Formal Draft:** The auditor should prepare a formal draft, in view of the outcome of the exit meeting and other discussions. Upon review of such changes by the auditor and the management, the final report should be issued.

4. **Final Report:** The report should be submitted to the appointing authority or such members of management, as directed.

Test Yourself

M/s XYZ & Co. Practicing Company Secretary Firm, was appointed as Secretarial Auditor of ABC Ltd. During the conduct of secretarial audit certain irregularities were found. However, before the finalisation of the Report, the Company Secretary of the Company suggested a communication on the subject. Brief the stages involved for communication and discussion to finalise the Final Report of Secretarial Auditor?

AUDITOR'S RESPONSIBILITY

The Auditor's Report shall include a section with the heading "Auditor's Responsibility". Auditor's Report shall state that the responsibility of the Auditor is to express the opinion on the compliance with the applicable laws and maintenance of Records based on audit. The Auditor's Report shall also state that the audit was conducted in accordance with applicable Standard. The Auditor's Report shall also explain that those standards require that the Auditor comply with Statutory and Regulatory requirements and plan and perform the audit to obtain reasonable assurance about compliance with applicable laws and maintenance of Records.

Auditor's Report shall state that due to the inherent limitations of an audit including internal, financial and operating controls, there is an unavoidable risk that some misstatements or material non-compliances may not be detected, even though the audit is properly planned and performed in accordance with the standards.

The Auditor has a responsibility to perform procedures to identify, assess and respond to the risks of material misstatement or non-compliance arising from the Auditee's failure appropriately to account for or disclose an event or transaction.

Auditor's Report includes a separate section with heading "Auditor's Responsibility" that will state or express the opinion of the Auditor about the following:

- Whether the audit has been conducted as per the applicable Auditing Standards.
- Whether the Auditor has obtained reasonable assurance about whether the statements prepared, documents or records maintained by the Auditee are free from misstatement.
- That Auditor has the responsibility to only express his opinion on the evidences collected, information received and records maintained by the Auditee or given by the Management.
- Whether the Auditee has followed applicable laws, act, rules or regulations in maintaining their records, documents, statements, or have complied with applicable laws or rules while performing any corporate action

FORMAT OF REPORT

The report shall be addressed to the Appointing Authority unless otherwise specified in Audit Engagement Letter or provided in the applicable law. The report shall be detailed enough to serve its intended purpose. Where specific formats (like MR-3 for Secretarial Audit Report) are prescribed, those formats shall be followed for reporting. If any information cannot be conveniently captured within the paragraphs of the report, it shall be given in the form of annexure(s).

Signature block shall mention the name of the Audit Firm, the name of the Auditor, along with certificate of practice number, the membership number of the Auditor specifying whether associate or fellow member. The auditor shall clearly mention date and place of signing the report. In case report is signed by two different persons on different dates or different places; same shall be mentioned in the report.

Audit report is the result of the audit performed in as per its scope and objectives. It includes a summary of information and can consist of further observation. In case of an audit of compliances, Audit Report may point out areas of compliance and non-compliance, as well as areas for improvement. The report is addressed to the Appointing Authority or otherwise, as may be prescribed in applicable law, acts rules or regulations. The

Appointing Authority would be the Board of Company, in case Auditee is a Company and in other cases, it would be the persons who have been entrusted with the responsibility of governance and compliances of the Auditee. Further, the Appointing Authority may also include Court, Tribunal or Regulators or any officer thereof, depending upon the type of Auditee's entity as explained in the Guidance Note on CSAS-1.

The Audit Report must be prepared in detail so that the purpose of preparing the report and showcasing the true state of affairs of the Auditee can be attained. Furthermore, the Audit Report prepared must be precise, accurate, clear and should be unbiased with suggestions and opinions. The detailed Audit Report means that Auditor must try to explain and point out each and every minute compliance, non-compliance or any improvement in the business procedures, documents, statements or any transactions or any other area that has been audited so as to form an accurate Audit opinion and in case the provided format of Audit Report as per the laws, rules or regulations is not enough to provide detailed statement, the Auditor shall attach additional annexures or pages to give full disclosures and opinions thereon.

The Audit Report must be signed by one or more Auditors as the case may be at the end of the Audit Report along with the name of their Firm, Firm's Registration No., Designation of the Auditor in the Firm (like partner, proprietor etc.), Certificate of Practice No. and Membership No. of the Auditor, whether the Auditor is a Fellow or Associate member of the Institute. The report must mention the correct date and place of signing and if two Auditors are signing the same report at different date and place then, the same shall be mentioned.

Further, as per Peer Review Guidelines of the ICSI, it is mandatory to mention the Peer Review Certificate Number in Secretarial Audit Report/Annual Secretarial Compliance Report and the signature of the PCS should be in following format:

	For XYZ & Associate
	Company Secretaries
	Name .....
	FCS .....
Date:.....	CP.....
Place:.....	PR 123/2018

Pre requisite for the Reporting:

An Audit report should be:

- **Accurate** - Free from errors and distortions and faithful to the underlying facts.
- **Objective** - Fair, impartial, and unbiased and is a result of a fair minded and balanced assessment of all significant and relevant information.
- **Clear**-Easily understandable and logical, avoiding unnecessary technical language and providing all significant and relevant information.
- **Concise** - To the point, avoid unnecessary elaboration, superfluous detail, redundancy, repetitiveness and wordiness.
- **Constructive** - Helpful to the engagement client and the organization and leads to improvements where needed.
- **Complete** - Lacking nothing that is essential to the target audience and includes all significant and relevant information and observations to support recommendations and conclusions.
- **Timely** - Opportune and expedient, depending on the significance of the issue, allowing management to take appropriate corrective action.

Submission of Audit Report

After considering the clarifications/replies of the management, the auditor should prepare the audit report in prescribed format. Sometimes the report is addressed to the members but is to be submitted to the Board. The report shall contain the opinion on the statutory compliances examined by the Auditor and shall state whether in his opinion the company is carrying out/not carrying out due compliances of the applicable provisions of the various laws. The report shall be provided with or without qualifications.

Signing of Audit Report

The auditor's signature is either in the name of the audit firm,the personal name of the auditor or both,as appropriate for the particular jurisdiction. In addition to the auditor's signature, in certain jurisdictions, the auditor may be required to declare in the auditor's report the auditor's professional accountancy designation or the fact that the auditor or firm, as appropriate, has been recognized by the appropriate licensing authority in that jurisdiction.

However, in case of secretarial audit report the report should be signed by the secretarial auditor who conducted or under whose supervision the secretarial audit was conducted indicating his FCS/ACS number along with certificate of practice number issued by the Institute of Company Secretaries of India.

In case of PCS firm, the secretarial audit report may be signed by the partner who conducted or under whose supervision the secretarial audit was conducted indicating his FCS/ACS number along with his certificate of practice number. The secretarial audit report cannot be signed by an employee of the PCS firm even if he/she may be a member of the ICSI holding certificate of practice number.

Reporting with Qualification

1. A qualification, reservation or adverse remarks, if any, should be stated by the auditor at the relevant places in his report in bold type or in italics.

Test Yourself

Question: What is the manner of reporting Qualification in the Secretarial Audit Report?

Answer: A qualification, reservation or adverse remarks, if any, should be stated by the Secretarial Audito at the relevant places in his report in bold type or in italics. If the Secretarial Auditor is unable to express an opinion on any matter, he should mention that he is unable to express an opinion on that matter and the reasons therefor. If the scope of work required to be performed is restricted on account of restrictions imposed by the company or on account of circumstantial limitations (like certain books or papers being in the custody of another person who is not available or a Government Authority), the Report should indicate such limitations. If such limitations are so material that the Secretarial Auditor is unable to express any opinion, the Secretarial Auditor should state that in the absence of necessary information and records, he is unable to report on compliance(s) relating to such areas by the Company. Further, the Board of Directors, in its Board's report, shall explain in full any qualification or observation or other remarks made by the Company Secretary in Practice in the Secretarial Audit Report.

CASE STUDY

ABC Ltd is a listed company. The company has appointed M/s SS & Associates as its secretarial auditor for the FY 2021-2022. The secretarial auditors have conducted the audit and submitted the audit report in Form MR-3 stating that -

During the Audit Period, the Company has complied with the provisions of the Act, Rules, Regulations, Guidelines, Standards etc. mentioned above except to the extent as mentioned below:

(a) Board composition:

There were non-compliances with the requirements of Regulation 17(1)(a) & (b) of SEBI (LODR) Regulations, 2015 (SEBI LODR) during part of the Audit Period, as the Company did not have requisite number of Independent Directors on its Board, including no woman Independent Director till 13th November, 2021.

The Company made appointment of 4 Independent Directors including one woman Independent Director on 14th November, 2021. Further, the Company made appointment of 1 (one) more Independent Director on 31st December, 2021. The Company has become compliant with the requirements of Regulation 17(1) (a) of SEBI LODR w.e.f. 14th November, 2021 and Regulation 17(1)(b) of SEBI LODR a w.e.f. 1st January, 2022.

(b) Audit Committee and Nomination & Remuneration Committee:

The Audit Committee and Nomination & Remuneration Committee were not constituted with minimum two Independent Directors as per provisions of Regulations 18 and 19 of the SEBI (LODR) Regulations, 2015 and till 13th November, 2021, as the Company had only one Independent Director on its Board. No meeting of the Audit Committee was convened from 1st April, 2021 to 14th December, 2021. However, mandatory functions of the Audit Committee such as review of quarterly results/annual financial statements and approval of related party transactions etc. were directly reviewed and approved by the Board.

2. If the auditor is unable to express an opinion on any matter, he should mention that he is unable to express an opinion on that matter and the reasons therefor.
3. If the scope of work required to be performed is restricted on account of restrictions imposed by the company or on account of circumstantial limitations (like certain books or papers being in the custody of another person who is not available or a government authority), the report should indicate such limitations.
4. If such limitations are so material that the Auditor is unable to express any opinion, the Auditor should state that in the absence of necessary information and records, he is unable to report on compliance(s) relating tosuch areas by the Company.

Further, the Board of directors, in its report prepared under section 134(3) of the Companies Act, 2013, shall provide and explanation in full on any qualification or observation or other remarks made by the Company Secretary in practice in the secretarial audit report.

LESSON ROUND-UP

- An unqualified opinion contains no reservations concerning the company. This is also known as a “clean” opinion, meaning that the affairs of the company are presented fairly.
- The auditor should express modified opinion when the auditor concludes that there is non-compliance, with the applicable laws in terms of timelines and process or the records as a whole are not free from misstatement; etc.
- The modification on opinion can be in the following three categories depending upon the nature and severity /extremity of the matter under consideration: the qualified opinion; the adverse opinion; the disclaimer of opinion.
- The auditor should obtain audit evidence which are competent, relevant and reasonable evidence to support his judgement and conclusions.
- An Audit report should be Accurate, Clear, Concise, Constructive and Complete.

- This Auditing Standard on Forming of opinion is applicable to the Auditor undertaking Audit under any statute. The Standard deals with basis and manner for forming Auditor's opinion on subject matter of the audit. This standard aims to promote consistency in opinion forming and reporting thereof to enable users of the report to identify the audit findings.
- "Misstatement" means any information or statement which is false, incorrect, incomplete, misleading or misrepresents, omits or suppresses a material fact.
- An Opinion can be considered as a qualified opinion when the auditor specifically provides the additionalparagraph or points out the specific instances where the company has failed to do compliance as required under the law, or provides reasons for the not issuing the unqualified report on the affairs of the company.
- An Opinion can be considered as an adverse opinion, which is considered as the Out of track Opinion, wherein the auditor concluded that the affairs of the company are not in line with its objectives, government rules, and the company has neglected and grossly misstated its records.
- Instances, where the auditor is unable to access the records of the company on any grounds such as geographical reasons, regulatory, natural calamity or could not complete the audit due to absence of requisite records or insufficient co-operation from management, the auditor issues a disclaimer of opinion.

GLOSSARY

Misstatement: Misstatement means any information or statement which is false, incorrect, incomplete, misleading or misrepresents, omits or suppresses a material fact

Materiality: Materiality is the threshold above which missing or incorrect information is considered to have an impact on the decision making of the Auditor. Information is considered as material if its omission or misstatement could influence the opinion of the Auditor. Materiality can also be construed in terms of net impact

Third Party: Third Party means any person who does not have a direct connection with the audit but whose inputs or opinion might influence the audit conclusion and includes an expert

Advocacy threat: There is an apparent threat to the Auditor's objectivity, if he becomes an advocate for (or against) the Auditee's position in any adversarial proceedings or situations

PCS: Practicing Company Secretary

ACS: Associate Company Secretary

FCS: Fellow Company Secretary.

TEST YOURSELF

(These are meant for recapitulation only, answer to these questions are not to be submitted for evaluation)

1. What do you mean by Audit Opinion and describe the various forms of Auditor's Opinion?
2. Explain under what circumstances the Auditor should express the Qualified Opinion and how the Auditor should express the same in the audit report.
3. Explain the manner for signing of secretarial audit report.
4. "Materiality" is the threshold above which missing or incorrect information is considered to have an impact on the decision making of the Auditor. In context of the above lines explain the concept of materiality.

5. Threats to objectivity can arise in a number of ways, some general in nature and some related to the specific circumstances of an assignment or role. Explain the threats to objectivity.
6. The Auditor shall adhere to generally accepted precedence and practices in relation to forming of an opinion as may be available from historical perspective of any kind of audit. Elucidate.
7. Objectivity is essen tial for any Secretarial Auditor in exercising professional judgement during the audit. In light of above statement, explain the term objectivity and various threats to Auditor's Objectivity in detail.

LIST OF FURTHER READINGS

- Company Secretaries Auditing Standards (CSAS-3)
- Guidance Note on CSAS-3
- Articles published by Professionals

OTHER REFERENCES (Including Websites / Video Links)

- https://www.icsi.edu/auditing-standard/

Secretarial Audit

Lesson 13

KEY CONCEPTS

■ Secretarial Audit ■ Secretarial Audit Process ■ CSAS-4 ■ Code of Conduct ■ Board Composition ■ Board Processes ■ Detection of Fraud ■ Audit Report

Learning Objectives

To understand:

- Secretarial Audit as a proactive governance measure that will have a positive effect on corporate entities.
- Secretarial Audit as a form of Compliance Auditing that is used in carrying out auditing of compliances with all laws, rules and regulatory requirements applicable to the company.
- The process of conducting Secretarial Audit and various aspects of legal compliance requirements.
- Various aspects of the reporting of fraud with specific reference to Secretarial Audit.

Lesson Outline

REGULATORY FRAMEWORK

- The Companies Act, 2013 and rules mentioned thereunder
- SEBI (LODR) Regulations, 2015
- ICSI CSAS-4

INTRODUCTION

The term "Secretarial Audit" refers to the mechanism which is connected with the audit of the non-financial aspects of the company. It gives necessary comfort to the investors, management, regulators and other stakeholders, as to the compliance of all applicable laws by the company and certifies the existence of adequate systems and processes for ensuring compliance of laws in the company.

Secretarial Audit is not just an audit of the diligent compliance or that of the adherence to the law in true letter and spirit but has proved to be a strong founding pillar of the governance framework of the Indian Corporate Sector and a futuristic torchlight for the entire Indian Economy. Secretarial Audit, as a result of faith of the law makers and the Regulatory Authorities in the Governance Professionals or as the law puts it, in the practicing company secretaries, bestows a huge responsibility on the Secretarial Auditors.

In the era of minimum government, maximum governance, the Secretarial Audit postulates for an independent verification of the records, books, papers and documents by a Company Secretary to check the compliance status of the company according to the provisions of various statutes, laws and rules & regulations and also to ensure the compliance of legal and procedural requirements and processes followed by the company. 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.

The implementation of Secretarial Audit and the Annual Secretarial Compliance Report was an important milestone for the Profession of Company Secretaries. It opened up new vistas for Practising Company Secretaries. As for Companies, it was altogether a transformation with respect to adopting good corporate governance practices and thereby instilling confidence among the various stakeholders. It also boosted the overall confidence of the investors.

SECRETARIAL AUDIT & COMPANY SECRETARY IN PRACTICE (PCS)

A Company Secretary in practice is a professional who is well-versed in matters of statutory, procedural and practical aspects of laws applicable to companies, both listed and unlisted public and private companies. A strong knowledge base makes him a competent professional to conduct 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 issue the Secretarial Audit Report to the company.

Students are advised to refer the Auditing Standards issued by the Institute of Company Secretaries along with the Guidance Note on Auditing Standards, the updated Guidance Note on Secretarial Audit, Guidance note on the Annual Secretarial Compliance Report for the detailed checklist on the other aspects relating to Secretarial Audit which is not covered in this study material.

Test Yourself:

Question: Who can conduct Secretarial Audit?

Answer: 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. [Section 204(1) of Companies Act, 2013]

SECRETARIAL AUDIT-LEGAL PROVISIONS

The genesis of the Secretarial Audit can be traced to the Companies (Amendment) Act, 1988 which amended Section 161 of the Companies Act, 1956. This amendment introduced the requirement of certification of annual return of listed Companies by a Practising Company Secretaries. Thereafter, Companies (Amendment) Act, 2000 amended Section 383A of the Companies Act, 1956. By this amendment, it was mandated that companies which had a paid-up share capital of Rs.10 lakh or more and which did not require to employ a Whole-time Company Secretary had to obtain a Certificate from a Practising Company Secretaries on an annual basis regarding the compliance of the various provisions of the Act.

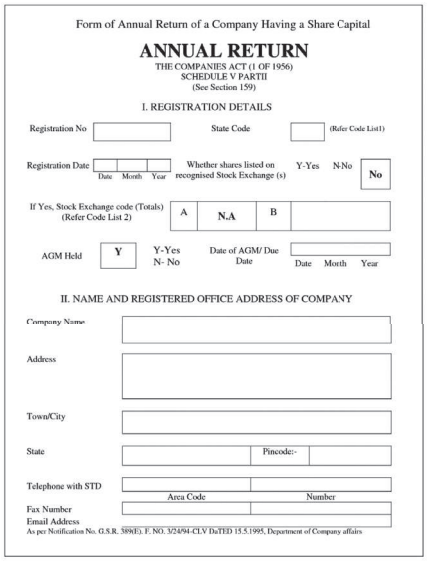
This certificate was to be attached with the Board's Report. In 2002, Naresh Chandra Committee Report on Corporate Audit and Governance recommended introduction of Compliance Audit. Later in the year 2003, the Ministry of Corporate Affairs (MCA) introduced the Companies (Amendment) Bill, 2003, which introduced the concept of Secretarial Audit by giving powers to Central Government to order, at any time, the secretarial compliance audit of the company for any period. Similarly, the Concept Paper published by MCA in 2004, contemplated to enact a new Company Law in which the concept of the Secretarial Compliance Audit was included. Later on, Corporate Governance Voluntary Guidelines, 2009 was released in December 21, 2009, which insisted on adoption of Secretarial Audit for public companies and private companies, particularly the bigger ones. Para V of the Guidelines stated 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." Thereafter, the 21st report of the Parliamentary Standing Committee on Finance on the Companies Bill, 2009 also specified about Secretarial Audit. The extract from the said report is reproduced below:

"Para 7.8 of Chapter VII: 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."

At last, Secretarial Audit for bigger Companies has been notified from 1st April 2014 under the Companies Act, 2013 (the Act). As the Public shareholders subscribe to the shares of listed entities and public companies, it is necessary that the interest of the public is protected from the impact of non-compliances of the various provisions of the Act and other Corporate Laws. Besides, this would insulate the directors and other stakeholders like employees, suppliers, banks and financial institutions from the ill effects of non-compliance.

Secretarial Audit Journey



Form of Annual Return of a Company Having a Share Capital

ANNUAL RETURN

THE COMPANIES ACT (1 OF 1956)
SCHEDULE V PARTII
(See Section 159)

I. REGISTRATION DETAILS

Registration No | State Code | (Refer Code List1)

Registration Date (Date Month Year) | Whether shares listed on recognised Stock Exchange (s) | Y-Yes N-No | No

If Yes, Stock Exchange code (Totals) (Refer Code List 2) | A | N.A | B

AGM Held | Y | Y-Yes N- No | Date of AGM/ Due Date (Date Month Year)

II. NAME AND REGISTERED OFFICE ADDRESS OF COMPANY

Company Name

Address

Town/City

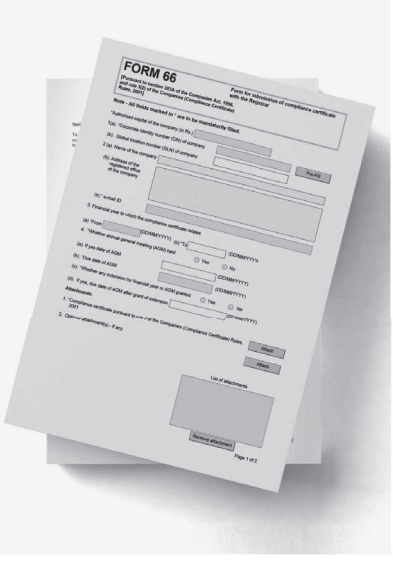
State | Pincode:-

Telephone with STD (Area Code Number)

Fax Number

Email Address

As per Notification No. G.S.R. 589(E). F. NO. 3/24/94-CLV DaTED 15.5.1995, Department of Company affairs



FORM 66

Form No. MR-3

SECRETARIAL AUDIT REPORT

FOR THE FINANCIAL YEAR ENDED ... ...

[Pursuant to section 204(1) of the Companies Act, 2013 and rule No.9 of the Companies (Appointment and Remuneration Personnel) Rules, 2014]

SECRETARIAL AUDIT REPORT

FOR THE FINANCIAL YEAR ENDED ... ...

To,
The Members,
..... Limited

I/We have conducted the secretarial audit of the compliance of applicable statutory provisions and the adherence to good corporate practices by..... (name of the company).(hereinafter called the company). Secretarial Audit was conducted in a manner that provided me/us a reasonable basis for evaluating the corporate conducts/statutory compliances and expressing my opinion thereon.

Based on my/our verification of the ..... (name of the company's) books, papers, minute books, forms and returns filed and other records maintained by the company and also the information provided by the Company, its officers, agents and authorized representatives during the conduct of secretarial audit, I/We hereby report that in my/our opinion, the company has, during the audit period covering the financial year ended on

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THE COMPANIES ACT, 2013

Section 204(1) of the Companies Act, 2013 read with rule 9 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 provides that-

a) Every Listed Company;

b) Every public company having a paid-up share capital of fifty crore rupees or more; or

c) Every public company having a turnover of two hundred fifty crore rupees or more;

d) Every company having outstanding loans or borrowings from banks or public financial institutions of one hundred crore rupees or more.

shall annex with its Board's report made in terms of sub-section (3) of section 134 of the Act, a Secretarial Audit report given by a Practising Company Secretaries., in form No. MR-3, as attached as **Annexure -A**.

Explanation to this sub-rule clarifies that the paid-up share capital, turnover, or outstanding loans or borrowings as the case may be, existing on the last date of latest audited financial statement shall be taken into account.

Section 204 (2) - It shall be the duty of the company to give all assistance and facilities to the company secretary in practice, for auditing the secretarial and related records of the company.

Section 204 (3) - The Board of Directors, in their report made in terms of sub-section (3) of section 134, shall explain in full any qualification or observation or other remarks made by the company secretary in practice in his report under sub-section (1).

Section 204 (4) - If a company or any officer of the company or the company secretary in practice, contravenes the provisions of this section, the company, every officer of the company or the company secretary in practice, who is in default, shall be liable to a penalty of 2,00,000 rupees.

Applicability of Section 204 to a Company which is a subsidiary of a Public Company:

Section 2(71) of the Companies Act, 2013 defines a "Public Company" as a company which –

(a) is not a private company; and

(b) has a minimum paid-up share capital as may be prescribed.

The proviso to the definition states that "provided that a company which is a subsidiary of a company, not being a private company, shall be deemed to be public company for the purposes of this Act even where such subsidiary company continues to be a private company in its articles."

Illustration:

PPP Pvt. Ltd. was incorporated in the year 2010 as Private Company. Its paid up capital is Rs. 35 crore, but the annual turnover for the financial year ended on 31st March, 2023, first time crossed from Rs. 240 crores to Rs. 300 crores. SSS Ltd, a public company, controls the composition of the Board of Directors of PPP Pvt. Ltd, hence in terms of Section 2(87) of Companies Act, 2013, PPP Pvt. Ltd is treated as subsidiary company of SSS Ltd. A newly appointed Company Secretary of PPP Pvt. Ltd suggested the Board of Directors to get the Secretarial Audit of this company. Whether the Secretarial Audit of a Private Limited Company is mandatory as per the provisions of the Companies Act, 2013.

By above mentioned definition, it can be inferred that Secretarial Audit would be applicable to a private company which is a subsidiary of a public company, and which falls under the prescribed class of companies.

In view of this, it is clear that Section 204 is applicable to a private company which is a subsidiary of a public company, and which falls under the prescribed class of companies.

Although, the companies which are not covered under section 204 may opt for conducting Secretarial Audit voluntarily as it provides an independent assurance of the compliances of applicable laws by the company.

Need of Secretarial Audit:

The need for secretarial audit arises from several factors, all of which contribute to ensuring corporate transparency, compliance with laws and regulations, and the overall health of the organization. Here are some key reasons why secretarial audit is essential:

1. **Compliance Verification**: Secretarial audit helps verify compliance with various laws, regulations, and guidelines applicable to the company, such as the Companies Act, SEBI regulations, FEMA regulations, etc. It ensures that the company operates within the legal framework and fulfils its statutory obligations.

2. **Corporate Governance**: Secretarial audit plays a crucial role in promoting good corporate governance practices. By reviewing the company's governance structure, board procedures, disclosure practices, and adherence to ethical standards, it helps identify areas for improvement and ensures transparency and accountability.

3. **Risk Mitigation**: Conducting regular secretarial audits helps identify potential risks and deficiencies in internal controls, policies, and procedures. By identifying these risks early on, companies can take proactive measures to mitigate them and prevent potential legal, financial, or reputational damage.

4. **Stakeholder Confidence**: Secretarial audit enhances stakeholder confidence by demonstrating the company's commitment to transparency, compliance, and ethical business practices. It provides assurance to investors, lenders, regulators, and other stakeholders that the company's affairs are conducted in a responsible and lawful manner.
5. **Preventing Fraud and Mismanagement:** Secretarial audit helps detect instances of fraud, mismanagement, or irregularities within the organization. By examining the company's records, transactions, and governance practices, auditors can identify red flags and investigate further to prevent or mitigate potential fraud or misconduct.
6. **Legal Requirements**: In many jurisdictions, secretarial audit is a legal requirement for certain types of companies or for companies above a certain size threshold. Failure to conduct a secretarial audit or comply with its findings may lead to legal and regulatory consequences, including penalties, fines, or even legal action against the company and its officers.
7. **Improving Efficiency and Effectiveness**: Through the process of secretarial audit, companies can identify inefficiencies in their administrative and compliance processes and implement measures to improve efficiency and effectiveness. This can lead to cost savings, enhanced productivity, and better utilization of resources.

In conclusion, secretarial audit is indispensable for ensuring legal compliance, promoting good corporate governance, mitigating risks, enhancing stakeholder confidence, preventing fraud and mismanagement, complying with legal requirements, and improving overall organizational efficiency and effectiveness. It is a valuable tool for companies to maintain integrity, transparency, and accountability in their operations.

Secretarial Audit as a Tool for Good Corporate Governance:

Secretarial audit serves as a crucial corporate governance tool by ensuring transparency, compliance, and accountability within organizations. Here's how secretarial audit contributes to effective corporate governance:

1. **Ensuring Regulatory Compliance**: Secretarial audit verifies compliance with various laws, regulations, and guidelines applicable to the company. By reviewing corporate records, governance practices, and statutory filings, secretarial auditors ensure that the organization operates within the legal framework and fulfills its regulatory obligations.

2. **Monitoring Corporate Practices**: Secretarial audit monitors corporate practices to ensure they align with ethical standards and best practices. By assessing board procedures, decision-making processes, and governance structures, secretarial auditors help identify areas for improvement and ensure that the organization adheres to principles of good governance.

3. **Assessing Board Effectiveness**: Secretarial audit evaluates the composition, independence, and performance of the board of directors. By reviewing board meeting minutes, director appointments, and adherence to governance guidelines, secretarial auditors assess the effectiveness of the board in fulfilling its oversight responsibilities and promoting the interests of stakeholders.

4. **Enhancing Transparency and Disclosure:** Secretarial audit promotes transparency by ensuring accurate and timely disclosure of information to stakeholders. By reviewing disclosure practices, communication channels, and shareholder relations, secretarial auditors help maintain open and transparent communication with investors, regulators, and other stakeholders, building trust and confidence in the organization.

5. **Identifying Risks and Controls**: Secretarial audit helps identify risks and evaluate the effectiveness of internal controls within the organization. By assessing compliance mechanisms, risk management frameworks, and corporate policies, secretarial auditors assist in identifying potential risks, such as legal liabilities or reputational risks, and recommend measures to strengthen internal controls.

6. **Supporting Strategic Decision-Making**: Secretarial audit provides insights that support strategic decision-making processes. By identifying governance gaps, compliance issues, and opportunities for improvement, secretarial auditors help management and the board make informed decisions that promote the long-term success and sustainability of the organization.

Overall, secretarial audit plays a crucial role in promoting good corporate governance practices, fostering trust among stakeholders, and ensuring the integrity and credibility of the organization. By providing independent assurance on governance processes and compliance practices, secretarial audit helps organizations uphold their commitments to transparency, accountability, and ethical conduct.

Objectives of a Secretarial Audit

The objectives of a secretarial audit encompass various aspects of ensuring legal compliance, promoting good corporate governance, and enhancing transparency within an organization. Here are the key objectives of secretarial audit:

1. **Verification of Compliance:** To verify compliance with the provisions of applicable laws, regulations, and guidelines governing the company's operations, including the Companies Act, SEBI regulations, FEMA regulations, and other relevant statutes.

2. **Assessment of Governance Practices:** To assess the adequacy and effectiveness of corporate governance practices within the organization, including the composition and functioning of the board of directors, adherence to governance guidelines, and ethical standards.

3. **Identification of Legal and Regulatory Risks:** To identify potential legal and regulatory risks faced by the company and assess the adequacy of internal controls and compliance mechanisms in mitigating these risks.

4. **Evaluation of Board Procedures:** To evaluate the procedures and processes followed by the board of directors in discharging their duties and responsibilities, including decision-making processes, meeting protocols, and adherence to statutory requirements.

5. **Review of Statutory Registers and Records:** To review the maintenance and accuracy of statutory registers, records, and filings required under company law, ensuring that they are up-to-date and compliant with legal requirements.

6. **Examination of Disclosures and Reporting:** To examine the accuracy and completeness of disclosures

made by the company to regulators, shareholders, and other stakeholders, ensuring transparency and accountability in reporting practices.

7. **Assessment of Related Party Transactions:** To assess the adequacy of controls and disclosures related to transactions with related parties, ensuring compliance with regulatory requirements and safeguarding against potential conflicts of interest.

8. **Detection of Fraud and Mismanagement:** To detect instances of fraud, mismanagement, or irregularities within the organization by conducting a comprehensive review of corporate records, transactions, and governance practices.

9. **Recommendation of Remedial Measures:** To recommend remedial measures to address any deficiencies or weaknesses identified during the audit, ensuring that the company takes corrective action to enhance compliance and governance practices.

10. **Enhancement of Stakeholder Confidence:** To enhance stakeholder confidence by providing independent assurance on the company's compliance and governance practices, fostering trust and credibility among investors, regulators, and other stakeholders.

Test Yourself:

Question: Is Secretarial Audit applicable on private limited companies, which is subsidiary of public company having turnover of more than Rupees 250 Crore?

Answer: Yes.

SECRETARIAL AUDIT AND SECRETARIAL COMPLIANCE REPORT UNDER THE SEBI (LISTING OBLIGATIONS AND DISCLOSURE REQUIREMENTS) REGULATIONS, 2015

In view of the criticality of secretarial functions for ensuring efficient functioning of the Board, the Kotak Committee on Corporate Governance, in its report dated October 05, 2017, recommended that-

(a) Secretarial Audit to be made compulsory for all listed entities under the SEBI (Listing Obligations and Disclosure Requirements) Regulations, in line with the provisions of the Companies Act, 2013.

(b) Secretarial Audit to be extended to all material unlisted Indian subsidiaries in line with the recommendations of the Committee on strengthening group oversight and improving compliance at a group level for listed entities.

Accordingly, SEBI vide circular no. CIR/CFD/CMD1/27/2019 dated February 08, 2019 notified the following provisions to be included in the SEBI (LODR) Regulations, 2015:

- *Regulation 24A*: Secretarial Audit: Every listed entity and its material unlisted subsidiaries incorporated in India shall undertake secretarial audit and shall annex with its annual report, a secretarial audit report, given by a company secretary in practice, in such form as may be prescribed with effect from the year ended March 31, 2019.

This will ensure the strengthening of the oversight of group companies of the listed entities. The term 'Material Subsidiary' means a subsidiary, whose income or net worth exceeds ten per cent (10%) of the consolidated income or net worth, respectively, of the listed entity and its subsidiaries in the immediately preceding accounting year.

The above provision has been substituted by the SEBI vide amendment dated 05.05.2021 which reads as under:

- **Regulation 24A: Every listed entity and its material unlisted subsidiaries incorporated in India shall undertake secretarial audit and shall annex a secretarial audit report given by a company secretary in practice, in such form as specified, with the annual report of the listed entity.**

Every listed entity shall submit a secretarial compliance report in such form as specified, to stock exchanges, within 60 days from end of each financial year.

The format for the Annual Secretarial Compliance Report is placed at **Annexure-B.**

The circular further provides that the listed entities and their material subsidiaries shall provide all such documents/information as may be sought by the PCS for the purpose of providing a certification under the Regulations and this circular.

SEBI while reposing immense confidence in the members of ICSI has mandated the issuance of Annual Secretarial Compliance Report by a Company Secretary in Practice to the listed entities to enable them to undertake certifications in accordance with the Regulations and this circular in letter and in spirit. Annual Secretarial Audit shall cover a broad check on compliance with all laws applicable to the entity, listed entities shall additionally, on an annual basis, require a check by the Company Secretary in Practice on compliance of all applicable SEBI Regulations and circulars / guidelines issued thereunder, consequent to which, the Company Secretary in Practice shall submit a report to the listed entity in the manner specified in this circular.

The Annual Secretarial Compliance Report is applicable to all Listed Entities.

The Annual Secretarial Compliance Report postulates for an independent verification of the records, books, papers and documents by a Company Secretary in Practice to check the compliance status of the company with the provisions of all applicable SEBI laws, Regulations and circulars/ guidelines issued thereunder.

Test Yourself:

Question: Is it compulsory for a listed entity to annex Secretarial Audit Report to annual report?

Answer: Yes, as section 204 requires the Secretarial Audit Report with Board Report, but Regulation 24A of SEBI (LODR) Regulations, 2015 provides the requirement of annexing it with Annual Report.

Exemptions:

As per regulation 15 of the SEBI (LODR) Regulations, 2015 the compliance specified in regulations 24A, shall not apply, in respect of –

15(2)(a)Listed entity having paid up equity share capital not exceeding rupees ten crore and net worth not exceeding rupees twenty five crore, as on the last day of the previous financial year:

Provided that where the provisions of regulations 17 to 27, clauses (b) to (i) and (t) of sub-regulation (2) of regulation 46 and para C, D and E of Schedule V become applicable to a listed entity at a later date, it shall ensure compliance with the same within six months from such date.

Provided further that once the above regulations become applicable to a listed entity, they shall continue to remain applicable till such time the equity share capital or the net-worth of such entity reduces and remains below the specified threshold for a period of three consecutive financial years.

15(2)(b)listed entity which has listed its specified securities on the SME Exchange:

Provided that for other listed entities which are not companies, but body corporate or are subject to regulations under other statues, the provisions of corporate governance provisions as specified in regulation 17, 17A, 18, 19, 20, 21,22, 23, 24, 24A, 25, 26, 27 and clauses (b) to (i) of sub-regulation (2) of regulation 46 and para C , D and E of Schedule V shall apply to the extent that it does not violate their respective statutes and guidelines or directives issued by the relevant authorities.

AUDITING STANDARD ON SECRETARIAL AUDIT (CSAS-4)

The Auditing Standard on Secretarial Audit (CSAS-4) formulated by Auditing Standards Board (ASB) of the Institute of Company Secretaries of India (ICSI) and issued by the Council of ICSI, is effective from 1st July, 2019 on recommendatory basis and mandatory with effect from 1st April, 2021.

The Standard shall apply to Secretarial Audit undertaken under Section 204 of the Companies Act, 2013 and Regulation 24A of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015. The Standard deals with basis and manner for carrying out the Secretarial Audit.

The objective of the Standard is to lay down the principles for evaluation of statutory compliances and corporate conduct in relation thereto.

The application of this Standard is not mandatory for:

- Annual Secretarial Compliance Report issued in terms of SEBI Circular No. CIR/CFD/CMD1/27/2019 dated 8th February, 2019; and
- Secretarial Audit entrusted on a voluntary basis by an Auditee to an Auditor. However, adherence to the Standard is recommended in respect of Audits entrusted on voluntary basis also.

Note: *This Standard is not applicable in case the Secretarial Audit is mandated by any third party or regulatory authority.*

However, if the Auditor has followed the Auditing Standards issued by the ICSI while performing the Audit, he should state the fact that he has followed the Auditing Standards (CSAS 1 to CSAS 4) issued by the Institute of Company Secretaries of India.

How adherence to other standards has to be ensured while complying with CSAS-4?

An Auditor while accepting Secretarial Audit, shall also comply with the principles laid down in CSAS-1 to CSAS 3.

For example, M/s. ABC & Associates, a practicing company secretaries firm, accepts an audit assignment on 20th April, 2021 for the FY 2021-2022. The firm should adhere to the principles laid down in the CSAS-1 (Audit Engagement) while accepting the audit assignment, the Auditor should plan, proceed and perform the audit assignment as per the CSAS-2 (Audit Process and Documentation) and give his opinion based on the Audit Process performed by him in line with the principles given in CSAS-3 (Forming of Opinion).

CONCEPT & ADVANTAGES

CONCEPT

Secretarial audit can be an effective multi-pronged weapon to assure the regulators, generate confidence amongst the shareholders, the creditors and other stakeholders in companies, assure FIIs/FIs/SFCs/SIDCs/ Banks and instil self-regulation and professional discipline in companies. It is a tool of risk mitigation and will allow companies to effectively address compliance risk issues.

Test Yourself:

Question: What is periodicity of Secretarial Audit?

Answer: Proactive Secretarial Audit on a continuous basis would help the company in initiating corrective measures and strengthening its compliance mechanism and processes. It is therefore, advisable that the Secretarial Audit is carried out periodically (quarterly / half year / annually) and adverse finding if any, is reported on interim basis to the Board immediately. The Secretarial Audit Report to be annexed with Board's report is required to be submitted before the preparation of Board's Report.

Once the Secretarial Audit Report is submitted by the secretarial auditor, the Government as well as other stakeholders can gauge in first instance the level of compliances or non-compliances by the company concerned. It can then immediately take suitable corrective measures under the specific applicable legislations.

The measures would act as a check on frauds as well as reduce the number of prosecutions by the Government and consequent litigation on account of non-compliance with the provisions of corporate and securities laws, thereby resulting in healthy and orderly development of the corporate sector. This would, in turn, lead to reduction of investor grievances and enhance various stakeholders' confidence.

In addition to the Government and shareholders, introduction of secretarial audit would be in the interest of companies themselves.

Secretarial audit besides ensuring due compliance of the statute, will act as an aid to the management by proving to be a strong internal control device. It can relieve the company and their directors from consequences of unintended non-compliance of law. Independent directors and nominee directors can be assured that the affairs of the company are being conducted as per law. Besides the Secretarial Auditor can act as a fearless adviser to the company so that the mistakes and lapses, if any, could be rectified well in time and management is reassured that internal systems are guarded.

Few risks of non-compliance with laws and regulations:

Failure of legal compliance	Failure to keep proper books and records or non-compliance with the provisions of corporate laws and securities laws, executing certain unviable or undesirable corporate actions or transactions with related parties or loan to directors, issue, allotment and transfer of security or otherwise, without proper authority of the board of directors or the general meeting or the memorandum of association, etc., could lead to the ability by third parties to play with the stakeholder's limited liability protection.
Failure to obtain proper approvals/permissions/ Licenses	Failure to obtain proper approvals/permissions/licenses could lead to fines, penalties or/and imprisonment in some cases, even closure of the business by government or governmental agencies.
Regulatory actions	Failure to comply with certain laws and regulations may lead to initiation of action by the regulators like MCA, SEBI, RBI or others authorities, which may jeopardize the very stability of the financial and manufacturing operations.
Non-compliances of Environment Laws	Failure to adopt proper environment law compliance and policies which are reviewed periodically could give rise to governmental and civil liability, besides causing risk to the environmental sustainability.
Failure to keep accurate records	Failure to keep accurate records and minutes of its decision-making procedures, proves that directors are not exercising informed judgment, and may subject the company and its board to liability to its shareholders and investors.
Failure to monitor the company's reporting requirements	Failure to monitor the company's reporting requirements may put the company into a position of default with lenders or investors.
PCS as extended Arm	Company secretary in practice acts as an extended arm of the regulators in ensuring the compliances. Detecting and reporting any non-compliance before it takes seriously alarming shape.

The inclusion of Secretarial Audit Report in the Directors' Report would go a long way in reassuring public, financial institutions and all others dealing with the company about the quality of corporate governance in the corporate entity concerned.

Companies entering into joint ventures and foreign collaborations will need such an audit to assure foreign partners that the laws of the land are duly complied with. A secretarial audit will serve as a first line due diligence. The secretarial audit will provide an in-built mechanism for enhancing corporate compliances generally and help restore the confidence of investors in the capital market through greater transparency in the corporate functioning.

ADVANTAGES

Secretarial Audit provides an effective mechanism to ensure that compliance of various legislations and regulations including the Companies Act, SEBI Law, Secretarial Standards and other corporate and economic laws applicable to the company has been diligently done. This would give necessary comfort to the Investors, Management, Regulators and Other Stakeholders.

The periodical Secretarial Audit helps to detect the instances of non-compliances and facilitates taking corrective-measures well in time to avoid any further risk.

Secretarial Audit facilitates monitoring compliances with the requirements of law through a formal compliance management programme which can produce following positive results to the stakeholders of a company:

- Better compliance of laws leading to reduction in number of frauds and consequent prosecutions.
- Protecting the interest of stakeholders and strengthening their faith in the corporates.
- Protecting the company/directors from the consequences of unintended non-compliance of laws.
- Independent assurance and comfort to independent/non-executive/nominee directors that the affairs of the company have been conducted as per law.
- Instilling professional discipline and self-regulation.
- Reducing workload of regulators due to better and timely compliances.
- Enhancing quality of services to investors.
- Any qualification in the Report will immediately alert the investor.

(a) *Promoters*

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 owner's stake is not being exposed to unintended risks.

(b) *Non-executive/Independent directors*

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) Government authorities/regulators

It also facilitates reducing the burden of the regulators in ensuring compliances and they can take timely actions against the offenders.

(d) *Investors*

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) *Other Stakeholders*

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.

RISK OF SECRETARIAL AUDITOR

Section 204(4) - Punishment for Contravention:

If a company or any officer of the company or the company secretary in practice, contravenes the provisions of section 204, then the company, every officer of the company or the company secretary in practice, who is in default, shall be liable to a penalty of two lakh rupees.

In case the Practicing Company Secretary failed to comply with the provisions of section 143 is liable for a penalty:

(a) in case of a listed company, be liable to a penalty of five lakh rupees; and

(b) in case of any other company, be liable to a penalty of one lakh rupees.

Section 447- Punishment for fraud: Without prejudice to any liability including repayment of any debt under this Act or any other law for the time being in force, any person who is found to be guilty of fraud, shall be punishable with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud provided that where the fraud in question involves public interest, the term of imprisonment shall not be less than three years.

Section 448 - Punishment for false statement: Save as otherwise provided in this Act, if in any return, report, certificate, financial statement, prospectus, statement or other document required by, or for, the purposes of any of the provisions of this Act or the rules made thereunder, any person makes a statement, (a) which is false in any material particulars, knowing it to be false; or (b) which omits any material fact, knowing it to be material, he shall be liable under section 447.

Also, as per section 451 of the Companies Act 2013, punishment is provided for repeated default :

If a company or an officer of a company commits an offence punishable either with fine or with imprisonment and where the same offence is committed for the second or subsequent occasions within a period of three years, then, that company and every officer thereof who is in default shall be punishable with twice the amount of fine for such offence in addition to any imprisonment provided for that offence.

Professional misconduct as per Company Secretaries Act, 1980:

Company Secretary in whole time employment and as well as Practicing Company Secretary both are liable for disciplinary action for professional misconduct under provisions of Company Secretaries Act, 1980.

In addition to the penal provisions contained in the Companies Act, 2013, the Institute of Company Secretaries of India (ICSI), has also made penal provision which are contained in Part I of First and Second Schedule of Company Secretaries Act, 1980 which provides the professional misconduct in relation to Company Secretaries in Practice.

Section 21C of the Act provides that where the Disciplinary Committee is of the opinion that a member is guilty of a professional or other misconduct mentioned in the Second Schedule or both the First Schedule and the Second Schedule, it shall afford to the member an opportunity of being heard before making any order against him and may thereafter take any one or more of the following actions, namely:

(a) Reprimand the member;

(b) Remover the name of the member from the Register permanently or for such period, as it thinks fit;

(c) impose such fine as it may think fit, which may extend to Rs 5 lacs.

CASE LAW

Non-Reporting of related party transaction led Secretarial Auditor to pay penalty

In the matter of Sun Pharmaceutical Industries Ltd, Adjudication Order passed by RoC Gujarat, Dadra & Nagar Haveli dated 28.04.2023

Facts of the case:

On receipt of whistle blower compliant in respect of Related Party Transaction, money diversion from Sun Pharmaceutical Ltd to Aditya Medisales Ltd and other group companies, the Inquiry of M/s Sun Pharmaceutical Industries Ltd under section 206(4) of the Companies Act, 2013 was ordered by Ministry of Corporate Affairs for FYs 2014 to 2018. During the inquiry it was observed by the inquiry officer that Secretarial Auditor of the company has not reported "Aditya Medisales Ltd.' as related party.

As per section 204 of the Companies Act, 2013 the Secretarial Auditor plays a crucial role in laws for effective compliances. The object of Secretarial Audit is evaluation and form an opinion and to report to the shareholders as to whether, the company has complied with the applicable laws comprising various statutes, rules, regulations, guidelines, followed by board processes also to report on existence of compliance management system.

The Practicing Company Secretary has to examine the transactions during the period of audit to identify whether any fraud element is present in the transaction. Also that, the ICSI has issued Guidance Note for Secretarial Audit. As per the Guidance Note the Secretarial Auditor is need to adhere the checklist to review the related party transaction.

In this matter, the instead of complying his duty as per the Guidance Note in respect of related party transaction u/s 188, the Secretarial Auditor has merely relied on the statutory Auditors' report, which led to non-compliance on his part pertaining to non-reporting of related party transaction.

Decision:

After considering the facts and submissions, the adjudicating officer had reasonable cause to believe that the Secretarial Auditor of the company has failed to discharge their duty as per provisions of section 143(14) read with section 188 and 204 of the Companies Act, 2013 read with ICSI Guidance Note on Secretarial Audit issued by ICSI and imposed a penalty on Secretarial Auditor.

CODE OF CONDUCT

A Code of Conduct is a necessary component of any profession to maintain standards for the individuals within that profession to adhere. It brings about accountability, responsibility and trust to the individuals that the profession serves. A professional needs to constantly live up to its values so that the clients, stakeholders, regulators, fellow professionals and the public at large repose full trust in the profession. The corporate world in which the professionals operate today has become quite demanding and competitive with new regulatory prescriptions each passing day and added emphasis on self-regulation.

Code of Conduct is a set of Principles outlining the responsibilities of, or proper practices with values for, an individual, party or organization.

"People forget how fast you did a job – but they remember how well you did it"

-Howard Newton

World over, the professions have accorded highest priority to professional ethical standards in the dealings and relationship of professionals with their employers, employees, Government, fellow professionals and the public at large. The fundamental principles which should govern the conduct of a professional with others have been broadly identified as to encompass;

— Integrity;

— Independence;

— Competence;

— Objectivity;

— Ethical behaviour;

— Conformance to the prescribed technical standards; and

— Confidentiality of information acquired in the course of professional work.

Adherence to the Code of Conduct coupled with high level of integrity and ethical behaviour are the hallmark of quality of professional services. Company Secretaries being Secretarial Auditors under the Companies Act, 2013 hold huge responsibilities they serve and influence the investors, employees, customers, suppliers, lenders, government and the society at large.

In order to evoke the necessary interest and awareness among the members and to create the necessary climate for laying down the right type of conduct which should govern the profession, the ICSI organised in February 1976, a National Convention, primarily to evolve the necessary framework for a code of conduct. After the conclusion of that Convention, the Council of the Institute appointed a Code of Conduct Committee with the task of formulating a model code of conduct. The Council of the Institute accepted the recommendations of the Code of Conduct Committee which inter alia prescribed:

(a) rules applicable to all members; and

(b) rules applicable to members in service or in practice.

In formulating the code of conduct, the Committee and the Council adopted a certain normative approach or value judgment. The codes evolved were rooted in the principles of Dharma stating positively what the profession stands for, what it expects from the members and what it cherishes as valued ideals of the society. The code also negatively laid down what constitutes a breach of the code in any given situation and the penal consequences for any violation or misconduct.

The code of conduct acquired statutory status with the conversion of the Institute into a statutory body under the Company Secretaries Act, 1980 ('the Act'), with effect from 1st January, 1981. In the year 2006 substantial amendments were made to Act and also to the First and the Second Schedules to the Act which encompass in detail, various instances of professional misconduct on the part of the members of the Institute in practice as well as in service.

SCOPE OF SECRETARIAL AUDIT

<table>
<tr><th>Examination & Specific Reporting on Compliance under:</th><th>Examination & Specific reporting on Compliance of other laws as may be Applicable specifically to the Company</th><th>Further Reporting</th><th>Further Reporting</th></tr>
<tr><td>The Companies Act, 2013 and the Rules made thereunder</td><td>E.g. Banks-all laws applicable to banking Industry</td><td rowspan="8">Whether there are Adequate systems and processes in the Company commensurate with its size & operation to monitor and ensure compliance with applicable laws including general laws like labour law, environmental laws.</td><td>Constitution of Board of Directors</td></tr>
<tr><td>Securities Contracts (Regulation) Act, 1956 ('SCRA') and the rules made thereunder</td><td>Companies in petroleum sector- All laws applicable to petroleum Industry</td><td>Notices, Agenda and Minutes of Board Meetings etc.</td></tr>
<tr><td>Depositories Act, 1996 and the Regulations framed thereunder</td><td rowspan="6"></td><td rowspan="6">Board processes</td></tr>
<tr><td>Foreign Exchange Management Act, 1999</td></tr>
<tr><td>Regulations and Guidelines under the SEBI Act, 1992 as enlisted in Form MR-3</td></tr>
<tr><td>Secretarial Standards issued by ICSI</td></tr>
<tr><td>Listing Agreement entered into by the company with Stock Exchange(s) if any</td></tr>
</table>

The scope of Secretarial Audit comprises verification of the compliances according to the provisions of following enactments, rules, regulations, notifications and guidelines:

(i) The Companies Act, 2013 (the Act) and the Rules made thereunder:

The Act is divided into 29 chapters, 470 sections and VII Schedules. On various matters, Central Government has been empowered to make rules. A perusal of the scheme of the Act makes it clear that compliances under the Act may be divided into two categories. Compliances of the first type are annual and non-event based such as filing of the annual return, annual report including secretarial audit report, wherever applicable, etc. The compliances of second category are event based i.e. on happening of certain event. Secretarial audit envisages the verification of all secretarial records of a company.

(ii) The Securities Contracts (Regulation) Act, 1956 ('SCRA') and the rules made there-under;

(iii) The Depositories Act, 1996 and the Regulations and Bye-laws framed there-under;

(iv) Foreign Exchange Management Act, 1999 and the rules and regulations made there-under to the extent of Foreign Direct Investment, Overseas Direct Investment and External Commercial Borrowings;

(v) The following Regulations and guidelines as prescribed under the Securities Board of India Act, 1992 (SEBI Act):

(a) The Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011;

(b) The Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015;

(c) The Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018;

(d) The Securities and Exchange Board of India (Share Based Employee Benefits) Regulations, 2014;

(e) The Securities and Exchange Board of India (Issue and Listing of Debt Securities) Regulations, 2008;

(f) The Securities and Exchange Board of India (Registrars to an Issue and Share Transfer Agents) Regulations, 1993;

(g) The Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2021;

(h) The Securities and Exchange Board of India (Buyback of Securities) Regulations, 2018;

(i) The Securities and Exchange Board of India (Listing Obligations and Disclosures Requirements), Regulations, 2015.

(vi) Mention the other laws as may be applicable specifically to the company) Other Applicable Laws include:

Reporting on compliance of 'Other laws as may be applicable specifically to the company' shall mean all the laws which are applicable to specific industry for example for Banks- all laws applicable to Banking Industry; for insurance company-all laws applicable to insurance industry; likewise for a company in petroleum sector; all laws applicable to petroleum industry; similarly for companies in pharmaceutical sector, cement industry etc.

'Other areas' which need to be checked

Secretarial Auditor needs to examine and report on the compliance with the applicable clauses of the following:

(i) Secretarial Standards issued by The Institute of Company Secretaries of India.

(ii) The Listing Agreements entered into by the Company with the respective Stock Exchange(s), if applicable;

Secretarial Audit report also requires reporting on whether –

- The Board of Directors of the Company is duly constituted with proper balance of Executive Directors, Non-Executive Directors, Independent Directors, and Women Director.
- The changes in the composition of the Board of Directors that took place during the period under review were carried out in compliance with the provisions of the Act.
- Adequate notice is given to all directors to schedule the Board Meetings, agenda and detailed notes on agenda were sent at least 07 days in advance, and a system exists for seeking and obtaining further information and clarifications on the agenda items before the meeting and for meaningful participation at the meeting.
- Majority decisions are carried through while the dissenting members' views are captured and recorded as part of the minutes.

- There are adequate systems and processes in the company commensurate with the size and operations of the company to monitor and ensure compliance with all applicable laws including general rules like labour laws, competition law, environmental laws, regulations and guidelines.

Secretarial Auditor is required to report and provide details of specific events and actions that occurred during the reporting period having major bearing on the affairs of the company in pursuance of above referred laws/ rules & regulations.

SECRETARIAL AUDIT – THE PROCESS

Secretarial Audit is a process to check compliance with the provisions of all applicable laws and rules/ regulations/ procedures; adherence to good governance practices with regard to the systems and processes of seeking and obtaining approvals of the Board and/or shareholders, as may be necessary, for the business and activities of the company, carrying out activities in a lawful manner and the maintenance of minutes and records relating to such approvals or decisions and implementation. The secretarial auditor is also expected to express an opinion, after satisfying himself, that there exist adequate systems and processes in the company commensurate with the size and operations of the company to monitor and ensure compliance with applicable laws, rules, regulations and guidelines. The secretarial auditor has to verify whether diverse requirements under applicable laws have been complied with.

Appointment of Secretarial Auditor

As per Rule 8 of the Companies (Meetings of Board and its powers) Rules, 2014, read with Section 179 of the Companies Act, 2013, secretarial auditor is required to be appointed by means of resolution passed at a duly convened board meeting. Further the appointment shall also be in compliance with the Auditing Standards prescribed by the Institute of Company Secretaries of India.

Communication to earlier Incumbent

Whenever a company secretary in practice is engaged as a secretarial auditor in place of an earlier incumbent, he shall communicate to the earlier incumbent about the proposed engagement in writing to be sent by registered/ speed post or any other mode of delivery, as may be recognized by the Institute of Company Secretaries of India.

The Council of ICSI at its meeting held on 16th March, 2019 has made amendments in Guidelines wherein for Practice Company Secretaries, communication to previous incumbent would be mandatory before accepting the assignment, in terms of Clause (8) of Part i of the First Schedule to the Company Secretaries Act, 1980. The Council has approved some services in respect of which it shall be mandatory to communicate to the previous incumbent (Company Secretary) before accepting the assignment in terms of terms of clause (8) of part I of the First Schedule to the Company Secretaries Act, 1980, which includes the Issuance of Secretarial Audit Report in terms of Section 204 of the Companies Act, 2013 and Issue of Secretarial Audit Report to material unlisted subsidiaries of Listed entities (whose equity shares are listed) under Regulation 24A of SEBI (LODR) Regulations, 2015.

Acceptance of Appointment

A formal letter for appointment should be issued by the company to the secretarial auditor along with the copy of the board resolution for appointment. The secretarial auditor should confirm acceptance of appointment in writing.

Preliminary Discussions/Surveys

It is important to have relevant information about the company. The secretarial auditor is expected to take general overview of the obtain of the company and interact with the personnel involved to know about the nature of the business. He may opt for surveys for generating information about the company.

Preliminary Meeting

The preliminary meeting with the senior management and the administrative staff involved in the audit will give a fair idea of what is expected and the manner in which audit activities are to be undertaken. At this stage, a

time frame of the secretarial audit should be determined and finalized. The secretarial auditor shall discuss the scope and objectives of the audit, gather information on important Board processes, evaluate existing control systems and prepare the audit plan.

Finalization of Audit Plan and Briefing the Staff

It is important to work out an audit plan. The plan involves briefing the audit staff as to allotment of work, fieldwork responsibilities and other roles. The audit plan should comprehensively outline the fieldwork and usage of auditing tools. The review of controls helps the auditor determine the areas of highest risk and design tests to be performed in the fieldwork section. It is essential that the audit plan adheres to the timelines. Detailed checklist for each aspect of secretarial audit should be prepared and audit staff should be properly sensitized before commencement of audit.

Testing, Interviews and Analysis

The secretarial auditor may use a variety of tools and technology to gather information about the company's operations. The secretarial auditor should determine whether the controls identified during the preliminary review are operating properly, and in the manner described by the Company.

Fieldwork typically consists of interviewing with staff of the company whether formally or informally, reviewing procedure manuals and processes, testing and analysing compliance with applicable policies and procedures and laws, rules, regulations and assessing the adequacy of controls. This exercise may result in significant findings which the secretarial auditor may bear in mind while preparing the secretarial audit report.

Working Papers

Working papers are a vital tool of the audit process. They form the basis for expression of the audit opinion. They connect the management's records and information to the auditor's opinion. They are comprehensive and serve many purposes for the company as well as for the Auditor.

Audit Summary for Discussions

It is recommended that the findings during the course of audit are summarized and presented for initial discussions with the management for their views/ clarifications/replies.

Submission of Secretarial Audit Report

After considering the clarifications/replies of the management, the secretarial auditor shall prepare the secretarial audit report in Form MR - 3. The report is addressed to the members but is to be submitted to the Board. The report shall contain the opinion on the statutory compliances examined by the auditor and shall state whether in his opinion the Company is carrying out/not carrying out due compliances of the applicable provisions of the various laws. The report shall be provided with or without qualifications.

Auditing Standards

Secretarial Audit should be conducted in accordance with the Auditing Standard issued by the Institute of Company Secretaries of India.

IDENTIFICATION AND SEGREGATION OF APPLICABLE LAWS

SECRETARIAL AUDIT – TO ENSURE COMPLIANCE OF SPECIFIC LAWS AND GENERAL LAWS

The Auditor shall take note of the industry specific laws and other laws as may be applicable to the auditee based on the identification/ segregation by the Management and his own verification.

Industry specific laws

Identification of all laws applicable to the auditee, as well as industry specific laws and the segregation thereof, is the primary responsibility of the auditee. Auditor's role is to verify that the laws identified and segregated by the management are appropriate and sufficient having regard to the business of the auditee and the auditee should

communicate the same to the secretarial auditor. The Auditor shall exercise his professional judgment to verify that the identification and segregation of the laws made by the Management, as may be applicable specifically to the auditee, is correct. In case, the Auditor is not satisfied by the identification and segregation made by the Management, or no such identification and segregation has been made, he should seek explanation from the management to form the opinion and report accordingly.

The Institute of Company Secretaries of India vide communication dated 22nd December, 2014 and 15th May, 2015 has clarified regarding the scope of Secretarial Audit with regard to industry specific and other laws as under:

(1) Reporting on the compliance of 'other laws as may be applicable specifically to the company' include all the laws which are applicable to specific industry, For example, for Banks - all laws applicable to Banking Industry; for insurance companies - all laws applicable to Insurance industry; likewise, for a company in Petroleum sector - all laws applicable to petroleum industry; similarly, for companies in pharmaceutical sector, cement industry, etc. - all laws specifically applicable to them;

(2) Examining and reporting whether the adequate systems and processes are in place to monitor and ensure compliance with general laws like labour laws, competition laws, and environmental laws.

(3) The provisions relating to audit of accounts and financial statement of a company are dealt in the Statutory Audit, and that relating to taxation is dealt in Tax Audit. Hence, the Secretarial Auditor may rely on the reports given by statutory auditors or other designated professionals.

Applicable Laws

"Other laws as may be applicable specifically to the company" shall mean all the laws, rules and regulations that are applicable specifically to the company. The Secretarial Auditor may take note of all such laws, rules and regulations identified by the management of the company;

For example for Banks - all laws applicable to Banking Industry; for insurance company - all laws applicable to insurance industry; likewise, for a company in petroleum sector - all laws applicable to petroleum industry; similarly, for companies in pharmaceutical sector, cement industry, etc.

Principles for making such segregation

Segregation of laws applicable on the Company into the industry specific and general is essential for Secretarial Audit. Based on the following factors auditor should verify the correctness of the segregation of the laws:

- Registration with various authorities such as SEZ, Sectoral Regulators, etc.
- Segments such as Manufacturing/ Trading/ Service/ E-commerce and Industry classification thereof
- Status of company such as listed/ unlisted
- Geographic location of registered office, units/ divisions/ plants/ branches, etc.
- However, for identification of laws applicable on the company, in addition to above following factors shall also be considered
- Key financial parameters such as Turnover, Paid-up Share Capital, Net Worth, Borrowings, etc.
- Type/Class of company such as Private, Public, Holding, Subsidiary, Foreign, Nidhi, Producer, Section 8, etc.
- Agreements governing rights, obligations of shareholders such as Joint venture agreements, shareholders agreements etc.
- Number, class and category of employees/ workers such as women, contractual employees, etc.

It is important to note that certain laws which may fall in the category of General Laws may also become specific laws for particular industries.

Illustrations for various Industries Specific Laws

Illustration 1: For a food & beverages manufacturing & processing unit, industry specific laws includes National Food Security Act, 2013, Food Safety and Standard Act, 2006 and State specific laws, if any.

Illustration 2: For a Coal Mining company, industry specific laws includes Mines Act, 1952, Indian Explosives Act, 1884, Colliery Control Order, 2000 and rules & regulations made thereunder, Coal Mines Pension Scheme, 1998, Coal Mines Conservation & Development Act, 1974, The Mines Vocational Training Rules, 1966, The Mines Creche Rules, 1961, The Mines Rescue Rules, 1985 etc.

The Form MR-3 as notified by the MCA under section 204 of the Companies Act, 2013 has provided that the Secretarial Auditor shall report on the status of the compliance of other laws as may be applicable specifically to the company as specified in point No. (vi) of MR-3.

Further the Form MR-3 also provides for further reporting on the status of the compliance along with the comments on the adequacy of the systems and procedures in the company to manage the compliance of the laws, rules, regulations and guidelines applicable to the company under the following paragraph of the report.

"I/we further report that there are adequate systems and processes in the company commensurate with the size and operations of the company to monitor and ensure compliance with applicable laws, rules, regulations and guidelines."

This part of the Secretarial Audit report specifically refers to the compliance of the other applicable laws apart from the Laws covered in the Form MR- 3 and Laws specifically applicable to the company.

Test Yourself:

Question: What is the format of Secretarial Audit Report?

Answer: Secretarial Audit Report is required to be provided in the format prescribed in Form MR-3. (Rule 9 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014).

Question: To Whom Secretarial Audit Report is addressed?

Answer: Secretarial Auditor is appointed by the Board of Directors of the Company. However Secretarial Audit Report is addressed to the members of the Company.

REPORTING OF GENERAL LAWS

As stated above, the Secretarial Auditor should verify and report that adequate system and processes are in place to monitor and ensure compliance with general laws like labour laws, competition law, and environmental laws.

VERIFICATION OF CORPORATE CONDUCT AND COMPLIANCE OF LAWS

Identification of Events/ Corporate Actions

The Auditor shall identify events/ corporate actions that took place during the audit period. The identification shall be made by reviewing the website of the regulators, website of the Auditee, statutory records including books and papers, interaction with the Management and in any other appropriate manner.

Events/ corporate action

A corporate action is an event initiated by a company that brings or could bring an actual change to the working of the company, such as the investment made during the period under audit, change in the borrowing limits, issuance of the securities-equity or debt, appointment of the KMPs, etc., as approved by its board of directors and/or shareholders.

An action based event may be defined as any activity that amends the functioning of an organization and impacts its stakeholders, including Shareholders, both common and preferred, as well as Lenders. These events are generally approved by the company's board of directors or shareholders of the company, some of the examples are given below for reference:

- Events/ actions altering the Charter documents of the company;
- Changes in the Capital structure of the company;
- Change in the Affairs/ Management of the company;
- Change in the Licensing or permission for the business operation of the company;
- Casual Vacancy of statutory auditor/ director/ KMP;
- Borrowing in excess of limits specified in Section 180 of the Companies Act, 2013.

Identification of Events/Coprorate Events

The Auditor is expected to identify the Corporate Actions from which a compliance requirement may arise. Corporate actions may primarily be identified from the following:-

- Financial statements;
- Agenda and Notes on Agenda of Board/ Committee/ Members' Meetings;
- Minutes of the Board/ Committees/ Members' Meetings;
- Reporting and Filing to the regulators;
- Annual Report;
- Statutory Disclosures on website of the company, website of the Ministry of Corporate Affairs and on any other platform such as Stock Exchange;
- Third party sources which may include registrar and transfer agents, banks, financial auditor, stakeholders etc.

Verification of Compliance

The Auditor shall verify all event and calendar-based compliances from the Records of the Auditee, database or website of the regulators and other relevant sources.

The Auditor shall use systematic and comprehensive audit checklists for carrying out the audit and verifying the compliance requirements. The Auditor shall compile and validate the checklists for use in the audit process on the basis of information gathered about the Auditee and scope of the audit. It is a useful tool to ensure that no compliance point is missed or omitted while conducting the audit. The audit checklist should provide structure and continuity to an audit. Audit checklists should be reviewed and updated from time to time to meet the scope of audit and its effectiveness.

The Auditor should verify the compliances of applicable laws and rules based on the information gathered by the Auditor.

BOARD COMPOSITIONS

The Auditor shall verify compliance of the Companies Act, 2013, SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015, Agreement with Lenders/ Investors, Articles of Association and provisions of other Acts/ Rules/ Regulations specific to the industry, Guidelines and Policies of the Government for promotion of particular industry or location-specific industry, board decisions, shareholders decisions, as may be applicable to the Auditee with regard to:

1. **The overall composition of the Board including the minimum and maximum strength of the Board.**

Various provisions mandating the Board Composition

There are certain companies which are governed by the Specific Acts and legislations, as applicable in addition to the Companies Act, 2013 with certain exemptions, for example., Banking Companies, Insurance Companies, State Financial Corporations, Public Sector Undertakings, in such cases the Auditor shall ensure the Board Composition is as per the requirements of the applicable laws and acts to the Auditee. A few examples of special situations are given below for reference:

Illustration 1: *In case the Auditee is a non-scheduled flight operator, then it will require prior approval from the Ministry of Civil Aviation for the appointment of a new member on its Board.*

Illustration 2: *The board composition in the State Bank of India (SBI) is regulated by the State Bank of India Act, 1955.*

Role of Auditor in the verification of Board Composition

The Auditor should identify the laws and rules that govern the company and check the compliances of the Board Composition in accordance with those applicable laws and rules. For example, a Banking Company is regulated by the Banking Regulation Act, 1949, therefore, the Auditor should ensure that the Board Composition is in compliance of the Banking Regulation Act, 1949 or any other law specifically applicable to the Auditee in addition to the basic governing laws enumerated under the Companies Act, 2013 or SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.

In case of audit of any nationalized bank, the Auditor should check the Board Composition in line with Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980 and Nationalised Bank (Management & Miscellaneous Provisions) Scheme, 1980.

The Auditor should examine the applicability of the various laws and regulations applicable to the Auditee to verify the requirement of a minimum and maximum number of directors on the Board of the Auditee. In the case of specific categories of companies to which special Acts apply such as the Insurance Act, 1938, the Banking Regulation Act, 1949 and the Electricity Act, 2003, different rules are prescribed w.r.t a minimum and maximum number of the Board of Directors and accordingly the auditor should consider the compliances envisaged under those laws, Articles of Association and arrangements as may be appropriate in the context.

2. **Optimum Combination of the Board include a proportion of executive, non-executive, independent, non-independent, retiring, non-retiring, women and nominee directors.**

Various provisions mandating optimum combination

The optimum combination of the Board should be as per the provisions laid down in various Statutes such as the Companies Act, 2013, the SEBI (Listing Obligation and Disclosure Requirement) Regulations, 2015, the Banking Regulation Act, 1949, the Insurance Act, 1938, etc., as may be applicable to the company.

For example, provisions of the Companies Act, 2013 w.r.t. the Board Composition is given as under:

- As per section 149(2), Every Company shall have at least 01 director who stays in India for a total period of not less than 182 days during the financial year.

  Provided that in the case of a newly incorporated company the requirement under this sub-section shall apply proportionately at the end of the financial year in which it is incorporated.

- As per section 149(3), Every Listed Public Company shall have at least one-third of the total number of directors as independent directors and the Central Government may prescribe the minimum number of independent directors in case of any class or classes of public companies.

Explanation – for the purposes of this sub-section, any fraction contained in such one-third numbers shall be rounded off as one.

An independent director in relation to a company, means a director other than a managing director or a whole-time director or a nominee director.

As per second Proviso to Section 149(1) read with Rule 3 of The Companies (Appointment and Qualification of Directors) Rules, 2014 of the Companies Act, 2013, the following classes of companies are required to appoint at least 01 Woman Director:

(i) Every Listed Company;

(ii) Every Other Public Company having –

(a) paid–up share capital of 100 crore Rupees or more; or

(b) turnover of 300 crore Rupees or more.

For the appointment of Woman Director, paid up share capital or turnover, as the case may be, as on the last date of latest audited financial statements has to be taken into account.

Similarly, Regulation 17 of SEBI (Listing Obligation and Disclosure Requirements) Regulations, 2015 provides Board Composition as under:

The composition of the Board of Directors of the listed entity shall be as follows:

(a) Board of Directors shall have an optimum combination of executive and non-executive directors with at least 01-woman director and not less than 50% of the Board of Directors shall comprise of non-executive directors.

Provided that the Board of Directors of the top 500 listed entities shall have at least 01 independent woman director by April 1, 2019 and the Board of Directors of the top 1000 listed entities shall have at least 01 independent woman director by April 1, 2020.

Explanation: The top 500 and 1000 entities shall be determined on the basis of market capitalization, as at the end of the immediate previous financial year.

(b) Where the Chairperson of the Board of Directors is a non-executive director, at least one-third of the Board of Directors shall comprise independent directors and where the listed entity does not have a regular non-executive Chairperson, at least half of the Board of Directors shall comprise independent directors.

Provided that where the regular non-executive chairperson is a promoter of the listed entity or is related to any promoter or person occupying management positions at the level of the Board of Directors or at one level below the Board of Directors, at least half of the Board of Directors of the listed entity shall consist of independent directors.

(c) The Board of Directors of the top 1000 listed entities (with effect from April 1, 2019) and the top 2000 listed entities (with effect from April 1, 2020) shall comprise of not less than six directors.

Explanation: The top 1000 and 2000 entities shall be determined on the basis of market capitalization as at the end of the immediate previous financial year.

(d) Where the listed company has outstanding Superior Voting Rights (SR) equity shares, at least half of the Board of Directors shall comprise of independent directors.

Additional Requirements for NSE Prime Companies

The National Stock Exchange (NSE) launched 'NSE Prime' in December 2021-a framework that allows listed companied to sign up voluntarily for higher governance standards than what is required under the law.

Composition:

- The Board of Directors shall consist of a minimum of 8 directors.
- The Chairperson of the Board of Directors shall not be a relative of the Managing Director or Chief Executive Officer of the NSE Prime Company.
- Where the public shareholding is in excess of 50%, more than half of the Board of Directors shall comprise Independent Directors; and in case of any fractions, the same shall be rounded to the higher number.
- Where the public shareholding is 50% or less, at least half of the Board of Directors shall comprise Independent Directors; and in case of any fractions, the same shall be rounded to the higher number.
- With effect from July 01, 2025, at least 2 directors shall be women, with at least one such Woman Director also being an Independent Director.

Role of Auditor in the verification of optimum combination

Laws specifically applicable to the company may also mandate to have optimum combination of directors. The Auditor should also verify the compliance thereof and report deviations, if any.

3. Eligibility criteria including disqualifications of directors

Various provisions mandating qualifications/ disqualification

The conditions for qualifications/ disqualification of a director prescribed in the Companies Act, 2013 or any other industry specific Act or law, need to be checked while verifying the Board Composition of the company. For example, Section 164 of the Companies Act, 2013 lays down the provisions for disqualifications for the appointment as Director on the board of the company. Further, the Auditor also needs to check the eligibility criteria including disqualifications of the directors as may be prescribed in any other industry specific Act or laws applicable to the company.

4. Constitution and Composition of Committees of the Board

Various provisions mandating Board Committees

The constitution of various Committees and the terms of reference of the Committees can be as per various regulatory requirements. For example, for banking companies, stipulated Committees shall mean committees constituted in compliance with the Banking Regulation Act, 1949, Circulars issued by the Reserve Bank of India (RBI) and the Government of India (GOI) from time to time.

Other than Banking companies or other specific companies to which special Acts apply, there are certain mandatory committees that are required to be constituted by certain class or classes of companies as per the Companies Act, 2013, SEBI (Listing Obligation and Disclosure Requirement) Regulations, 2015 and certain industry/ sector specific laws. Such mandatory committees include:

- Audit Committee
- Nomination and Remuneration Committee
- Stakeholders Relationship Committee
- CSR Committee
- Risk Management Committee (Note: Secretarial Standard - 1 is not applicable as it is not a Board's Committee under the Companies Act, 2013)
- Internal Committee constituted under the POSH Act

Role of Auditor in verification of Board Committees

The Auditor needs to check whether the constitution of committees, as constituted by the auditee, is as per the laws, act, rules, regulations and standards applicable to the Auditee.

Preferable Board size as per Proxy Advisors Guidelines

Iias

Iias prefers a Board size of 6-15 members. Board size should be commensurate with the size and operations of the company. Iias believes that, given the nature and quantum of work involved, three directors may not be optimal. Their guidelines are therefore aligned with the Kotak Committee threshold of at least 6 directors. On the other hand, consensus on many critical issues may be difficult to achieve if Board size exceeds 15 members.

Key risks of big Board size highlighted by them include:

- Board size may be increased to accommodate family members.

- Large Board size may make consensus building difficult.

InGovern

InGovern prefers a Board size of 7-15 members. A Board size outside of this range is considered less effective either due to low diversity of expertise and opinion, and low representation of Independent Directors on Kay Committees or a big Board size of greater than 15 members present the disadvantages of delayed decision making that come along an uncontrollable size and risk of having majority of promoters and related parties on board, InGovern too is not in favour of huge Board size.

SES

SES prefers a Board size of 6-15 members. If the proposed Board size is outside this range, SES expects that the company must provide a rationale for the same.

BOARD PROCESSES

The Board of directors as an institution plays a prominent role in Corporate Governance. It is responsible for directing and overseeing the business and management of the Company. Given this pivotal role of the board, directors are considered as fiduciaries in that they are required to act in the interest of various constituencies in a Company such as shareholders and other stakeholders. Accordingly, the law foists on the directors duties and liabilities as instruments that modulate their conduct.

Directors are, however, entitled to various protective measures in the form of mitigating factors either conferred upon them by law or through practical mechanisms they may establish. The Section 118(10) mandates on every company to observe the Secretarial Standards on the meeting of the Board of Directors (SS-1) as specified by the Institute of Company Secretaries of India (ICSI).

The SS-1 helps in providing clarity in certain areas where the law is either silent or ambiguous. Wherever the law is silent, certain good governance practices have been recommended and where it is ambiguous, the standards try to bring in more clarity and adhere the common board processes across country.

CASE LAW

RoC imposes penalty on company, directors and company secretary for Non-compliance of SS-1

In the matter of M/s Polaris India Private Limited (ROC /D/ADJ Order /118(10)/ Polaris/ 328 to 333) adjudication order by the Registrar of Companies, NCT of Delhi & Haryana on 19th January 2022. The company was under obligation to comply with the Secretarial Standard -1 relating to meetings of the board of directors issued by the Institute of Company Secretaries of India which inter alia requires that the company shall hold at least four meetings of its board in each calendar year with a maximum interval of one and hundred and twenty days.

The company has failed to comply with Secretarial Standard – 1 in respect of holding at least four meetings of its board as well as the gap between board meetings. Upon realizing the default / non-compliance committed by the company, the company has *suo-moto filed an application via e-form GNL-1 for adjudication of penalty.*

Accordingly, Registrar of Companies, upon receipt of the application for adjudication received from the company, in the interest of natural justice, before imposing the penalty on the company, its directors who is in default, or any other person, as the case may be, a reasonable opportunity of being heard was given to them by issuing a notice for personal hearing. On the day of the personal hearing, the Company secretary of the company appeared before the authorities on behalf of the company and its directors / officers and explained that the defaults are of technical nature, which were committed inadvertently and without any mala-fide intentions.

The Registrar of Companies / Adjudicating Officer, in the exercise of the powers conferred on him and having considered the facts and circumstances of the case besides written and oral submissions, imposed penalty on the company and its officers including the Company Secretary amounting to Rs. 1.60 Lacs in total.

To ensure the effective board processes, the auditors shall verify that the decisions of the Board and its Committees are taken and recorded in compliance with applicable laws, rules, regulations, guidelines, standards and defined internal processes, if any.

Various provisions mandating Board Processes

Provisions w.r.t Board processes may include:

- Meetings of Board and Committees
- Meetings of Committees that exercise powers of the Board under Section 179 of Companies Act, 2013
- Meeting of Members
- Board's performance evaluation and training
- Appointment and Resignation of the members of the Board.

Role of Auditor in the verification of Board Processes

The Auditor shall verify notice of the meetings, minutes, and supporting records, including the agenda, to satisfy himself whether the Auditee has complied with the applicable laws, rules, regulations, guidelines, standards and defined internal processes (defined internal processes to be explained). Many corporates have manuals for Board Processes, in such cases, the Auditor should verify whether the Auditee has complied with the policy and processes laid down in the manual of the Auditee.

Deviations, if any, observed during the course of audit from the policies and processes laid down in the manual adopted by the Board.

Directors, collectively called Board of Directors, in fulfilling the fiduciary objectives need to ensure that the company adheres to transparent, ethical and responsible governance of the company. It is, therefore, important that the Board processes of the company are robust. The board process refers to the processes followed for decision making by the Board and its committees. They can be broadly divided into two parts namely: -

1. Part A – Board Structure
2. Part B – Board Systems and Procedures

CASE STUDY

Mr. CS is appointed as a Company Secretary of Flowers Pvt Ltd. Mr. CS have to conduct the audit for the financial year 2022-23. Mr. CS is required to draft the guidelines for verification of Board Composition & Board Process as per the CSAS-4 (Auditing Standard on Secretarial Audit).

Board Composition the auditor shall verify:

1. Overall composition of the Board including the minimum and maximum strength of the Board as per provisions of the Companies Act, 2013, SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015, Articles of Association and provisions of other Acts/rules/regulations as may be applicable to the Company.
2. Optimum combination of Executive, Non-executive, Independent, Non-independent, retiring, non-retiring, woman, nominee in the Board as per provisions of the Companies Act, 2013, SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, Articles of Association, agreement with Lenders/Investors and provisions of other Acts/rules/regulations as may be applicable to the company.
3. Eligibility criteria including qualifications of Directors in accordance with the provisions/principles laid down in the Companies Act, 2013, SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, Articles of Association and provisions of other Acts/rules/regulations as may be applicable on the Company.
4. The constitution and composition of Committees of the Board.

Board Processes:

The Auditor shall verify that the decisions of the Board and its Committees are taken and recorded in compliance with applicable laws, rules, regulations, guidelines, standards and defined internal processes, if any. In case of conflict between various provisions the stricter compliance to be verified.

SYSTEM AND PROCESS

System and process broadly refer to the framework of legal and procedural compliances of the Auditee including but not limited to internal regulations, control, guidance and governance.

Meaning of systems and processes

A system is the core element, that company management has and/or implements in its business. It's something that helps the business run. The processes are all the things that company management do in order to make any given system work most efficiently. In other words, systems are designed to connect all of an organization's intricate parts and interrelated steps to work together for the achievement of the business strategy. System and process in the context of Secretarial Audit includes internal policies, decisions or procedures, etc. laid down by the Auditee for ensuring the compliance of the various laws, rules, standards and guidelines as may be applicable to the company. The Auditor should verify those policies, decisions, procedures, etc. of the Auditee to verify the adherence thereof and ascertain that the systems and processes are adequate and commensurate to its size and operations to ensure compliance with applicable laws, rules, regulations, standards, guidelines and defined internal processes.

The Auditor shall assess the efficacy and adequacy of the system and processes of the Auditee commensurate with its size and operation for verifying compliance of applicable laws, rules, regulations, standards, guidelines, and defined internal processes, if any by:

- Reviewing records maintained by the Auditee.
- Understanding compliance responsibility centers, control points, matrix, the flow of information, escalation of non-compliances to different levels, reporting of any non-compliance.
- Assessing compliance mechanism and understanding its extent, coverage and severity mapping. The Auditor shall also assess compliance manual/ standard operating procedures, if any, available with the Auditee.
- Analysing instances of show cause notices received, prosecution initiated, fine or penalties levied, imprisonment ordered, qualification, adverse remark or observations in the statutory, internal or industry specific audit, orders passed by regulatory bodies or judicial/ quasi-judicial authorities.

Illustrations:

Below mentioned companies are observing certain best practices for Board Processes (2022):

1. Bharti Airtel Limited

- The company submits audited quarterly results to the Stock Exchange.

- Separate meeting of Independent Directors on a quarterly basis.

- The evaluation of the Board of Directors is done by an external agency

- Linkage of remuneration of MD & CEO and Senior Management with ESG/sustainability targets.

2. Hindustan Unilever Limited

The Board of directors has adopted 'Corporate Governance Code' a statement of practices and procedures to be followed by the company and its officers and employees.

3. Mahindra Logistics Limited

- The company has voluntarily adopted the practice of scheduling its AGM within 5 month of end of financial year as a god governance measure.

- The company, voluntarily as a good governance practice, observes a 'silent/quiet period' for 15 days prior to the announcement of quarterly and annual financial results.

- The company has structured system-based PAN India compliance mechanism, with process management and end-to-end visibility for its compliance process.

4. AU Small Finance Bank Limited

The Executive Directors are duty bound with Malus and Claw back clause, which activates in the event of subdues or negative financial performance of the Bank.

Companies in India that have historically been recognized for good corporate governance practices:

Tata Group: Tata Group is known for its strong corporate governance practices. It has a diverse board, with independent directors playing a significant role in decision-making processes.

Infosys: Infosys has been recognized for its transparent board processes and proactive engagement with shareholders. The company regularly updates stakeholders on its performance and strategic initiatives.

Reliance Industries Limited: Reliance has made efforts to enhance its corporate governance framework in recent years. The company has a well-structured board and has implemented several best practices recommended by regulatory authorities.

HDFC Bank: HDFC Bank has been praised for its robust risk management practices and transparent communication with stakeholders. The bank's board comprises experienced professionals with diverse backgrounds.

Wipro: Wipro has focused on strengthening its corporate governance practices to align with global standards. The company has a comprehensive code of conduct and ethics and emphasizes accountability at all levels.

DETECTION OF FRAUD

The Auditor shall exercise professional judgment and maintain professional scepticism throughout the planning and performance of the audit to detect and report the fraud envisaged under the provisions of Section 143(12) of the Companies Act, 2013 read with Companies (Audit and Auditors) Rules, 2014. A fraud may impact the organization adversely in monetary or other terms. The Auditor shall report the fraud, if the same has been observed by him during the course of audit.

Here, *professional scepticism* means, an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.

Professional scepticism includes being alert to, for example:

- Audit evidence that contradicts other audit evidence obtained.
- Information that brings into question the reliability of documents and inquiries to be used as audit evidence.

Professional Judgement means, the application of the accumulated knowledge and experience gained through a relevant accounting or auditing training, by making use of the ethical standards, resulting in making informed decisions about the courses of action that are appropriate in specific circumstances.

The Auditor shall check whether the company has any anti-corruption and/or anti-bribery policy, ethics policy which may be in place at the Company. During the course of the audit, if the Auditor suspects commission of any fraud, he shall endeavour to collect further evidence for the same. The suspicion may arise on perusal of internal control systems, complaint under whistle blower mechanism and reports of the other auditors, etc.

'*Suspicion*' is a state of mind more definite than speculation, but falls short of knowledge based on evidence. It must be based on some evidence, even if that evidence is tentative – simple speculation that a person may be engaged in fraud is not sufficient grounds to form a suspicion. Suspicion is a slight opinion but without sufficient evidence.

- Examples of information which could be classified as suspicion are provided below: Recurring negative cash flows from operations or an inability to generate cash flows from operations while reporting earnings and earnings growth.
- The practice by management in maintaining or increasing the entity's stock price or earnings trend.

The Auditor may communicate directly with the internal auditors and statutory auditors to verify whether they have suspected/identified any fraud during the course of their audit. The Auditor shall ensure to collect sufficient evidence which substantiates his suspicion of the commission of the fraud against the Auditee by its employees and officers.

During the course of the audit, if the auditor suspects any commission of fraud, he shall endeavour to collect further evidence for the same. The suspicion may arise on perusal of internal control systems, perusal of any complaints under whistle blower mechanism, reports of the other auditors, etc.

The auditor shall ensure to collect sufficient evidence which substantiates his suspicion of the commission of the fraud against the Company by the employees and officers of the company. The auditor shall ensure that he has sufficient reason to believe that there is commission of fraud and should have justifiable grounds for the same.

Transaction which may involve the fraud

In the past, "Fraud" has been noticed in many cases of scams in the following kinds of transactions:-

- **Related Party Transactions**

CASE STUDY

1. **Poly Pack:** British Textile company – diverted funds to related companies through 88 separate deals, mostly companies owned by his son and relatives - led to enactment of the Code of Corporate Governance in UK.
2. **Lehman Brothers:** One of the largest global financial services company in USA – Attempted to show rosy financial statements through a series of re-purchase contracts with related parties at artificial prize.

3. **Satyam computer services:** MD and CEO Mr. Ramalinga Raju put through RPT transactions to the tune of $ 1.6 billion to Maytas Properties and Maytas Infrastructure, companies predominantly owned and managed by his sons.
4. **Sun Pharmaceutical Industries Limited (2019):** Sun Pharma, India's largest pharmaceutical company, came under investigation by SEBI for alleged corporate governance lapses, including related party transactions. SEBI examined transactions involving Sun Pharma's co-promoter, Sudhir Valia, and his brother-in-law, Dilip Shanghvi (founder of Sun Pharma), related to certain real estate deals.
5. **Infrastructure Leasing & Financial Services (IL&FS) (2018):** IL&FS, a major infrastructure financing and development company, collapsed due to a liquidity crisis and allegations of mismanagement. The company's board was accused of approving numerous related party transactions without adequate disclosure or scrutiny. The IL&FS case led to significant regulatory reforms in India's corporate governance framework.
6. **Kingfisher Airlines (2012):** Vijay Mallya, the chairman of Kingfisher Airlines, faced allegations of financial irregularities, including questionable related party transactions. The airline, which eventually collapsed under a mountain of debt, was accused of providing loans and guarantees to companies associated with Mallya and his family.

- **Excessive Managerial Remuneration**

CASE STUDY

1. **Tyco – (USA):** CEO Dennis drew $600 million excess compensation and spent $2 million on his wife's birthday party at company's expense.
2. **Global Crossings:** Four CEO's drew $23 million each from the company and later removed such liabilities through write of driving the company to bankruptcy.
3. **Infosys (2017):** Infosys, one of India's leading IT services companies, faced shareholder criticism over the high severance pay awarded to its former CFO, Rajiv Bansal, in 2015. The severance package amounted to approximately ₹17.38 crore (around $2.5 million USD), raising concerns about governance and transparency.
4. **Tata Motors (2016):** In 2016, Tata Motors faced shareholder dissent over the compensation package of its former CEO and Managing Director, Cyrus Mistry. Mistry's remuneration, which included a significant severance payout upon his removal from the position, drew scrutiny from investors and governance experts.
5. **Wipro (2019):** Wipro, another major Indian IT services company, faced shareholder dissent over the proposed remuneration package of its CEO, Abidali Neemuchwala, in 2019. Shareholders raised concerns about the size of Neemuchwala's compensation and its alignment with company performance.

- **Insider Trading**

CASE STUDY

1. **ENRON:** Largest American energy company. Fortune-100 named ENRON "America's Most Innovative Company" for six consecutive years. Kenneth Lay CEO and his wife Linda sold all the shares held by them in the company worth $ 90 million @ $ 90 per share. After CEO's wife completed sale of all shares between 10 am and 10.20 am, share price crashed less than a dollar around 10.30 am due to announcement of filing under chapter 11 for bankruptcy.

2. **Galleon:** Raj Rajarathnam obtained inside information from Rajath Gupta, a member of the Board of Goldman Sachs that Warren Buffet's Berkshire Hathaway was going to make a crucial investment in Goldman Sachs. Raj Rajarathnam was convicted to pay fine $ 92.8 million and sentenced to 11 years imprisonment.
3. **Martha Stewart (2001):** The lifestyle guru was convicted in 2004 for insider trading related to the sale of ImClone Systems shares. Stewart sold her shares after receiving insider information from her broker about the FDA's rejection of ImClone's cancer drug.
4. **SAC Capital Advisors (2013):** SAC Capital, a hedge fund founded by Steven Cohen, pleaded guilty to insider trading charges in 2013. The firm agreed to pay $1.8 billion in penalties.

- Inter Company transactions
- Mergers/demergers/acquisitions
- IPO frauds

Other means of Corporate fraud are the inadequate disclosures, false or misleading information, theft of assets, false expenses, corruption, theft in formation, fraudulent applications, misuse of assets, dishonest business partners, fraudulent billing.

These areas are not exhaustive but only some examples are given so as to guide fraud detection.

REPORTING OF FRAUD

Secretarial Auditor in the course of performance of his duties as auditor it has reason to believe that an offence involving fraud is being committed or has been committed against the Company by its officers/employees needs to report the fraud. A very significant duty has been cast on the Company Secretary in Practice under section 143 (12) of the Companies Act, 2013. It provides that if the Company Secretary in Practice, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government. As per section 143(12):

"Notwithstanding anything contained in this section, if an auditor of a company in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud involving such amount or amounts as may be prescribed, is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the Central Government within such time and in such manner as may be prescribed:

Provided that in case of a fraud involving lesser than the specified amount, the auditor shall report the matter to the audit committee constituted under section 177 or to the Board in other cases within such time and in such manner as may be prescribed:

Provided further that the companies, whose auditors have reported frauds under this sub-section to the audit committee or the Board but not reported to the Central Government, shall disclose the details about such frauds in the Board's report in such manner as may be prescribed."

A very significant duty has been cast on the Company Secretary in Practice under section 143 (12) of the Companies Act, 2013. It provides that if the Company Secretary in Practice, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government, or to the Audit Committee or the Board.

Duty of Report Fraud to Central Government

The section 143(12) read with the Companies (Audit and Auditors) Rules, 2014 provides that if an auditor of a company in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud which involves or is expected to involve individually an amount of rupees one crore or above, is being or has been committed against the company by its officers or employee, the auditor shall report the matter to the Central Government.

Duty of Report Fraud to Audit Committee/ Board

In case of a fraud involving lesser than rupees one crore, the auditor shall report the matter to audit committee or to the board immediately but not later than two days of his knowledge of the fraud and he shall report the matter specifying the following:-

(a) Nature of fraud with description;

(b) Approximate amount involved; and

(c) Parties involved.

Disclosures in the Board's Report

The following details of each of the fraud reported to the Audit Committee or the Board during the year to be disclosed in the Board's Report:-

(a) Nature of fraud with description;

(b) Approximate amount involved;

(c) Parties involved, if remedial action not taken; and

(d) Remedial actions taken.

Consequence on failure in Reporting of fraud

In case, Company Secretary in Practice does not comply with the provisions of section 143(12), he shall be punishable with fine which shall be liable to a penalty of five lakh rupees in case of a listed company, and one lakh rupees in case of any other company [section 143(15)]. Further, section 143(13) provides that no duty to which an auditor of a company is subject to shall be regarded as having been contravened by reason of his reporting the matter (fraud) if it is done in good faith.

Who is considered as an Auditor for Fraud Reporting?

The auditor includes the-

- Statutory Auditors of the company 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 and the Branch Auditors referred to in section 143(8) of the Companies Act, 2013.

However, the Internal Auditor or such other professionals appointed under any other statutes rendering other services to the company such as a tax auditor appointed under Income Tax Act, GST auditors appointed under the respective GST legislations are not covered under section 143 of the Companies Act, 2013.

CASE STUDY

M/s ABC & Co., Practicing Company Secretaries were the Secretarial Auditors of Opoco Ltd. During the secretarial audit, the Secretarial Auditor was verifying the board approvals and other documentation for the loan taken by the Company and they found that a fraud of Rs. 3.5 crores was committed against the Company, by its officers which was not observed by the Statutory Auditors of the Company. In this background, below mentioned are the duties and responsibilities of Secretarial Auditors under the Companies Act, 2013.

The obligations and duties of the Secretarial Auditors in the mentioned case under Companies Act, 2013 are as provided under rule 13 of the Companies (Audit and Auditors) Rules, 2014:

If an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud, which involves or is expected to involve individually an amount of rupees one crore or above, is being or has been committed against the company by its officers or employees, the auditor shall report the matter to the Central Government as under:

- the auditor shall report the matter to the Board of Directors or the Audit Committee, as the case may be, immediately but not later than two days of his knowledge of the fraud, seeking their reply or observations within forty-five days.
- on receipt of such reply or observations, the auditor shall forward his report and the reply or observations of the Board of Directors or the Audit Committee along with his comments (on such reply or observations of the Board or the Audit Committee) to the Central Government within fifteen days from the date of receipt of such reply or observations;
- in case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of forty-five days, he shall forward his report to the Central Government along with a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he has not received any reply or observations;
- the report shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed cover by Registered Post with Acknowledgement Due or by Speed Post followed by an e-mail in confirmation of the same;
- the report shall be in the form of a statement as specified in Form ADT-4;
- as per Sec 143(15), any non-compliance of this duty by any auditor, cost accountant, or company secretary in practice, attracts penalty, which shall be-

  (a) in case of a listed company five lakh rupees; and

  (b) in case of any other company one lakh rupees.

Difficulties in estimating the quantum of fraud

By and large the Auditor including the Secretarial Auditor goes by the estimates or reasonable range provided by the management for the purpose of estimating the quantum of the fraud amount and reporting. Depending upon the complexity and duration of the fraud, at times it could be difficult for the auditing personnel to determine the quantum of fraud and loss suffered. In the event, after some time, it is discovered that the quantum of fraud has exceeded the threshold limit of one crore, then subsequent reporting may be required and thus the Secretarial Auditor may have to report to the Central Government within 45 days of the determination of the revised fraud estimate or loss which crossed one crore limit. In view of the above, the estimation of the amount of fraud is very critical and if the estimation goes wrong even after taking reasonable care, then it will impact the decision whether to report to the concerned Authorities or otherwise. Since the provision says that in case of fraud exceeding one crore is only required to be reported to Central Government and fraud involving less than a crore is required to be reported only to Audit Committee / Board. Hence, the secretarial auditor is required take extreme care in estimating the quantum of fraud.

Very interesting question at this juncture

One question arises in the mind as to whether regulatory non-compliance would come under the purview of fraud reporting. It may be noted that as per Ministry of Corporate Affairs notification there is no distinction

between fraud and regulatory non-compliance as long as the quantum of fraud loss can be reasonably quantified due to regulatory non-compliance. Again, there would be difficulty for the Secretarial Auditor to determine the quantum of fraud if the fraud is arising under regulatory non-compliance. Where the secretarial auditor discovers instances involving bribery, money laundering, corruption or other regulatory non-compliance committed by either by the company or its employees or its management, then the secretarial auditor is duty bound to communicate the same to the Audit Committee / Board and depending upon the quantum he is also required to report to the Central Government if the determination of fraud exceeds the threshold limit of one crore.

PROCEDURE FOR REPORTING OF FRAUD

(i) Reporting of frauds by auditor involving amount more than Rs. 1 crore

If an auditor of a company, in the course of the performance of his duties as statutory auditor, has reason to believe that an offence of fraud, which involves or is expected to involve individually an amount of rupees one crore or above, is being or has been committed against the company by its officers or employees, the auditor shall report the matter to the Central Government. Auditor should report such frauds as soon as possible but not later than 60 days of his knowledge about the frauds:

STEP-I - Report to Board & Audit Committee

Auditor shall forward his report to the board of directors or the audit committee, as the case maybe, within 2 days of his knowledge of the fraud, seeking their reply or observations within 45 (forty-five) days;

STEP-II - Report to Central Government after reply of board

On receipt of such reply or observations, the auditor shall forward his report and the reply or observations of the board or the audit committee along with his comments (on such reply or observations of the board or the audit committee) to the central government within 15 fifteen days of receipt of such reply or observations;

STEP-IIA - Report to Central Government if no reply received

In case the auditor fails to get any reply or observations from the board or the audit committee within the stipulated period of forty-five days, he shall forward his report to the Central Government along with a note containing the details of his report that was earlier forwarded to the board or the audit committee for which he failed to receive any reply or observations within the stipulated time.

(ii) Reporting of frauds by auditor involving amount less than Rs. 1 crore

As per the Sub-rule (3) of Rule 13 of the Companies (Audit and Auditors) Rules, 2014 in case of fraud involving an amount less than Rs. 1 Crore, the auditor shall report the matter of fraud to the audit committee or to the board within 2 days of his knowledge of the fraud.

The report should specify the nature of the fraud with description, approximate amount of the fraud and parties involved in the fraud.

In such case, as per sub-rule (4), the Board shall disclose in its report (Board's Report) the nature of fraud with description, approximate amount of the fraud, parties involved in the fraud and remedial action taken. Name of parties should be disclosed only when the board or audit committee has not taken any remedial action against the fraud.

CASE LAW

Fraud detection and reporting requires the practicing company secretary to focus beyond compliance

In the matter of *Globe Motors Limited v. Mehta Teja Singh & Company,* the Delhi High court observed that although an agreement in which a director was interested could not said to be invalid in view of compliance with the requirements of the Act, yet it is only a formal aspect of compliance with the statutory provisions; the basic question is as to the conduct of the director and whether it satisfies the test considering their fiduciary relationship to the company. Justice Sachar further observed that the directors are expected to display utmost good faith towards the company in their dealings with the company or on behalf of the company; they should not use the company's money or other property or information or other matters in their possession in order to gain any advantage to themselves. Therefore, a practicing company secretary should not be satisfied only with compliance during secretarial audit. He needs to look beyond and satisfy himself that the transactions which have taken place during audit period do not contain any fraud element.

FRAUD V/S NON-COMPLIANCE

The term fraud can be defined as act or course of deception, an intentional concealment, omission, or perversion of truth, to-

1. gain unlawful or unfair advantage,
2. induce another to part with some valuable item or surrender a legal right, or
3. inflict injury in some manner.

Wilful fraud is a criminal offense which calls for severe penalties, and its prosecution and punishment. However, incompetence or negligence in managing a business or even a reckless waste of firm's assets (for example by speculating on the stock market) does not normally constitute a fraud.

Non-Compliance:

The term non-compliance refers to failure to comply with the laws, rules regulations etc., the term non-compliance is commonly used in regard to a failure to meet the compliance requirements or failure to doing compliance be it the failure in following procedures, filing of information, eligibility conditions, reporting etc.

The relationship between Fraud and non-compliance can be constructed as the non-compliance in the company may lead to a fraud, however it may also be noted that the fraud can also be made in the compliant company.

IDENTIFICATION AND REPORTING OF THE EVENTS/ACTIONS HAVING MAJOR BEARING ON AUDITEE'S AFFAIRS

The Secretarial Auditor shall identify and report all events/actions having major bearing on the Company's affairs/ Governance in pursuance of the applicable laws, rules, regulations, guidelines, standards, etc. It shall be the duty of the Auditor to identify and report all events/actions having major bearing on the Company's affairs. An event/action may be considered as having major bearing on Company's affairs includes the following situations:

Events having a major bearing on Auditee's Affairs

1. The Auditor shall assess and identify the material action or events having bearing on the Auditee's affairs in pursuance of the applicable laws, act, rules, regulations, guidelines, standards, etc. and report accordingly.
2. The identification of the corporate actions or events having bearing on the Auditee's affairs in terms

of applicable laws, act, rules, regulations, guidelines, standards, etc. is a subjective matter and needs to be concluded keeping in mind various parameters. Such parameters may include the following:

a. The consideration involved in the transaction as a percentage of the consolidated turnover, net worth or profit;

b. The transaction whether or not in the ordinary course of business;

c. The transaction representing a significant shift from the company's strategy;

d. The omission of an event or information is likely to result in significant market reaction if the said omission came to light at a later date.

3. Further, following are indicative actions and/or events may be considered to have a bearing on the Auditee's affairs:

a. Future plans of Merger or Amalgamation.

b. Revision in Rating(s).

c. Fraud/ defaults by promoter or key managerial personnel or by listed entity or arrest of key managerial personnel or promoter.

d. Agreements [viz. shareholder agreement(s), joint venture agreement(s), family settlement agreement(s) (to the extent that it impacts management and control of the listed entity), agreement(s)/ contract(s) with media companies)], which are binding and not in normal course of business, revision(s) or amendment(s) and termination(s) thereof.

e. Corporate Debt Restructuring.

4. The Auditor shall disclose the material non-compliances and transactions as observed during the course of Audit.

Further, the SEBI (LODR) Regulations, 2015 include the following events which are considered as having bearing on affairs of the company:

1. default in timely payment of interests/preference dividend or redemption or repayment amount or both in respect of the non-convertible debt securities and non-convertible redeemable preference shares and also default in creation of security for debentures as soon as the same becomes apparent;

2. any attachment or prohibitory orders restraining the company from transferring non-convertible securities from the account of the registered holders along-with the particulars of the numbers of securities so affected, the names of the registered holders and their demat account details;

3. any action which shall result in the redemption, conversion, cancellation, retirement in whole or in part of any non-convertible securities;

4. any action that shall affect adversely payment of interest on non-convertible debt securities or payment of dividend on non-convertible redeemable preference shares including default by issuer to pay interest on non-convertible debt securities or redemption amount and failure to create a charge on the assets;

5. any change in the form or nature of any of its non-convertible debt securities or non-convertible securities that are listed on the stock exchange(s) or in the rights or privileges of the holders thereof and make an application for listing of the securities as changed, if the stock exchange(s) so require;

6. any changes in the general character or nature of business/activities, disruption of operation due to natural calamity, and commencement of commercial production/commercial operations;

7. any events such as strikes and lock outs which have a bearing on the interest payment/dividend payment/ principal repayment capacity;

8. details of any letter or comments made by debenture trustees regarding payment/non-payment of interest on due dates, payment/non-payment of principal on the due dates or any other matter concerning the security, listed entity and/or the assets along with its comments thereon, if any;

9. delay/default in payment of interest or dividend/principal amount/redemption for a period of more than three months from the due date;

10. failure to create charge on the assets within the stipulated time period;

11. any instance(s) of default/delay in timely repayment of interests or principal obligations or both in respect of the debt securities including, any proposal for re-scheduling or postponement of the repayment programmes of the dues/debts of the Company with any investor(s)/lender(s). Explanation. - For the purpose of this sub-para, 'default' shall mean non-payment of interest or principal amount in full on the pre-agreed date and shall be recognized at the first instance of delay in servicing of any interest or principal on debt.

12. any major change in composition of its board of directors, which may amount to change in control as defined in Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011;

13. any revision in the rating;

14. the following approvals by board of directors in their meeting:-

    (a) the decision to pass any interest payment;

    (b) short particulars of any increase of capital whether by issue of bonus securities through capitalization, or by way of right securities to be offered to the debt security holders, or in any other way;

15. all the information, report, notices, call letters, circulars, proceedings, etc. concerning non-convertible debt securities;

16. fraud/defaults by promoter or key managerial personnel or director or employees of listed entity or by listed entity or arrest of key managerial personnel or promoter.

IMPACT OF AUDIT REPORT

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.

Secretarial Audit facilitates monitoring compliances with the requirements of law through a formal compliance management programme which can produce positive results to the stakeholders of a company.

The Secretarial Audit Report should be prepared in accordance with the Auditing Standards issued by the Institute of Company Secretaries of India and be signed by the Secretarial Auditor who has been engaged by the company to conduct the Secretarial Audit and in case of a firm of Company Secretaries, by the partner under whose supervision the Secretarial Audit was conducted.

- An effective mechanism to make sure of the compliance with the legal and procedural Requirements.
- Provides a level of confidence to the directors & Key Managerial Personnel etc.
- Secretarial Audit ensures legal and procedural requirements so directors can concentrate on important business matters.

- Strengthen the goodwill of a company for their regulators and stakeholders.
- Secretarial Audit is an effective governance and compliance risk management tool.
- It helps the investor in analysing the compliance level of companies, thereby increases the reputation.

Annexure -A

FORM NO. MR-3

SECRETARIAL AUDIT REPORT FOR THE FINANCIAL YEAR ENDED

[Pursuant to section 204(1) of the Companies Act, 2013 and rule No.9 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014]

To,

The Members,

..... Limited

I/We have conducted the secretarial audit of the compliance of applicable statutory provisions and the adherence to good corporate practices by..... (name of the company).(hereinafter called the company). Secretarial Audit was conducted in a manner that provided me/us a reasonable basis for evaluating the corporate conducts/ statutory compliances and expressing my opinion thereon.

Based on my/our verification of the ..... (name of the company's) books, papers, minute books, forms and returns filed and other records maintained by the company and also the information provided by the Company, its officers, agents and authorized representatives during the conduct of secretarial audit, I/We hereby report that in my/our opinion, the company has, during the audit period covering the financial year ended on, complied with the statutory provisions listed hereunder and also that the Company has proper Board-processes and compliance mechanism in place to the extent, in the manner and subject to the reporting made hereinafter:

I/we have examined the books, papers, minute books, forms and returns filed and other records maintained by ..... ("the Company") for the financial year ended on, according to the provisions of:

(i) The Companies Act, 2013 (the Act) and the rules made thereunder;

(ii) The Securities Contracts (Regulation) Act, 1956 ('SCRA') and the rules made thereunder;

(iii) The Depositories Act, 1996 and the Regulations and Bye-laws framed thereunder;

(iv) The Foreign Exchange Management Act, 1999 and the rules and regulations made thereunder to the extent of Foreign Direct Investment, Overseas Direct Investment and External Commercial Borrowings;

(v) The following Regulations and Guidelines prescribed under the Securities and Exchange Board of India Act, 1992 ('SEBI Act'):

  (a) The Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011;

  (b) The Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992;

  (c) The Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009;

  (d) The Securities and Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999;

  (e) The Securities and Exchange Board of India (Issue and Listing of Debt Securities) Regulations, 2008;

(f) The Securities and Exchange Board of India (Registrars to an Issue and Share Transfer Agents) Regulations, 1993 regarding the Companies Act and dealing with client;

(g) The Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009; and

(h) The Securities and Exchange Board of India (Buyback of Securities) Regulations, 1998.

(vi) ..... (Mention the other laws as may be applicable specifically to the company)

I/we have also examined compliance with the applicable clauses of the following:

(i) Secretarial Standards issued by The Institute of Company Secretaries of India.

(ii) The Listing Agreements entered into by the Company with ..... Stock Exchange(s), if applicable;

During the period under review the Company has complied with the provisions of the Act, Rules, Regulations, Guidelines, Standards, etc. mentioned above subject to the following observations:

Note: Please report specific non-compliances / observations / audit qualification, reservation or adverse remarks in respect of the above para wise.

I/we further report that :

The Board of Directors of the Company is duly constituted with proper balance of Executive Directors, Non-Executive Directors and Independent Directors. The changes in the composition of the Board of Directors that took place during the period under review were carried out in compliance with the provisions of the Act.

Adequate notice is given to all directors to schedule the Board Meetings, agenda and detailed notes on agenda were sent at least seven days in advance, and a system exists for seeking and obtaining further information and clarifications on the agenda items before the meeting and for meaningful participation at the meeting.

Majority decision is carried through while the dissenting members' views are captured and recorded as part of the minutes.

I/we further report that there are adequate systems and processes in the company commensurate with the size and operations of the company to monitor and ensure compliance with applicable laws, rules, regulations and guidelines.

Note: Please report specific observations / qualification, reservation or adverse remarks in respect of the Board Structures/system and processes relating to the Audit period.

I/we further report that during the audit period the company has.....

(Give details of specific events / actions having a major bearing on the company's affairs in pursuance of the above referred laws, rules, regulations, guidelines, standards, etc. referred to above)

For example:

(i) Public/Right/Preferential issue of shares / debentures/sweat equity, etc.

(ii) Redemption / buy-back of securities.

(iii) Major decisions taken by the members in pursuance to section 180 of the Companies Act, 2013.

(iv) Merger / amalgamation / reconstruction, etc.

(iv) Foreign technical collaborations.

Place: Signature:

Date: Name of Company Secretary in Practice/Firm:

ACS/FCS No.

C P No.:

Note: Parawise details of the Audit finding, if necessary, may be placed as annexure to the report.

Annexure-B

Format of Annual Secretarial Audit Compliance Report - ICSI

Secretarial Compliance Report of [•] [Name of the listed entity] for the year ended _____

I/We have conducted the review of the compliance of the applicable statutory provisions and the adherence to good corporate practices by ..... (hereinafter referred as 'the listed entity'), having its Registered Office at ..... Secretarial Review was conducted in a manner that provided me/us a reasonable basis for evaluating the corporate conducts/statutory compliances and to provide my/our observations thereon.

Based on my/our verification of the listed entity's books, papers, minutes books, forms and returns filed and other records maintained by the listed entity and also the information provided by the listed entity, its officers, agents and authorized representatives during the conduct of Secretarial Review, I/we hereby report that the listed entity has, during the review period covering the financial year ended on _____ complied with the statutory provisions listed hereunder in the manner and subject to the reporting made hereinafter :

I/We _____ have examined:

(a) all the documents and records made available to us and explanation provided by [●] [Name of the listed entity] ("the listed entity"),

(b) the filings/ submissions made by the listed entity to the stock exchanges,

(c) website of the listed entity,

(d) any other document/ filing, as may be relevant, which has been relied upon to make this report,

for the financial year ended [●] ("Review Period") in respect of compliance with the provisions of :

(a) the Securities and Exchange Board of India Act, 1992 ("SEBI Act") and the Regulations, circulars, guidelines issued thereunder; and

(b) the Securities Contracts (Regulation) Act, 1956 ("SCRA"), rules made thereunder and the Regulations, circulars, guidelines issued thereunder by the Securities and Exchange Board of India ("SEBI");

The specific Regulations, whose provisions and the circulars/ guidelines issued thereunder, have been examined, include:-

(a) Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015;

(b) Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018;

(c) Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011;

(d) Securities and Exchange Board of India (Buyback of Securities) Regulations, 2018;

(e) Securities and Exchange Board of India (Share Based Employee Benefits and Sweat Equity) Regulations, 2021;

(f) Securities and Exchange Board of India (Issue and Listing of Non-Convertible Securities) Regulations, 2021;

(g) Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015;

(h) (other regulations as applicable) and circulars/ guidelines issued thereunder;

(Note: The aforesaid list of Regulations is only illustrative. The list of such SEBI Regulations, as may be relevant and applicable to the listed entity for the review period, shall be added.) and based on the above examination, I/We hereby report that, during the Review Period:

I. (a) (**) The listed entity has complied with the provisions of the above Regulations and circulars/

guidelines issued thereunder, except in respect of matters specified below:

Sr. No.	Compliance Requirement (Regulations/ circulars/ guidelines including specific clause)	Regulation/ Circular No.	Deviations	Action Taken by	Type of Action	Details of Violation	Fine Amount	Observations/ Remarks of the Practicing Company Secretary	Management Response	Remarks
					Advisory/ Clarification/ Fine/Show Cause Notice/ Warning, etc.					

(b) The listed entity has taken the following actions to comply with the observations made in previous reports:

Sr. No.	Compliance Requirement (Regulations/ circulars/ guidelines including specific clause)	Regulation/ Circular No.	Deviations	Action Taken by	Type of Action	Details of Violation	Fine Amount	Observations/ Remarks of the Practicing Company Secretary	Management Response	Remarks
					Advisory/ Clarification/ Fine/Show Cause Notice/ Warning, etc.					

II. Compliances related to resignation of statutory auditors from listed entities and their material subsidiaries as per SEBI Circular CIR/CFD/CMD1/114/2019 dated 18th October, 2019:

Sr. No.	Particulars	Compliance Status (Yes/No/ NA)	Observations/ Remarks by PCS*
1.	**Compliances with the following conditions while appointing/re-appointing an auditor**		
	i. If the auditor has resigned within 45 days from the end of a quarter of a financial year, the auditor before such resignation, has issued the limited review/ audit report for such quarter; or		

Sr. No.	Particulars	Compliance Status (Yes/No/ NA)	Observations/ Remarks by PCS*
	ii. If the auditor has resigned after 45 days from the end of a quarter of a financial year, the auditor before such resignation, has issued the limited review/ audit report for such quarter as well as the next quarter; or iii. If the auditor has signed the limited review/ audit report for the first three quarters of a financial year, the auditor before such resignation, has issued the limited review/ audit report for the last quarter of such financial year as well as the audit report for such financial year.		
2.	**Other conditions relating to resignation of statutory auditor**		
	i. Reporting of concerns by Auditor with respect to the listed entity/its material subsidiary to the Audit Committee: a. In case of any concern with the management of the listed entity/material subsidiary such as non-availability of information / noncooperation by the management which has hampered the audit process, the auditor has approached the Chairman of the Audit Committee of the listed entity and the Audit Committee shall receive such concern directly and immediately without specifically waiting for the quarterly Audit Committee meetings.		
	b. In case the auditor proposes to resign, all concerns with respect to the proposed resignation, along with relevant documents has been brought to the notice of the Audit Committee. In cases where the proposed resignation is due to non-receipt of information / explanation from the company, the auditor has informed the Audit Committee the details of information/ explanation sought and not provided by the management, as applicable. c. The Audit Committee / Board of Directors, as the case may be, deliberated on the matter on receipt of such information from the auditor relating to the proposal to resign as mentioned above and communicate its views to the management and the auditor. ii. Disclaimer in case of non-receipt of information: The auditor has provided an appropriate disclaimer in its audit report, which is in accordance with the Standards of Auditing as specified by ICAI / NFRA, in case where the listed entity/ its material subsidiary has not provided information as required by the auditor.		
3.	The listed entity / its material subsidiary has obtained information from the Auditor upon resignation, in the format as specified in Annexure-A in SEBI Circular CIR/ CFD/CMD1/114/2019 dated 18th October, 2019.		

**Observations/Remarks by PCS are mandatory if the Compliance status is provided as 'No' or 'NA'*

Sr. No.	Particulars	Compliance Status (Yes/No/ NA)	Observations/ Remarks by PCS*
1.	**Secretarial Standards:** The compliances of the listed entity are in accordance with the applicable Secretarial Standards (SS) issued by the Institute of Company Secretaries of India (ICSI).		
2.	**Adoption and timely updation of the Policies:** ● All applicable policies under SEBI Regulations are adopted with the approval of board of directors of the listed entities ● All the policies are in conformity with SEBI Regulations and have been reviewed & updated on time, as per the regulations/circulars/guidelines issued by SEBI.		
3.	**Maintenance and disclosures on Website:** ● The Listed entity is maintaining a functional website ● Timely dissemination of the documents/ information under a separate section on the website ● Web-links provided in annual corporate governance reports under Regulation 27(2) are accurate and specific which re-directs to the relevant document(s)/ section of the website		
4.	**Disqualification of Director:** None of the Director(s) of the Company is/ are disqualified under Section 164 of Companies Act, 2013 as confirmed by the listed entity.		
5.	**Details related to Subsidiaries of listed entities have been examined w.r.t.:** (a) Identification of material subsidiary companies (b) Disclosure requirement of material as well as other subsidiaries		
6.	**Preservation of Documents:** The listed entity is preserving and maintaining records as prescribed under SEBI Regulations and disposal of records as per Policy of Preservation of Documents and Archival policy prescribed under SEBI LODR Regulations, 2015.		
7.	**Performance Evaluation:** The listed entity has conducted performance evaluation of the Board, Independent Directors and the Committees at the start of every financial year/during the financial year as prescribed in SEBI Regulations.		
8.	**Related Party Transactions:** (a) The listed entity has obtained prior approval of Audit Committee for all related party transactions; or (b) The listed entity has provided detailed reasons along with confirmation whether the transactions were subsequently approved/ratified/rejected by the Audit Committee, in case no prior approval has been obtained.		

Sr. No.	Particulars	Compliance Status (Yes/No/ NA)	Observations/ Remarks by PCS*
9.	**Disclosure of events or information:** The listed entity has provided all the required disclosure(s) under Regulation 30 along with Schedule III of SEBI LODR Regulations, 2015 within the time limits prescribed thereunder.		
10.	**Prohibition of Insider Trading:** The listed entity is in compliance with Regulation 3(5) & 3(6) SEBI (Prohibition of Insider Trading) Regulations, 2015.		
11.	**Actions taken by SEBI or Stock Exchange(s), if any:** No action(s) has been taken against the listed entity/ its promoters/ directors/ subsidiaries either by SEBI or by Stock Exchanges (including under the Standard Operating Procedures issued by SEBI through various circulars) under SEBI Regulations and circulars/ guidelines issued thereunder except as provided under separate paragraph herein (**).		
12.	**Additional Non-compliances, if any:** No additional non-compliance observed for any SEBI regulation/ circular/guidance note etc.		

Note:

1. *Provide the list of all the observations in the report for the previous financial year along with the actions taken by the listed entity on those observations.*
2. *Add the list of all observations in the reports pertaining to the periods prior to the previous financial year in case the entity has not taken sufficient steps to address the concerns raised/ observations.*

   E.g. In the report for the financial year ended 31st March, 2023, the PCS shall provide a list of:

   - *all the observations in the report for the year ended 31st March, 2022 along with the actions taken by the listed entity on those observations.*
   - *the observations in the reports pertaining to the year ended 31st March,2022 and earlier, in case the entity has not taken sufficient steps to address the concerns raised/ observations in those reports.)*

Assumptions & Limitation of scope and Review:

1. Compliance of the applicable laws and ensuring the authenticity of documents and information furnished, are the responsibilities of the management of the listed entity.
2. Our responsibility is to report based upon our examination of relevant documents and information. This is neither an audit nor an expression of opinion.
3. We have not verified the correctness and appropriateness of financial Records and Books of Accounts of the listed entity.
4. This Report is solely for the intended purpose of compliance in terms of Regulation 24A (2) of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 and is neither an assurance as to the future viability of the listed entity nor of the efficacy or effectiveness with which the management has conducted the affairs of the listed entity.

Place:

Signature:

Date:

Name of the Practicing Company Secretary
ACS/ FCS No.:
CP No. :
UDIN : ....
PR No. : ....

LESSON ROUND-UP

- Secretarial Audit is an independent and objective assurance intended to add value and improve operations of a company.
- Only a member of the Institute of Company Secretaries of India holding certificate of practice can conduct Secretarial Audit and furnish the Secretarial Audit Report to the company.
- 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, so as to allow the Auditor to make an opinion as to whether there exist adequate systems and processes in the company to monitor and ensure compliance with applicable laws, rules, regulations etc.
- The Secretarial Audit Report should be prepared in accordance with the Auditing Standards issued by the Institute of Company Secretaries of India and be signed by the Secretarial Auditor who has been engaged by the company to conduct the Secretarial Audit and in case of a firm of Company Secretaries, by the partner under whose supervision the Secretarial Audit was conducted.
- Proactive Secretarial Audit on a continuous basis would help the company in initiating corrective measures and strengthening its compliance mechanism and processes. It is therefore, advisable that the Secretarial Audit is carried out periodically (quarterly / half year / annually) and adverse finding if any, is reported on interim basis to the Board immediately.
- The Accounting/ Financial related fraud shall be reported by the statutory auditors, whereas in case of nonfinancial fraud by the Secretarial Auditor and in case of the fraud relating to the costing Fraud it needs to be reported by the Cost Accountant in practice.

GLOSSARY

Listed Entity : The terms listed entity means an entity which has listed, on a recognised stock exchange(s), the designated securities issued by it or designated securities issued under schemes managed by it, in accordance with the listing agreement entered into between the entity and the recognised stock exchange(s).

MR-3 : The form prescribed for Secretarial Audit Report.

Secretarial Standards : It means the Secretarial Standard Issued by The Institute of Company Secretaries of India and approved by the Central Government under Section 118(10) of the Companies Act, 2013

Auditing Standard : It means "Auditing Standard" issued by the Institute of Company Secretaries of India.

Public Company : It is a Company as defined under section 2 (71) of the Companies Act, 2013.

TEST YOURSELF

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation).

1. Indicate the scope of secretarial audit, which should be taken into consideration by a Practicing Company Secretary, to examine and report the compliance of various laws/regulations as specified in the form MR-3, for submission in Secretarial Audit Report.
2. Elucidate the Importance of Auditing Standard on Secretarial Audit.
3. Define the risk of Secretarial Auditor & code of conduct.
4. Explain reporting of specific event under Secretarial Audit Report.
5. Mehar, a Chartered Accountant was working as a Manager in Finance team of Sita Mining Ltd. Mehar was curious to know about the Secretarial Auditor comments on compliance with applicable laws and regulations. In the preliminary meeting, he asked Rohan, the Secretarial Auditor about the process of identification of applicable laws to the Company. Explain the process.
6. Explain compliances specified in the Regulation 24A regarding applicability of secretarial audit under the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015. Also state the exemptions provided from this Regulation.
7. You are appointed as a Company Secretary of Aparana Pvt Ltd. You have to conduct the audit for the financial year 2019-20. Draft the guidelines for verification of Board Composition & Board Process as per the CSAS-4 (Auditing Standard on Secretarial Audit).
8. Z, one of the director of Shyam International Ltd. leaked an insider information in the market for personal benefit. Ram, Secretarial auditor of the company, in the course of performance of his duties find out this offence which involved the amount of Rs. 2.40 crore. As a Secretarial Auditor of the company how would Ram report about this ? Also state the consequences of non-compliance by the Auditor under the Companies Act, 2013.

LIST OF FURTHER READINGS

- Companies Act, 2013 and Rules made thereunder
- SEBI Act, 1992 and Regulations made thereunder
- The Secretarial Standards issued by ICSI.
- The Auditing Standards issued by ICSI
- ICSI Manual on Secretarial Audit
- Guidance Note on ICSI Auditing Standards (CSAS-1 to CSAS-4)
- Secretarial Audit under SEBI LODR Regulations
- ICSI FAQs on Secretarial Audit
- ICSI Guidance note on Code of Conduct for Company Secretaries

OTHER REFERENCES (Including Websites/ Video Links)

- https://www.mca.gov.in/content/mca/global/en/acts-rules/ebooks/acts.html?act=NTk2MQ==
- https://www.sebi.gov.in/
- https://www.icsi.edu/media/webmodules/publications/A1_Guidance_Note_on_Secretarial_Audit_(Release1.4).pdf
- https://www.icsi.edu/media/webmodules/09092022_ManualonSecretarialAudit_Complete.pdf
- https://www.icsi.edu/media/webmodules/Guidance_Notes_on_ICSI%20AS_Book_05-6-2021.pdf

- https://www.indiacode.nic.in
- https://www.icsi.edu/auditing-standard/
- https://www.icsi.edu/ssb/home/
- https://www.icsi.edu/media/webmodules/companiesact2013/FAQs%20on%20Secretarial%20Audit.pdf
- https://www.icsi.edu/media/portals/0/Henry_Richard_Fraud%20Detection.pdf
- https://www.icsi.edu/media/webmodules/publications/Guidance_Note_CodeofConduct_CompanySecretaries.pdf

Internal Audit & Performance Audit

Lesson 14

KEY CONCEPTS

■ Internal Audit ■ Audit Techniques ■ Operational control ■ Risk areas of the organisation ■ Internal Controls ■ Risk management

Learning Objectives

To understand:

- Internal Audit as a mechanism to provide an independent and objective assessment of the effectiveness and efficiency of a company's operations, specifically its internal control structure.
- How the function of internal audit helps an organization to accomplish its objectives by bringing systematic and disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.
- The broad scope of Internal Auditing and what are the Internal Audit Techniques.
- How Internal Audit includes effects the efficiency of internal control, operations, IT controls, the reliability of financial reporting, deterring and detecting fraud and compliance with laws and regulations.
- The pro-active and central role Company Secretary plays in the governance of the company.
- Role of Internal Audit in organisation Control Mechanism.

Lesson Outline

REGULATORY FRAMEWORK

- The Companies Act, 2013
- The Companies (Meeting of the Board and its Power), Rules, 2014
- The Companies (Accounts) Rule, 2014

INTRODUCTION

Historically, internal auditing was confined to ensure that, the accounting and allied records have been properly maintained, the assets of the organization have been properly safeguarded and that the policies and procedures laid down by the management have been complied with. Post liberalization of economy, the growth and expansion made it increasingly difficult for organizations to maintain control and operational efficiency. The economic conditions further expanded organizations' responsibilities for scheduling, managing with limited materials and labourers, complying with government regulations, and an increased emphasis on cost efficiency It was difficult for management to observe all the operating areas or be in touch with everybody. This requires companies to appointed auditing personnel for report on affairs of the company, which are known as 'Internal Auditors'.

The operations of the Companies which have huge and sophisticated business structure and have decentralization of their business activities among the various functional heads and division or wherein the top management is remotely concerned with the day-to-day activities of the concern. Now a day, the role of internal auditing has a great significance in the performance of the company.

With the changes in the economic conditions, now the scope of internal auditing is not confined to financial transactions it is extended up to the minute activities of the company, which may or may not be the cost centre but have an impact on the efficiency of the company.

DEFINITION OF INTERNAL AUDIT

As defined by the Institute of Internal Auditors (IIA)

Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

Independence is established by the organizational and reporting structure. Objectivity is achieved by an appropriate mind-set. The internal audit activity evaluates risk exposures relating to the organization's governance, operations and information systems, in relation to:

1. Effectiveness and efficiency of operations;
2. Reliability and integrity of financial and operational information;
3. Safeguarding of assets;
4. Compliance with laws, regulations, and contracts.

According to *Professor Walter B. Meigs,* "Internal auditing consist of a continuous, critical review of financial and operating activities by a staff of auditors functioning as full time salaried employees."

Based on the results of the risk assessment, the internal auditors evaluate the adequacy and effectiveness of how risks are identified and managed in the above areas. They also assess other aspects such as ethics and values within the organization, performance management, communication of risk and control information within the organization in order to facilitate a good governance process. An effective internal audit activity is a valuable resource for management and the board and the audit committee due to its understanding of the organization and its culture, operations, and risk profile. The objectivity, skills, and knowledge of competent internal auditors can significantly add value to an organization's internal control, risk management, and governance processes. Similarly an effective internal audit activity can provide assurance to other stakeholders such as regulators, employees, providers of finance, and shareholders.

Nature of Internal Audit:

1. **A Management tool:** Internal Audit is management tool performed by the employees of the organisation or the engaged professional firm to check the appropriateness of internal checks and control in the organisation. The reporting authority is generally board of directors and audit committee.
2. **A continuous Exercise:** Internal Audit is a continuous and systematic process of examining and reporting the operations and records of a concern by its employees or external agencies specially assigned for this purpose. It is, in essence, auditing for the management and its scope may vary depending upon the nature and size of the concern.
3. **A Control System:** It is a control system concerned with examination and appraisal of other control mechanisms.
4. **A Risk Management Tool:** The internal audit work encompasses fostering the creation of a risk management process and ensuring it addresses key objectives, and the subsequent evaluation of the process. The internal audit work also encompasses an identical role in the creation and subsequent evaluation of, the business continuity planning process, and the information security and privacy system.

CASE STUDY

HDFC Bank's Risk Management Framework: Robust and stress-tested framework

Our robust Risk Management framework and the independence of our risk management function set us apart as a responsible banker. It enables the execution of our strategic priorities without taking on undue financial and non-financial risks. Our risk policies and processes and their effective implementation through technology and governance enabled us to endure and even grow in these highly uncertain and disruptive times. Stress testing is one of the key risk management tools we use to mitigate and manage the existing as well as emerging risks.

Source: Integrated Annual Report 2021-22

INTERNAL AUDIT UNDER THE COMPANIES ACT, 2013

The concept of the internal audit has been recognized as a statutory exercise under Section 138 of the Companies Act, 2013, and has been made mandatory. As per Rule 13 of Companies (Accounts) Rule, 2014, the following class of companies shall be required to appoint an internal auditor which may be either an individual or a partnership firm or a body corporate, namely:

Listed Company
All the listed companies

Every Unlisted Public Company having			
(i) paid up share capital of fifty crore rupees or more during the pre-ceding financial year; or	(ii) turnover of two hundred crore rupees or more during the preceding financial year; or	(iii) outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year; or	(iv) outstanding deposits of twenty five crore rupees or more at any point of time during the preceding financial year.

Every Private Company having	
(i) turnover of two hundred crore rupees or more during the preceding financial year; or	(ii) outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year.

CASE STUDY

1. **ABC Pvt. Ltd. having Rs. 90 lacs paid-up capital, Rs. 5 crores reserves and turnover of last three consecutive financial years, immediately preceding the financial year under audit, being Rs. 50 crores, Rs. 175 crores and Rs. 300 crores, but does not have any internal audit system. In view of the management, the internal audit system is not mandatory. Comment?**

   Solution:

   Applicability of Provisions of Internal Audit: As per section 138 of the Companies Act, 2013, read with rule 13 of Companies (Audit and Auditors) Rules, 2014, every private company shall be required to appoint an internal auditor or a firm of internal auditors, having-

   (i) turnover of two hundred crore rupees or more during the preceding financial year; or

   (ii) outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year.

   Conclusion: In the instant case, ABC Pvt. Ltd. is having a turnover of Rs. 300 crores during the preceding financial year which is more than two hundred crore rupees. Hence, the company has the mandatorily statutory requirement to appoint an Internal Auditor and mandatorily conduct an internal audit.

2. Will the Partnership firm / Proprietary firm mandatorily required appointing an Internal Auditor?

Solution:

No, the Partnership firm / Proprietary firm is not mandatorily required to appoint an Internal Auditor. However, voluntary the Partnership firm / Proprietary firm can appoint an internal auditor of the organization.

3. The Management of XYZ Pvt. Ltd appointed Luthra and Co. (Chartered Accounting Firm) as an internal auditor of the company who is also a statutory auditor of the XYZ Pvt. Ltd. Is the appointment of Luthra and Co. (Chartered Accounting Firm) as an Internal Auditor of XYZ Pvt. Ltd. is valid?

Solution:

- As per section 138, the internal auditor shall either be a chartered accountant or a cost accountant (whether engaged in the practice or not), or such other professional as may be decided by the Board to conduct an internal audit of the functions and activities of the company.
- The internal auditor may or may not be an employee of the company. However, Statutory Auditor shall not be appointed as internal auditor of the Company.

Therefore, the appointment of Luthra and Co. (Chartered Accounting Firm) as an internal auditor of XYZ Pvt. Ltd. is not valid as Luthra and Co. is also a statutory auditor of XYZ Pvt. Ltd.

The audit committee of the company or the board shall, in consultation with the internal auditor, formulate the scope, functioning, periodicity and methodology for conducting the internal audit.

The Companies Act, 2013 does not prescribes any specific time frame for conducting internal audit but it is considered a good practice to conduct the audit on a quarterly basis so that the compliances are monitored properly and there are no frauds or deviations in the company.

Internal Audit is performed by professionals with an in-depth understanding of the business culture, systems, and processes. Internal audit activity provides assurance that internal controls in place are adequate to mitigate the risks, governance processes are effective and efficient, and organizational goals and objectives are met.

Penal Provisions for default/non-compliance

As per section 450 of the Companies Act, 2013, if a company or any officer of a company or any other person contravenes any of the provisions of this Act or the rules made thereunder, or any condition, limitation or restriction subject to which any approval, sanction, consent, confirmation, recognition, direction or exemption in relation to any matter has been accorded, given or granted, and for which no penalty or punishment is provided elsewhere in this Act, the company and every officer of the company who is in default or such other person shall be liable to a penalty of ten thousand rupees, and in case of continuing contravention, with a further penalty of one thousand rupees for each day after the first during which the contravention continues, subject to a maximum of two lakh rupees in case of a company and fifty thousand rupees in case of an officer who is in default or any other person.

Question: Is there any penalty for non-compliance with respect to appointment of internal auditor?

Answer: Yes, If a company or any other officer of the company, contravenes the provisions of this section, then the company or any officer of the company who is in default is liable for punishment with a penalty of up to Rs.10,000. In case of continuation of default in complying with the above section further fine of Rs.1,000 per day will be imposed subject to a maximum of Rs. 2,00,000 in case of a company and Rs. 50,000 in case of an officer who is in default or any other person.

CASE LAW

In the matter of *M/s. Indu Nissan Oxo Chemical Industries Limited, ROC-GJ/ADJ-order/Section 454 /Indu Nissan /Sec.138/ 2022-23 /6504 – 6506 dated 02.01.2023* ROC Gujarat has passed an adjudication order pertaining to consequences of default while complying with the provisions of section 138(1) of the Companies Act 2013 relating to the appointment of internal auditor in specified class (es) of companies.

Facts of the case:

The Ministry of Corporate Affairs has ordered to inquiry of the subject company under section 206 of the Companies Act 2013. During the course of an inquiry, it was observed that the company is the eligible company to appoint an internal auditor and the company failed to appoint an internal auditor which is the mandatory requirement under section 138 of the Companies Act 2013 read with Rule 13 of the Companies (Accounts) Rules, 2014. The company has failed to appoint an internal auditor for the period from 1st April 2014 to 31 March 2021 (for seven financial years) and violated the provision of section 138 of the Companies Act 2013.

Consequently, ROC issued a show cause notice to the company and its directors. The company replied that the company has been shut down since 1999 and it had stopped its production completely and the company had been a sick unit since the year 2002. Further the company was also registered with Board for Industrial and Financial Reconstruction (BIFR) under the Sick Industrial Companies (Special Provisions) Act 1985.

The ROC issued Personal hearing notice to give a reasonable opportunity of being heard to the company and its directors. On the scheduled date of the hearing neither the company nor KMP had appeared for the hearing and also not submitted any reply / letter, in spite of further reminder / written notice issued to the company / its director. Hence, the Registrar of Companies / Adjudicating Officer proceeded on the matter in the absence of a reply of the company / non- appearance of any of the company officials even after providing the sufficient opportunity to the Company / director.

Decision:

Based on the forgoing facts and circumstances, the Registrar of Companies/ Adjudicating Officer came to the conclusion that the company and its director committed the default of section 138 by not appointing an internal auditor for a period of seven years and therefore, it is concluded that the company and its director in default were liable for penalty under section 454 of the Companies Act 2013 for default under section 138 of the Companies Act 2013.

Since none of the company officials appeared and presented themselves for the personal hearing in spite of reminders and in the absence of any response from the company, the Registrar of Companies / Adjudicating Officer went ahead on this matter ex-parte and passed the adjudicating order as per the provisions of Section 454 (3) of the Companies Act 2013 read with sub-rule 11 of Rule 3 of the Companies (Adjudication of Penalties) Rules 2014.

The Registrar of Companies / Adjudicating Officer imposed penalty on the company and its directors amounting to Rs. 1.4 lacs.

ROLE OF COMPANY SECRETARY AS AN INTERNAL AUDITOR

A Company Secretary as an Internal Auditor allocated in the act, is expected to:

- Ensure proper following of accounting standards and conventions by the company.
- Ensure audit of the company's financial statements and books of accounts.
- Ensure management of compliance timely and properly and true representation of management funding and financial risk in business.
- Ensure safely keeping of records of meetings held in the company.
- Provide required advisory on finance usage and corporate litigation.

- Ensure proper management of capital, debt and tax planning.
- Prepare cost structures and representing efficiency indicators of the business.
- Design audit methodologies and reporting criteria.

APPOINTMENT OF INTERNAL AUDITOR

Section 179 of Companies Act, 2013 read with Rule 8 (4) of the Companies (Meeting of the Board and its Power), Rules 2014 provide that the appointment of the internal auditors shall be done only through a resolutions passed by the board of directors at the meetings of the board.

Test Yourself:

Question: Internal Auditor is appointed by the _____

a) Shareholders of the Company

b) Statutory Auditor

c) Institute of Internal Auditors of India

d) Board of Directors of the Company

Correct Option: d) Board of Directors of the Company

Also, the resolution for appointment of the Internal Auditor shall be filed with the Registrar of Companies within 30 days from the passing of the said resolution pursuant to the provisions of Section 117 & 179 of the Companies Act, 2013.

Hence, it could be very well interpreted that the appointment of internal auditor can be made only at the meeting of the board and whenever an internal auditor is appointed in a company, the resolution should be filed with the concerned Registrar of Companies vide e-Form MGT-14 within 30 days from the date of passing of the said resolution. In case of Private Companies, an exemption has been granted from filing of e-Form MGT-14, for resolution passed in pursuance of sub-section (3) of section 179 of the Companies Act 2013, vide notification issued by the Ministry of Corporate Affairs dated 5th June, 2015.

Certain best practices adopted by companies in terms of Internal Audit (2022):

Bharti Airtel Limited

The Company has 100% Independent Audit Committee. The Company has a robust Internal Assurance Group (IAG) led by Chief Internal Auditor supported by reputed independent firms.

Cipla Limited

Independent Assurance Report on the non-financial/ sustainability performance.

The audit committee reviews and approves the non-audit services availed from the Statutory Auditor and confirmed that such services did not affect the independence of the auditor in any manner.

UNO Minda Limited

The company rotates Internal Auditors at regular intervals.

ONGC Videsh Limited

Statutory Auditors and Internal Auditors are invited for their remarks and observations at the quarterly audit committee meetings.

Tata Chemicals Limited

The company conducts internal audit through an independent external agency on a continuous basis.

Terms of reference

The overall scope of internal audit should be formalized in terms of reference. It is often referred to as an audit manual, and approved by the board, normally through the audit committee. These should then be communicated to the functional heads within the organisation. Internal audit's terms of reference or manual should provide clarity about its:

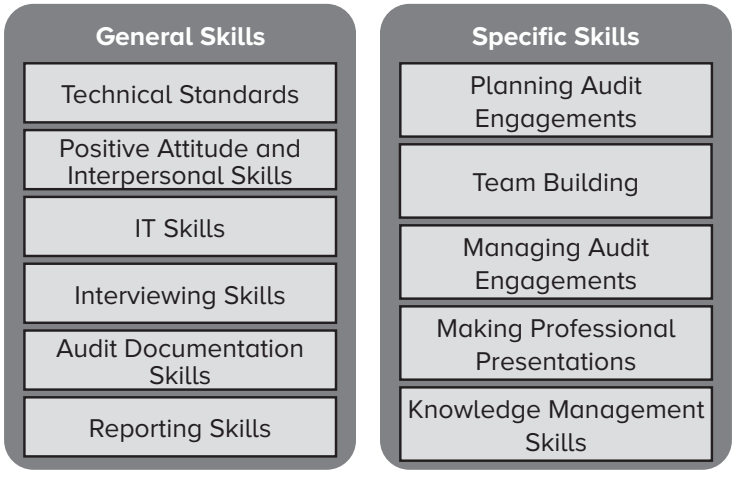
- **Strategy and objectives;**
- **Role and responsibilities within the organisation;**
- **Scope of work;**
- **Accountability to the audit committee;**
- **Reporting lines for line management purposes;**
- **Accessibility to the board and the audit committee; and**
- **Unfettered access to all information, people and records across the organisation.**

The terms of reference should make it clear that internal audit should not be put in a position where it has to review its own work.

Internal Auditor's Skills

In general, internal auditors should develop and maintain a healthy level of professional skepticism and objectivity to assist in evaluating information and making judgments. Internal audit professionals should possess exceptional verbal and written communication skills,

and be proficient in negotiating and reasoning with a variety of departments and groups over which internal audit may have no formal authority. Further personal integrity, professional due diligence and curiosity are important traits for individuals tasked with conducting internal audit work.



General Skills

The internal auditor needs to possess the following general skills for discharging their professional obligations proficiently.

- **Technical Standards:** The internal auditor should have adequate knowledge of the applicable Indian Accounting Standards and also in-depth knowledge on how to apply them in practice.
- **Positive Attitude and Interpersonal Skills:** The internal auditor should possess positive and objective attitude, free of any prejudice. He should posses good interpersonal and communication skills.
- **IT Skills:** With the rapid proliferation of information technology (IT) in the accounting and other operational aspects of an entity, it is essential for an internal auditor to be able to work in an IT driven environment. Thus, it is essential that the internal auditor should either have or acquire sufficient knowledge of how information technology has been integrated in the functioning of the organization and also skills that would enable him to effectively use IT tools in carrying out a purposeful internal audit.
- **Interviewing Skills:** Interviewing is the process of ascertaining information through verbal interaction with clients. It involves detailed questioning on various processes and procedures to ascertain whether the client's organization complies with the established standard operating procedure and practices and whether there is favorable or adverse variance from the standards, and in case of adverse variance what measures have been initiated by the management to ensure prevention of such adverse variances in future.
- **Audit Documentation Skills:** Audit documentation is the process of compiling and filing of the findings of audit. It involves collating requisite documents as evidences for supporting audit findings, filing the analysis and supporting papers in a logical manner and assimilating information for presentation in a structured manner.
- **Reporting Skills:** Reporting is the result of any audit assignment. It is therefore necessary that the audit report is written in such a manner that all issues are reported objectively and process gaps are addressed properly. It is also necessary that each observation is constructed in a manner that it represents the facts about the issue, its monetary or other impact, the cause of the issue and the suggestions for remedial actions and improvements.

Specific Skills

These skills would be required at senior levels and will assist the senior internal audit personnel in discharging the supervisory and management role efficiently and effectively.

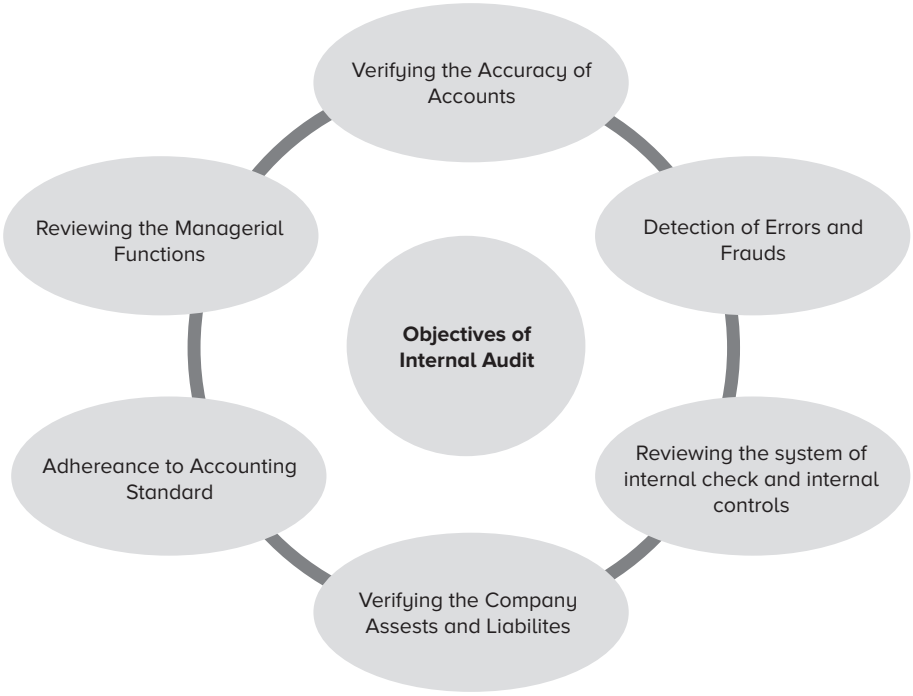
- **Planning Audit Engagements:** This involves the ability to plan audit engagements on the basis of a comprehensive risk assessment prior to commencement of audit. The individual has to be experienced in the conduct of a brainstorming discussion on risk assessment. He should also have the necessary experience and capability to be able to preempt significant issues that might come up during the audit, needing greater focus.
- **Team Building:** This involves collecting people and facilitating coordination among them to ensure that they work as a unified team. It involves identification of team leaders, delegation of authority, motivating the team and communicating to them the results expected.
- **Managing Audit Engagements:** This involves administration of the audit assignment. It involves the task of meeting auditees, understanding their expectations, communicating the engagement plan to them, selecting the right team, etc.
- **Making Professional Presentations:** An experienced internal auditor should be able to make effective presentations to the Audit Committee. This would involve selecting and presenting the major issues that warrant senior management attention in a clear and unambiguous manner.

- **Knowledge Management Skills:** An internal auditor either has or obtains sufficiently detailed knowledge of the operations of the entity as well as the constituents of the external environment in which the entity operates. For example, the industry, the regulators, the customers, etc. Some of this knowledge might be confidential and critical to the working of the entity. The internal auditor needs to have skills to effectively manage the knowledge, for example, deciding on issues such as:
  i. collating the knowledge.
  ii. how and where to apply the knowledge.
  iii. assessing which team member needs what type and quantum of knowledge.
  iv. assessing when the knowledge has become obsolete and needs updating.
  v. establishing the relationships between various pieces of knowledge and assessing how the same affects the internal audit.
  vi. deciding on manner and channels of flow of information.
  vii. Benchmarking Skills

Besides the above skills, an Internal Auditor should also possess:

1. Analytical/Critical thinking skills
2. Data mining and Analysis Skills
3. Good Business Acumen and the ability to understand different business needs
4. He should have the ability to trace out facts and figures
5. Should be methodical and tactful while dealing with people and processes
6. Should be a hard worker, always cautious, vigilant and inquisitive
7. Should be courageous, assertive and determined with the ability to take independent decisions
8. Should lead by being punctual, reliable and updated with the latest knowledge and skill set.

OBJECTIVES OF INTERNAL AUDIT



The main objective of the internal audit process is to provide an assurance on the organisation's risk management, internal control environment and governance framework through review and appraisal of:

(a) Operational control framework including fundamental and basic systems in all areas of the business. The adequacy of risk identification, assessment and mitigation in the organisation. This shall include fraud risks.

(b) Extent, adequacy, relevance of, and compliance with existing policy, plans and procedure documents within the organisation.

(c) The extent of compliance with relevant statutory requirements.

(d) Status of implementation of internal / external audit recommendations.

(e) Evaluating internal control. Internal control is broadly defined as a process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of the following core objectives for which all businesses strive:

- Effectiveness and efficiency of operations;
- Reliability of financial and management reporting;
- Compliance with laws and regulations;
- Accomplishment of established goals for operations;
- Safeguarding of assets;

(f) Determines the risk area of the organisation;

(g) Establishes the risk management framework;

(h) Identifies potential threats and assesses risks;

(i) Decides on response to risks like implementation of control;

(j) Monitors and coordinates the risk management processes and the outcomes;

(k) Provides assurance on the effectiveness of risk management processes;

Excerpts from the interview of Chief Internal Auditor of Hindustan Unilever Limited in 2017

The success of the internal audit division at HUL begins with its clear Vision and Objective.

The vision of the internal audit is "Zero Surprise, Risk Controlled Organisation." The vision itself is quite formidable to have a zero surprise organisation. The objective is "Provide to the management a proactive and value adding independent review process which enables them to maintain the risk profile at an acceptable level, in a rapidly changing environment" The vision and objectives are very clearly aligned to the company's vision and objectives and that I believe is our biggest success points.

How did the HUL go about giving shape to its vision?

".....Firstly, the Company adopted the "Best in Class Approach" through Control Assurance in a multi-pronged manner viz, Risk based Transaction review, Process reviews and proactive forensic reviews. This three pronged approach gives us focussed view and fits for all as well as wider coverage."

Source : *https://www.iiabombaychapter.com/iianewsletter-april-17/interview.html*

SCOPE OF INTERNAL AUDIT

The Institute of Internal Auditors defines scope of internal auditing as 'The examination and evaluation of the adequacy and effectiveness of organization's system of internal control and the quality of actual performance'

Accordingly, the internal audit is concerned with an evaluation of both internal control as well as the quality of actual performance. According to the Institute of Internal Auditors, internal audit involves the following areas of operations, which can be discussed as follows:

1. Review of Internal Control Systems and Procedures

The internal auditor should determine whether the internal control system is in consonance with the organizational structure. As far as possible, control should be in built in the operating functions, if they are cost effective.

For example, the establishment of a separate credit control department would be justified if the objective of reducing the credit risk and minimizing debt recovery period could be met through controls in-built in the accounting and sales systems especially in small and medium size concerns

Each control should be reviewed and analysed in terms of its costs and benefits. It should also be seen whether the internal controls were in use throughout the period of intended reliance. A breakdown in internal controls for a specific portion of the intended reliance would need specific attention.

CASE LAW

In the matter of United Phosphorous Ltd. and Ors. vs. DCIT and Ors. (28.09.2011 - ITAT Mumbai), it was recognised by the court that the company has proper internal control and the internal auditor also seems to verify majority of the expenses and report to the management in the case of any adverse finding.

2. Reliability and Integrity of Financial and Operating Information

The internal auditor should review the information systems to evaluate the reliability and integrity of financial and operating information given to management and to external agencies such as governmental bodies, trade organisations and labour unions.

For the purpose the internal auditor should review the means used for measuring, classifying and reporting information including the records from which the information is extracted. He should examine the accuracy and reliability of financial and operational records. He should review the frequency and timeliness of the reports keeping in view the statutory time limits in the case of reports to government agencies. He should examine the information mentioned in the report is meaningful to the user. The usefulness of the report and the records should be evaluated with reference to their costs. The internal auditor should examine whether the reporting is by exception i.e. the reports highlight the significant and distinctive features.

Internal Auditors should review the reliability and integrity of financial and operating information and the means used to identify, measure, classify and report such information.

3. Economical and Efficient Use of Resources

The internal auditor should check whether proper operating standards and norms have been established for measuring economical and efficient use of resources. They should be detailed

enough to be identifiable with specific operating responsibilities and should be capable of being used by operating personnel for monitoring and evaluating their performance. The internal auditor should review the methods of establishing the operating standards and norms. He should carefully examine the assumptions made while setting the standards to ensure that they are appropriate and necessary. The variances should be examined to evaluate whether or not the standards and norms are practical. Where there is a wide divergence between actual performance and the corresponding standards, reasons may be looked into. The system of identification and analysis of deviations from standards should be examined. The internal auditor should examine whether analysis of variances is communicated to those concerned in time. He should also examine whether in communicating the variances serious matters are highlighted and whether exceptional variances are communicated more expeditiously than is done in the normal course. As a part of evaluating resources utilization, identifying the facilities which are under-utilized is an important function of the internal auditor. Such instances may consist of under-utilized machines, unoccupied storage space, huge cash or bank balances, idle man power etc. The internal auditor may also identify under-staffing and overstaffing in various areas as these prevent optimum use of resources.

While commenting on staffing, the internal auditor should pay special attention to non-productive work being performed. This would require an enquiry into the job descriptions of employees combined with an intelligent observation of the work being done. Finally the internal auditor should review all procedures with reference to their costs and benefits. One of the factors resulting in inefficiency is that in many cases procedures become hindrance to operations.

4. Compliance with Laws, Policies, Plans, Procedures, and Regulations

It is essential that the various functional segments of an enterprise comply with the relevant policies, plans, procedures, laws and regulations so that the operations are carried out in coordinated manner. The internal auditor should examine whether the management has a system by which its policies, plans and procedures are communicated to all concerned. He should examine whether management formulates the major accounting policies after due regard to their effect on the financial statements both present and future. He should also examine the system of periodical review of existing policies particularly when there is a change in the method and nature of operations of the enterprise. By combining the results of his review of the adequacy of the systems with the result of his compliance tests, the internal auditor should be able to evaluate the effectiveness of the former. He should point out specific weaknesses and suggest remedial action.

Internal Auditor should review the systems established to ensure compliance with those policies, plans and procedures, law and regulations which could have a significant impact on operations and should determine whether the organization is in compliance thereof.

Illustration:

It is common to us that the business undertakings require some certified statement on various matters and the auditors certify such statements after carrying out audit which might be necessary under the particular cases.

Suppose when a company applies to a bank for some loan, a certified statement showing the turnover of the company for the past two or three years along with the current year might be necessary, and for this purpose the certified statements are to be attached with the application, otherwise the application will be rejected. So these certified statements showing the turnover of the company depicts compliance with laws, policies, plans, procedures, and regulations. Internal audit for compliance could be more broad base to include compliance with documented procedures/ policies, compliance with statutory requirements in the relevant areas etc.

5. Review of Organizational Structure

The internal auditor should conduct an appraisal of the organisation structure to ascertain whether it is in harmony with the objectives of the enterprise and whether the assignment of responsibilities is in consonance therewith. For this purpose he should review the manner in which the activities of the enterprise are grouped for managerial control. It is also important to review whether responsibility and authority are in harmony with the grouping pattern. The internal auditor should examine the organisation chart to find out whether the structure is simple and economical and that no function enjoys an undue dominance over the others. He should see whether the lines of authority and responsibility are clearly defined and communicated to all the organisational levels. He should particularly see that the responsibilities of managerial staff at headquarters do not overlap with those of chief executives at operating units. This situation often results in organisational chaos. He should examine whether there is a satisfactory balance between authority and responsibility of important executives i.e., the authority of each executive should be commensurate with the responsibility assigned to him. This can be evaluated by discussing the problems of operations and implementation with various executives. The internal auditor should examine the reasonableness of the span of control of each executive (the number of sub-ordinates that an executive controls). There should be a proper balance between the span of control of different executives at different levels. He should examine whether there is a unity of command i.e., whether each person reports only to one superior. Where dual responsibilities cannot be avoided, the primary one should be specified and the specific responsibility to each senior fixed. This must be made known to all concerned. He should examine whether there is a sufficient flexibility in the day to day working of the organisation and that initiative is not being stifled by a strict adherence to rules. One way of reducing organizational rigidity without sacrificing control is to have a quick and free flow of information within the enterprise. Finally he should evaluate the process of managerial development in the enterprise. This is a vital aspect in a fast growing enterprise. Unless executives are properly groomed to take over positions of responsibilities when senior people retire, there is bound to be organizational chaos.

6. Accomplishment of Established Goals for Operations

The internal auditor should review the overall objectives of the enterprise to evaluate whether they are clearly stated and are attainable. The translation of such overall objectives into specific objectives for each department and programme should be reviewed. It should be examined whether the objectives are revised periodically in the light of changes in internal and external environment. The internal auditor should examine whether to the extent possible, objectives are expressed in precise quantifiable terms (both monetary and non-monetary) to facilitate detailed planning and execution. Budgeting forms an important part of such planning. Line managers who are to implement the plans should fully participate in framing them. This will ensure that plans anticipate the problem areas. There should also be sufficient flexibility in the plans to permit such improvements in their implementation, as would benefit the enterprises as a whole. The responsibility for achieving specific facets of a plan should be clearly identified with the concerned person or department. Apart from these, the internal auditor should examine whether departmental plans are supported by top management. The departmental plan summaries should be sent to concerned managers. These should be discussed and communicated at meetings at which all managers participate.

Internal Auditor should review operations and programmes to ascertain whether results are consistent with established objectives and goals and whether the operations or programmes are being carried out as planned.

7. Review of Custodianship and Safeguarding of Assets

The Internal Auditor should verify the existence of the assets and also review the control system to ensure that all assets are accounted fully. He should review the means used for safeguarding assets against losses e.g. fire, improper or negligent activity, theft and illegal acts etc. He should review the

control systems for intangible assets e.g. the procedures relating to credit control. Where an enterprise uses electronic data processing equipment, the physical and systems control on processing facilities as well as on data storage should be examined. He should also review the adequacy of the insurance cover for the various risks involved.

INTERNAL AUDIT CORE PRINCIPLES

As per the Institute of Internal Auditors (IIA), core principles of Internal Audit hovers around the performance of effective internal auditing and all of them must be present and working well. How an internal auditor, as well as an internal audit function, demonstrate achievement of the core principles may be quite different from organisation-to-organisation. But, failure to achieve any of the core principles implies that an internal audit activity is not as effective as it could be in achieving internal audit's mission. Core principles of internal audit are:

1	● Demonstrates integrity.
2	● Demonstrates competence and due professional care.
3	● Independent and objective exercise.
4	● Aligns with the strategies, objectives, and risks of the organisation.
5	● Is appropriately positioned and adequately resourced.
6	● Demonstrates quality and continuous improvement.
7	● Communicates effectively.
8	● Provides risk-based assurance.
9	● Insightful, proactive, and future-focused.
10	● Promotes organisational improvement.

CASE STUDIES:

1. Credit Suisse admits failures in internal risk assessments

In its Annual report, the banking giant stated "management has identified certain material weaknesses in our internal control over financial reporting for the years 2021 and 2022."

The issue is related to failure to design and maintain an effective risk assessment process to identify and analyze the risk of material misstatements and various flaws in internal control and communication.

(Source: https://www.investmentweek.co.uk/news/4080433/credit-suisse-admits-failures-internal-risk-assessments)

2. The story of internal controls and Netflix

The corporate fraud stories are becoming more pervasive and are not isolated to a particular industry. In recent years, we have seen stories on the illegal conduct of executives from WorldCom, Tyco, Wells Fargo, Fannie Mae and others. One root cause amongst all of them: internal controls.

On December 14, 2021, Mr. Michael Kail, the former vice president of IT operations at Netflix, was sentenced to 30 months after his conviction for fraud and money laundering.

Like most companies, Netflix maintains a Code of Ethics; Code of Conduct; and a Gifts, Travel and Entertainment policy that addresses and prohibits employee conflicts of interest and requires the disclosure of actual or apparent conflicts of interest, and the reporting of gifts from entities seeking to sell products or services to the company. Although these policies are essential, it is equally important to build a culture that emphasizes ethical behavior, operationalizes procedures and monitors compliance with the program. Often, the failure to monitor provides employees with the opportunity to engage in misconduct and exposes the company to unnecessary risk and potential liability.

From 2011 until 2014, Kail was Netflix's VP in charge of IT operations. He approved contracts to purchase IT products and services from smaller outside vendors and authorized the corresponding payments as part of his role. However, he selected the IT contracts according to the kickbacks he would receive rather than on their merit. As the evidence at trial demonstrated, Netflix's internal control failures allowed Kail to employ a "pay-to-play" scheme. As part of his scheme, he approved millions of dollars in contracts for goods and services, and in exchange, he received over $500,000 and stock options from nine tech companies.

This case emphasizes the need for a robust compliance program. The Committee of Sponsoring Organizations (COSO) of the Treadway Commission identifies internal controls' five integral components: the control environment, risk assessment, control activity, information and communication, and monitoring activities. Performing periodic evaluations of the program, a subset of the monitoring component, is critical to ascertain if internal controls are present, designed appropriately and functioning properly and effectively. Similarly, periodic evaluations help identify the relative strengths and weaknesses of the company's risk and control environment.

Kail's actions impacted Netflix's operations and compliance objectives, hurt the company's shareholders and tarnished Netflix's reputation.

It's no secret the regulators continue to scrutinize compliance. Many deferred prosecution, non-prosecution and enforcement releases hammer companies for poor internal controls. The regulators don't realize that companies need a methodology to have properly designed internal controls, where everyone consistently follows without exception. Many are treating the symptoms and not the root cause.

(*Source: https://www.bakertilly.com/insights/the-story-of-internal-controls-and-netflix)*

RECOMMENDED CONTROLS TO PREVENT AND DETECT FRAUD AND EDUCATE TO IMPROVE THE ORGANIZATION'S FRAUD AWARENESS

There are several controls that an organization can implement to prevent and detect fraud, and education is a crucial component in improving an organization's fraud awareness.Here are some recommendations for controls and educating across the entity:

1. **Segregation of duties:** Ensure that no single person has control over multiple aspects of a process or transaction. For example, the person who approves a purchase should not be the same person who pays for it. Maker, Checker and Approver is an excellent tool to prevent errors and frauds.

2. **Rotation of duties:** Ensure that there is periodical rotation of duties for key positions. We saw in the largest municipal fraud that in the absence of rotation of duties, huge fraud perpetrated by one employee gone unnoticed. Punjab National Bank fraud also happened due to absence of mandatory job rotation or transfer of few employees of the branch.
3. **Mandatory vacation:** Having a HR policy for giving mandatory vacation to key employees helps the employees to come fresh after vacation and also prevents employees from hiding their tracks of crime.
4. **Treat employees well:** It has been observed that if the employees are treated well by giving timely rewards and recognition for their work, they feel motivated. If they are treated badly like being underpaid or overlooked for promotion, they look for the opportunity and rationalise to do frauds to take revenge on their employers.
5. **Regular audits:** Conduct regular internal audits especially at remote locations where there are significant projects being executed or manufacturing facilities are run to identify potential fraud and ensure compliance with internal controls.
6. **Background checks:** Conduct thorough background checks on employees, especially those in positions of trust or responsibility.
7. **Whistleblower hotline:** Implement a confidential hotline for employees to report suspicious activity without fear of retaliation.
8. **Use of technology:** Implement fraud detection software and use data analytics to identify patterns of suspicious activity.
9. **Fraud awareness training:** Provide periodical training to all employees on the types of fraud that can occur, how to identify it, and how to report it. Also ensure that adequate documents are kept in HR as evidence to prove that the employee participated in the training and understood it. This will help on a later date if the fraudulent employee feigns ignorance.
10. **Code of conduct:** Establish a code of conduct that clearly defines ethical behavior and expectations for employees.
11. **Management oversight and Tone at the top:** Ensure that management regularly reviews and approves transactions and financial statements. Ensure that independent directors are really independent.
12. **Reinforce accountability:** Hold employees accountable for their actions and ensure that consequences are enforced when necessary.
13. **Document retention:** Establish policies for the retention and destruction of records to ensure that important documents are not lost or destroyed.

Communicate all key changes to Policies and Procedures of the entity to all stakeholders like employees, vendors, customers and document evidence in support of the same that these stakeholders have read and understood the implications of changes made.

By implementing the above controls and providing education on fraud prevention and detection, organizations can help protect themselves against potential fraud and improve their overall fraud awareness.

INDEPENDENCE OF INTERNAL AUDITOR

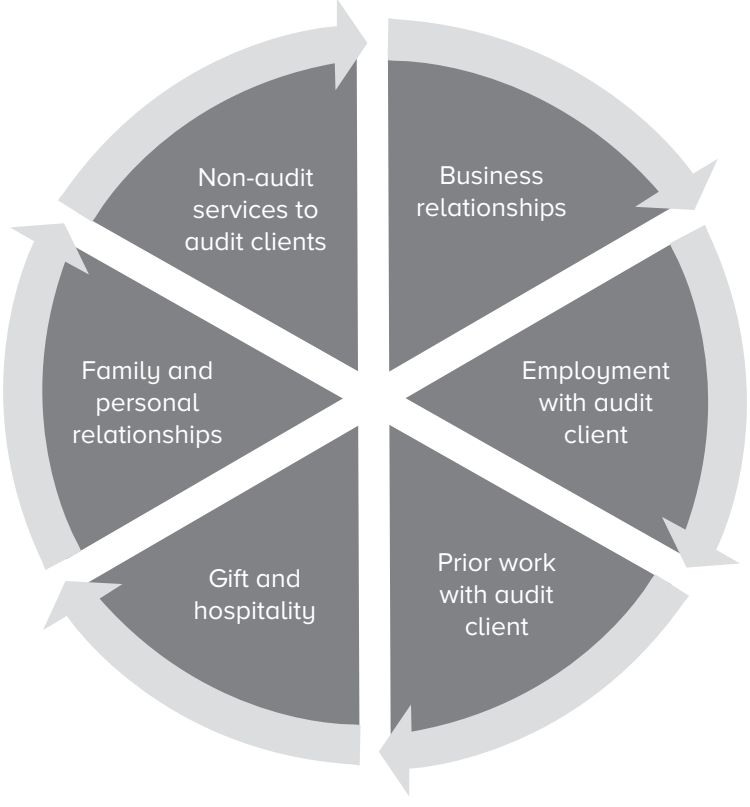
"Independence is the freedom from conditions that threaten the ability of the internal audit activity to carry out internal audit responsibilities in an unbiased manner".

"Objectivity is an unbiased mental attitude that allows internal auditors to perform engagements in such a manner that they believe in their work product and that no quality compromises are made. Objectivity requires that internal auditors do not subordinate their judgment on audit matters to others".

Achieving independence and objectivity in work is one of the critical preconditions that internal auditors need to meet to serve the purpose. Independence means ensuring the possibility of objective performance of internal auditor's duties, and is linked to the organizational positioning of internal audit in the company, reporting relationships with boards of directors, audit committee, or other governing bodies separated from the management, authority for the evaluation of information, reports, and the like.

Internal auditing, being an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations, the concept of independence is equally relevant for the internal auditor. As mentioned above, under the statutory provisions of Companies Act, 2013, internal auditor may or may not be an employee of the company, but he evaluates the functioning of the management at different levels. Therefore, to be efficient and effective, the internal auditor must have adequate independence. It may be noted that by its very nature, the internal audit function cannot be expected to have the same degree of independence as is essential when the external auditor expresses his opinion on the financial information. To ensure his independence he is made responsible directly to the board of directors through audit committee. Such a channel of communication provides an independent mode whereby an internal auditor can communicate and share his views on the scope of internal audit, findings, etc. If internal auditor is made subordinate to lower level management, his independence will be effected which will affect his functioning and effectiveness. An outsider, like a chartered accountant or a company secretary or a firm of chartered accountants or a firm of company secretaries, if acting as internal auditor, is likely to be more independent than an employee of the organization.

The following factors impairing the independence of internal auditors:



Business relationship: involves common commercial or financial interest between the auditor and client. This shall create self-interest or advocacy threats towards audit independence. Therefore, the business relationship shall be restricted as much as possible. Let's take an example: The wife of auditor is the supplier of the client. The auditor here has indirectly created business relationship between him and the client.

Employment with audit client: Any kind of employment relationship with the Auditee Client gives the impression that the audit is not performed independently. Such relationships create self-review threats, familiarity threats, and intimidation threats.

Prior work with audit client: The senior personnel may have had prior work experience with the audit client. This ought to create familiarity and self-interest threats if the work experience resulted in good relationships between them. Such association may create or help in the longer audit tenure of the audit function. This will in turn impact the audit independence and objectivity.

Gift and hospitality: The auditors should not accept any gifts (or kind) from the auditee. The acceptance of such gifts may impair the auditor's objectivity. The internal auditors are also required to immediately report any such offer to their supervisors if any. Such gift and hospitality ought to create familiarity and self-interest threats.

Family and personal relationships: There may exist family and personal relationships between member of audit team and audit client. This creates self-interest and familiarity threats towards audit independence.

Non-audit services to audit clients: Offering non audit services to audit clients creates self-review threats to auditor's independence inherent in the model of business of audit firms.

CASE STUDY

Toshiba – a case of internal audit failure

In July 2015, Toshiba Corp president Mr. Hisao resigned after investigations found that the company inflated earnings by $1.2 billion during the period 2009-2014. The company Toshiba was one of the early adopters of corporate governance reforms initiated in Japan.

Some of the observations of the independent investigation committee of the company on internal audit demand discussion and debate.

The investment committee observed:

a) The fault in internal audit in Toshiba was that it focused on consultation service rather than assurance service.

b) In Toshiba, the audit committee was neither capable nor independent. Internal Audit can function independently only if audit committee is capable, independent and effective, and internal auditor reports to the audit committee.

   The three external members of audit committee had no knowledge of finance and accounting. The ex-CFO, who was the CFO during the timeframe when accounting irregularities occurred, was the only whole time member of the audit committee.

c) A corporate culture existed in Toshiba whereby employees could not act contrary to the intent of their superiors. In such a culture an upright internal auditor cannot survive, particularly if he is not independent of the management.

Internal auditor is the 'eyes and ears' and 'go-to man' of the audit committee. Therefore, internal audit failure leads to corporate governance failure.

INTERNAL AUDIT TECHNIQUES

An internal auditor uses internal audit tools/techniques to ensure that controls, processes and policies are adequate and effective, and that they adhere to industry practices and regulatory mandates. The techniques which are often used by an internal auditor are discussed herein.

(a) Review of Operating Environment

For carrying out the audit effectively, it is necessary for an internal auditor to understand how the company operates. He determines it by referring to departmental employees, external auditors report, and risk specialists. A firm's operating environment describes management's ethical qualities,

leadership style and business practices. An internal auditor also could determine how a corporation operates by evaluating industry trends and regulations.

(b) Review Controls

An internal auditor determines how a company's segment or departmental controls operate by reading prior audit reports or working papers and by inquiring from segment employees who perform such controls on a regular basis. An auditor applies generally accepted auditing standards (GAAS) to detect mechanisms, procedures, tools and methodologies that build controls.

(c) Test Controls

An internal auditor tests a business organization's controls, policies and guidelines to ensure that such controls are adequately designed and are operating effectively. Controls are mechanisms and methodologies a corporation's management puts into place to prevent losses due to error, fraud, theft or breaks in technology systems. Effective controls remedy deficiencies and problems properly. Controls are adequate if they provide detailed step-by-step procedures and guidelines for task performance, decision-making processes and lines of hierarchy.

(d) Account Details

An internal auditor performs tests of account details to ensure that financial statements of a business entity are not "materially misstated." tests of account details and account balances are referred to as substantive tests. An auditor conducts such tests if a firm's controls and processes are not adequate or not functioning properly. "Material" means significant or substantial in accounting and audit parlance; a misstatement could result from human errors, intentional fraud or technology system weaknesses.

The above list is not exhaustive and other techniques may also be used by an internal auditor in the internal audit exercise.

INTERNAL AUDIT PROCESS: STEP WISE APPROACH

Step 1	● Establish and communicate the scope and objectives for the audit to appropriate management.
Step 2	● Develop an understanding of the business area under review. This includes objectives, measurements and key transaction types. This involves review of documents and interviews. Flow charts and narratives may be created if necessary.
Step 3	● Describe the key risks facing the business activities within the scope of the audit.
Step 4	● Identify control procedures used to ensure each key risk and transaction type is properly controlled and monitored.
Step 5	● Develop and execute a risk-based sampling and testing approach to determine whether the most important controls are operating as intended.
Step 6	● Report issues and challenges identified and negotiate action plans and solutions with management to address the problems.
Step 7	● Follow-up on reported findings at appropriate intervals. Internal audit departments maintain a follow-up database for this purpose.

EVALUATION OF INTERNAL AUDIT FUNCTION BY AN AUDITOR

During the performance of the Secretarial Audit, the secretarial auditor also needs to report on the adequacy of systems and process in the company. The internal audit function greatly assist the Secretarial auditor in determining the extent to which he can place reliance upon the work of the internal auditor. The Secretarial auditor should document his evaluation and conclusions in this respect. The important aspects to be considered in this context are:

1. **Organisational Status -** Whether internal audit is undertaken by an outside agency or by an internal audit department within the entity itself. The internal auditor reports to the management, in an ideal situation he reports to the highest level of management and is free of any other operating responsibility. Any constraints or restrictions placed upon his work by management should be carefully evaluated. In particular, the internal auditor should be free to communicate fully with the external auditor.

2. **Scope of Audit Function -** The external auditor should ascertain the nature and depth of coverage of the assignment which the internal auditor discharges for management. He should also ascertain to what extent the management considers, and where appropriate acts upon internal audit recommendations.

3. **Technical Competence -** The external auditor should ascertain that internal audit work is performed by persons having adequate technical training and proficiency. This may be accomplished by reviewing the experience and professional qualifications of the persons undertaking the internal audit work.

4. **Due Professional Care -** The external auditor should ascertain whether internal audit work appears to be properly planned, supervised, reviewed and documented. An example of the exercise of due professional care by the internal auditor is the existence of adequate audit manuals, audit programmes and working papers.

5. **Monitoring of internal control:** The internal audit function may be assigned specific responsibility for reviewing controls, monitoring their operation and recommending improvements thereto.

6. **Examination of financial and operating information:** The internal audit function may be assigned to review the means used to identify, measure, classify and report financial and operating information, and to make specific inquiry into individual items, including detailed testing of transactions, balances and procedures.

7. **Review of operating activities:** The internal audit function may be assigned to review the economy, efficiency and effectiveness of operating activities, including non- financial activities of an entity.

8. **Review of compliance with laws and regulations:** The internal audit function may be assigned to review compliance with laws, regulations and other external requirements, and with management policies and directives and other internal requirements.

9. **Risk management:** The internal audit function may assist the organization by identifying and evaluating significant exposures to risk and contributing to the improvement of risk management and control systems.

10. **Governance:** The internal audit function may assess the governance process in its accomplishment of objectives on ethics and values, performance management and accountability, communicating risk and control information to appropriate areas of the organization and effectiveness of communication among those charged with governance, external and internal auditors, and management.

REPORT WRITING – COMMUNICATING ENGAGEMENT RESULTS

The essential part of internal audit is the dissemination of the results of internal audit and reporting the findings to management, and those charged with governance. The internal audit report of the company is a significant aspect which throws light on any kind of non-compliance with the regulations that are needed to be kept in mind. It also highlights the aspects which need to be improved.

Objectives of Reporting

The objectives of issuing Internal Audit Reports on significant internal audit assignments are to:

(a) Share with the auditee, details of all significant findings based,on audit procedures undertaken;

(b) Allow management to understand the issues and take corrective actions

(c) Leads to improved performance and control framework

(d) The follow-up process monitors the progress of agreed upon management action plans and reports this progress to senior management and the audit committee.

The overall objective of reporting results is to highlight the effectiveness of internal controls and risk management processes to enhance governance in line with the Internal Audit Charter.

An Internal Audit report is basically a four step process comprising of :

1. What is Wrong?

Disclosure of findings and processes involved in arriving at such finding.

2. Why it is Wrong?

Description of the findings-the root cause analysis.

3. How to correct it?

Recommendations and Suggestions.

4. What will be done?

Auditee's views and comments.

ROLE OF INTERNAL AUDIT IN ORGANIZATION CONTROL MECHANISM

1. Internal Control

The internal control may be defined as "the process designed, implemented and maintained by those charged with governance, management and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, safeguarding of assets, and compliance with applicable laws and regulations". The term "controls" refers to any aspects of one or more of the components of internal control.

Definitions of Internal Control:

As per Section 134 of the Companies Act, 2013, the term "Internal Financial Controls" means the policies and procedures adopted by the company for ensuring, orderly and efficient conduct of business, including adherence to company's policies, safeguarding of its assets, prevention and detection of frauds and errors, accuracy and completeness of the accounting records, and timely preparation of reliable financial information.

Committee of Sponsoring Organizations of the Treadway Commission (COSO) defines internal control as "a process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting, and compliance."

The Institute of' Chartered Accountants of England and Wales defines Internal Control as "Internal Control means not only internal check or internal audit, but the whole system of control, financial and otherwise, established by management in order to carry on the business of the company in an orderly manner, safeguard its assets and secure as far as possible accuracy and reliability of its records".

Objectives

(i) To ensure that the transactions are executed in accordance with management's general or specific authorization;

(ii) To make sure that all the transactions are promptly recorded in the correct amount in the appropriate accounts and in the accounting period in which executed, so as to permit preparation of financial information within a framework of recognized accounting policies and practices and relevant statutory requirements, if any, and to maintain accountability for assets;

(iii) To ensure assets are safeguarded from unauthorised access, use or disposition; and

(iv) To make sure that appropriate action is taken with regard to any differences between the recorded assets are compared with the existing assets at reasonable intervals.

EXAMINE THE EFFECTIVENESS AND EFFICIENCY OF INTERNAL CONTROLS

Evaluating the design of a control involves considering whether the control, individually or in combination with other controls, is capable of effectively preventing, or detecting and correcting, material misstatements. Implementation of a control means that the control exists and that the entity is using it. There is little point in assessing the implementation of a control that is not effective, and so the design of a control is considered first. An improperly designed control may represent a material weakness or significant deficiency in the entity's internal control.

An entity's system of internal control contains manual elements and often contains automated elements. The use of manual or automated elements in internal control also affects the manner in which transactions are initiated, recorded, processed, and reported. An entity's mix of manual and automated elements in internal control varies with the nature and complexity of the entity's use of information technology.

CASE STUDY

WorldCom Scam, USA

In 1983, Bernard Ebbers and 3 other investors formed Long Distance Discount Services, Inc. based in Jackson, Mississippi and in 1985, Ebbers was named chief executive officer. The company acquired over 60 telecommunications firms and in 1995, it changed its name to WorldCom.

The company became a public company as a corporation in 1989 as a result of a merger with Advantage Companies Inc. The company name was changed to LDDS WorldCom in 1995. The company grew rapidly in the 1990s, after completing several mergers and acquisitions.

Accounting Manipulation

Beginning modestly during mid 1999 and continuing at an accelerated pace through May 2002, Ebbers, CFO Scott Sullivan, Controller David Myers and general accounting director Buford "Buddy" Yates used fraudulent accounting methods to disguise WorldCom's decreasing earnings in order to maintain the company's stock price by capitalizing expenses, it exaggerated profits.

In 1999, revenue growth slowed and the stock price began falling. In 2000,

WorldCom began classifying operating expenses as long-term capital investments. Hiding these expenses in this way gave them another $3.85 billion. Broadly financial statement fraud was accomplished primarily in two ways:

i. Booking "line costs" (interconnection expenses with other telecommunication companies) as capital expenditures on the balance sheet instead of expenses.

ii. Inflating revenues with bogus accounting entries from "corporate unallocated revenue accounts".

On July 1, Worldcom provided the SEC with a statement detailing what the company knew to date about its accounting problems.

Role of Internal Auditors as a Whistleblower

After tips were sent to the internal audit team and accounting irregularities were spotted in MCI's books, the SEC requested that WorldCom provide more information. The SEC was suspicious because while WorldCom was making so much profit, AT&T (another telecom giant) was losing money.

Cynthia Cooper, WorldCom's vice president - internal audit, instructed her internal audit team to audit all capital expenditures. Internal audit team also found $500 million computer expenses having been entered in the books without any documents. There was also another $2 billion in questionable entries. WorldCom's audit committee was asked for documents supporting capital expenditures, it could not produce them. Senior vice president and controller admitted to the internal auditors that they weren't following accounting standards and admitted to inflating its profits by $3.8 billion over the previous five quarters. When internal audit team informed about what happened, both the company's current auditor, KPMG, and its former auditor, Andersen, agreed that accounting entries were not in accordance with Generally Accepted Accounting Principles (GAAP).

After reviewed by the company's audit committee, WorldCom's board terminated accepted the resignation of senior vice president and controller. The SEC suit came a day later.

A little over a month after the internal audit began, WorldCom filed for bankruptcy.

Internal Control Mechanism

Internal Audit is a vital constituent of internal control mechanism. It is important to constitute and maintain an audit committee that shall provide assistance to the board of directors in fulfilling their oversight responsibility to the shareholders relating to:

(a) The integrity of the financial statements and the financial reporting process and principles;

(b) Internal controls;

(c) The qualifications, independence, remuneration, and performance of the independent auditors;

(d) Staffing, focus, scope, performance, and effectiveness of the internal audit function;

(e) Risk management; and

(f) Compliance with legal, regulatory, and corporate governance requirements.

The board defines clearly the roles and responsibilities of the audit committee. Management however, has primary responsibility for financial statements and reporting process, internal controls, legal and regulatory compliance and risk management

The internal auditor should examine and contribute to the ongoing effectiveness of the internal control system through evaluation and recommendations. However, the internal auditor is not vested with management's primary responsibility for designing, implementing, maintaining and documenting internal control. Internal audit functions add value to an organization's internal control system by bringing a systematic, disciplined approach to the evaluation of risk and by making recommendations to strengthen the effectiveness of risk management efforts.

The internal auditor should focus towards improving the internal control structure and promoting better corporate governance. The role of the internal auditor encompasses:

- Evaluation of the efficiency and effectiveness of controls
- Recommending new controls where needed or discontinuing unnecessary controls
- Using control frameworks
- Developing Control self-assessment

Companies Act, 2013-specifies:

Audit Committee

Section 177 (4)(vii) - Every Audit Committee shall act in accordance with the terms of reference specified in writing by the Board which shall inter alia, include evaluation of internal financial controls and risk management systems.

Section 177(5) - The Audit Committee may call for the comments of the auditors about internal control systems, the scope of audit, including the observations of the auditors and review of financial statement before their submission to the Board and may also discuss any related issues with the internal and statutory auditors and the management of the company.

Auditor's report

Section 143(3)(i) - Whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls.

Whilst section 134(5) requires directors to state their responsibility on internal financial controls in case of listed companies, auditors are required to report on the adequacy and operating effectiveness of such controls in case of all companies.

Further, Rule 8(5)(viii) of the companies (Accounts) Rules, 2014 requires the board report of all companies to state the details in respect of adequacy of internal financial controls with reference to the financial statements. IFC to be included as part of Directors Responsibility Statement from March 31, 2015 onwards and as part of Statutory Auditors Report from March 31, 2016 onwards.

SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, specifies:

Regulation 4(f)(ii)(7) Board of Directors	Ensuring the integrity of the listed entity's accounting and **financial reporting systems,** including the independent audit, and that appropriate systems of control are in place, in particular, **systems for risk management, financial and operational control,** and compliance with the law.
Regulation 18 Audit Committee	Role of the audit committee and the information to be reviewed by the audit committee shall be as specified in Part C of Schedule II including: ● **evaluation of internal financial controls and risk management systems;** ● reviewing, with the management, performance of statutory and internal auditors, **adequacy of the internal control systems**
Part B: Compliance Certificate [Regulation 17(8)]	Compliance Certificate by Chief Executive Officer and Chief Financial Officer to state: Responsibility for **establishing and maintaining internal controls for financial reporting** and that they have evaluated the effectiveness of internal control systems pertaining to financial reporting.

2. Risk management

Meaning of Risk

Risk is a possibility that something bad will happen. Risk management minimises the probable loss through the effective and efficient management. It evaluates risks in terms of probability of occurrence and its impact.

Internal auditing professional standards require the function to monitor and evaluate the effectiveness of the organization's Risk management processes. Risk management relating to an organization objectives, and identification, analysis, and response to those risks that could potentially impact its ability to realize its objectives.

Generally, the risks fall under strategic, operational, financial reporting, and legal/regulatory categories. Management performs risk assessment activities as part of the ordinary course of business in each of these categories. Examples include: strategic planning, marketing planning, capital planning, budgeting, hedging, incentive payout structure, and credit/lending practices. The finance department access the risk relating to account preparation, financial reporting and disclosures, corporate legal adviser often prepares comprehensive assessments of the current and potential litigation a company faces. Internal auditors may evaluate each of these activities, or focus on the processes used by management to report and monitor the risks identified. For example, internal auditors can advise management regarding the reporting of forward-looking operating measures to the board, to help identify emerging risks.

Illustrations:

Below mentioned companies are observing certain best practices for Risk Management (2022):

1. Happiest Minds Technologies Limited

The Internal Auditor Taskforce conducts quarterly audits of support functions and Customer projects to ensure the processes confirm to ISO 9001''2015 and ISO 27001 standards.

The risk registries are maintained by respective functions and customer project team. The Internal Auditor Taskforce along with the compliance team reviews and monitors this regularly with the process owner responsible for the area of risk.

2. Reliance BP Mobility Limited

There is a system-based Risk Register for the foreseen issues with stakeholders at each level with reasonability matrix.

The Internal Audit Department reports to the Audit Committee on matters relating to status on audit coverage of top 10 risks in the financial year. The company also has a Business Risk and Assurance Committee (BRAC) for management of Business and Strategic Risk.

Business and Functional Leaders ensure identification and mitigation of existing and new risks and its monitoring on day to day basis through weekly meetings.

3. Corporate Governance

Internal auditing activity as it relates to corporate governance is generally informal, accomplished primarily through participation in meetings and discussions with members of the board of directors. Corporate governance is a combination of processes and organizational structures implemented by the board of directors to inform, direct, manage, and monitor the organization's resources, strategies and policies towards the achievement of the organizations objectives. The internal auditor is often

considered one of the "four pillars" of corporate governance, the other pillars being the board of directors, management, and the external auditor.

A primary focus area of internal auditing as it relates to corporate governance is helping the audit committee of the board of directors (or equivalent) perform its responsibilities effectively. This may include reporting critical internal control problems, informing the committee privately on the capabilities of key managers, suggesting questions or topics for the audit committee's meeting agendas, and coordinating carefully with the external auditor and management to ensure the committee receives effective information.

CASE STUDY ON FRAUDS AND ROLE OF INTERNAL AUDITOR

SATYAM COMPUTER SERVICES FRAUD, INDIA

Background

Satyam Computer Services Limited was founded in 1987 in Hyderabad, by Ramalinga Raju. Raju served as Chairman, his brother, B. Rama Raju, served as the Managing Director and Chief Executive Officer. It specialised in outsourcing IT and business process services. It began as a small company with only 20 employees quickly grew to become India's leading outsourcing company, employing over 53,000 people and serving over 650 companies worldwide.

The company was listed on stock exchanges around the world, including the New York Stock Exchange and the Bombay Stock Exchange.

On 16 December 2008, the Satyam board made the decision to invest $1.6 billion in Maytas Properties and Infrastructure without the agreement of their shareholders. Later it came to light that this was a last ditch attempt to fill the fictitious assets of Satyam with real ones acquired through Maytas. This move was highly criticised by investors and led to the company's stock plummeting on the New York Stock Exchange. As a result, the board of Satyam reversed the decision.

The Satyam fraud went on for a number of years and involved both the manipulation of balance sheets and income statements. Audit failure was a key factor in the failure of Satyam. The fraud was so apparent that it should have been spotted much earlier by auditors, before it grew to such a serious extent.

Accounting Manipulation

Revenues, operating profits, interest liabilities and bank balances were grossly inflated to show the company in good health. It presented a growing problem as facts had to be doctored to keep showing healthy profits for Satyam that was growing in size and scale.

Every attempt made to eliminate the gap failed. On 7th January 2009, the chairman of Satyam, Raju resigned, confessing that he had manipulated the accounts in several forms. Raju made shocking disclosure to the Board of Directors of Satyam that the financial statement contained

- Inflated Cash and Bank Balance of Rs.50.4 Billion.
- Non-existent accrued interest of Rs.3.76 Billion.
- An understated liability of Rs.12.30 Billion on account of funds arranged by Raju.
- An overstated Debtors position of Rs.4.90 Billion.

The company's global head of internal audit, V.S. Prabakar Gupta created fake customer identities, generated fake invoices against their names to inflate revenue and illegally obtained loans for the company.

Satyam overstated its income nearly every quarter over the course of several years in order to meet analyst expectations. Fake invoices and bills were created using software applications such as 'Ontime' that was used for calculating hours put in by an employee.· A secret programme was allegedly planted in the source code of the official invoice management system creating a user id 'Super User' with the power to hide or show the invoices in the system.

Raju explained his reasons for inflating revenues in his letter to the board:

"As the promoters held a small percentage of equity, their concern was that poor performance would result in a takeover, thereby exposing the gap." For the sake of meeting ambitious targets as well as gaining profits, Satyam lied to the stakeholders and the market about their financial health, attracting more investment into the company.

Raju also created numerous bank statements to advance the fraud using his personal computer. He falsified the bank accounts to inflate the balance sheet with balances that did not exist. Furthermore, Raju created 6000 fake salary accounts and took the money from these accounts after it had been deposited. The cash so raised was used by Maytas (reverse name of Satyam) to purchase several acres of land across Andhra Pradesh to ride on a booming realty market.

Description	March 31, 2008 In Million US $	March 31,2007 In Million US $
Revenue	2138.10	1461.40
Trade Receivable- Short Term (a)	598.80	396.10
Trade Receivable- Long Term (b)	38.20	21.20
Unbilled Revenue (c)	81.50	38.60
Bank Deposits (d)	894.80	782.70
Total (a+b+c+d)	1613.30	1238.60

Role of Internal and External Auditors

Internal audit system in Satyam was ineffective as they did not discover that Raju and Gupta collaborated to hide the company's true financial information. Satyam had claimed $1.04 billion on its balance sheet in non-interest-bearing deposits.

Pricewaterhouse (Pw) completely relied on the fixed deposit receipts and bank statements provided by the Chairman's office, without confirming the bank deposit independently. Pw failed to fulfill its role as an auditor as they should have noticed this large amount of bank balance and carried out further verification and substantive testing.

Table 4. Satym's Total Income and Audit Fees (Rs. In Millions)

Year	2004-05	2005-06	2006-07	2007-08
Total Income (A)	35,468	50,122.2	64,100.8	83,944.8
Audit Fees (B)	6.537	11.5	36.7	37.3
% of B to A	0.0184	0.0229	0.0573	0.0444

Source: Annual Reports of Satyam, Percntage computed

PwC audit fees increased by 5.7 times over a period of four years (from 2004 to 2008). These inflated audit fees suggests that auditors may have been bribed in order to keep the fraud from being discovered and to allow Satyam to continue their accounting irregularities.

The Verdict

Central Government disbands Satyam board, to appoint its own 10 directors. On 9 April 2015, Raju and nine others were found guilty of collaborating to inflate the company's revenue, falsifying accounts and income tax returns, and fabricating invoices, among other findings, and sentenced to seven years imprisonment by Hyderabad court.

Unlike Enron collapse, in March 2012 Tech Mahindra, the information technology (IT) arm of Mahindra and Mahindra Ltd (M&M), completed merger process with Satyam Computer Services, creating the fifth-largest IT company based in India, four years after acquiring the Hyderabad-based firm.

OLYMPUS CORPORATION FRAUD

JAPAN Background

Olympus was established on 12th October 1919. It initially specialized in microscope and thermometer businesses. In 1949, the name was changed again to Olympus Optical Co., Ltd. in an attempt to enhance its corporate image.

In 2003, the company made a fresh start as Olympus Corporation. In Greek mythology, Mt. Olympus is the home of the twelve supreme gods and goddesses. Olympus was named after this mountain to reflect its strong aspiration to create high quality, world famous products. Tsuyoshi Kikukawa was the board chairman and CEO.

Accounting Manipulation

British-born Michael Woodford was an Olympus veteran of 30 years, and previously executive managing director of Olympus Medical Systems Europa. As European Director in 2008, Woodford had noticed the "strange goings-on at the company" such as the Gyrus acquisition, which should have been within his scope but was instead handled from Tokyo. Woodford had set out to resign over the matter but stayed with Olympus after being reassured on the acquisition and being promoted to oversee Olympus' European businesses and appointed to the main Olympus board.

FACT

A Japanese monthly news magazine features economic information for readers. The magazine provides investigative reports. FACTA in the August 2011 issue said that Olympus had acquired from 2006 to 2008 three small companies — Altis, a medical waste recycling company, Humalabo, a facial cream maker, and News Chef, which makes plastic plates and containers for microwaves for US$773 million, but wrote down most of their value within the same fiscal year. The publication said that all three companies continued to post losses.

Apparently irregular payments for acquisitions had resulted in very significant asset impairment charges in the company's accounts and had come to Woodford's attention. He also wanted answers about the acquisition in 2008 of Gyrus Group Limited, a British medical equipment maker, for U.S. $2.2 billion.

Olympus had issued more than $600 million in preference shares "directly to AXAM Investment Limited, a company registered in the Cayman Islands, which is described as 'the portfolio manager for AXES Investment Limited LLC.'

Woodford wanted to know why Olympus had paid AXAM so much money to apparently "advise" Olympus on the acquisition of Gyrus. KPMG report, stated that Olympus hadn't accounted for the shares given to AXAM, and "in our opinion proper accounting records have not been maintained."

Olympus defended itself against allegations of impropriety when Woodford confronted Tsuyoshi Kikukawa, chairman of the Olympus board. Kikukawa called a special board meeting in October at company headquarters in Tokyo. The meeting began at 9:07. Kikukawa fired Woodford and didn't allow him to respond. The meeting ended at 9:15 a.m.

CEO blowing the whistle on his own Company

As a CEO, Woodford commissioned PricewaterhouseCoopers (PwC) to investigate the relationship and transactions with AXES/AXAMsurrounding the acquisition of Gyrus. PwC released its report in October.

The PwC report also stated that "there appears to be potential misstatements made in Gyrus' 2009 audited accounts and potential unlawful financial assistance provide by Gyrus to Olympus in relation to the transaction."

Afterreaching London, Woodford then delivered the six letters and the replies togetherwith the PwCreport to the Britain's Serious Fraud Office, the FBI, the U.S. Department of Justice; the Japan Securities, Exchange and Surveillance Commission; the Tokyo Metropolitan Police; and the Tokyo Prosecutors Office. "Olympus needs a complete and utter forensics accounting,"

On 26 October, 2011 Kikukawa was replaced by Shuichi Takayama as chairman, president, and CEO. On 8 November 2011, the company admitted that the company's accounting practice was "inappropriate" and that concealment of more than 117.7 billion yen ($1.5 billion) money had been used to cover losses on investments dating to the 1990s.

The company blamed the inappropriate accounting on former president Tsuyoshi Kikukawa, auditor Hideo Yamada and executive vice-president Hisashi Mori.

The Verdict

In July 2013, Kikukawa and Mori were both sentenced to 3 years in prison, 5 years suspended. The auditor who had been party to the fraud was sentenced to 2.5 years in prison, 4 years suspended. Olympus was fined 700 million yen ($7 million USD). In April 2014, six banks filed a civil suit against Olympus over the fraud, seeking an additional 28 billion yen in damages.

APPRAISAL OF MANAGEMENT DECISIONS

The management for the company owns the responsibility for establishing and maintaining a system of internal controls within an organization. Internal controls are those structures, activities, processes, and systems which help management effectively mitigate the risks to an organization's achievement of objectives. Management is charged with this responsibility on behalf of the organization's stakeholders and is held accountable for this responsibility by an oversight body (e.g. board of directors, audit committee, elected representatives).

A dedicated, independent and effective internal audit activity assists both management and the oversight body (e.g. the board, audit committee) in fulfilling their responsibilities by bringing a systematic disciplined approach to assessing the effectiveness of the design and execution of the system of internal controls and risk management processes. The objective assessment of internal controls and risk management processes by the internal audit activity provides management, the oversight body, and external stakeholders with independent assurance that the organization's risks have been appropriately mitigated. Because, internal auditors are experts in understanding organizational risks and internal controls available to mitigate these risks, they assist management in understanding these topics and provide recommendations for improvements.

Beside above, internal audit has become an important management tool for the following reasons:

1. Internal auditing is a specialized service to look into the standards of efficiency of business operation.
2. Internal auditing can evaluate various problems independently in terms of overall management control and suggest improvement.
3. Internal audit's independent appraisal and review can ensure the reliability and promptness of MIS and the management reporting on the basis of which the top management can take firm decisions.

4. Internal audit system makes sure the internal control system including accounting control system in an organization is effective.
5. Internal audit ensures the adequacy, reliability and accuracy of financial and operational data by conducting appraisal and review from an independent angle.
6. Internal audit is an integral part of "management by system".
7. Internal audit can break through the power ego and personality factors and possible conflicts of interest within the organization.
8. It ensures compliance of accounting procedures and accounting policies.
9. Internal auditor can be of valuable assistance to management in acquiring new business, in promoting new products and in launching new projects for expansion or diversification of business.

The main objective of appraisal of management decision is to see how decisions are taken by the management:

- Whether the decisions are taken after following the decision making process.
- Whether such decisions meeting the organisation objectives.
- Whether such decisions are documented in a fair manner.

Steps in appraisal of management decision.

In appraisal of management decision the following step should be considered by the auditor:

1. Whether the management decision are well defined or not.
2. Whether the Objectives and desired output has been set out clearly and relate explicitly with the policy or strategy adopted by the company to help in post event evaluation of the management decisions. Ideally the objectives of the every management decision should be specific, measurable, agreed, realistic and time-dependent.
3. While taking decision, whether the management has considered the effect of the associated risk; time availability; scale and location; scope for alternative arrangements with other public bodies; degree of involvement of regulators and civic bodies; capacity of the market to deliver the required output; alternative asset uses; use of new or established technology; and environmental issues.
4. In case of the major investment decision, whether the various possible options were considered.
5. Whether such potential options are analyzed reviewed in terms of value, costs, benefits, risk and uncertainties of options.
6. Whether the options are selected after due analysis and a consensus decision is taken after a manager has analyzed all the alternatives,
7. Whether the selected alternative implemented efficiently.
8. Ongoing review of management decision control and evaluation system actions need to be monitored.

PERFORMANCE ASSESSMENT

The first step in conducting assessment of the Internal Audit function involves reviewing the management's expectations and achievements. This may also include remediation measures for better results, if necessary, and should be reported to the board/audit committee.

Performance measurement ensures high standards for audit strategy, execution, and reporting. It also helps organizations align their audit strategy with the overall business strategy, thereby linking the audit's performance to the organization's mission and objective. This ensures that concerned stakeholder audit needs are fulfilled. Key benchmarks of performance assessment are mentioned below:

- Effectiveness of audit in covering key areas;
- Feedback of audit findings during audit;
- Duration and timeliness of the audit;
- Accuracy of audit findings;
- Value of the audit recommendation;
- Value added by the internal audit function.

Keeping Track of Performance

The Internal Audit functioning may be aligned by understanding the business environment and its changes, as well as its people's role in creating business value. In today's scenario management of the organization want auditors to clearly understand the nuances of business. This is necessary not only to assess the business operations but also to stimulate a healthy relationship.

Another essential point is to integrate the Internal Audit function with corporate governance. The Internal Audit function in an organization should become an integral part of governance with focus to provide independent advice to management on the organization's ability to meet its governance obligations.

The practical performance of the planned audit program is not only exists in the technicality of the audit function but also in its correctness. It is quite necessary that auditing and the measurement system need to be kept transparent. It also leads to high level of trust the most critical factor for success.

Finally, the Internal Audit function needs to focus on improving business performance by being fully integrated into the business and adding value by supporting strategic business objective.

With such a vital role to play in corporate governance and business performance, it is critical for the Internal Audit team to maintain oversight of the traditional requirements, and, at the same time, evolve with the demands of the role. The auditors would need to align people, process, and systems with the overall organizational objective, allowing the executive management to confidently answer the critical questions that investors are asking today.

CASE STUDY

Mindtree Limited

The performance evaluation of statutory auditors and internal auditors is done every year. The audit Committee in turn reviews he performance of Statutory Auditors as well as Internal Auditors and provides their feedback and suggestions to the management.

The CFO/Financial Controller conveys the feedback to the auditors based on the outcome of performance evaluation and Audit Committee's suggestions.

LESSON ROUND-UP

- Internal Audit is performed by professionals with an in-depth understanding of the business culture, systems, and processes. Internal audit activity provides assurance that internal controls in place are adequate to mitigate the risks, governance processes are effective and efficient, and organizational goals and objectives are met.

- There are various techniques of internal audit including Review of Operating Environment, review of controls, test controls, accounts details.
- The work of internal auditor and statutory auditor is interlinked. In his report, statutory auditor needs to comment on the adequacy of internal control system and internal audit. In many case, internal auditor is also required to refer the statutory auditor report.
- Internal audit and statutory audit differs with each other in terms of the scope, responsibilities, terms of reference etc.
- Internal audit play a very important role in risk management, corporate governance and internal control.
- He is who examine and contribute to the ongoing effectiveness of the internal control system through evaluation and recommendations.
- Internal Audit is management tool performed by the employees of the organisation or the engaged professional firm to check the appropriateness of internal checks and control in the organisation. The reporting authority is generally board of directors and audit committee.
- The concept of the internal audit has been recognized as a statutory exercise under Section 138 of the Companies Act, 2013, and has been made mandatory.
- Section 179 of Companies Act, 2013 read with Rule 8 (4) of the Companies (Meeting of the Board and its Power), Rules 2014 provide that the appointment of the internal auditors shall be done only through a resolutions passed by the board of directors at the meetings of the board.
- In general, internal auditors should develop and maintain a healthy level of professional skepticism and objectivity to assist in evaluating information and making judgments.
- The main objective of the internal audit process is to provide an assurance on the organisation's risk management, internal control environment and governance framework.

GLOSSARY

Terms of reference : Terms of reference is often referred to as an audit manual, approved by the board, normally through the audit committee.

Appraisal of Management Decision : Appraisal of Management Decision is to see how decisions are taken by the management.

Generally Accepted Auditing Standards : An auditor applies generally accepted auditing standards (GAAS) to detect mechanisms, procedures, tools and methodologies that build controls.

TEST YOURSELF

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation)

1. ABC Ltd. has to appoint the internal auditor for the financial year 2022-23. The company called a board meeting on 28th April, 2022 to appoint the internal auditor, but due to non-finalisation of audit firm, the Board of directors deferred the matter of appointment of internal auditor for next board meeting. Subsequently, the company has finalized the proposal of a practising Chartered Accountants firm for appointment as internal auditor. Now, in view of urgency, the directors of the company want to appoint the internal auditor by calling a board meeting at shorter notice. Examine whether the appointment of internal auditor in this manner is permissible under the Companies Act, 2013.
2. Can a Company Secretary be appointed as an Internal Auditor of the Company ? Explain the role of Internal Auditor.
3. List out the Companies which are required to appoint Internal Auditor under section 138 of the Companies Act 2013 read with Rule l3 of the Companies Accounts Rules 2014.

4. ''To be efficient and effective, the internal auditor must have adequate independence.'' Comment
5. Mr. Raju has recently started as a Company Secretary in Practice. He has got an assignment of internal audit. Advise Mr. Raju about internal audit and its stepwise approach.
6. Explain internal audit and its, objectives and scope.
7. What are the different techniques of internal audit?
8. Explain the role of internal audit in corporate governance, risk management and internal control.

LIST OF FURTHER READINGS

- The Companies Act, 2013

OTHER REFERENCES (Including Websites/Video Links)

- https://www.icsi.edu/media/portals/86/Geeta_Saar_99_Internal_Audit.pdf.
- https://metricstream.com/insights/audit-performance-measurement.htm.
- https://cnbc.com
- https://bakertilly.com/insights/the-story-of-internal-controls-and-netflix.

Peer Review and Quality Review

Lesson 15

KEY CONCEPTS

■ Associate ■ Attestation and Auditing Services ■ Engagement records ■ Peer Review ■ Peer Review Board ■ Quality Review ■ Quality Review Board

Learning Objectives

To understand:

- How Peer Review is directed towards maintenance as well as enhancement of quality of attestation and audit services.
- How Peer Review provides guidance to members to improve their performance and adhere to various statutory and other regulatory requirements.
- How Quality Review is focused towards evaluation and review of quality of services rendered by members and adherence to various statutory and other regulatory requirements.
- The setup of Quality Review Board and its objective, i.e., to review and enhance the quality of the services rendered by the members of the ICSI.
- The aim of the Board to standardize the practices followed by the Company Secretaries and enhance the quality of the services rendered by the members of ICSI on continuous basis.
- The detailed systems and procedures relating to the Peer Review and the Guidelines issued by the ICSI.

Lesson Outline

INTRODUCTION

The Institute of Company Secretaries of India (ICSI) holds the distinction of being the sole recognizedprofessional body entrusted with the development and regulation of the Company Secretary profession in India. It is a premier national professional body set up under an act of Parliament, the Company Secretaries Act, 1980. ICSI functions under the jurisdiction of the Ministry of Corporate Affairs, Government of India. ICSI has been contributing to the initiatives of Government of India that have potential to excel the social-economic growth of India. and it has consistently played a pivotal role in shaping and upholding the standards of corporate governance and professionalism within the country

The Institute of Company Secretaries of India (ICSI) conducts various examinations and also prescribes standards for adherence by its members.

The concept of whole-time practice, which gained its initial recognition in 1988, got further momentum after the enactment of the Companies (Amendment) Act, 2000 which required Compliance Certificate to be issued by Practicing Company Secretary for certain class of companies. Members in practice are also being recognised for issuing certificates under various laws in India. The Companies Act, 2013, also introduced concept of Secretarial Audit to specified class of companies, which indicates that regulators have confidence in the Company Secretary profession in India.

The performance of any professional can only be accurately assessed and improved to achieve excellence through evaluation by another competent professional. The Council of the Institute of Company Secretaries of India (ICSI), therefore, in its 202nd meeting held on 25th and 26th August, 2011 decided to introduce Peer Review for Practicing Company Secretaries to periodically review the Practice Units and evaluate the quality, systems process, procedures and practices, so that excellence in their performance can be monitored and maintained.

ICSI Guideline No. 1 of 2011 – Guidelines for Peer Review of Attestation Services by Practicing Company Secretaries notified in the official Gazette of India dated October 18, 2011 and made effective from October 1, 2011. These Guidelines were revised by the Council in its 229th Meeting held on March 19-20, 2015; 254th (Adj.) meeting held on 1st September, 2018 and in 287th (Special) Meeting held on 26-27 August, 2022.

PEER REVIEW

In simple terms Peer Review is a process used for examining the work performed by one's equals (peers) and to understand the systems, practices and procedures followed by the Practice Unit and provides suggestions for improvement if needed

The dictionary meaning of the term "Peer" is, a person of the same legal status or a person who is equal to another, in abilities, qualifications, age, background, etc.

"Review" means to look back upon (a period of time, series and sequence of events, etc.)

Thus, "Peer Review" is mainly a self-improvement process and is a method of evaluation of a person's work or performance, by a person or group of people, in the same occupation, profession, or industry.

Professional peer review mainly focuses on the performance of professionals, with a view to improving quality, upholding standards, or providing certification. Professional Peer Review activity is widespread in the field of accounting, law, engineering (e.g., software peer review, technical peer review, etc.)

Test Yourself:

Question: What is Peer Review?

Answer: Peer Review is a process used for examining the work performed by one's equals (peers) It helps to understand the systems, practices, and procedures of a Practice Unit and provides suggestions for improvement if needed.

PROFESSIONAL PEER REVIEW

Professional Peer Review focuses on the performance of professionals, with a view to improving quality, upholding standards, or providing certification. Professional Peer Review activity is widespread in the field of accounting, law, engineering (e.g., software peer review, technical peer review, etc.), aviation, and even forest fire management. In academia, Peer Review is common in decisions related to faculty advancement and tenure.

PEER REVIEW FOR COMPANY SECRETARIES

Peer Review mainly considers examination of the systems and approach of a Practice Unit (PU) by another member of the Institute with the objective of identifying the areas, where the member may require guidance in improving the quality of his performance and adherence to the requirements of various technical standards.

The focus lies on the promotion of continuing quality improvement in an atmosphere of openness and mutual trust that contributes to enhancing transparency and comparability. Good practice is valued and mutual learning is encouraged in a dynamic and motivating process, from which both the Practice Unit and the Reviewer get benefit.

A Peer Review examines whether a Practice Unit has adequate policies and procedures (including documentation systems) in place to comply with the ICSI Auditing Standards, Guidance Notes, Manuals, Referencers and advisories issued by the ICSI and other legal requirements for maintaining the quality of the Services/ work they perform.

OBJECTIVES OF PEER REVIEW

The main objectives of Peer Review are to ensure that while rendering Professional Services, the members of the Institute of Company Secretaries of India (ICSI) in practice:

The main objective of Peer Review is to ensure that in carrying out their Services, the PCS has complied with the ICSI Guidance on Office Administration and Systems in the office of PCS, ICSI Auditing Standards, Guidance

Notes, Manuals, Referencers and advisories issued by the Institute and has in place proper systems (including documentation systems) for maintaining the quality of professional assignments undertaken by it.

Peer Review is directed towards maintenance as well as enhancement of quality of professional services and to provide guidance to members to improve their performance and adhere to various statutory and other regulatory requirements. Essentially, through review of professional services engagement records, Peer Review identifies the areas where a practicing member may require guidance in improving the quality of his/her performance and adherence to various regulatory requirements.

BENEFITS OF PEER REVIEW

There are significant benefits which a Practice Unit (PU) will obtain in undergoing a Peer Review.

These may be summarised below:

1. A successful Peer Review will provide comfort to the Practice Unit that it has adhered to various statutory, documentary and other regulatory requirements.
2. If deficiencies are noticed and corrective measures suggested, the Practice Unit will have an opportunity to correct the deficiencies and thereby enhance professional competence.
3. If a Peer Review Certificate is issued to the Practice Unit it enhances credibility of the Practice Unit in the eyes of the general public.
4. Since a Chinese Wall exists between the Peer Review Process and the Disciplinary Proceedings, the Practice Unit will benefit from Peer Review without any apprehension of any disciplinary proceedings being initiated against for any deficiencies noticed on its part.
5. Clients of the P.U. will benefit from knowing that their Practice Unit is periodically reviewed by the ICSI.
6. Furthermore, the benefits of getting Peer Reviewed Units can be seen by Guidelines issued by Council of the Institute from time to time.
7. To ensure the quality of services rendered by members of the Institute to their clients and to the society as a whole, the Council has decided that only Peer Reviewed Practice Units shall be permitted to undertake the following assignments:

   (a) Secretarial Audit Report under section 204(1) of the Companies Act, 2013 /Regulation 24 A(1) of the Securities & Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulation, 2015.

(b) Annual Secretarial Compliance Report under Regulation 24A (2) of the Securities & Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulation, 2015.

(c) Certification of Annual Return in terms of Section 92(2) of the Companies Act, 2013.

(d) Compliance Certificate under Schedule V, Clause E of the Securities & Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulation, 2015.

(e) Certification under Regulation 40(9) of Securities & Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulation, 2015.

(f) Quarterly Certificate for Reconciliation of Share Capital under Regulation 76 of Securities & Exchange Board of India (Depository Participants) Regulation, 2018.

The effective date of applicability for the above services for listed companies is 1st April,2022 and for all companies whether listed or otherwise it is 1st April, 2023.

(g) Internal Audit of Operations of the Depository Participants w.e.f. 1st April, 2020.

(h) Diligence Report for Banks in case of Consortium Lending/ Multiple Banking Arrangements w.e.f 1st July, 2020.

(i) Due Diligence and Certification under the Securities and Exchange Board of India (Delisting of Equity Shares) Regulation,2021 w.e.f. 10th June, 2021.

Further the Council has decided that the PCS shall mandatorily mention the Peer Review Certificate number while signing / certifying the above documents in the following format:

	For XYZ & Associates Company Secretaries Name ..... FCS/ACS ..... CP .....
Date: Place:	PR 1231/2023

AUTHORITY TO ADMINISTRATE PEER REVIEW

The Council of the Institute of Company Secretaries of India is constituted under the Company Secretaries Act, 1980, for discharging the functions assigned to the Institute under the Act. Section 15(1) of the Act provides that "The Institute shall function under the overall control, guidance and supervision of the Council and the duty of carrying out the provisions of the Act shall be vested in the Council", and enumerates various other duties of the Council. With a view to regulate the profession of Company Secretaries and in terms of the powers vested, the Council has issued guidelines for Peer Review of Attestation and Audit Services by Company Secretaries in Practice. The guidelines serve as a mechanism intended to further enhance the quality of professional work of Company Secretaries in Practice (PCS) over a period of time, thereby ensuring that the profession of Company Secretaries continues to serve the society in the manner envisaged.

The Guidelines on Peer Review are issued in relation to conduct of Peer Review of members rendering services:

- to promulgate an appropriate mechanism for ensuring the quality of professional services and guide the members in a manner that the Council considers appropriate;
- to provide guidance in relation to the statutory powers and obligations with respect to the parties involved in Peer Review;
- to prescribe the scope of Peer Review and the procedures to be adopted during the process of Peer Review; and
- to establish the expected conduct of members during a peer review.

SCOPE OF PEER REVIEW

At present the following Attestation and Audit Services are covered under the purview of Peer Review:

(i) Certification of Annual Return in Form MGT-8 under Section 92(2) of the Companies Act, 2013 and Rule 11(2) of the Companies (Management and Administration) Rules, 2014;

(ii) Issuance of Secretarial Audit Report in terms of Section 204 of the Companies Act, 2013 read with Rule 9 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014;

(iii) Issuance of Secretarial Audit Report to material unlisted subsidiaries of listed entities (whose equity shares are listed) in terms of Regulation 24A of SEBI (LODR) Regulations, 2015;

(iv) Issuance of Annual Secretarial Compliance Report to Listed entities (whose equity shares are listed) under SEBI Circular No. CIR/CFD/ CMD1/27/2019 dated 8th February, 2019;

(v) Certification under [Regulation 34(3) read with Clause 10(i) of Part C of Schedule V of the 4 SEBI (Listing Obligations & Disclosure Requirements) Regulations, 2015, that none of the directors on the board of the company have been debarred or disqualified from being appointed or continuing as directors of companies by the Board/ Ministry of Corporate Affairs or any such statutory authority.

(vi) Certification under Regulation 40(9) of SEBI (Listing Obligations & Disclosure Requirements)Regulations, 2015, certifying that all certificates have been issued within thirty days of the date of lodgment for transfer, sub-division, consolidation, renewal, exchange or endorsement of calls/allotment monies;

(vii) Conduct of Internal Audit of Operations of the Depository Participants registered with [National Securities Depository Limited (NSDL) and Central Depository Services Limited (CDSL)] under the Bye Laws issued by NSDL and CDSL;

(viii) Certification under Regulation 76 of SEBI (Depositories and Participants) Regulations,2018 for Reconciliation of Share Capital Audit;

(ix) Acting as Compliance Auditor under third party certification/Audit Scheme (Amendment), 2016 in the State of Haryana;

(x) Diligence reporting for Banks in case of multiple banking/consortium lending arrangements in terms of the circular issued by RBI;

(xi) Conduct of Internal Audit of the stock brokers/sub brokers under SEBI Circular No.MIRSD/ DPSIII/ Cir-26/ 08 dated 22nd August, 2008 and MRD/DMS/Cir-29/2008 dated 21st October, 2008;

(xii) Issuance of Certificate in case of the Indian company accepting the investment from a foreign investor, thereby confirming compliance of Companies Act, 2013 and other matters [As per Para 9 (1) (B) (i) of Schedule 1 to Notification No. FEMA 20/2000-RB dated 3rd May 2000];

(xiii) Compliance Certificate regarding compliance of conditions of Corporate Governance as prescribed under [Regulation 34(3), Schedule V, Part E of the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015];

(xiv) Signing of Annual Return in Form MGT-7 [through digital signature certificates (DSC) 11 under Section 92(1) of the Companies Act, 2013 and Rule 11(1) of the Companies (Management and Administration) Rules, 2014;

(xv) Due Diligence Report under Regulation 10 (3) of the SEBI (Delisting of Equity Shares) Regulations, 2021;

(xvi) Certificate relating to shares held by inactive shareholders under Regulation 21(a) (iii) of the SEBI (Delisting of Equity Shares) Regulations, 2021;

(xvii) Compliance Certificate under Regulation 10(b), 13, 26, 27, 36 of SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021;

(xviii) Scrutiniser's report pursuant to Section 108 of the Companies Act, 2013 read with Rule 20(4)(ix) and Rule 20(4)(xii) of Companies (Management and Administration) Rules, 2014;

(xix) All other Reports, Returns and Certificates in respect of which generation of UDIN is mandatory in terms of the ICSI Unique Document Identification Number (UDIN) Guidelines, 2019.

Since law is a dynamic subject, situations may arise whereby regulatory prescriptions may necessitate certification / recognition in other areas also in due course. The Council and the Peer Review Committee may include other services under the scope of Peer Review from time to time.

POWERS OF THE PEER REVIEW BOARD

"Council of the Institute of Companies Secretaries of India has issued guidelines on Peer Review, which lays down the framework for conduct of Peer Reviews by setting up the Peer Review Board."

Powers of the Board –

The Committee shall exercise such powers as provided in these guidelines for the purpose of discharging its duties under the provisions of these guidelines.

The duties of the Board shall include:

- To call for information from Practice Units in such form, as it deems fit.
- To maintain a panel of Peer Reviewers.
- To define the terms of appointment of the Reviewers.
- To send a Panel of at least 5(five) Peer Reviewers (from the panel maintained in terms of these Guidelines) to the Practice Unit and allow them to choose any one Reviewer from the panel so forwarded and if the Practice Unit is unable to choose any one Reviewer from the panel so sent, to send another Panel of 5 Peer Reviewers.

Provided that if the PU does not choose any one name from the panel of 5 or 10 Peer Reviewers (as the case may be), then the Practice Unit may make a specific request to the Board to provide names of Reviewers from outside the State / Region where the Practice Unit has its place of business, in which case the PU shall, in addition to the payment of fees to the Reviewer, bear extra costs that would be incurred for travelling, stay and other expenses.

Provided further that, in case no peer reviewers are available in the city or in close proximity to the PU, the PU may choose any reviewer from out of the panel maintained by the Committee, in which case the PU shall be liable to pay the travelling, stay and other expenses to the Peer Reviewer in addition to the Peer Review fee.

- To examine the aspects of basis of selection of records pertaining to the services in terms of the appropriate regulatory requirements.
- To arrange for such training programs for Reviewers and orientation programmes for practice unit as may be deemed appropriate.
- To prescribe the system, practice and procedure to be observed in relation to Peer Review; and
- On considering the Report of a Reviewer, to do any or all of the following:

  (a) to issue recommendations to the Practice Unit;

  (b) to order a further Peer Review to be carried out.
- After considering the report of the Reviewer and compliance of recommendations by the Practice Unit, wherever deemed appropriate by the Committee, to issue Peer Review Certificate either in physical or digital mode.
- To guide the members on best practices on Peer Review including issuance of advisories to the Peer Reviewer and the Practice Unit.
- Such other action(s) as may be necessary for the fulfilment of these Guidelines.

Where deemed appropriate, the Board shall have the powers to make recommendations to the Council on:

(i) Measures for improvement of quality of professional services by members.

(ii) Guidance to be provided to the members for further improvement in quality of Attestation and Audit Services.

Further, the Board may perform any other duties or acts as may be incidental to, or, which it considers necessary or expedient for the performance of its functions or exercise of its powers as delegated to it by the Council including the formation of sub-committees for specific tasks.

GUIDELINES FOR MANDATORY PEER REVIEW FOR CERTIFICATION AND AUDIT SERVICES

The Council has issued Guidelines for Mandatory Peer Review for certification and Audit Services as under:

(a) Secretarial Audit Report under section 204(1) of the Companies Act, 2013 /Regulation 24 A(1) of the Securities & Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulation, 2015.

(b) Annual Secretarial Compliance Report under Regulation 24A (2) of the Securities & Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulation, 2015.

(c) Certification of Annual Return in terms of Section 92(2) of the Companies Act, 2013.

(d) Compliance Certificate under Schedule V, Clause E of the Securities & Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulation, 2015.

(e) Certification under Regulation 40(9) of Securities & Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulation, 2015.

(f) Quarterly Certificate for Reconciliation of Share Capital under Regulation 76 of Securities & Exchange Board of India (Depository Participants) Regulation, 2018.

The effective date of applicability for the above services for listed companies is 1st April,2022 and for all companies whether listed or otherwise it is 1st April, 2023.

(g) Internal Audit of Operations of the Depository Participants w.e.f. 1st April, 2020.

(h) Diligence Report for Banks in case of Consortium Lending/ Multiple Banking Arrangements w.e.f 1st July, 2020.

(i) Due Diligence and Certification under the Securities and Exchange Board of India (Delisting of Equity Shares) Regulation,2021 w.e.f. 10th June, 2021.

AUTHORITY OF THE GUIDELINES ON PEER REVIEW

The guidelines on Peer Review shall apply to all or any of the following cases:

(a) Whenever Peer Review is mandated on the Instructions of Government/ Regulators / Statutory Bodies;

(b) Whenever Peer Review is requested voluntarily by the Practice Unit;

(c) Whenever Peer Review is conducted on the basis of random selection;

(d) Upon the recommendation of the Committee of Discipline or Disciplinary Committee of ICSI / Quality Review Board / Council of ICSI.

The Council of the Institute on any legislative amendment to law may require a Peer Review to be conducted of any Practice Unit.

The Guidelines on Peer Review are issued in relation to the Peer Review of Attestation and Audit Services, so as:

– to prescribe and propagate an appropriate mechanism for ensuring the quality of professional assignments and guide the members to conduct themselves in a manner that the Council considers appropriate;

– to provide guidance in relation to the powers and obligations with respect to the parties involved in Peer Review;

– to prescribe the scope of Peer Review and the procedures to be adopted during the conduct of Peer Review; and

– to establish the expected conduct of members during Peer Review.

Question: *What are the Guidelines applicable for Peer Review of a Practice Unit having Branch Office(s)?*

Answer: *The Practice Units having Branch office(s) are required to undergo for Peer Review as a whole.*

QUALIFICATIONS FOR A PEER REVIEWER

To be empanelled as Peer Reviewer, an individual shall–

(a) be a member with at least 10 years of post-qualification experience as Company Secretary; and out of the 10 years of post-qualification experience, should have been in practice for a continuous period of not less than five years at the time of empanelment;

(b) be currently holding Certificate of Practice as issued by the Institute;

(c) have undergone the Training Programme for Peer Reviewers and qualified the Certification Programme for Peer Reviewers organized by the Institute;

Further to be empanelled as Peer Reviewer, a member shall not have: -

(a) disciplinary action / proceedings pending against him during the past 3 years;

(b) been found guilty of professional or other misconduct by the Committee of Discipline / Disciplinary Committee, at any time, as the case may be;

(c) been convicted by a Competent Court whether within or outside India, of an offence involving moral turpitude and punishable with imprisonment.

The Board may examine the quality of the report and shall have powers to remove the Reviewer from the panel of Peer Reviewers, in case the quality of the review/report fails to match the desired standards.

Sitting members on the Council / Regional Council / Chapter Management Committee, and the members of the Peer Review Board of the ICSI shall not act as Peer Reviewers till they demit their office.

Illustrations:

(1) Mr. X member of ICSI having post qualification experience of 12 years as Company Secretary but not holding Certificate of Practice then he/she shall not be empanelled as Peer Reviewer. He /She must be holding Certificate of Practice as issued by the Institute.

(2) Mr. A member of ICSI having 10 years of post-qualification as a company secretary in practice, applied on 20.04.2023 for empanelment as Peer Reviewer. He faced disciplinary action and proceedings were pending against him on 02.04.2021 and has been found guilty of professional misconduct guidelines by the Disciplinary Committee for conducting advertisement of his firm against advertisement, he shall not be qualified to be empanelled as Peer Reviewer.

EMPANELMENT OF PEER REVIEWERS

The Board has prescribed a format for inviting applications from members fulfilling the criteria and willing to be empanelled as Reviewers. The application form seeks to collate information on professional experience, educational qualifications, practice areas, etc. which would enable the Board to assess the core competence of the applicant for empanelment as Reviewer. When a Peer Review is required to be conducted, the Board would endeavour to match the relevant experience and standing of the Reviewer with the profile of Practice Unit which is being reviewed.

THE REVIEWER'S APPROACH FOR PEER REVIEW

(a) The approach of the Reviewer should be courteous, professional and helpful throughout the review process.

(b) He should be appreciative of good practices while suggesting areas of improvement.

(c) He should adopt a collaborative approach with the Practice Unit during the review process and should ensure minimum disruption to the Practice Unit during the peer review.

(d) He should be able to provide practical and insightful comments in a discussion mode as a Peer during the review process.

(e) He should try and give value addition to Practice Unit and not merely adopt a tick box approach.

(f) In determining issues which are subjective, the purpose is not to replace the PU's opinion with the opinion of the Reviewer but to verify the process followed in exercise of judgment by the Practice Unit. Verification of the process will include verification of working papers maintained by the Practice Unit.

PRE-REQUISITES FOR REVIEWER

The nature and complexities of Peer Review requires the exercise of professional judgment. The reviewer should: -

(a) Be well acquainted with the technical aspects of the Attestation and Audit Services.

(b) Know the provisions of Code of Conduct of ICSI.

(c) Have studied various cases decided on Code of Conduct of ICSI.

(d) Get himself/herself acquainted with decisions of various courts on 'cases relating to deficiency in service'.

(e) Be aware of relevant provisions of Company Secretaries Act 1980, Company Secretaries Regulations, 1982, Consumer Protection Act, Evidence Act, Indian Penal Code, etc.

(f) Have studied the ICSI Auditing Standards, Guidance Notes, Manuals, Referencers, Notifications, Guidelines and advisories issued by Council of ICSI from time to time.

(g) Be aware of evolving standards and best practices in the field.

(h) Be good at drafting, written and spoken English.

(i) Display professional and courteous behaviour while on peer review visit.

(j) Understand his limitations.

(k) Be clear about what is outside the scope of Peer Review.

PEER REVIEW PROCESS

Once a practice unit is selected for review, its engagement records pertaining to the immediately preceding financial year shall be subject to review.

The Review shall focus on:

(i) Compliance with ICSI Guidance on Office Administration and Systems in the Office of PCS, ICSI Auditing Standards, Guidance Notes, Manuals, References and advisories issued by the Institute;

(ii) Quality of Reporting;

(iii) Office systems and procedures; and

(iv) Training Programs for staff (including trainees), including appropriate infrastructure.

Test Yourself:

Question: Records of how many years are subject to Peer Review by the Reviewer?

Answer: The Engagement records of immediately preceding financial year shall be subject to peer review.

TRAINING AND DEVELOPMENT OF REVIEWERS

To ensure that the objective of Peer Review is attained in letter and spirit, adequate training facilities (either offline or online or both) shall be provided, from time to time, to the Reviewers and also to other persons who assist the Board in the manner considered appropriate by the Board.

Reviewer shall be expected to be fully familiar with all procedures, ICSI Guidance on Office Administration and Systems in the Office of PCS, ICSI Auditing Standards, Guidance Notes, Manuals, Referencers and advisories issued by the Institute, guidelines and other decisions as may be issued by the Board from time to time.

A Reviewer may be required to assess his/her capability to perform Peer Review exercise. He/she should also consider carefully the number and availability of trained staff in deciding whether he/ she would be in a position to perform Peer Review of a Practice Unit.

To equip the Reviewers with the required inputs for Peer Review, the Institute undertakes Training Programmes for Reviewers on regular basis. Institute has also developed a Training Module to guide the Reviewers.

VALIDITY OF REVIEWERS EMPANELMENT

The validity of the Peer Review Empanelment shall be five years from the date of empanelment, post which the Reviewers shall have to again undergo the Training Programme for Peer Reviewers and qualify the Certification Programme offered by the Institute.

STATEMENT OF CONFIDENTIALITY

The process of Peer Review requires high level of integrity on the part of the Peer Reviewer and Qualified Assistant(s) who may assist Reviewer during the Review. The Board has prescribed a Statement of Confidentiality for this purpose. Before accepting to undertake Peer Review assignment, the Reviewer and Qualified Assistant(s) are required to sign the Statement of Confidentiality and shall send the same to the Peer Review Board.

Strict confidentiality provisions shall apply to all those involved in the Peer Review process, namely, Reviewers, Qualified Assistant(s), members of the Board, the Council, or any person who assists any of these parties.

Those persons subject to the secrecy provision:

1. Shall at all times after their appointment preserve and aid in preserving secrecy with regard to any matter coming to their knowledge in the performance or in assisting in the performance of any function, directly or indirectly related to the process and conduct of Peer Review;
2. Shall not at any time communicate any such matter to any other person; and
3. Shall not at any time permit any other person to have any access to any record, document or any other material, if any, which is in their possession or under their control by virtue of their being or having been so appointed or their having performed or having assisted any other person in the performance of such a function.

Non-compliance with the secrecy provisions in the above clause shall amount to professional misconduct as defined under Section 22 of the Company Secretaries Act, 1980.

A statement of confidentiality shall be filled in by the person(s) who are responsible for the conduct of Peer Review, i.e., Reviewers/ the members of the Board and others who assist them.

METHODOLOGY TO BE FOLLOWED BY REVIEWER

(a) Offsite Review

- This contemplates studying the information given by the PU in the Questionnaire and based on the same make his own observations about possible areas where improvement is possible and to note other aspects to be discussed in personal meeting with PU.

(b) Onsite Review

- Verification of information given by the PU.
- Test checks in respect of attestation assignments handled by the PU.
- Interaction with the staff & trainees of PU should be a part of the peer review.
- Calling for the records in respect of the client maintained by the PU to verify whether proper systems and procedures have been followed.

COMPLIANCE WITH PEER REVIEW GUIDELINES

Practice Units are required to comply with the provisions of these Guidelines. Practice Units failing in this regard will be required to undergo appropriate review of their quality controls by the Board in terms of such specific directions as may be given to it by the Council in these regards from time to time and as notified to the members.

Practice Units failing to comply with these Guidelines shall be liable for disciplinary action as provided under the Company Secretaries Act, 1980.

Both the Peer Reviewers as well as the Practice Units shall adhere to the timelines for Peer Review as mandated by the Board from time to time.

OBLIGATIONS OF THE PRACTICE UNIT

The Obligations of the Practice Unit include the following:

The Practice Units are supposed to practice under the name duly approved and allotted by the ICSI as per the name approval Guidelines as amended from time to time.

The Practice Unit under review shall provide access to any record or document as may be asked by the Reviewer. For these purposes:

Any person who is reasonably believed by a Reviewer to have in his possession or under his control any record or other document, which contains or is likely to contain information relevant to the Peer Review shall:

(1) (a) Produce to the Reviewer or afford him access to, any record or document specified by the Reviewer or any other record or document which is of a class or description so specified, and which is in his possession or under his control/ being in either case a record or other document which the Reviewer reasonably believes is or may be relevant to the Peer Review, within such time as the Reviewer may reasonably require;

(b) If so required by the Reviewer, afford and provide to him such explanation or further particulars in respect of anything produced in compliance with requirement mentioned above, as the reviewer shall specify; and

(c) Provide to the Reviewer all assistance in connection with Peer Review which he is expected to provide.

(2) Where any information or matter relevant to a Practice Unit is recorded otherwise than in a legible form, the Practice Unit shall provide and present to the Reviewer a reproduction of any such information or matter, or of the relevant part in a legible form, with a suitable translation in English if the matter is in any other language, and such translation is requested for by the Reviewer.

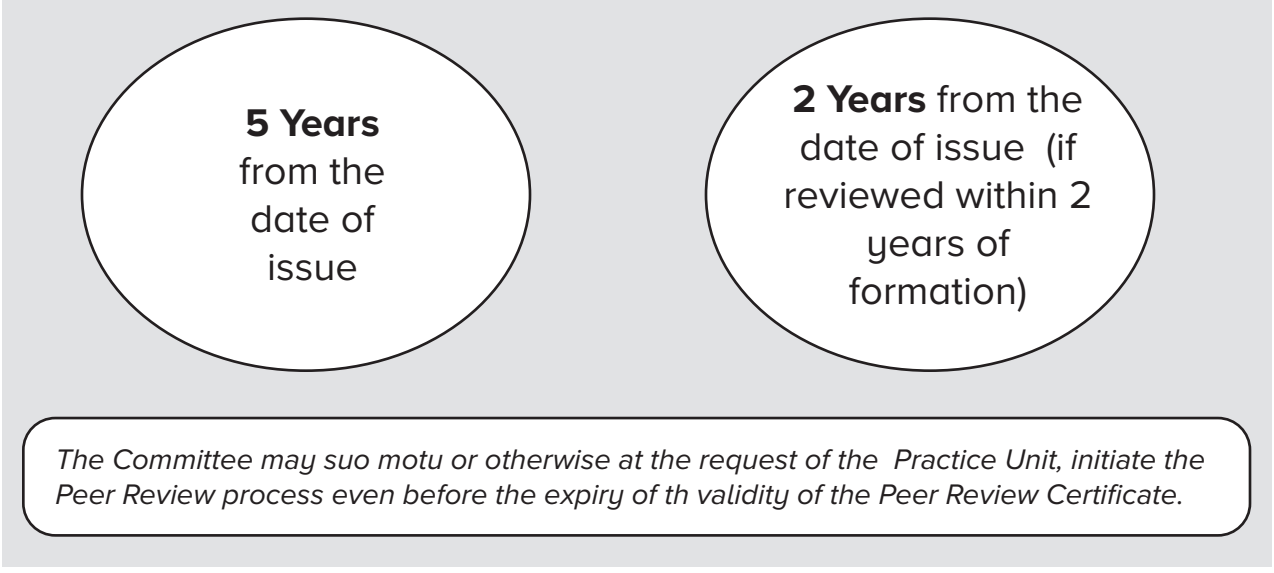
(3) In case the Practice Unit has more than one office, the Practice Unit shall ensure that the Reviewer is given access to all documents relevant to review no matter in which office of the Practice Unit, these documents may be available in.

(4) A Practice Unit shall allow the Reviewer to inspect, examine or take any abstract of or extract from a record or document or copy there from which may be required by the Reviewer. However, in order to ensure the confidentiality of the contents of the client's file with the PU, the Reviewer shall, under no circumstances seek names of the clients or make copies or extracts of any document from the clients' files received by him, or of any client records acquired by him while conducting peer review, as part of his working papers.

For the purpose of this clause a person means an individual / Sole Proprietor / Partner of a partnership firm / designated partner of a LLP to which the particular review relates or any person employed by or whose services are engaged by such unit.

VALIDITY OF PEER REVIEW CERTIFICATE

The validity of the Peer Review Certificate shall be five years from the date of issue.



Provided that the Board may *suo motu* or otherwise at the request of the Practice Unit, initiate the Peer Review process even before the expiry of the validity of the Peer Review Certificate.

Further, in case the PU is reviewed within two years of its formation, the validity of the Peer Review Certificate shall be for two years.

REVIEW FRAMEWORK

Essentially, a Peer Review entails a review of engagement records and related financial / other statements to ascertain whether the Practice Unit is adhering to ICSI Auditing Standards, Guidance Notes, Manuals, Referencers and advisories issued by the Institute. Where a Practice Unit is not following any of the ICSI Auditing Standards, Guidance Notes, Manuals, Referencers and advisories issued by the Institute, in certain situations, suggestions and recommendations for improvement may be made, and possibly followed by a further review, in keeping with the primary thrust of Peer Review.

REPORTING

The central element of a Peer Review is the assessment, i.e., the professional judgment by the peers. Guidelines for Peer Review contains provisions for the report of Peer Reviewer. It has been provided that at the end of an on-site review, the Reviewer shall, before making his report to the Board, communicate a preliminary report to the Practice Unit, in case the Reviewer observes any deficiency in the systems and procedures of the Practice Unit. The Reviewer shall report on the areas where systems and procedures had been found to be deficient or where he has noticed noncompliance with reference to any other matter. In arriving at this conclusion, the Reviewer shall be expected to examine the materiality of the non-compliance or deficiency, the number of occasions when such non-compliance was noticed and its overall impact on the quality of professional service rendered by the Practice Unit.

Question 1: *What are the basic components of a Reviewer's Report?*

Answer: *The basic components of a Reviewer's Report are:*

- *Scope of Peer Review;*
- *Reference to the quality control standards;*
- *A statement indicating that the quality control is the responsibility of the reviewed firm;*
- *Limitations if any on the review conducted;*
- *A reference to the preliminary report;*
- *Description of why modified report is required, instead of clean report.*

Question 2: *Can a Reviewer give qualifications in his Review Report?*

Answer: *Yes. Under following situations, a reviewer can qualify the report:*

- *Non-compliance with quality control policies and procedures;*
- *Any deficiency found in quality control procedures;*
- *Non-adherence to ICSI Auditing Standards, Guidance Notes, Manuals, Referencers and advisories issued by the Institute;*
- *No internal control systems prevail in the PU;*
- *Current and permanent files were not maintained as per standards laid down;*
- *Adequate training programmes were not organized for the staff.*

Question 3: *What does clean Report means?*

Answer: *Clean Report is a report that states that Reviewer is of the opinion that the PU is conducting its affairs in adherence to the Technical Standards as applicable to it.*

QUESTIONNAIRE FOR PRACTICE UNIT

The Peer Review process requires each Practice Unit (PU) to provide some basic information about the PU to the Reviewer in the questionnaire specifically designed by the Committee for the purpose.

The questionnaire with the answers provided, would enable the Reviewer to make a fair assessment as to the key control areas prevalent in the Practice Unit and the degree of reliance that can be placed on the internal control mechanism and records maintained by the Practice Unit. The questionnaire is expected to act as guidance to the Practice Units as to the basic internal control measures that each Practice Unit should normally undertake. Non-existence of any of the internal control measures as elucidated in the questionnaire does not necessarily mean that the Practice Unit has failed in any aspect related to quality of services. Still it is desirable that the Practice Unit has in place all the internal control mechanisms contained in the questionnaire as a measure of good practice.

All the responses to the questionnaire would be kept strictly confidential by the Reviewer and his team and no information contained therein would be shared with any third party.

The Reviewer places a great deal of reliance on the responses provided by the Practice Unit in the questionnaire while designing his / her review plan. Care should therefore be taken by the Practice Unit while answering the question.

COST OF PEER REVIEW

The cost of Peer Review, payable to the Reviewer, shall be borne by the Practice Unit. Each of the branch / office under review would be considered separately for the purpose of payment of cost of Peer Review. The cost of Peer Review shall be paid by the Practice Unit within 30 days from the date of receipt of Invoice from the Peer Reviewer. The Committee may modify the cost of Peer Review payable to the Reviewer from time to time.

Test Yourself

Question: *If any PU want a Peer Reviewer from outside its State or region then what are the pre-requirements for the same?*

Answer: *The PU may make a special request to the Peer Review Board to provide names of Reviewers from outside the State/Region of place of business of Practice Unit. However, in such a case PU would have to bear the extra cost that would be incurred for TA / DA etc.*

REVIEW PROCESS

(i) Preparation

A practice unit will be notified in writing about an impending peer review and will be sent a Questionnaire for completion. the PU is required to send the duly filled in Questionnaire to the Committee.

Return of completed Questionnaire - The practice unit shall have to complete and return the Questionnaire to the Secretariat within 7 days of the receipt. The information will be used for the planning of the review.

The Board will send a Panel of at least 5 (five) Peer Reviewers (from the panel maintained in terms of these Guidelines) to the Practice Unit and allow the Practice Unit to choose any one Reviewer from the panel so forwarded and if the Practice Unit is unable to choose any one Reviewer from the panel so sent, to send another Panel of 5 Peer Reviewers.

Provided that if the PU does not choose any one name from the panel of 5 or 10 Peer Reviewers (as the case may be), then the Practice Unit may make a specific request to the Board to provide names of Reviewers from outside the State / Region where the Practice Unit has its place of business, in which case the PU shall, in addition to the payment of fees to the Reviewer, bear extra costs that would be incurred for travelling, stay and other expenses.

Provided further that, in case no peer reviewers are available in the city or in close proximity to the PU, the PU may choose any reviewer from out of the panel maintained by the Board, in which case the PU shall be liable to pay the travelling, stay and other expenses to the Peer Reviewer in addition to the Peer Review fee.

Illustrations:

(1) How much will it cost PU to get Peer Reviewed?

PU shall pay to the Peer Reviewer, a fee of Rs. 10,000/- (inclusive of GST, TA/DA and any out of pocket expenses) or an amount as may be prescribed by the Peer Review Board from time to time. In case Reviewer has to conduct second review, the same rate would apply to the second review also. Each Branch/office under Review would be considered separately.

(2) To whom shall the fee for Peer Review be paid?

The cost of Peer Review shall be paid by the PU directly to the Reviewer within 30 days from the receipt of Invoice raised by the Peer Reviewer. The said payment of Honorarium shall be paid to the Reviewer by crossed account payee cheque/Demand Draft/NEFT/RTGS/IMPS or any other electronic mode.

(ii) Planning

On acceptance of the Peer Review by the selected Reviewer, the Practice Unit will be notified.

The Reviewer may also require the Practice Unit to provide other information as he considers necessary to facilitate the selection of a sample of services engagements, which is representative of the Practice Unit's client portfolio, for review.

- **Sample of Attestation services Engagements**

  (a) From the complete Services, client list, an initial sample will be selected by the Reviewer. The Peer Reviewer shall choose not less than 10% of the actual attestation assignments undertaken by the PU under each category or five assignments under each category, whichever is more. In case the sample size is smaller than this, the reasons therefor shall be specifically stated in the Peer Review Report.

  (b) Practice Units will be notified of the selection in writing preferably 2 (two) weeks in advance, requesting the relevant records of the selected Attestation and Audit Services, to be made available for review.

  (c) At the execution stage, the initial sample may be reduced to a smaller actual sample for review. However, if the reviewer considers that the actual sample does not cover a fair cross-section of the Practice Unit's Attestation and Audit Services engagements, he/she may make further selections.

- **Confirmation of visit**

In consultation with the Practice Unit, date(s) will be set for the onsite review to be carried out. Flexibility will be permitted to ensure that Practice Units are not inconvenienced at especially busy periods. The on-site review date(s) will be arranged by mutual consent such that the review is concluded within 21 (twenty one) days of appointment of Peer Reviewer, by the Committee.

(iii) Execution

(a) On site review

Peer review visits will be conducted at the practice unit's head office or other officially noted/ recorded

place of office. The complete on-site review of a practice unit may take one or two full days depending upon the size of the practice unit and scope of the peer review. This is based on the assumption that the practice unit concerned has made all the necessary information and documentation available to the reviewer for his review. However, in any case this on-site review should not extend beyond three working days.

(b) Initial meeting

An initial meeting will be held between the reviewer and the sole proprietor/ partner(s) of the practice unit designated to deal with the review (designated partner). The primary purpose of this meeting is to discuss the agenda of the peer visit and confirm the accuracy of the responses given in the Questionnaire. The description of the system in the Questionnaire may not fully explain all the relevant procedures and policies adopted by the practice unit and this initial meeting can provide additional information. The reviewer should have a full understanding of the system and be able to form a preliminary evaluation of its adequacy at the conclusion of the meeting. During the meeting, a decision can also be taken on the evaluation method and the person(s) in the office of the PU to be interviewed and who will be able to assist the Reviewer in completing the Peer Review Process during his/her visit.

(c) Compliance Review-General Controls

(i) The reviewer may carry out a compliance review of the General Controls and evaluate the degree of reliance to be placed upon them. The degree of reliance will, ultimately, affect the attestation services engagements to be reviewed. The following five key controls will be considered as General Controls:

- Independence
- Maintenance of Professional Skills and standards
- Outside Consultation
- Staff Supervision and Development
- Office Administration

Practice units are expected to address each of the five key control areas.

(ii) In each key control area there shall be supplementary questions and matters to consider. These are intended to ensure that the controls that are expected to be maintained, are installed and operated within practice units.

(iii) All questions in the questionnaire may not necessarily be relevant to particular types of practice units because of its size, nature and type of its practice. However, practice units should still assess their internal control systems to ascertain whether they address the objectives under the five key control areas.

(iv) The Reviewer should evaluate these general controls to understand the functioning of the office of the Practice Unit.

(iv) Selection of attestation services engagements to be reviewed

(a) The number of attestation services engagements to be reviewed depends upon:

- The number of practicing members involved in attestation services engagements in the practice unit;
- The degree of reliance placed, if any, on general quality controls; and
- The total number of attestation services engagements undertaken by the practice units for the period under review.

(b) The engagements reviewed should be a balanced sample from a variety of different types of companies. Accordingly, if the reviewer considers that the actual sample is not representative of the practice unit's attestation services client portfolio, he may make further selections from the initial sample or from the complete attestation services client list.

(c) The Reviewer should not undertake Peer Review of attestation engagements which have been the subject matter of disciplinary proceedings nor should the Practice Unit influence the Reviewer to select such engagements for Peer Review.

(v) Review of records

The reviewer may adopt a compliance approach or substantive approach or a combination of both in the review of attestation services engagement records.

(a) Compliance approach - services engagements

– *The compliance approach is to assess whether proper control procedures have been established by the practice unit to ensure that attestation services are being performed in accordance with Auditing Standards, Guidance Notes, Manuals, References and advisories issued by the Institute.*

– *Practice units should have procedures and documentation sufficient to cover each of the key areas. If Members in smaller practices find some of the documentation too elaborate for their clients and they tailor their services documentation to suit their particular circumstances with justification for doing should be provided to the reviewer.*

– *If the size of the Practice Unit is small or medium (a matter left to the judgement of the Reviewer), the Compliance Approach may not be appropriate. In such a case, the Reviewer may choose the Substantive Approach for conduct of Review.*

(b) Substantive approach - Attestation services Engagements

A substantive approach will be employed if the reviewer chooses not to place reliance on the practice unit's general controls on attestation engagements or is of the opinion that the standard of compliance is not satisfactory or not appropriate in the case of a specific Practice Unit selected for Peer Review. This approach requires a review of the attestation working papers in order to establish whether the attestation work has been carried out as per norms of Technical Standards.

(vi) Reporting

(i) Preliminary Report of Reviewer

At the end of an on-site review, in case any deficiency / non-compliance is noticed in the systems and procedures of the Practice Unit in rendering professional services to the client, the reviewer shall, before making his report to the Board, communicate a preliminary report to the Practice Unit. The Reviewer shall report on the areas where systems and procedures had been found to be deficient or where non-compliance with reference to any other matter was noticed.

The Practice Unit shall make submissions or representations, in writing to the Reviewer, concerning the preliminary report within 7 (seven) days from the date of receipt of preliminary report from the Reviewer.

(ii) Final Report of Reviewer

(a) The Reviewer will submit a Final Report to the Board with a copy to the Practice Unit (the Reviewer's Report), incorporating the findings. The Final Report will be examined/inspected by the Board in terms of the degree of compliance with the ICSI Guidance on Office Administration and Systems in the Office of PCS, ICSI Auditing Standards, Guidance Notes, Manuals, Referencers and advisories issued by the Institute by the reviewed Practice Unit. The model forms of such Final Reports shall be communicated to the Reviewer by the Board.

(b) The Board may, if deems fit, issue Peer Review Certificate to the Practice Unit.

OR

(c) The Board, having regard to the Report and any submissions or representations attached to it, may:

- make recommendations to the Practice Unit concerned regarding the application by it of ICSI Guidance on Office Administration and Systems in the Office of PCS, ICSI Auditing Standards, Guidance Notes, Manuals, Referencers and advisories issued by the Institute;
- if it is of the opinion that:

  (1) In case the review is related to a firm, any one or more or all of the partners in the firm may have failed to observe, maintain or apply, as the case may be, ICSI Guidance on Office Administration and Systems in the Office of PCS, ICSI Auditing Standards, Guidance Notes, Manuals, Referencers and advisories issued by the Institute;

  (2) In case the review is related to a member practicing on his own account, the member may have failed to observe, maintain or apply, as the case may be, ICSI Guidance on Office Administration and Systems in the Office of PCS, ICSI Auditing Standards, Guidance Notes, Manuals, Referencers and advisories issued by the Institute; then, the Board may;

  - Issue instructions to the Reviewer to carry out, within such period as may be specified in the instructions (which period shall not commence earlier than six months after the date on which the instruction is issued), a further Peer Review as regards the Practice Unit to which the report relates; and
  - Specify in the instruction, the matters as regards to which the review is to be carried out;

(d) The Board will make recommendations to the Practice Unit where:

(i) based on the report of the Reviewer, it appears that the Practice Unit has satisfied all key control objectives, which the Board has determined and/or prescribed in respect of maintenance of/ adherence to Technical Standards but where further improvements could be made to internal quality control systems; and

(ii) based on the report of the reviewer, it appears that the Practice Unit has satisfied the major key control objectives but some weaknesses exist in other areas.

The Practice Unit is expected to consider the recommendations for rectifying the weaknesses thus identified and informed by the Board and take all necessary actions to ensure that all key control areas are addressed.

(e) A follow up review will be required where the Practice Unit has not satisfied the Committee that all the key control objectives have been maintained and where, in the opinion of the Committee the deficiencies are likely to materially affect the overall quality of engagements of the Practice Unit. In such cases the Board will also make recommendations, which it expects the practice unit to implement in order to ensure the maintenance of professional standards. The implementation of these recommendations will be examined during the follow up review.

OFFICE SYSTEM AND PROCESS

The Peer Review is expected to examine the office systems and procedures with regard to Compliance Professional Services.

The reviewer shall verify whether the practice unit has adequate office systems and procedures in place. However, the extent and scale of these systems may vary from one practice unit to another, depending upon the size and scale of practice of the practice unit.

The reviewer shall particularly examine the following aspects, besides forming his own judgment during the review:

1. Whether the practice unit has a document management system which should ideally include the filing system, record storage and retrieval system (whether in hard copy or soft copy),
2. Whether allocation of attestation assignments among the staff/trainees are commensurate with the capability of the staff, whether the assignments are properly carried out and the attestation services are verified by the proprietor or partner of the practice unit or a qualified assistant in the office of the practice unit before authentication.

Test Yourself

Question: *What does Qualified Assistant mean?*

Answer: *Qualified Assistant means a person assisting the Reviewer for carrying out peer review and who:*

(a) is a member of the Institute,

(b) has not been held guilty of misconduct under the Company Secretaries Act, 1980

(c) is a partner or Associate of the Peer Reviewer.

Question: *If PU have been Peer Reviewed once, it will be required to be Peer Reviewed again?*

Answer: *Yes, if the Peer Review Board so decides or upon expiring validity of the Certificate issued.*

Question: *After the Successful Peer review, is there any protection from disciplinary proceedings under the Code of Conduct?*

Answer: *No. Peer Review is only a broad examination of the systems and procedures followed by the Practice Unit. The fact that you have been Peer Reviewed does not provide immunity from Disciplinary Action.*

Question: *Can a Reviewer refuse to accept/perform any Peer Review assignment allotted to him/her?*

Answer*: Yes, the Reviewer can refuse to accept / perform the Peer Review assignment after giving a valid reason to the Board.*

The refusal of assignments can be made on the following grounds:

- *Conflict of Interest between the Reviewer and PU*
- *Ill Health*
- *Other work or pre-occupations*
- *Reviewer feels that he cannot act independently in that Firm/or with Reviewee due to past connections or so.*

Question: *What can be done if Reviewer wants to take the extracts of records or documents of the PU?*

Answer: *Firstly, Reviewer in no circumstances, is allowed to take extracts or make copies of any document or records from the client's files reviewed by him or of any client's records acquired by him while conducting peer review, but he may have access to, or take the abstracts of the records and documents in order to carry out the review work at PU's office.*

In case, if Reviewer wants to take any document or record alongwith, PU should be aware that reviewer is not permitted to do so and can deny the same.

Training programs for staff (including apprentices) concerned with attestation functions, including appropriate infrastructure

Proper training and capacity development of the apprentice staff/trainee(s) and other staff in the office of the practice unit is very essential to maintain the quality of professional services. As it may become difficult for company secretaries in Practice/Partner(s) of the PU to attend all the services rendered by their PU, most practice units generally rely on the trainees for execution of the professional services. In this context, the peer reviewer may examine whether:

1. The trainees are maintaining a training diary to record the work done every day, the dairy is being examined by the proprietor/partner/qualified assistant of the practice unit periodically.
2. Whether any staff induction process is in place.
3. Whether the staff are periodically encouraged to attend any training program or any other capacity building programme, including any in-house mechanism for their professional development.
4. Whether the office of the practice unit is equipped with a library or reference material relating to professional services.
5. Whether the overall décor/appearance of the office of the practice unit is satisfactory.

The list furnished above is only illustrative. The peer reviewer may like to examine any other matters also. However, in doing so, the peer reviewer shall keep in mind the size of the practice unit and its scale of operations.

REFERRAL OF DISPUTES AND APPEAL

Where a dispute arises over the powers of Reviewers or the process or conclusions reached after the review or to any other matter related to the review, the Practice Unit, the Reviewer or both may refer the dispute, in writing, to the Board.

Such referral shall have to be made within 2 (two) months of occurrence of the issue in dispute, in such manner as may be prescribed by the Board in this regard.

Where a dispute is referred, after considering any submissions or representations (which shall be made in writing) made by the relevant Practice Unit and/or the relevant Reviewer, the Board:

- Shall decide the dispute within 6 (six) months of the reference and communicate such decision to each of the parties to the dispute, simultaneously;
- May issue directions relating to the matter in dispute to such Practice Unit or the Reviewer concerned and require such Unit or Reviewer to comply with them within 30 (thirty) days and send a report to the Board of the said compliance within 15 (fifteen)days of such compliance;
- Shall convey its decision in these regards to each of the parties within 15 days from the date of the decision.

Where either of the parties are dissatisfied with the decision of the Board, it may refer the matter to the Council within 2 (two) months in such manner as may be prescribed.

QUALITY REVIEW BOARD

Quality Review Board (QRB) is constituted by Government of India in exercise of the powers conferred by Section 29 A of the Company Secretaries Act, 1980 read with rules 8, 9 and 10 of the Company Secretaries Procedures of Meetings of Quality Review Board, and Terms and Conditions of Service and Allowances of the Chairperson and Members of the Board Rules, 2006.

The Board has been set up to review and enhance the quality of the services rendered by the members of the ICSI. The Board aims to standardize the practices followed by the Company Secretaries and enhance the quality of the services rendered by the members of ICSI on continuous basis.

The Company Secretaries Act, 1980 provides for the regulation of the profession of Company Secretaries in India. The Act was amended in the year 2006 and sections 29A to 29D were inserted making provision for the establishment of Quality Review Board. Accordingly, the Government of India, Ministry of Corporate Affairs, vide their notification no. S.O. 68 (E) dated 6th February, 2012 constituted QRB of the Institute of Company Secretaries of India for promoting "Quality" considerations in rendering various professional (both statutory and non-statutory) services by the Members of the Institute. Government of India, Ministry of Corporate Affairs, vide their notification no. G.S.R. 736(E) dated 27th November, 2006 also notified the Company Secretaries Procedures of Meeting of Quality Review Board, and Terms and Conditions of Service and Allowance of Chairpersons and Members of the Board, Rules, 2006.

The relevant legislations are given below:

THE COMPANY SECRETARIES (AMENDMENT) ACT, 2006

The below sections were inserted by the Company Secretaries (Amendment) Act, 2006 in the Company Secretaries Act, 1980.

Establishment of Quality Review Board (Section 29A)

1. The Central Government shall, by notification, constitute a Quality Review Board consisting of a Chairperson and four other members.
2. The Chairperson and members of the Board shall be appointed from amongst the persons of eminence having experience in the field of law, economics, business, finance or accountancy.
3. Two members of the Board shall be nominated by the Council and other two members shall be nominated by the Central Government.

Functions of Board (Section 29B)

The Board shall perform the following functions, namely: —

1. to make recommendations to the Council with regard to the quality of services provided by the members of the Institute;
2. to review the quality of services provided by the members of the Institute including secretarial Audit services; and
3. to guide the members of the Institute to improve the quality of services and adherence to the various statutory and other regulatory requirements.

Procedure of Board (Section 29C)

The Board shall meet at such time and place and follow in its meetings such procedure as may be specified.

Terms and conditions of service of Chairperson and members of Board and its expenditure (Section 29D)

1. The terms and conditions of service of the Chairperson and the members of the Board, and their allowances shall be such as may be specified.
2. The expenditure of the Board shall be borne by the Council.

QUALITY MANAGEMENT SYSTEM

Quality Assurance (QA) and Quality Control (QC) as both terms are the integral part of the quality management systems. For an effective operation, it is important to realies the differences between these terms.

Effective Quality Management Systems (QMS) contribute enormously to the success of a Practicing Unit, whereas when it is poorly understood, the QMS are likely to be weak and ineffective in ensuring the timely delivery and incompetent in satisfying the customer's requirements.

QUALITY ASSUARNCE

Quality Assurance is focused on planning, documenting and agreeing on a set of guidelines that are necessary to assure quality which are issued by the various regulators on time to time. One of the example for quality assurance is instruction kit of various e-forms, whereas the purpose of the Instruction kit is to provide guidance on the requirement of the form and to have correct record in place.

Normally the QA guideline provides Do's and Don'ts, instructions, verification methodology, possible errors and defect along with the remedial action required for the same.

The purpose of QA is to prevent defects from entering into system and In other words, QA is a pro-active management practice that is used to assure a stated level of quality in place.

The quality assurance could also be considered as a tool of risk mitigation. However, the effective communication between the Company, its directors KMP's, officers is very important to take informed decision and to take support and guidance from experts before taking and corporate Action, which may cause a risk to the company, its directors KMP,s Officers and Other stakeholders.

QUALITY CONTROL- DETECTION AND IMPROVEMENT

Quality Control can be referred as the examination of Output, Review of the work and assignment already taken place, on the various parameter like time involved, number of resubmission, deficiency, cost, manpower, expertise engaged etc. QC involves verification of output conformance to desired quality levels. This means to checked delivery against customer requirement.

Guide to Conduct Quality Review

The Quality Review is focused towards evaluation and review of quality of services rendered by members and adherence to various statutory and other regulatory requirements. It involves assessment of the work of the member while rendering professional services so as to enable QRB to assess:

(a) compliance with statutory and regulatory requirements;

(b) the quality control framework adopted by the member; and

(c) the quality of reporting.

Appointment of Quality Reviewers

- The Quality Reviewers are being appointed by the QRB on the basis of their experience in terms of seniority and the relevant work exposure.
- The eligibility conditions for empanelment of Quality Reviewers are as per the criteria mentioned in following para I or II

I. An individual desiring to be empanelled, shall:

(a) Be a Fellow member of ICSI; and

(b) Possess at least fifteen (15) years of post-membership experience as Company Secretary in Practice or employment in the Secretarial Department of a Company or as a combination of practice and employment in the Secretarial Department of a Company; and

(c) Be currently in practice of the profession of company secretaries.

'or'

II. An individual desiring to be empanelled shall:

(a) Be empanelled as Peer Reviewer in terms of the Guidelines for Peer Review of Attestation and Audit Services by Company Secretary in Practice and has completed minimum 5 assignments of Peer Review.

While only a Company Secretary in Practice fulfilling the eligibility criteria can be empanelled as Quality Reviewer, the other conditions to be fulfilled includes that the member shall not have been found guilty under the

Company Secretaries Act, 1980 or regulations made thereunder by Board of Discipline / Disciplinary Committee during the previous 5 years.

It is further noted that, for getting assignments the Quality Reviewers must have undergone training organized for the purpose by the Board from time to time.

Manner of Selecting Practice Units for Quality Review

The Board is empowered to decide the Practice Unit(s) to be reviewed. The selection of a Practice Unit for review is based on objective criteria as may be determined by the QRB.

Communication with Practice Unit under Review (PU)

On selection of a Practice Unit (PU) for review, intimation is sent regarding its selection with request to provide basic information related to the services rendered and other details.

Once the basic information is received from PU, the Quality Reviewer (QR) is assigned and the basic information of the PU is shared with the Reviewer. The Reviewer should send a communication to the PU specifying aspects such as:

- Date of commencement of the review;
- Expected date of completion of review;
- Documents required for review;
- Identification and contact details of the Reviewer;
- Composition of the review Team, if any; and
- Any other detail as may be required for the purpose of review.

It is also advisable that for a smooth conduct of the review, the Reviewer and the PU reach an understanding on the following matters:

- Details and duration of visit at the Office of PU so as to ensure minimum disruption to the PU. Main contact person/s in the PU for Reviewer's requirements relating to the review.
- Normal lead time required for production of documents, resolution of queries, etc.
- Logistical arrangements, as available within the PU, for conduct of review.
- Any other support/coordination required by Reviewer from PU and vice versa.
- The frequency and timing of communications related to issues or findings noted by the Reviewer.

Submission of Report

The Reviewer is required to submit a preliminary report within three weeks from the date of assignment to the Practice Unit on the review of the quality of audit and attestation services rendered by the Practice Unit.

Any observation indicating a non-compliance with the applicable technical standard(s) should be included in the preliminary report for seeking views / comments of PU thereon.

The Board may, upon request, extend the time limit for submission of preliminary review report. The Reviewer, based upon consideration of the responses received from Practice Unit on the preliminary report, shall issue the final report to the Board on the basis of his findings on the quality of services rendered by PU.

Consideration of the Reports of the Quality Review Board

The Quality Review Reports as submitted by Reviewer are considered by the Board. The Board on receiving final report from Reviewer may take any of the following actions:

- Consider and take on record of the report received;
- Issue instructions to the Practice Unit, wherever it is required;
- Ask for more clarifications from the Reviewer / Practice unit, as it may deem fit;
- Make recommendations to the Council with regard to the best practices to be adopted.

QUALITY CONTROL IN QUALITY REVIEW

Part – A relates to Expectations from Practice Unit; and

Part – B explains the major responsibility of the Quality Reviewers while conducting the review exercise.

Part – A :

Expectations from Practice Unit: The Regulators are reposing more faith on services of the professionals like ours. It is the responsibility of we professionals to maintain the recognition secured from the Regulators. For maintaining and enhancement of the standards of the quality of services rendered, a Practice Unit is expected to have a system of quality control in place.

(i) Leadership Responsibilities

- The firm should assign responsibility for each assignment to one of its partners or the team leader who shall be responsible for overall quality of such assignment.
- The proprietor / partner(s) of the PU shall be responsible for quality maintenance and quality improvement of which recommended features are:

  (i) Communication of the quality control policies and procedures to all team members / relevant personnel. The methods for communication, scope and frequency thereof should be established.

  (ii) Establishing a process that encourages personnel to communicate their views or concerns on quality control matters.

  (iii) Clearly establishing responsibilities of the proprietor / partner(s) of the PU and other senior personnel for quality control.

  (iv) Documenting quality control policies and procedures of the firm and its circulation to all relevant personnel.

(ii) Ethical requirements

- The proprietor, partner(s) or the team leader responsible for an assignment should ensure that the relevant personnel have complied with relevant ethical requirements.
- Ethical requirements include:

  Independence : The PU shall not try to acquire the assignments on the basis of personal relations with clients. Independence is required for fair dealing with the clients; otherwise the quality of services may be threatened.

  Familiarity Threat : A familiarity threat arises when, by virtue of a close or long-term relationship with a client, its directors, officers or employees, the PU or person on an engagement team may become too casual and sympathetic to the client's interests, compromising the quality of service and independence of the PU.

  Integrity : While carrying out the assignments, firm should ascertain the integrity aspects of the client. It is associated with soundness or moral principles and character in dealings with others.

  Objectivity : The test of objectivity shall be whether the professional assignments were carried out in

an impartial and fair manner without fear, favour or prejudice. The PU should base his assessment and opinion purely on facts, evidences, sound analysis and judgment.

Professional competence and due care : The PU shall have enough Professional competence to deal with the assignments. The PU shall ensure possession of appropriate qualifications, experience, ability of the personnel to whom responsibilities of an assignment is given.

Confidentiality : Confidentiality is the spirit of any profession and as a Company Secretary; complete confidentiality of information obtained during assignment is the basic requirement.

Professional conduct: Company Secretaries are looked upon as trustworthy guardians, caring for interest of all stakeholders, guides to corporate world in secretarial leadership. The professional conduct of the PU must also be illustrative.

Technical standards: The PU should be fully conversant with various pronouncements by the regulatory bodies and should keep updated with the technical standards which may be prescribed from time to time and applicable to the PU.

- **Human Resources:** Requirements, Training & Development In case of a professional firm, human resource is the prime asset responsible for success or failure of the firm. The constitution of the team and members which make the team is the major determinant in rendering the quality of professional services and hence, the recruitment of right person to the right place is the pre-requisite to deliver quality services to the clients.
- **Performance Evaluation**
  - Performance Evaluation is necessary for developing and maintaining competence and commitment to deliver quality services.
  - The PU shall make personnel aware of its expectations regarding performance
  - The PU shall have an established mechanism for evaluation of performance of its personnel.
- **Monitoring**
  - Monitoring refers to a process which is an ongoing exercise for evaluation of PU's quality control systems which also includes periodic inspection of completed assignments on sample basis to provide the PU with reasonable assurance that its quality control systems are operating effectively.
  - A PU shall monitor its personnel, performance procedures, system for reporting and soon as an ongoing exercise.

Part – B : Responsibility of the Quality Reviewer (QR)

A quality review is an engagement that needs to be carried out in a manner that ensures that the work performed by the Quality Reviewer and the review team meet the professional standards established by ICSI. Any shortcomings in the quality of the Review process would defeat the very purpose of the process of the quality review established by the Quality Review Board. It is, therefore, of utmost importance that ensuring quality in an assignment given by the Board, remains priority for a Quality Reviewer. The quality of a Review is directly affected by factors such as:

- Knowledge and experience of the Quality Reviewer and his team
- Time devotion
- Composition of the Review team
- Understanding of the objective and scope of work
- Monitoring, direction and supervision of the Review team In fact, maintaining the quality in a Review as also the final report of the Review, is and remains the responsibility of the Quality Reviewer.

Planning the Quality Review

A well planned review engagement ensures that a review is performed in an effective manner. It involves establishing the overall strategy for the review and developing the review plan. A well planned review helps the reviewer to, interalia:

- Devote appropriate attention to important areas of review;
- Identify and resolve problems on timely basis;
- Facilitate direction and supervision of the team members and their work.

The nature and extent of the planning required for a review will vary according to the size of the PU, nature and complexity of the quality control system in PU and the engagements under review, the experience and competence of the review team and any changes that may occur subsequently in the circumstances of the review.

The initial planning activities relating to the review would include:

- Performing procedures regarding the acceptance of the review assignment;
- Evaluating compliance with independence requirements;
- Establishing an understanding of the terms of the assignment.

The Reviewer should establish an overall review strategy that would set the scope, timing and direction of the Quality Reviewer, and guide the development of plan to conduct the quality review. In establishing the overall review strategy, the Reviewer needs to consider the following:

- Characteristics of the review assignment that would determine the scope of the review, viz., evaluation of design and implementation of systems and evaluation of compliances;
- Reporting objectives of the review, to plan the timing of the review and the nature of the communication required with the PU;
- Factors that, in the Reviewer's judgment, are significant in directing the review team's efforts; and
- Ascertain the nature, timing and extent of resources necessary to perform the review assignment.

Since quality review is essentially an "on-site" engagement, it is important that the on-site visit to the PU is also properly planned.

This planning would include:

- Preparing the checklists of the activities during review process.
- Preparing a list of documents that would be required from PU for quality review.
- Coordinating with the PU as to the timing of the visit and the authorised coordinating person/s at PU so as to ensure minimum disruption to the PU.

CONDUCTING THE QUALITY REVIEW

The Quality Reviewer is responsible to design such procedures as may be appropriate to obtain evidence to support the conclusion in the quality review report to be issued pursuant to the quality review. As per the illustrative reporting format issued by the Board, the Reviewer is required to examine the procedures and implementation thereof in the Practice Unit being reviewed, for ensuring:

(a) Compliance with ICSI Guidance on Office Administration and Systems in the Office of PCS, ICSI Auditing Standards, Guidance Notes, Manuals, Referencers and advisories issued by the Institute; and

(b) Implementation of a system of controls with reference to the applicable standards.

Based on the procedures performed during the review, the Reviewer also concludes to the effect that nothing has come to the notice of the Reviewer's attention that causes the Reviewer to believe that the PU has not complied with the applicable ICSI Guidelines, other laws and regulations.

A quality review of the services rendered by the PU in terms of the 'Terms of Reference for Quality Reviewers' issued by the QRB and as amended from time to time ("the Procedures") involves interviewing, making enquiries and performing such other procedures to examine whether the PU has complied with the ICSI Guidelines relating to the services rendered, the professional and other standards as issued by the Institute of Company Secretaries of India (ICSI) and considered relevant laws and regulations. It also includes review of the system of quality control which the PU has implemented. The policies and procedures of the PU under review can be examined with reference to the specific engagement.

Obtaining an Understanding of the Engagement

In order to achieve the objectives of the review, the Quality Reviewer, should, prior to commencement of on-site review:

(a) go through the questionnaire as submitted by Practice Unit in respect of which review has been initiated for the period under review and ask for further information, which could enhance understanding of the systems and procedures followed by PU; and

(b) obtain the relevant knowledge in which the Practice Unit has rendered services, including the applicable laws and regulations, during the period to which the audit and attestation engagement relates.

PU's Responses to the Quality Review Questionnaire

QRB has developed Quality Review Questionnaire for use by Quality Reviewer. The Questionnaire work as an aid for the Quality Reviewer and contain questions relevant for determining compliance with the requirements of the ICSI Guidelines and the system and procedures followed by PU.

PUs are also required to submit their responses to each of the questions given in the Quality Review Questionnaire. Prior to commencement of on-site review, Quality Reviewer must obtain the responses from PU for each of the question.

Obtaining an Understanding of the Practice Unit

Prior to the commencement of the review, it is important for the Reviewer to obtain an understanding of the PU. This involves obtaining an understanding of the aspects including:

(a) Size of the practice;

(b) Legal form (CP holder/sole proprietorship/partnership/LLP);

(c) Service verticals within the PU;

(d) Geographical spread of PU;

(e) Governance structure in the PU, with respective roles and responsibilities of the partners and other staff;

(f) Policies and procedures designed and implemented by PU to ensure compliance;

(g) The methodology being used by the PU.

While Reviewer can obtain the understanding of the PU either on site or prior to commencement of the review, it is recommended that the relevant inquiries in this regard are made prior to the commencement of the on site review.

While preparing the quality review documentation, the Reviewer, therefore, may have regard to the aspects such as:

a) reference to the source of the general and internal control;

b) if procedures were implemented, then a walk through, if any, performed to determine implementation;

c) in respect of the concerned assignment, a reference to the relevant working papers;

d) matters examined; and

e) conclusions reached (duly supported with the basis of conclusion).

Evaluating the Findings of Quality Review

The Reviewer is responsible to evaluate whether the evidence obtained during the review is sufficient to support the report to be issued pursuant to the review engagement.

The review may indicate (a) deficiencies in the policies and procedures instituted by the PU; or (b) the procedures performed by the PU were not designed or performed appropriately to provide it with sufficient appropriate evidence that the PU has compiled with the applicable technical standards; or (c) deficiencies in the procedures performed by PU to ensure that the services rendered by the PU were appropriate in the circumstances.

As and when the Reviewer has collated the findings which are required to be evaluated, they should communicate those findings to the PU and allow reasonable time to respond to the queries. It is essential for the review team to consider the information and explanations made available by the PU in response to the findings.

The presence of one or more of the following events would indicate possibility of existence of a material deficiency in policies/ procedures:

(a) Identification of non-compliances, whether or not material, on the part of the senior management of PU;

(b) Non-compliances with the established policies/procedures in previous periods;

(c) Identification by the review team of a material noncompliance in the current period in the circumstances that indicate the non- compliance would not have been detected by the PU's systems of control; and

(d) Ineffective oversight by the senior management of the PU's external reporting on compliances with all or some elements of the systems of control.

It may be noted that the above is only an inclusive list of such events.

Documenting a Finding

The Reviewer should give attention to the manner in which a finding is documented. The Reviewer should ensure that each of the documented finding has the following characteristics:

(a) All relevant facts and background information necessary to understand the finding or the issue being raised by the Quality Reviewer are present;

(b) Requirements of the ICSI Guidelines or other relevant laws/regulations that have not been complied with;

(c) Factors mitigating the effect of the finding, if any;

(d) Explanations/responses provided by the PU; and

(e) Conclusions reached by the Quality Reviewer.

It has been observed that sometimes there is an inconsistency between the findings reported by the Quality Reviewer and the responses given by the PU on the engagement documentation available with the PU. In order to avoid any such situation, the Reviewer and the PU should discuss all the issues, make note of all the documentation and working papers available with the PU and also minute the discussion which may be signed by both the Reviewer and the PU.

REPORTING

The Reviewer, after completion of the review, is required to submit a preliminary report to the PU, on the review of the quality of professional services rendered by the PU, within three weeks from the date of assignment. This preliminary report is to be submitted before submitting the final report to the QRB. It is suggested that any observation indicating a non-compliance with the technical standard(s), as applicable, should also be included in the preliminary report for seeking final views/comments of PU thereon. The Reviewer, based upon his consideration of the responses received from the PU, shall submit a final report to the QRB within a period of three months from the date of assignment by the Quality Review Board.

The Quality Reviewers at the time of acceptance of the assignment are required to give an undertaking that they will conduct the review and submit report(s) within the stipulated timeframe.

The Reviewer should adhere to all the prescribed requirements mentioned while preparing the report. It may be noted that the requirements mentioned apply to the preliminary as well as the final reports of the Reviewer. The Reviewer, based on the conclusions drawn from the review, would issue a preliminary report and, subsequently, the final report. A clean final report indicates that the Reviewer is of the view that the affairs are being conducted in a manner that ensures the quality of services rendered. However, a Reviewer may qualify the report due to one or more of the following in respect of the particular engagement:-

- non-compliance with ICSI Guidance on Office Administration and Systems in the Office of PCS, ICSI Auditing Standards, Guidance Notes, Manuals, Referencers and advisories issued by the Institute;
- non-compliance with relevant laws and regulations;
- quality control system design deficiency;
- non-compliance with policies and procedures; or
- non-existence of adequate training and capacity building programmes for self and staff.

Cost of the Quality Review

The Quality Review Board shall pay to the Quality Reviewer a fee of Rs. 25,000/- per quality review subject to submission of satisfactory Quality Review Report. The Quality Reviewer shall bear the cost of local transport, food, communications, printing, cost of submission of report etc. (for Quality Review Assignments within or under the radius of 50 Kms. of the city of residence of Reviewer);

In case the Quality Review Assignment is beyond 50 Kms. of the city of residence of Reviewer, the Quality Reviewer shall be reimbursed over and above the fee of Rs.25,000/-, cost of to and fro travel to the station nearest to the Practice Unit subjected to Quality Review from the place of his residence, accommodation and other expenses in accordance with the travel policy approved by the Board.

CASE STUDIES

1. Mr. X has reviewed M/s. ABC & Co. having three partners Mr. A, Mr. B and Mr. C. Neither Mr. A, Mr. B nor Mr. C will be able to do review of Mr. X. same is the case with Sole Proprietor / members practicing in Individual capacity.
2. If the client of M/s XYZ ask Board to get the Practice Unit Peer Reviewed and then in this case cost of Peer Review shall be borne by the client .
3. Mr. R (Peer Reviewer) received a Peer Review Assignment then in this case he can also refuse to accept / perform the Peer Review assignment after giving a valid reason to the Board.

   The refusal of assignments can be made on the following grounds:

   – Conflict of Interest between the Reviewer and PU

– Ill Health

– Other work or pre-occupations

– Reviewer feels that he cannot act independently in that Firm/or with Reviewee due to past connections or so.

4. Mr. Q (Peer Reviewer) received a Peer Review Assignment in this case he shall be allowed to take assistance from any one Qualified Assistant. The Qualified Assistant should be member of the Institute and has undergone adequate training in the manner considered appropriate by the Board in terms of clause 15.1 of the Guidelines.

5. Mr. X has reviewed M/s. ABC & Co. having three partners Mr. A, Mr. B and Mr. C . Mr. X shall be bound by Confidentiality Agreement with the Peer Review Board. If the Reviewer misuses the information disclosed by PU, he may be subject to disciplinary action by the Institute.

CASE STUDIES

1. Can M/s PQR & Co. choose its Peer Reviewer?

Answer: The Peer Review Board would send a panel of at least three reviewers and PU may choose any one name out of the panel sent to PU.

2. If M/s XYZ Associates is not satisfied with the order of the Peer Review Board then what remedy be available in this case?

Answer: It can appeal against the Order of the Peer Review Board to the Central Council of the ICSI.

3. If Mr. A is an empanelled as a Reviewer with ICSI will definitely allotted Review work to him?

Answer: No, because selection of Reviewer also depends on various other factors like experience, choices made by the PU, etc.

4. If Mr. P is an empanelled as a Reviewer with ICSI will be exposed to any liability?

Answer: The reviewer, by virtue of carrying out the peer review shall not incur any liability other than the liability arising out of his own conduct under the Code of Conduct under the Company Secretaries Act, 1980 and Regulations framed thereunder as well as under the relevant clauses of these Guidelines.

5. The information disclosed by M/S PQR & Co. be kept confidential by the reviewer?

Answer. The Peer Reviewer is bound by Confidentiality Agreement with the Peer Review Board. If the Reviewer misuses the information disclosed by PU, he may be subject to disciplinary action by the ICSI.

LESSON ROUND-UP

- "Peer Review" is mainly a self-improvement process and is a method of evaluation of a person's work or performance, by a person or group of people, in the same occupation, profession, or industry.
- A Peer Review examines whether a Practice Unit has adequate policies and procedures (including documentation systems) in place to comply with the Technical Standards of ICSI and other legal requirements for maintaining the quality of the Services/ work they perform.
- To be empanelled as Peer Reviewer, an individual shall–

  (a) be a member with at least 10 years of post-qualification experience as Company Secretary of which not less than 5 years should be as a company secretary in practice;

  (b) be currently holding Certificate of Practice as issued by the Institute;

(c) have undergone the Training Programme for Peer Reviewers and qualified the Certification

Programme for Peer Reviewers organized by the Institute; Further to be empanelled as Peer Reviewer, a member shall not have: -

(a) disciplinary action / proceedings pending against him during the past 3 years;

(b) been found guilty of professional or other misconduct by the Committee of Discipline / Disciplinary Committee, at any time, as the case may be;

(c) been convicted by a Competent Court whether within or outside India, of an offence involving moral turpitude and punishable with imprisonment;

- Peer Review Certificate shall be five years from the date of issue. Provided that the Board may suo motu or otherwise at the request of the Practice Unit, initiate the Peer Review process even before the expiry of the validity of the Peer Review Certificate. Further, in case the PU is reviewed within two years of its formation, the validity of the Peer Review Certificate shall be for two years.
- Quality Review Board (QRB) has been set up to review and enhance the quality of the services rendered by the members of the ICSI. The Board aims to standardize the practices followed by the Company Secretaries and enhance the quality of the services rendered by the members of ICSI on continuous basis.

GLOSSARY

- **Professional Peer Review :** Professional Peer Review focuses on the performance of professionals, with a view to improving quality, upholding standards, or providing certification.
- **Peer Review Board** : means the Board constituted by the Council in terms of the Statement from time to time.
- **Composition of Peer Review Board :** Composition of Peer Review Committee shall consist of Not less than seven members to be appointed by the Council, of whom at least four shall be from amongst the Members of the Council of ICSI.
- **Peer Review Manual :** Manual as prescribed & issued by ICSI for Peer Review.
- **Quality Review Board (QRB):** Quality Review Board (QRB) is constituted by Government of India in exercise of the powers conferred by Section 29 A of the Company Secretaries Act, 1980 (56 of 1980) read with rules
- 8, 9 and 10 of the Company Secretaries Procedures of Meetings of Quality Review Board, and Terms and Conditions of Service and Allowances of the Chairperson and Members of the Board Rules, 2006.
- **Functions of Board Quality Review Board (QRB) :** Functions of Quality Review Board (QRB) shall be as specified under Section 29B of the Company Secretaries Act, 1980:

  The Board shall perform the following functions, namely: —

  1. to make recommendations to the Council with regard to the quality of services provided by the members of the Institute;
  2. to review the quality of services provided by the members of the Institute including secretarial Audit services; and
  3. to guide the members of the Institute to improve the quality of services and adherence to the various statutory and other regulatory requirements.

TEST YOURSELF

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation).

1. ''The Peer reviewer is expected to examine the office systems and procedures with regard to compliance of attestation services provided by a practice unit.'' Comment.
2. Explain "Statement of Confidentiality" in Peer Review in detail. Who is required to file it and what are the consequences of non-compliance in this regard ?
3. What types of information with respect to 'Maintenance of Professional Skills and Standards' are sought by Quality Review Board during the peer review of Practicing Company Secretary/Firm?
4. ''The methodological approach involved in peer review can be described in four stages''. Explain the planning process of the peer review.
5. ''A Peer Reviewer has to report under certain guidelines as prescribed by ICSI. The reporting is to done in three different forms''. Discuss in brief the statement as given in the guidelines.
6. What are the benefits of Peer Review?
7. Describe the Scope of Peer Review.
8. Who can be empanelled as Peer Reviewer?
9. What is the Process for Peer Review?
10. Define Quality Review Board (QRB).
11. What are the Objectives of Quality Review Board (QRB)?

LIST OF FURTHER READINGS

1. ICSI Peer Review Manual
2. Guide to conduct Quality review.

OTHER REFERENCES (Including Websites/ Video Links)

- https://www.icsi.edu/media/webmodules/Peer_Review_Manual_Final_051119.pdf
- https://www.icsi.edu/prb/guidelines-peer-review/
- https://www.icsi.edu/media/webmodules/PRB/FAQs_on_Peer_Review.pdf
- https://www.icsi.edu/prb/procedure/
- https://www.icsi.edu/media/webmodules/PRB/For%20empanelment.pdf

Due Diligence

Lesson 16

KEY CONCEPTS

■ Due diligence ■ Risk assessment ■ Pre diligence ■ Post Diligence ■ Non-Disclosure Agreement ■ Legal Due diligence ■ Due Diligence Techniques

Learning Objectives

To understand:

- Concept of Due diligence
- Objectives of Due Diligence
- Need of Due Diligence
- Scope of Due Diligence
- Advantages of Due Diligence
- Process and stages of Due Diligence
- Techniques of Due Diligence and Risk Assessment
- Types of Due Diligence

Lesson Outline

- Overview of Due Diligence
- Stages/Process of Due Diligence
- Legal Due Diligence
- Financial Due Diligence
- Bank Due Diligence
- Due Diligence for Takeover
- Due Diligence for Labour Laws
- FEMA Due Diligence
- FCRA Due Diligence
- Various other types of Due Diligence
- Bank Due Diligence
- Non-Disclosure Agreement
- Lesson Round-Up
- Glossary
- Test Yourself
- List of Further Readings
- Other References (Including Websites/ Video Links)

REGULATORY FRAMEWORK

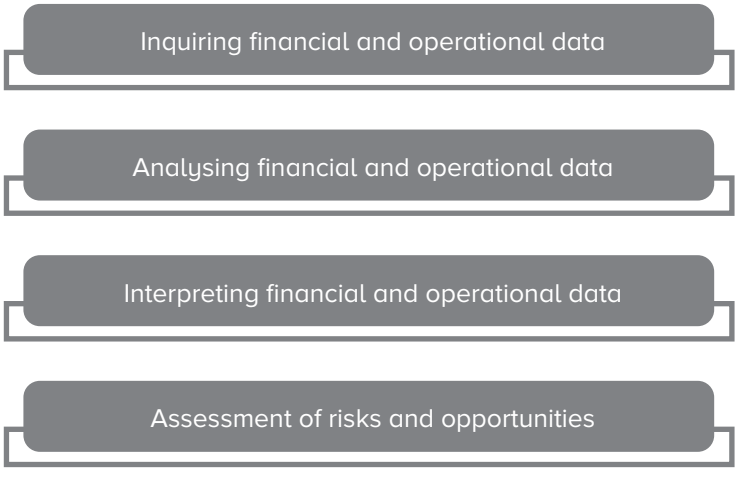
- SEBI (SAST) Regulations, 2011
- Foreign Contribution (Regulation) Act, 2010
- Foreign Contribution (Regulation) Rules, 2011
- Foreign Exchange Management Act, 1999

OVERVIEW AND INTRODUCTION: DUE DILIGENCE

Due diligence refers to investigation into the affairs of an entity prior to its acquisition, restructuring, fund raising or other similar transaction. Due Diligence is not restricted to check the facts but also to evaluate, interpret and communicate the facts so as to ensure that prospective investors make an informed investment decision. It is process of gathering information about the target company, its business and the environment in which it operates.

> "Due diligence" is an analysis and risk assessment of an impending business transaction. It is the careful and methodological investigation of a business or persons, or the performance of an act with a certain standard of care to ensure that information is accurate, and to uncover information that may affect the outcome of the transaction.

A Due diligence is an interactive process that includes:



As a part of the business strategy, the Companies before making any relationship with the other party conduct the background checks of the client, customer, supplier etc. to ensure that the parties to the transaction have the disclosed the information as required to proceed with the transaction and is a process to completely understand a business capability and its past performance.

CASE STUDIES

In 1998, a German company Daimler Benz merged with Chrysler Group for a value of $36 billion. However, the merger was not successful and the value of Chrysler fell to $7.4 billion after a couple of years. According to various experts, Daimler failed to conduct a proper due diligence process which resulted in over-valuation of the target company.

Bank of America and Countrywide (2008): US$2 billion

When Bank of America acquired Countrywide at the beginning of 2008 for a price of "just" **US$2 billion**, many thought it was a shrewd investment.

Even though every economic indicator in the United States was already pointing downward, the deal in theory stood to combine the country's biggest retail bank with its biggest mortgage provider.

This does have a ring to it. The issue is that what constituted '**mortgage**' in the first decade of the 21st century in the United States was yet to become apparent.

Bank of America had basically acquired bad debt for **US$2 billion**. It ultimately ended up paying **US$50 billion** for the acquisition, **making one wonder where the financial due diligence was when it was needed most.**

Source: https://dealroom.net/blog/biggest-mergers-and-acquisitions-failures

While exploring any business opportunity, it is the foremost requirement for a corporate to investigate and evaluate the potential and risk associated with such business. The due diligence covers the activities relating to pre-transaction, during the transaction and post transaction exercise with all relevant aspects of the past, present, and predictable future of the any business.

After the conduct of the due diligence, a due diligence report prepared to provide information and insight on various aspects such as the risks of a transaction, the value at which a transaction should be undertaken, the warranties and indemnities that needs to be obtained from the vendor etc.

In any transaction, the seller does investigation of a buyer to ensure that the buyer has adequate resources to complete the transaction, as well as other business aspect covering the technical and human resource, cultural, taxation etc. which would affect the company after entering into the transaction. The chapter covers the various types of due diligence performed by the company on voluntarily and for entering to the any business transaction or before going for any corporate action relating to the merger, de-merger, amalgamation, take over, joint venture etc.

CASE STUDIES

Amazon began due diligence to buy MX Player

In March 2023, Amazon.com Inc. made advanced talks to acquire MX Player, the video streaming platform owned by Times Internet. Amazon owns the subscription streaming service Prime Video and an ad-supported MiniTV service in India. Amazon launched the free MiniTV service in May 2021 within the Amazon shopping app for phone users.

In 2018, Bennett Coleman & Co Ltd (BCCL)-owned Times Internet, acquired MX Player for ₹1,000 crore (around $140 million at that time) to mark its entry into video streaming.

The US e-commerce giant has hired one of the Big Four accounting firms to carry out due diligence of MX Player exclusively, and the process is expected to take 30-40 days. As per the anticipations of experts, a deal could happen within two months if all goes well.

Earlier, Times Internet was asking for over $100 million for MX Player, while Amazon's internal team valued it at around Rs.500 crore ($60 million). The deal is likely to be in the range of Rs.600-900 crore.

(Source: *https://www.livemint.com/companies/news/amazon-begins-due-diligence-to-buy-mx-player-11679247835309.html)*

Mukesh Ambani-controlled Reliance Industries and New York Stock Exchange-listed Walt Disney have reportedly appointed law firms and started antitrust due diligence of their planned mega media and entertainment merger. t, Reliance has appointed law firm Khaitan & Co and Shardul Amarchand Mangaldas, while Disney has roped in AZB & Partners.

The Reliance and Disney merger, would bring together two streaming services and 120 television channels and create an entertainment superpower.

Source: *https://www.businesstoday.in/latest/corporate/story/reliance-industries-disney-start-antitrust-diligence-on-media-merger-report-411900-2024-01-04*

KEY POINTS DESCRIBING DUE DILIGENCE

- It is not limited to accounting analysis but has a business oriented approach;
- It analysis the information on the basis of the actual facts;
- Considers the industry of the target company;
- Examines the business affairs having a significant impact on the prospects of the business;
- Explores significant business practices and business models;
- Examination of relevant aspects of the past, present and near future of the business;
- Assesses the advantages and risks associated with a particular transaction.

CASE STUDIES

- In September 2008, UAE based Etisalat acquired 45% stake in the Indian telecom operator Swan Telecom (renamed as Etisalat DB) for $900 million. A year later, the Supreme Court of India revoked 2G licences awarded to Swan Telecom due to impropriety in obtaining the licences. The due diligence process carried out by Etisalat failed to detect any impropriety in obtaining telecom licenses. Etisalat faced significant financial
- losses of upto 827 million dollars and later took an exit from the company. Thereafter, Etisalat issued legal proceedings against the promoters of Swan Telecom (renamed as Etisalat DB) on the grounds of fraud and misrepresentation.

In a setback to Nirma, the Supreme Court dismissed its appeal against a Securities Appellate Tribunal (SAT) decision which upheld SEBI's order rejecting the company's request for withdrawal of the open offer for Shree Rama Multi Tech, an Ahmedabad-based packaging firm, whose pledged shares the detergents maker had invoked.

Nirma has to complete the open offer for Shree Rama Multi Tech for a minimum price of Rs 18.60 per share. Shares of Shree Rama Multi-Tech surged 20% to close at Rs 5.74 as there were no sellers, only buyers.

Nirma approached Supreme Court after SAT upheld the SEBI order in which the market regulator refused to allow Nirma to withdraw the open offer for the shares of Shree Rama Multi-Tech.

Nirma invoked the pledged shares of Shree Rama Multi Tech in 2005 after the latter defaulted in payment. This has resulted in Nirma Group's stake increasing to 24.25% triggering the mandatory open offer. In keeping with the takeover code the company came out with an open offer to acquire a further 20% in Shree Rama Multi-tech.

However, later, Nirma wanted to revise the offer as the market price of the stock was much below its offer price. But SEBI did not approve the revision. Subsequently, Nirma applied to SEBI for a withdrawal of the open offer as they alleged that the erstwhile promoters of Rama Multi Tech had siphoned off funds from the company and that this came to light only after the public announcement for the open offer was made.

But, SEBI refused to accept the circumstances and pointed out that Nirma should have done their due diligence before invoking the pledge and should not have acquired the shares if the circumstances so warranted. The SC directed Nirma to complete its open offer.

Read more at: *https://economictimes.indiatimes.com/supreme-court-dismisses-nirmas-appeal-against-sat-decision/articleshow/19974110.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst*

OBJECTIVES OF DUE DILIGENCE

The objective of due diligence is to verify the strategic identification or attractiveness of the target company, valuation, risk associated etc. The objective of due diligence may be to:

Generally, the SWOT analysis of any business carried out as a part of due diligence to reveal the strengths and weaknesses of not only the financials but also intangibles. To perform effectively, the potential buyer needs to be clear about the goals and motives for acquiring the target company, as well as the value the buyer is attempting to create with the purchase. For example, if there is a legal risk, such as an outstanding lawsuit, that will not only jeopardize the financial stability of the company but also the loyalty of existing customers. This will erode the target company's market of customers by a new and stronger competitor. The target company's talent is the asset desired, and much of this depends on employee relations and accordingly cultural issues have to be addressed in time.

A thorough due diligence helps to reveal any of the negatives, but the process of due diligence rarely goes smoothly because of one major stumbling block and that is availability of information. The target company is rarely eager to reveal to the other party that it is up for sale and wants to keep this information confidential from its competitors, customers and employees. So getting any information from these sources can be tricky, depending upon what the potential buyer wants to gain from the transaction. The buyer who aims to get new market of customers with the transaction wants to make sure that the target company has a good relationship with existing customers. But, during due diligence, the target company does not want any contact with its existing customers for fear that customers might leave because of the impending sale. As another example, a potential buyer sees the employee talent as the company's main asset, but the target company is nervous about letting the potential buyer talk to key employees because it does not want to let them know that it is going to be sold. Because of the confidential nature of transactions, not all the information that is necessary to make a good decision can be revealed. This is why services of experts are hired in due diligence before beginning the process so the buyer receives reliable guidance. Further, it is also critical to meet with trusted advisors - both inside and outside

Transactions that require proper Due Diligence:

- Joint Enterprise Collaborations;
- Partnerships;
- Mergers and Acquisitions;
- Strategic Alliance;
- Business Coalition;
- Outsourcing Agreement;
- Technology or Product Licensing;
- Joint venture through
  - Technical or Financial Collaboration;
  - Venture Capital Investment;
  - Public Issue etc.

about what has been discovered and brainstorm the different scenarios of what can go wrong before going ahead with the deal.

Once a purchase price is agreed upon, the prospective buyer usually enters into a conditional agreement with a due diligence clause with the target business, in which the buyer has a limited period to conduct due diligence. During this time, the potential buyer requests full access to all relevant materials in the target business, customer, vendor, financial and other information in order to conduct a thorough investigation. Here, it is to be ensured that the potential buyer does not use this information for its own benefit if it decides to back out of the deal, hence a confidentiality agreement is usually signed to protect the target businesses' interests. But a possibility of re-negotiation of the purchase price or cancellation of the agreement on the part of buyer is seen if the information found is not acceptable to the potential buyer. Again after due diligence, the goal is to either reaffirm the purchase price or renegotiate, depending on what was discovered under Due diligence. But the ultimate goal is to make a rational decision based on the facts.

CASE STUDIES

PhonePe's due diligence on ZestMoney was unsatisfactory

Recently, in April 2023 the Walmart-backed PhonePe has called off its deal with Zest Money over due diligence concerns. The due diligence that PhonePe carried for nearly six months while evaluating the much-anticipated acquisition of ZestMoney did not meet its bar.

ZestMoney facilitates Buy Now Pay Later (BNPL) loans by disbursing the purchase amount from the lending partner directly to the merchant, allowing the customer to repay the lender in installments. PhonePe initiated talks to acquire ZestMoney to bolster its digital lending forays.

(Source: *https://www.moneycontrol.com/news/business/startup/due-diligence-deal-did-not-meet-our-bar-phonepes-sameer-nigam-on-why-the-zestmoney-deal-fell-through-10361941.html*)

Hindustan Motors, European partner complete due diligence for EV project

In October 2022, Hindustan Motors Ltd and its European partner have completed due diligence for the proposed electric two-wheeler project. The Joint Venture (JV) is likely to launch the electric vehicles in the next financial year at Hindustan Motors' Uttarpara plant in West Bengal.

According to the company's statement, after the formation of JV, around six months are required to start a pilot run. The structure of the JV is being finalised, including the proportion of equity to be held by the partners.

NEED FOR DUE DILIGENCE

- To confirm that the business is what as it appears;
- To create a trust between two unrelated parties;
- To access the risks and opportunities of a proposed transaction;
- To reduce the risk of post transaction;
- To investigate into the affairs of business as a prudent business person;
- To confirm all material facts related to the business;
- Representation & warranties for indemnification;
- Negotiation price concessions;
- To verify that the transaction complies with investment or acquisition criteria;
- To investigate & evaluate a business opportunity;

- To determine compliance with relevant laws and disclose any regulatory restrictions on the proposed transaction;
- To evaluate the condition of the physical plant and equipment; as well as other tangible and intangible assets;
- To ascertain the appropriate purchase price and the method of payment;
- To determine details that may be relevant to the drafting of the acquisition agreement.
- To discover liabilities or risks that may be deal-breakers;
- To analyze any potential antitrust issues that may prohibit the proposed M&A;
- To evaluate the legal and financial risks of the transaction.

CASE STUDIES

1. *Bharti – Zain Deal*

   Airtel acquired Zain a Kuwait based telecom company's assets in Africa's 15 countries. The company suffered low EBITDA even after 5 years. Various reasons like Africa's economy contributed to the failure of the acquisition. The due diligence of Bharti lacked somewhere to appreciate and identify the risks of failure in this acquisition. A comprehensive and complete due diligence could have placed Bharti Airtel in a better position.

2. *In Satyam Fraud case*, Accounting regulator ICAI's probe panel has hit out at banks for not doing due diligence on Satyam Computer Services before giving loans. The banks that gave loans to Satyam during 2000-08, despite the company claiming huge surpluses, were HDFC Bank (Rs 530 crore), Citibank (Rs 223.87 crore) Citicorp Finance (Rs 222.28 crore), ICICI Bank (Rs 40 crore) and BNP Paribas (Rs 20 crore), totalling Rs 1,221.16 crore.

SEBI Penalised 5 Ex-directors of Bombay Dyeing, Others over Alleged Due Diligence Lapses

The Securities and Exchange Board of India (SEBI) has penalised five former independent directors of Bombay Dyeing and Manufacturing Company (BDMCL) with a total fine of Rs59 lakh for alleged failure to carry out adequate due diligence and exercise independent judgement as members of the audit committee.

(Source: https://www.moneylife.in/article/sebi-penalises-5-ex-directors-of-bombay-dyeing-others-over-alleged-due-diligence-lapses/68779.html)

SCOPE OF DUE DILIGENCE

Due diligence is generally understood by the legal, financial and business communities/ potential investors to mean the disclosure and assimilation of public and proprietary information related to the assets and liabilities of the business being acquired. This information includes financial, human resources, tax, environmental, legal matters, intellectual property matters etc.

Scope of due diligence is transaction based and is depending on the needs of the people who are involved in the potential investments, in addressing key uncovered issues, areas of concern/ threat and in identifying additional opportunities.

Due diligence would include thorough understanding of all the obligations of the target company: debts, rights and obligations, pending and potential lawsuits, leases, warranties, all high and impact laden contracts - both inter-corporate and intra-corporate.

The investigation or inspection would cover below mentioned aspects:

- To determine tax structure and its implications;
- To assist in determining the final value of financial investment;
- To determine overvalued assets or under recorded liabilities, hidden assets or liabilities;
- Ensuring the all applicable law compliances;
- Ascertaining the penalties in case of non- compliances of statutory laws applicable to the company;
- Assessing the quality of management and identification of key employees of the Target Company;
- To assess the commercial and technical feasibility;
- To assess the resource availability of the business;
- To synergise between the organisations (In case acquirer company and target company);
- Litigation and assessment of feasibility of pursuing litigation;
- Financial statements;
- Assets - real and intellectual property, brand value etc.;
- Unpaid tax liens and/or judgments;
- Past business failures and consequential debt;
- Exaggerated credentials/Fraudulent claims;
- Misrepresentations or character issues;
- Cross-border issues - double taxation, foreign exchange fluctuation, sovereign risk, investment climate, cultural aspects.
- Reputation, goodwill and other intangible assets.

Silicon Valley Case Study

Silicon Valley has gained a reputation for being home to numerous "unicorn" companies, startups valued at over $1 billion. While these companies may appear to be the future of tech innovation, they often have inflated valuations that are not supported by their financial performance. This is partly due to a lack of due diligence from investors who are eager to get in on the ground floor of the next big thing.

Due diligence is the process of conducting a thorough investigation into a company's financial, legal, and operational status before investing in it. It helps investors assess the risks and potential returns of a potential investment, as well as identify any red flags that may indicate fraud or mismanagement. Despite its importance, many investors in Silicon Valley have been criticized for neglecting due diligence in their eagerness to invest in the next "unicorn" startup.

Through this case the importance of due diligence is re-iterated. Proper due diligence can help investors make informed decisions and avoid costly mistakes, leading to more sustainable growth and long-term success.

(Source: https://businesscloud.co.uk/news/how-silicon-valley-is-suffering-due-to-a-lack-of-due-diligence-from-investors/)

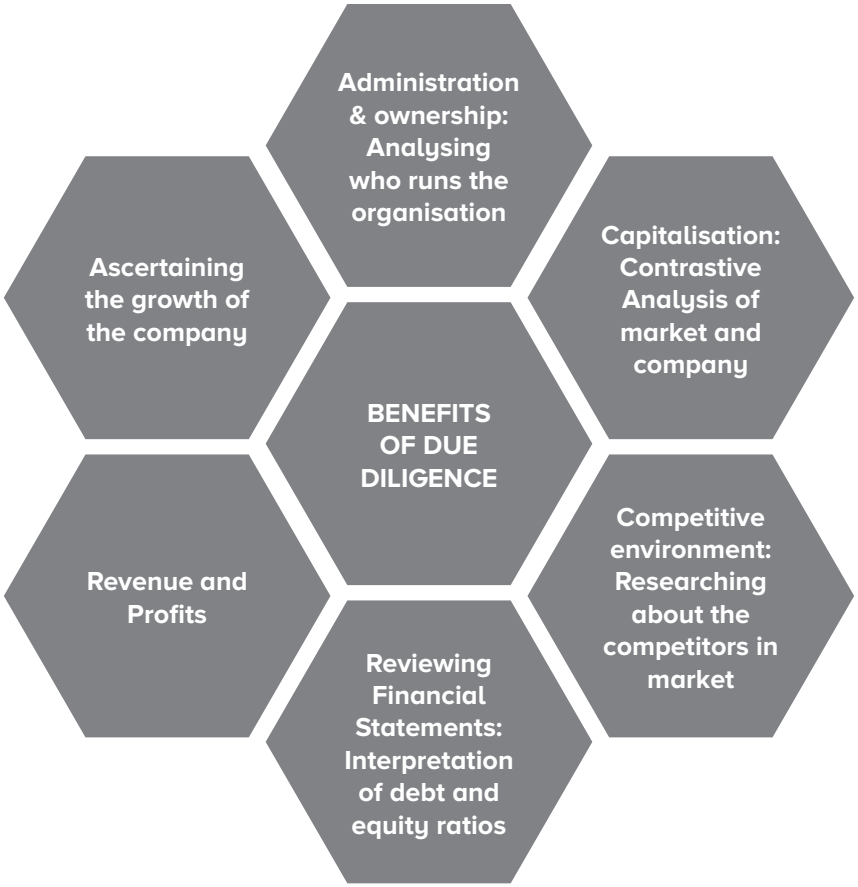
In 2011, US based company, Hewlett-Packard carried out only six hours of due diligence on the finances of the British software company Autonomy before buying it for £8bn, in a deal that ended in disaster and a $5bn (£3.8bn) fraud case. HP failed to notice the accounting improprieties during the due diligence process and was sued by its shareholders for negligence in missing red flags and not performing adequate due diligence related to Autonomy purchase. The former CFO Cathie Lesjak of HP later admitted that not only did she never read the preliminary due diligence report prepared by accounting firm KPMG, no further due diligence was conducted.

Source: *https://blog.ipleaders.in/consequences-inadequate-due-diligence-processes/*

In June 2008, Japanese company Daiichi Sankyo paid $4.6 billion and acquired a 64% state in Indian drug making company Ranbaxy Laboratories Limited. After a couple of months, the United States Federal Drug Administration (USFDA) banned 30 generic drugs manufactured from three of Ranbaxy's units in India citing gross violation of approved manufacturing norms, forgery of documents and fraudulent practice. Daiichi initiated legal proceedings against the former promoters of Ranbaxy for allegedly concealing facts and supressing regulatory issues with USFDA during the due diligence process. In 2016, Singapore arbitration tribunal ordered the promoters to pay around $525 million to Daiichi in damages on grounds of fraudulent misrepresentation and concealment of material facts. The arbitral award was later upheld by the Delhi High Court after being challenge by the promoters in India.

ADVANTAGES OF DUE DILIGENCE

- It analyses who administers, owns and run the organisation.
- It examines the company and the market in a contrast way to assess the volatility of the market.
- It researches about the competitors of the target company existing in the market.
- It reviews the financial statements of the company such calculating debt equity ratio, etc.
- It examines the rise or fall in revenue/profits of the company.
- It expects the growth of the company with maximisation of the profits of the organisation.



CASE STUDY

1. **Zee Entertainment – Sony India Merger**

   Zee Entertainment Enterprises Limited (ZEEL) and Sony Pictures Networks India (SPNI), two of India's biggest media conglomerates, have taken the first steps towards a multibillion-dollar merger. The Zee board of directors approved the merger between the two companies. The agreement has the potential to make the newly created company one of the country's largest and most sought after.

   Sony Pictures Entertainment would invest $1.575 billion in the newly consolidated firm as part of the acquisition. On September 22nd, Zee's board of directors gave in-principle permission for the execution of a non-binding term sheet with SPNI. In addition, the two parties will sign a non-compete agreement.

   According to R Gopalan, chairman of Zee Entertainment, "ZEEL continues to chart a strong growth trajectory and the board firmly believes that this merger will further benefit ZEEL,", "The value of the merged entity and the immense synergies drawn between both the conglomerates will not only boost business growth but will also enable shareholders to benefit from its future successes."

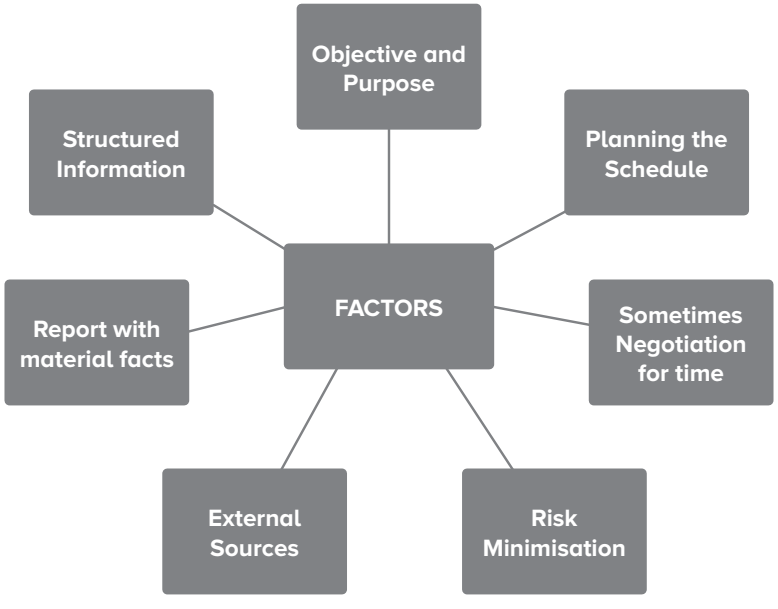
   Results:

   With the Zee-Sony merger, viewers of the Sony network in India will gain access to over 260,000 hours of Zee television content and also its film library with rights to more than 4,800 movie titles across languages. On the cost front, too, the merged entity will have an advantage. In terms of content offering, Sony is strong in General Entertainment and Sports and Zee has an edge in regional content. With this merger Zee has gained access to Sony's 10 sports channels. Although the deal is not executed yet.

2. ABC Limited (manufacturing company in food segment) is considering merging with a smaller food manufacturer company (DEF Limited), with the aim to absorb their operations. After agreeing in principle, the ABC Limited enters the due diligence phase and performs in-depth research on the company they are considering to acquire i.e. DEF Limited. During this step, the ABC Limited asks the DEF Limited, for extensive financial information.

   After completing its thorough financial diligence of the DEF Limited, the ABC Limited directs the research team to evaluate the value of the IP assets, namely their brands and logos. This entire process brought positive reactions from all involved. The ABC Limited was content because it had bigger plans with this merger and its objectives combined. This becomes a positive opportunity for both to expand into a larger company.

FACTORS TO BE KEPT IN MIND WHILE CONDUCTING DUE DILIGENCE



1. Objectives and purpose

A key step in any due diligence exercise is to develop an understanding of the purpose for the transaction. The goal of due diligence is to provide the party proposing the transaction with sufficient information to make a reasoned decision as to whether or not to complete the transaction as proposed. It should provide a basis for determining or validating the appropriate terms and price for the transaction incorporating consideration of the risks inherent in the proposed transaction.

The following factors may be kept in mind in this regard:

(i) Be clear about your expectations in terms of revenues, profits and the probability of the target company to provide you the same.

(ii) Consider whether you have resources to make the business succeed and whether you are willing to put in all the hard work, which is required for any new venture.

(iii) Consider whether the business gives you the opportunity to put your skills and experience to good use.

(iv) Learn as much as you can about the industry you are interested in from media reports, journals and people in the industry.

2. Planning the schedule

Once it is decided for a particular business, make sure of the following things:

- Steps to be followed in due diligence process
- Areas to be checked
- Aspects to be checked in each area
- Information and other material to be requested from the seller

3. Negotiation for time

Sometimes, it may be the case that, sellers want the process to get over as soon as possible and try to hurry the proceedings. When the seller gives a short review period, negotiations can be made for adequate time to have a complete review on crucial financial and legal aspects.

4. Risk Minimisation

All the information should be double checked- financials, tax returns, patents, copyrights and customer base to ensure that the company does not face a lawsuit or criminal investigation. The financials are very important and one needs to be certain that the target company did not engage in creative accounting.

The asset position and profitability of the company are vital. Since, due diligence exercise deals with the overall business, it is important to consider aspects such as:

- background of promoters
- performance of senior management team
- organizational strategy
- business plans
- risk management system
- technological advancement
- infrastructure adequacy
- optimum utilization of available resources.

5. Information from external sources

The company's customers and vendors can be quite informative. It may be found from them whether the target company falls in their most favored clients list. Any flaws that the audit uncovers help to re-negotiate down the sale price. Hence, the Due diligence is "a chance to get a better deal".

6. Limit the report with only material facts

While preparing the report it is advisable to be precise and only the information that has a material impact on the target company is required to be included.

7. Structure of information

Once the due diligence process is over, while preparing the report, information has to be structured in an organized manner in order to have a better correlation on related matters.

Challenges in conducting due diligence

A professional may face many challenges while conducting due diligence. He needs to deal with these challenges and bring the best result of due diligence. Few examples of the challenges faced are as under:

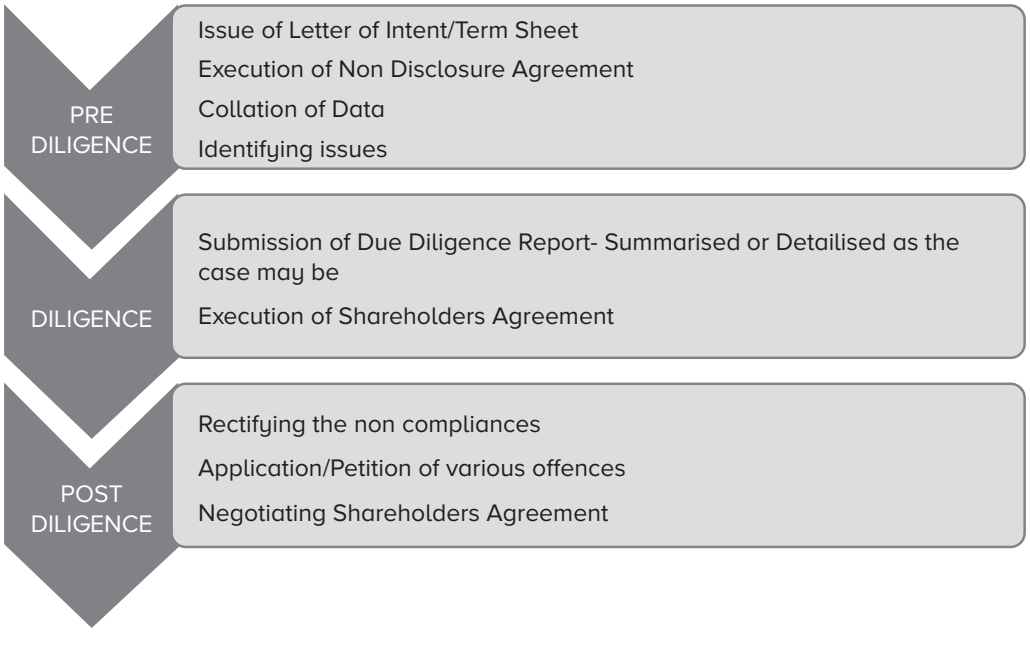
i) Non-availability of the information or incomplete information: For eg. Non availability of evidence related to compliances. While dealing with difficulty, he can try to find the alternate source of getting the information.

ii) Lack of time: Many a times a professional cannot check all the information due to paucity of time. A professional may confine the scope of checking in this scenario.

iii) Non-cooperation by the employees: It is possible that few of the employees may start non-cooperating as this may lead to focus on their mistakes. Reporting to the concerned authority may be a good solution in this scenario.

PROCESS AND STAGES OF DUE DILIGENCE

A due diligence process can be divided into three stages i.e. (i) Pre Diligence, (ii) Diligence, and (iii) Post Diligence.



(i) STEP 1: Pre diligence

A pre diligence is primarily the activity of management of paper, files and people.

1. **Signing the Letter of Intent (LOI) :** The first and foremost step for the management of the target company, is that the investor is to sign a Letter of Intent (LOI) or a term sheet which underlines the various terms on which the proposed deal is going to be concluded. It includes:

Scope –

- Areas to be covered;
- Manner of maintenance and collection of data;
- Final work product-
  - Due Diligence Report
  - Only Executive Summary
  - Comprehensive Bible with Executive Summary, detailed report on all segments, data sheets
- Timelines - Time within which the exercise is to be complete.

2. **Execution of the Non-Disclosure Agreement (NDA)/ Engagement letter:** After the receipt of the LOI the investors sign an NDA with the various agencies who is going to conduct the due diligence, be it finance, accounting, legal or a secretarial diligence.
3. **Receipt of documents from the company and review of the same with the checklist of documents already supplied to the company:** The company would usually receive a checklist from the agency conducting the diligence. The checklist is invariably exhaustive in nature, and therefore, the company may either collate and compile the documents in-house or outsource this to an external agency.
4. **Identifying the issues:** The next step is to identify the issues existing therein that may be relevant.
5. **Organising the papers required for a diligence:** The next is to organise all the paper, documents and information requiste for conducting due diligence.
6. **Creating a data room:** While the data is being collated care should be taken to ensure that there are no loose ends that may probably arise.

Key points to be considered in regard to data room:

Some of the important things that one should take cognizance of from the corporate viewpoint are the following:

- Do not delay deadlines (leads to suspicion).
- Mark each module of the checklist provided separately.
- In case some issues are not applicable spell it out as “Not Applicable”.
- In case some issues cannot be resolved immediately, admit it.
- Put a single point contact to oversee the process of diligence.
- Keep a register, to track people coming in and going out.
- An overview on the placement of files.
- Introduction to the point person.

During the diligence, care should be taken to adhere to certain hospitality issues, like:

1. Be warm and receptive to the professionals who are conducting diligence.
2. Enquire on the Due Diligence team.
3. In case of any corrections - admit and rectify.

As regards the process of diligence, as a professional care should be taken to scrutinize every document that is made available and ask for details and clarifications, since the Due diligence is a time bound activity and is needed to be wrapped up at the earliest. However, the company may be provided an opportunity to clear the various issues that may arise out of the diligence.

Getting Ready Components of the Deliberative Overview

(a) Transaction Structure i.e. concerned parties, whether structured as share or asset purchase, tax considerations, restrictive covenants, etc.;

(b) Transaction Funding i.e. how is funding contemplated and preliminary consideration of any significant issues in respect thereof;

(c) Regulatory Issues such as restriction on foreign holding, subsidiaries, approvals, competition law issues and foreign exchange considerations;

(d) International Aspects including the question of engaging overseas professional advisers; Timelines i.e. determination of time schedules for various stages of the contemplated Transaction;

(e) Confidentiality Agreements i.e. whether Target seeks powers to restrict the release of certain information or data and review of covenants in relation thereto (Particularly in a listed company);

(f) Exclusivity or Lock-In Arrangements as per negotiations between the parties;

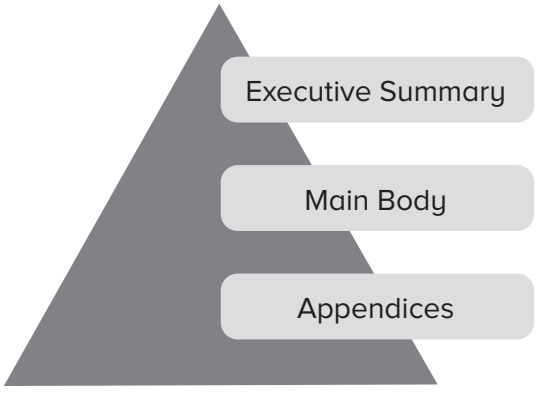
(g) Data Room Guidelines regarding the due diligence process on Target entity;

(h) Overall Due Diligence Strategy and consideration of the due diligence checklist as is usually circulated prior thereto; and

(i) Specialized Issues such as industry-segment and relevant sector-specific issues including any specialized legislative requirements and such other details.

(ii) STEP 2: Diligence Report

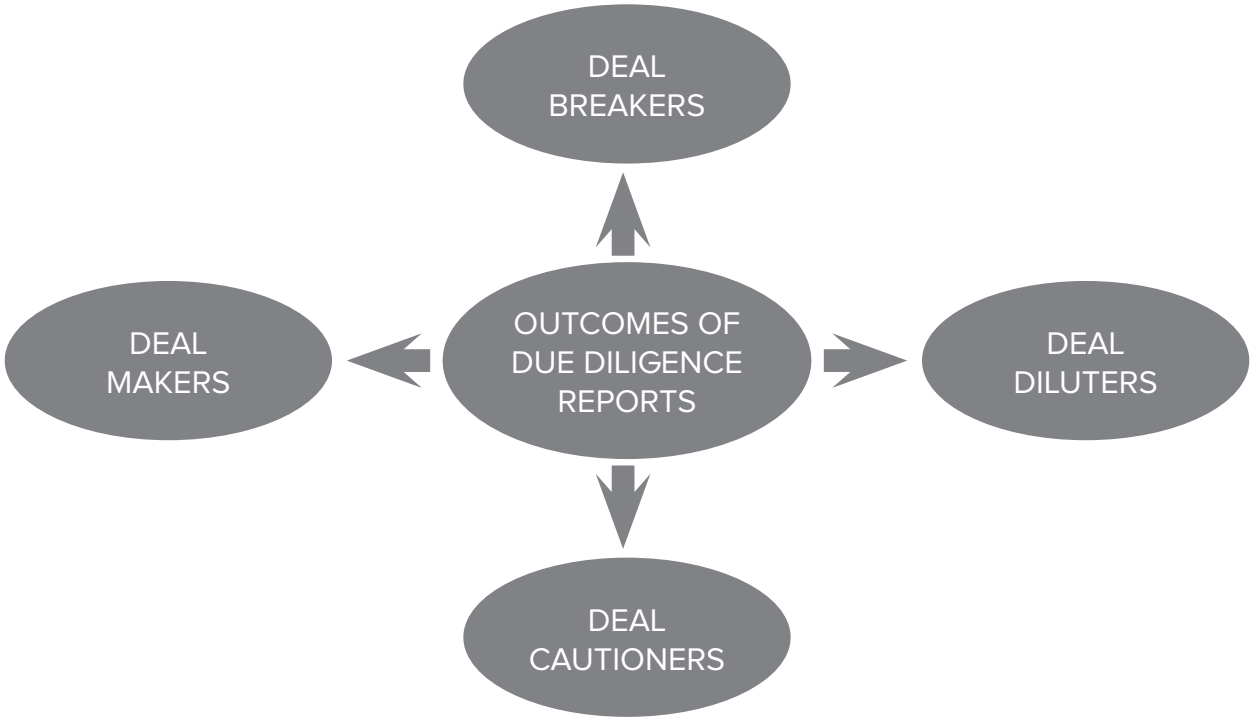
After the diligence is conducted, the professionals submit a report which in common parlance which is called as Due Diligence report. These reports can be of various kinds, a summary report; a detailed report or the like; and the findings mentioned in the report can be very significant, in as much as the deal is concerned. The due diligence report would typically consist of the following three sections: –



- **Executive Summary:** This draws to the attention of the Acquirer, any items of concern or otherwise requiring attention and could usually start with the most critical points or deal breakers.
- **Main Body:** This would ideally follow the order and headings of the terms of reference or the checklist.
- **Appendices:** This section includes data sheets and/or documentation which are relevant to a critical issue.

The most important part of due diligence is writing of report in a presentable form. If the report does not provide the actual view of the organization than the activity will become worthless. Identifying the problem is not the only work of due diligence. A good diligence report should also provide the suggestions for solving the problem. The report may interalia cover General Information, Financial Data, relevant business agreements, pending litigations, contingent liabilities, details of intangible assets like IPRs, marketing position, Internal Controls, Environmental compliance, position of CSR aspects, Human resource assets and the culture of the organisations. The report should also make the reference and purpose of the conducting DD. For eg. Whether it is conducted due to statutory requirements or for entering into Business transaction or as a fact finding analysis. The report should also include the source of information. List of document reviewed including the documents not available should also be the part of the report. Assumptions wherever made should be part of report. Reference to reliance on certain undertakings and certificates should also made part of DD report. Risk analysis section should also one of the mandatory part of the DD report. The report shall also state the confidentiality and restriction clause providing the limited use of the report, wherever feasible.

OUTCOMES OF DUE DILIGENCE REPORTS



- *Deal Breakers*: In their report, the findings can be very glaring and may expose various non-compliances that may arise - any criminal proceedings or known liabilities.
- *Deal Diluters*: The findings arising out a diligence may contain violations which may have an impact in the form of quantifiable penalties and in turn may result in diminishing the value of company.

- *Deal Cautioners*: It covers those findings in a diligence which may not impact the financials, but there exist certain non-compliances which though rectifiable, require the investor to tread a cautious path.
- *Deal Makers*: Which are very hard to come by and may not be a reality in the strict sense, are those reports wherein the diligence team have not been able to come across any violations, leading them to submit what is called a 'clean report'.

It may be noted that only after the reporting formalities are over and various rectifications are carried out, the "shareholders agreement" (which is the most important document) is executed. This agreement contains certain standard clauses like the tag along and drag along rights; representations and warranties; condition precedents and other clauses that have an impact on the deal.

(iii) Post Diligence

Post diligence sometimes result in rectification of non-compliances found during the course of due diligence. There can be interesting assignments arising out of the diligence made by the team of professionals. It can range from making applications/filing of petition for compounding of various offences or negotiating the shareholders' agreement, since the investors will be on a strong wicket and may negotiate the price very hard.

TECHNIQUES OF DUE DILIGENCE AND RISK ASSESSMENT

Due diligence and risk assessment and control represent separate and distinct processes that take place prior to the commencement and throughout the duration of a commercial agreement respectively.

The Due diligence and risk assessment and control processes are central to good business practice. These processes are particularly important in taking leadership in the market and charge premium rate services. Where services are delivered to clients through Associates, which can, on occasion, include many different parties, the professional should prior to contracting with such party write down the expectation from such party in the process of due diligence.

All parties in the Due diligence team should be confident that the established team is for good positive business and industry-wide growth. Such processes are built on the following cornerstones:

Evaluation of the objective of the plan: The first step is to determine the main objective of the project which helps in ascertaining the exact information required that align with organisation's strategy.

Know your client - All businesses have risks, and these can vary significantly dependent on the nature of the company and the services being operated. It is important to know your client so you can properly identify the risks involved and assess how to manage them. This is not to limit or prevent commercial relationships forming but to ensure they are properly managed whether an issue ultimately arises or not.

Examination of Financials of the organisation: It examines the financial records of the organisation that helps in assessing the financial performance, asset health and stability of the organisation. Some of the Items inspected here include:

- Balance sheets and income statements
- Inventory schedules

- Future forecasts and projections
- Revenue, profit, and growth trends
- Stock history and options
- Short and long-term debts
- Tax forms and documents
- Valuation multiples and ratios in comparison to competitors and industry benchmarks.

Inspection of documents: The next step is to review all the documents/information records made available to get a better understanding of the organisation and it help to determine the growth and value of the business of the organisation.

Actions taken to control any risk: once risks are identified, industry members must make a proper assessment of the issues that would arise if incidents occur and take proportionate steps to minimise the likelihood of such issues resulting in consumer harm. Good process planning and/or staff training may have a positive impact on a company's ability to respond effectively when incidents do occur.

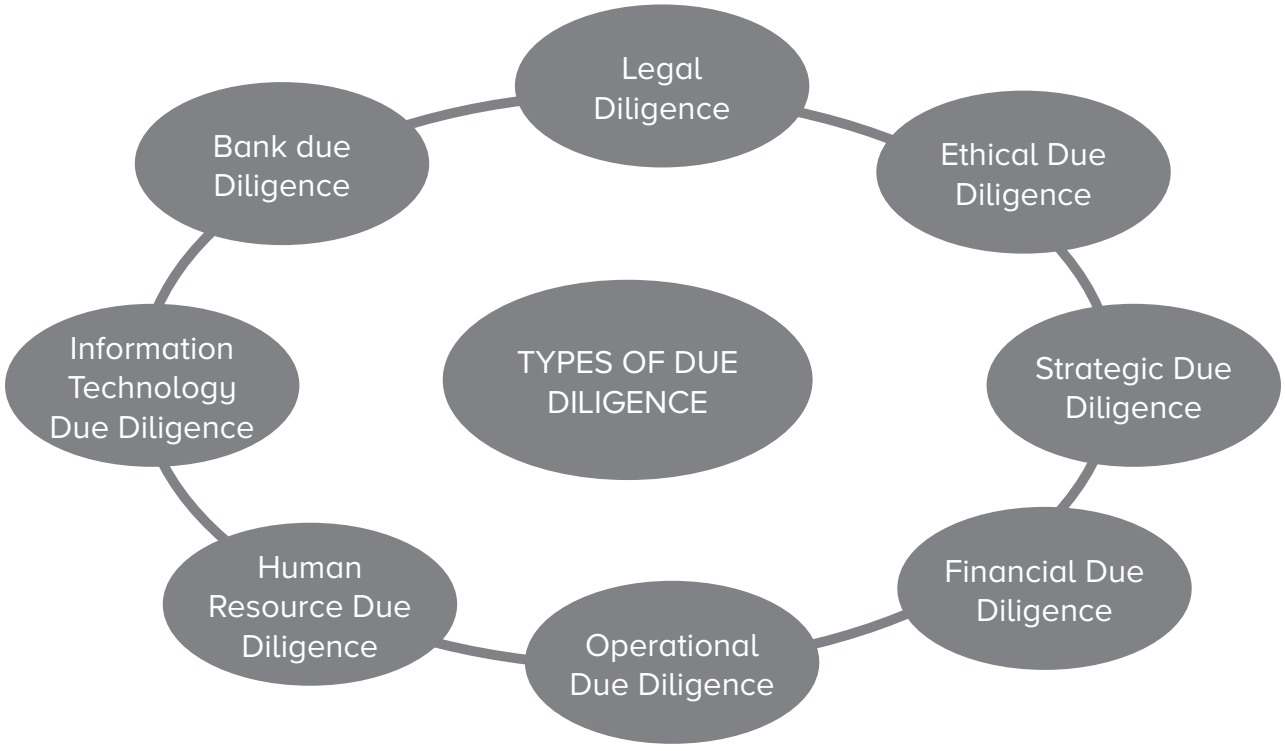
The formulation of an action plan could be based on the following:

- To periodically test and/or monitor certain 'risks' that would normally be associated to a particular service category (e.g. for a subscription service, it may be prudent to test the clarity of promotions, whether reminder messages have been sent, with delivery confirmation noted, and that 'STOP' commands have been properly processed);
- The frequency of such testing should reflect the risk posed by both the client and the service type. For example, a client with no breach history, or where none of the directors are linked to other companies with breaches, and low- risk service types (such as football score updates), would require far less monitoring than a client with an extensive breach history that provides a high- risk category of service (e.g. a subscription-based lottery alerts system with a joining fee);
- 'Mystery shopper' testing could be used as and when appropriate;
- Internal mechanisms to enable 'whistle-blowing' by staff, where appropriate;
- Putting in place internal checks that correlate with unusual patterns of activity which may indicate consumer harm (e.g. spikes in traffic and/or consumer complaints made directly to the provider about one specific service);
- Having a procedure to alter and address instances of non-compliant behaviour;
- Monitoring of the client's service to ensure that any directions given by the Phone-paid Services Authority have been complied with;
- Producing a compliance file, comprising of a written record of the assessment, the subsequent action plan and evidence of any monitoring and/or testing required by the plan having taken place. This record does not necessarily need to be lengthy (although this will depend on the client and the actions taken under the plan) but should be made available to the Phone-paid Services Authority upon request.

Responding to incidents - even where a business makes significant effort to comply with regulations and legal requirements, they may not be immune to problems arising. Providers ought to be prepared to respond calmly and proactively to incidents, working closely with the regulator and other parties in the value chain to identify, mitigate and correct any fallout, providing support to consumers. Breaches ought to be identified and acknowledged quickly when they arise so that they can be remedied and services are therefore delivered to a high standard to consumers.

TYPES OF DUE DILIGENCE

In business transactions, the due diligence process varies for different types of companies. The relevant areas of concern may include the financial, legal, bank, labour, tax, environment and market/commercial situation of the company. Other areas include intellectual property, real and personal property, insurance and liability coverage, debt instrument review, employee benefits and labour matters, immigration, and international transactions. The Business due diligence involves looking at quality of parties to a transaction, business prospects and quality of investment. The most important types of Due Diligence are :



LEGAL DUE DILIGENCE

A legal Due Diligence is a process of assessing all legal risks associated with organisation structure, its assets, contracts, securities, contracts, intellectual property, etc. of the target company. It is a safeguarding process to understand the strength and weakness of the organisation with maximum information available. It ensures safe execution of transaction with minimum issues in future.

A legal due diligence covers the legal aspects of a business transaction, liabilities of the target company, potential legal pitfalls and other related issues. Legal due diligence covers intra-corporate and inter-corporate transactions.

NCLT earlier this year in *Technology Frontiers (India) Private Limited* v. *Global Sports Commerce Pte Ltd & Ors.* took an alternative stance and held that a company secretary is a *'Watchdog of protecting the Principles of Corporate Governance as well as the collective interest of all the stakeholders so also the Company'.*

the NCLT emphasized that a company secretary is required to act not only with '*adequate*' diligence but with '*proper*' and '*necessary*' diligence while discharging duties, '*by sounding the knell*' to bring to the attention of the Board and all concerned, instances wherein there is any apprehension of deviations from sound corporate principles and prudent governance practices

Can highlight the role of CS in Legal Due diligence

Source: https://www.azbpartners.com/bank/nclt-recognises-the-role-of-a-company-secretary-as-a-watchdog-to-ensure-corporate-governance/

It includes preparation of regulatory checklists, meeting with personnel, independent check with regulatory authorities etc. apart from the verification of following document.

- Copy of Memorandum and Articles of Association; Minutes of Board Meeting for the last three years; Minutes of all meetings or actions of shareholders;
- Register of Members, charges, etc.
- Share transfer deeds
- Copy of share certificates issued to Key Management Personnel; Copy of all guarantees to which company is a party;
- All material contracts;
- Copies of all loan agreements, bank financing agreements, line of credit to which company is a Status of the order, awards issued by the various regulators and courts;
- Status of Pending litigations; Organisational chart; Returns filed with ROC; Search/status report if any;
- Details of branches and subsidiaries; Registrations documents under various laws; Documents/reports filed with stock exchanges; Related party transactions;
- Contracts and loans with directors; Borrowings and investment of the company;
- Matters like IPO, FPO, Prospectus, etc. in compliance with SEBI regulations; Maintenance of statutory registers, minute books, etc.;
- Various compliances, under applicable laws.

TRANSACTIONS COVERED UNDER LEGAL DUE DILIGENCE

Initial Public Offer/ FPOs/ QIPs	Private Equity	Joint Ventures
Mergers & Acquisitions	Corporate Restructuring	Corporate Governance Related Matters
Commercial Agreements	Leveraged Buy Outs	General Compliance Requirement

SCOPE OF LEGAL DUE DILIGENCE

Legal Due Diligence assesses the regulatory compliances applicable to the company under various laws such as:

- Company Law
- Income Tax Law
- Labour Law
- RERA Act
- SEBI Act, their rules and regulations
- Insurance Act
- RBI Act
- FEMA Act
- Intellectual Property Law etc.

DUE DILIGENCE FOR MERGER & AMALGAMATION

In case of the mergers and amalgamation of the companies, due diligence is a critical process which cannot be overlooked by the management as well as by the shareholders of the company while giving consent for the amalgamation. Due diligence in mergers not only requires the assessment of the financial, legal, and regulatory exposures but also requires insights into the target company's structure, operations, culture, human resources, supplier and customer relationships, competitive positioning and future outlook. The due diligence provides an assurance in taking decisions considering the factors which may be a potential deal-killers/shapers and provide assurances that the acquisition is the right decision at the right price. Due diligence also provides management an insight, holistic view of the target company that which helps in the easy integration of the target's people and business.

Merger with an existing company will, generally, have the same features as an acquisition of an existing company. However, identifying the right candidate for a merger or acquisition is an art, which requires sufficient care and calibre.

Once an organization has identified the various strategic possibilities, it has to make a selection amongst them. There are several factors financial/ non-financial/ open/ hidden factors that influence the ultimate choice of strategy. The process of analysis of strategic choices on various aspects for merger is done through due diligence process.

Due Diligence Process in the M&A Strategy

Stages	For Buyer	For Seller
Preparation Stage	● M&A strategy formulation ● Preparation of list of potential Targets ● Appoint external advisor for evaluation of targets ● Short list targets ● Create due diligence team	● Structure a business plan ● Preparation of list of potential buyers ● Appoint external advisor ● Shortlist buyers

Stages	For Buyer	For Seller
Pre Diligence	● Approach targets ● Negotiation of initial terms ● Execute non-disclosure agreement ● Compliation of list of data required	● Approach buyers ● Negotiate initial terms ● Execution of non disclosure agreement ● Creation of data room
Due Diligence	● Inspection of data room ● Analysis of private documents ● Evaluation of risk and return ● Structure the terms and conditions	● Assistance in data room ● Setting deadlines for offer
Negotiations	● Make final offer ● Negotiate and agree on terms	● Compile final offers ● Select best offer ● Negotiations
Documentation	● Execution of merger agreement, acquisition agreement, or purchase agreement	● Execution of merger agreement, acquisition agreement, or purchase agreement
Regulatory approvals	● Depending on the nature of the transaction and the industries involved, both companies may need to obtain regulatory approvals from board of directors, shareholders and various other stakeholders including regulatory agencies and government agencies.	● The company need to obtain regulatory approvals from board of directors, shareholders and various other stakeholders including regulatory agencies and government agencies.
Integration	● After the transaction is complete, the companies should begin the process of integrating their operations, systems, and cultures to realize the benefits of the transaction.	
Post Diligence	● Post merger integration and cultural adjustments	● Termination of data room and ownership exchange

DUE DILIGENCE FOR TAKEOVERS

For any business, doing takeover of a business company is not an easy task. Moreover, it is an important financial investment that implies a number of risks, some of which can run the entire process around. Which make the takeover due diligence as one of the prerequisites for takeover of a business.

The Takeover Due diligence is generally conducted in different domains; Financial, Legal, Taxation, social life, environment, etc. The Takeover Due diligence covers the history of the company, past performance, the present, and the future of a company. In effect, it must respond to certain requirements of the buyer, i.e., maximize

financial or non-financial benefits, and negotiate the risks of failure. Therefore, takeover due diligence is useful in allowing the buyer to confirm his or her decision of the sale, or in negotiating the conditions of the sale.

The takeover due diligence is having a great importance for a business as it synthetically expresses the overall value of the target enterprise. According to which the buyer will be able to analyze the potential of the target company while understanding the risks related in taking it over.

Thus, taking over a company brings inevitable risk, some of which can cause great detriment to the company. Due diligence allows the company to avoid a tragic end after being taken over. This being said, the acquisition audit is a complex process. Because of this, it is necessary to find people experienced in due diligence, so that the audit acquisition will be effective and useful.

The takeover due diligence allows the buyer to better discern the risks and opportunities linked to the target company. This due diligence will be performed once an agreement is signed or after the letter of intent. It will allow verification of the elements being negotiated between the parties, producing an accurate reflection of the current state of the target company.

Takeover of companies whose securities are listed on one or more recognized stock exchanges in India is regulated by the provisions of the Listing Agreements with various stock exchanges and the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011. The compliances under the regulations include event based/continual disclosures, open offer requirements including public announcement, escrow account, obligations of acquirer/target company/merchant banker, undertaking/ authorization, offer price etc.

CASE STUDIES

1. In the case of *Nirma Industries and Anr. v. Securities Exchange Board of India, Nirma* Industries sought withdrawal of an open offer under Regulation 27(d) of the Takeover Regulations on the ground that the promoters of the target company had committed a fraud and had embezzled funds. Nirma Industries applied to SEBI to allow the withdrawal of the open offer. The Supreme Court however rejected all the contentions of Nirma Industries and held that an investing company is responsible for its own decision to invest and should carry out appropriate diligence. The Court stated that Nirma Industries were aware of various litigations, the plea of ignorance of litigation and dangers of investment was thereby denied.

2. Total Energies said its $3.1 Billion Exposure In Adani Group taken after Due Diligence, Full Compliance

   TotalEnergies SE states its exposure of $3.1 billion, or about 2.4% of the company's employed capital, in Adani Group was taken in full compliance and with due diligence.

   Since 2018, the French energy major has invested in four Adani entities: 50% each in unlisted Adani Total and AGEL23, 37.4% in listed Adani Total Gas Ltd., and 19.75% in Adani Green Energy Ltd.

   All investments in Adani's entities were undertaken in full compliance and with due diligence, which "were consistent with best practices", the company said in a statement on February 03, 2023. "All relevant material in the public domain was reviewed, including the detailed disclosures to regulators required under applicable laws."

   (Source: *https://www.bqprime.com/business/totalenergies-says-its-31-billion-exposure-in-adani-group-taken-after-due-diligence-full-compliance*)

DUE DILIGENCE FOR ISSUE OF SECURITIES

A public company may issue securities to public through prospectus - Public offer by complying with the provisions of companies Act 2013 Part I of chapter III - Prospectus and Allotment of Securities; or through private placement by complying with the provisions of Part II of chapter III - Prospectus and Allotment of Securities; or through a rights issue or a bonus issue in accordance with the provisions of the Act and in case of a listed

company or a company which intends to get its securities listed also with the provisions of the Securities and Exchange Board of India Act, 1992 and the rules and regulations made thereunder, the key regulation governing the issue of securities and preparation of financial information are:

- The SEBI (Issue of Capital and Disclosure Requirement) Regulations, 2009/2018
- The SEBI (Listing Obligation and Disclosure Requirement) Regulations, 2015

A private company may issue securities by way of rights issue or bonus issue in accordance with the provisions of the Act; or through private placement by complying with the provisions of Part II of chapter III - Prospectus and Allotment of Securities & Chapter IV -Share Capital & Debentures of Companies Act, 2013.

The scope and comprehensiveness of the Issue of Securities due diligence is important not only from a legal standpoint to avoid liability but also from a reputational perspective as the reputation of the company and its promoters and other participants may be significantly vanished, if on a later date it appears that the company and other participants are failed to uncover and disclose to prospective investors critical issues relating to the issuer or the Securities.

While the specific requirements in connection with issue of securities are different under the Companies Act, 2013 and SEBI Laws & Regulations made thereunder, any non-compliance in these regulations are generally impose liability if the offering memorandum or prospectus contains a materially incorrect or misleading statement or omits a material fact, however in certain conditions the complete issue of securities stand cancelled. The violation of any applicable liability provisions may result in liability for offering participants, in particular the issuer and the underwriters. These liability provisions emphasize the need for careful preparation of all materials to be used in issue of securities offerings, in particular the offering memorandum or prospectus.

INTELLECTUAL PROPERTY LAW

The company which owns Intellectual Property (IPs) use there IPs to monetize their business. These IPs are something that differentiates their product and service from their competitors. However, the concept of valuation of intangible assets related to Intellectual Property like Patents, Copyrights, Design, Trademarks, Brands etc., also getting greater importance as these Intellectual Properties of the business are now often sold and purchased in the market by itself like any other tangible asset. Many Indian companies and corporate entities do not give much importance to the portfolio management of their Intellectual Property Rights (IPR). The main objective of intellectual property due diligence is to ascertain the nature and scope of target company's right over the intellectual property to evaluate the validity of the same and to ensure whether there are no infringement claims. Few of the items that need to be seen while conducting due diligence is:

- A schedule and copies of all consulting agreements, agreements regarding inventions, licenses, or assignments of intellectual property.
- Schedule of patents and its application.
- Schedule of copyrights, trademarks and brand names.
- Pending patents clearance documents.
- Any pending claims case by or against the company in violation of intellectual property.
- Details of Indian and international patents with the company.
- Details of threatened claims if any.

ENVIRONMENT LAW

List of important statutes for environment protection in India:

- The National Green Tribunal Act, 2010
- The Air (Prevention and Control of Pollution) Act, 1981
- The Water (Prevention and Control of Pollution) Act, 1974

- The Environment Protection Act, 1986
- The Wildlife Protection Act, 1972
- The Forest Conservation Act, 1980
- Public Liability Insurance Act, 1991
- The Biological Diversity Act, 2002.

Environmental due diligence analyses environmental risks and liabilities associated with an organisation. This investigation is usually undertaken before a merger, acquisition, management buy-out, corporate restructure etc. Environmental due diligence provides the acquirer with a detailed assessment of the historic, current and potential future environmental risks associated with the target organisation's sites and operations. It involves risk identification and assessment with respect to:

- Details of environmental permits and licenses.
- Hazardous substances used in the Company's operations.
- Copies of all correspondence with environment authorities.
- Litigation or investigations if any on environmental issues.
- Contingent environmental liabilities or continuing indemnification obligations, if any.
- Review of the environmental setting and history of the site.
- Assessment of the site conditions.
- Operations and management of sites.
- Confirm legal compliance and pollution checks from regulatory authorities etc.

Things to be reviewed by the management

- List of environmental permits and licenses and validities of the same.
- All correspondence and notices with EPA, state, or local regulatory agencies.
- Whether the company's disposal methods of various by products are in sync with the regulated guidelines.
- Whether there are any contingent environmental liabilities or continuing indemnification obligations.

LABOUR LAWS

List of major labour laws in India:

- Employees Compensation Act, 1923
- Payment of Wages Act, 1936
- Minimum Wages Act, 1948
- Factories Act, 1948
- Maternity Benefits Act, 1961
- Payment of Bonus Act, 1965
- The Payments of Gratuity Act, 1972
- Employees State Insurance Act, 1948
- Industrial Disputes Act, 1947
- Trade Unions Act, 1926
- The Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013

The purpose of a labour due diligence to conduct a comprehensive review. The compliance from a labour law perspective in order to identify gaps before an authority audit, any non-compliances relating to the inappropriate application of labour law regulations and to allow company to correct errors and deficiencies. The labour law due diligence is identify gaps and minimize labour law and payroll deficiencies before any regulatory action.

However, the Labour Law due diligence is important in case of the merger and acquisitions, takeovers, IPOs, joint ventures and winding up / liquidation of the companies. The scope of the labour law due diligence extends to all the labour & employment related central, state and local laws, rules and regulations applicable to the company.

- During the payroll and labour due diligence the auditor should examine and review the following areas:
- Labour law regulations and agreements;
- Employment contracts, amendments to employment contracts; Information, job descriptions;
- Legal declarations/agreements regarding termination of employment; Maintenance of records
- Labour law regulations and agreements;
- Employment contracts, amendments to employment contracts; Information, job descriptions;
- Legal declarations/agreements regarding termination of employment;
- Maintenance of records.

COMPETITION LAW

Due diligence on competition law aspects is an examination of the actual operations and practices of an enterprise to determine the extent of its compliance with the competition law and to identify potential risks and liabilities and assess the adherence to and effectiveness of the company's competition law compliance policy and training program.

Primary components of Competition Law due diligence are:

- An examination of selected company documents.
- Interviews with selected company personnel.
- Identify specific business activities that potentially could create antitrust exposure for the company.
- The results of the due diligence may suggest an enterprise to have an effective competition law compliance programme.
- The results of the due diligence may result in variation of deal value, withdrawal of deal and also make suggestions to structure a compliance program.
- How to go about the process of due diligence of competition law.

Due diligence of competition law may be made under the following heads:

1. Due diligence of various agreements (both existing and proposed)
2. Due diligence on dominance and its likely abuse if any, (existing)
3. Due diligence on combinations (i.e. effect of proposed Mergers & Acquisition).

Due Diligence of various agreements includes:

- Agreements relating to production, supply and distribution of goods or services Agreement if any with competitor relating to production, marketing or bidding, price etc. Agreements with customers and distributors.
- Purchase agreements. Non-compete covenants.
- Technology transfer/technical know-how agreements.
- Concession agreements.

Due diligence on abuse of dominance, if any includes :

- Examination as to the existence of dominance.
- Examination of relevant market, whether product or geographical Areas. Cases of abuse if any

Due diligence on regulation of combinations :

- Nature of combination.
- Acquisition of share, voting rights, assets or control or merger/amalgamation etc. Examination of total value of Assets or Turnover and the valuation methodology. Status of merger notification to be filed with CCI.
- Status of dominance after merger

FEMA DUE DILIGENCE

Foreign Exchange Management Act (FEMA) is the legislation which governs the foreign currency in India. The main aim of FEMA is to facilitate external trade, balance the payments, promote the orderly development, and maintain the foreign exchange market in India. Doing Compliance for cross border transactions in India is a big challenge for most of the companies covered in the FEMA. Further, an increased flow of funds, inbound as well as outbound has increased the level of check on compliances in context of foreign exchange. This requires companies to keep a regular eye on foreign exchange transactions, in context of sectoral caps, investment caps, to circumvent from the huge penalties. The FEMA Due diligence helps to avoid damaging circumstances and is helpful in ensuring compliance of Foreign Exchange laws. The FEMA Due diligence covers all types of cross border transactions - import, export, debt funding, equity capital infusion, transfer of shares etc.

The following are covered under the FEMA Due diligence:

- Capital Accounts transactions
- Current account transaction
- Currency Transactions
- Regulations, Master Directions and Circulars issued by RBI
- FDI Policy, approvals
- Setting up of Business through Liaison office, Branch office, project office, wholly owned subsidiaries, joint ventures, foreign institutional investors, and foreign venture capital investor, Non-Resident of India/ person of Indian origin.

FCRA DUE DILIGENCE

The Foreign Currency (Regulations) Act, 2010, the FCRA Rules, 2011, and FCRA Amendment Rules, 2015 were respectively enacted to regulate the inflow of foreign funds received by NGOs. The FCRA, 2010 replaces the erstwhile Foreign Contribution (Regulation) Act of 1976.

The FCRA legislation state that an organization cannot receive funding from a foreign source, unless it is registered under the Foreign Currency (Regulations) Act, 2010 or has obtained special government approval for a specific project. Also, the registered NGOs need to comply with various post-registration requirements, as detailed in the provisions of the Act and its rules of enforcement.

NGOs in India are categorized under three legal categories: society, trust, and a limited company. These may be founded for a specific cultural, economic, educational, religious, or social purpose. These organizations are heavily regulated by respective state and government agencies.

The Income Tax Department (IT Department) and Ministry of Home Affairs regulate registration and require all NGOs to file annual tax returns and submit audited account statements to their respective agencies. All types of NGOs are treated equally under the Income Tax Act of 1961.

The most important reporting requirement under the FCRA is the submission of annual returns. All NGOs are required to submit their annual returns to the central government (MHA) within nine months from the closure of the previous financial year.

OTHER BUSINESS LAWS

The business in India is regulated through various laws and regulations that secures sustainable development of the business and society as well. Apart from corporate and taxation laws there are other laws and regulations that keep a check on the business organisation.

- Registrations and approvals from various statutory authorities.
- Compliance under pollution control laws.
- Issues relating to immovable properties, title deeds, etc.
- Compliance under FEMA and Insurance Laws etc.
- Factories Act, 1948.
- Real estate and construction law.
- Labour and employment law.
- International business law.

FINANCIAL DUE DILIGENCE

One of the most important types of due diligence, is financial due diligence as it seeks to check whether the financials showcased in the Information Memorandum is correct or not. It also provides a deep understanding of all the :

- Company's financials, including but not restricted to audited financial statements for last three years, recent unaudited financial statements with comparable statements of last year,
- review of accounting policies,
- review of internal audit procedures, quality and sustainability of earnings and cash flow, condition and value of assets, potential liabilities, tax implications of deal structures,
- examination of information systems to establish the reliability of financial information, internal control systems etc.

Financial Due Diligence is the process of analysing requiring inquiry, analysis and interpretation of financial and operational data to assist a buyer in assessing certain risks and opportunities involved in a potential transaction.

The Financial Due diligence also review the company's projection and basis of such projections, capital expenditure plan, schedule of inventory, debtors and creditors, etc. Also, the process involves analysis of major top customer accounts, fixed and variable cost analysis, analysis on gross margins, customers with high profit margins and their contract period, internal control procedures etc. It will also involve the type of the company's order book and sales pipeline to better build projections.

Financial due diligence provides peace of mind to both corporate and financial buyers by analysing and validating all the financial, commercial, operational and strategic assumptions being made.

The Financial Due Diligence can further extended to tax due diligence which covers the Diligence on various taxes the company is required to pay and which ensure that the proper calculation with no intention of under-reporting of taxes. Status of any tax related case running with the tax authorities. The tax due diligence comprises an analysis of:

- tax compliance
- tax contingencies and aggressive positions
- transfer pricing
- identification of risk areas
- tax planning and opportunities.

COMPONENTS OF FINANCIAL DUE DILIGENCE

- Sustainable / normalised earnings
- Sales trends – by segment product geographies diligence Sales trends – by segment, product, geographies
- Customer / product profitability
- Overheads – fixed vs. variable
- Balance sheet – fixed assets, borrowings, working capital Unrecorded liabilities
- Commitments, contingencies
- Accounting policies
- Management BOD control environment Corp Governance Relationship between profit and operating cash flows Reliance on debt funds and usage of debt
- Debt repayment and potential debt trap
- Working capital lock up.

Illustration

ABC Ltd. negotiated a transaction with purchase consideration values at 5 times of normalized EBIT for the year ended 31.03.2022.

Purchase consideration was Rs. 2,860 million (5 *572 million)

It was revealed in the Due Diligence that reported EBIT of Rs. 572 million includes profits from sale of land amounting to Rs. 84 million. With this ABC Ltd. successfully negotiated purchase consideration with reduction of 380 million.

FOCUS AREAS OF FINANCIAL DUE DILIGENCE

Quality of earnings, gross margin & cash flows

Quality of assets- Working Capital

Net Debt

Potential liabilities & commitments

Separation/ Structuring/ Integration Issues

Related Party Transactions

Quality of earnings, gross margin & cash flows

- Identification of seasonable sales
- Growth rate in gross margins
- Change in margins with cost variances
- Impact of standalone costs
- Impact of foreign exchange rate fluctuations
- GAAP Applications
- Revenue Recognitions
- Recurring /non-recurring expenses
- Cash flows from operations - stability, timing and certainty
- Capitalisation of assets/ WIP
- Assets on lease/used but not owned /owned but not used.

Quality of assets - working capital

- Inventory Turnover ratio,
- Current Ratio,
- Debtors outstanding for more than and less than six months
- Cheques issues but not cleared
- Valuation of WIP
- Seasonal impact on working capital

Net Debt

- Transactions on cash/credit basis
- Debt-like items (pension underfunding, severance and other non-operating liabilities)
- Loan Agreements
- Complying with Debt Restructuring schemes.

Potential liabilities & commitments

- Contingent liabilities and off balance sheet items
- Pension and related obligations
- Conservative Policy
- Aggressive Policy
- Off Balance sheet items

Separation/ Structuring/ Integration Issues

- Changes in supply chain management
- MIS and accounting systems
- Standalone considerations (impact of economies of scale, support functions)
- Synergies
- Transition services agreement

Related Party Transactions

- Transaction at arm length basis
- Resources and cost sharing with related parties
- Financing arrangements with related parties

BANK DUE DILIGENCE

The Bank conduct due diligence whenever the company intends to borrow the money from the bank. The main objective of conducting due diligence by the bank are:

- Verification of details of directors/promoters.
- Statutory and procedural compliances by the company
- Examining the existing or previous charges created by the company in respect of loans and their satisfaction.
- Knowing the defaulting status of the directors,etc.

The Practising Company Secretary (PCS) is required to certify compliance in respect of matters specified in the RBI Circular No. DBOD NO. BP. BC. 46/08.12.001/2008-09 dated September 19, 2008. Para (2)(iii) of the RBI Circular specifies that the Diligence Report shall be in the format given in Annex III thereto.

Period of Reporting

Annex. III to the RBI Notification provides that the Diligence Report shall be made on a half yearly basis.

Right to Access Records and Methodology for Diligence Reporting

To enable the PCS to issue the Diligence Report, the Company (borrower) should provide the PCS access at all times to the books, papers, minutes books, forms and returns filed under various statutes, documents and records of the company, whether kept in pursuance of the applicable laws or otherwise and whether kept at the registered office of the company or elsewhere which he considers essential for the purposes of Diligence Reporting. The PCS shall be entitled to require from the officers or agents of the company, such information and explanations as the PCS may think necessary for the purpose of such Reporting. However, depending on the facts and circumstances he/she may obtain a letter of representation from the company in respect of matters where verification by PCS may not be practicable, for example matters like —

(i) show cause notices received;

(ii) persons and concerns in which directors are interested, etc.

Reporting with Qualification

The qualification, reservation or adverse remarks, if any, may be stated by the PCS at the relevant places. It is recommended that the qualifications, reservations or adverse remarks of PCS, if any, should be stated in thick type or in italics in the Diligence Report.

If the PCS is unable to form any opinion with regard to any specific matter, the PCS shall state clearly the fact that he is unable to form an opinion with regard to that matter and the reasons thereof.If the scope of work required to be performed, is restricted on account of limitations imposed by the company or on account of circumstantial limitations (like certain books or papers being in custody of another person or Government Authority) the Report shall indicate such limitation. If such limitations are so material as to render the PCS incapable of expressing any opinion, the PCS should state that:

"in the absence of necessary information and records, he is unable to report compliance(s) or otherwise by the Company".

PCS shall have due regard to the circulars and/or clarifications issued by the Reserve Bank of India from time to time. It is recommended that a specific reference of such circulars at the relevant places in the Report shall be made, wherever possible.

Professional Responsibility and Penalty for False Diligence Report

While the RBI Notification has opened up a significant area of practice for Company Secretaries, it equally casts immense responsibility on them and poses a greater challenge whereby they have to justify fully the faith and confidence reposed by the banking industry and measure up to their expectations. Company Secretaries must take adequate care while issuing Diligence Report.

Any failure or lapse on the part of a Practising Company Secretary (PCS) in issuing a Diligence Report may not only attract penalty for false Reporting and disciplinary action for professional or other misconduct under the provisions of the Company Secretaries Act, 1980 but also make him liable for any injury caused to any person due to his / her negligence in issuing the Diligence Report. Therefore, it becomes imperative for the PCS that he/she exercises great care and caution while issuing the Diligence Report and also adheres to the highest standards of professional ethics and excellence in providing his/her services.

Disqualifications of Secretary in Whole-Time Practice

With a view to ensure that PCS shows utmost integrity and independence of judgement in the performance of his/her duties, it is desirable that he/she, should not accept any assignment for giving Diligence Report to a Bank, if he/ it is-

(a) a body corporate;

(b) an officer or employee of the company;

(c) a person who is a partner, or who is in the employment, of an officer or employee of the company;

(d) a person who is indebted to the company for an amount exceeding one thousand rupees, or who has given any guarantee or provided any security in connection with the indebtedness of any third person to the company for an amount exceeding one thousand rupees;

(e) a person holding any security of that company which carries voting rights.

However, any securities held by such person as nominee or trustee for any third person and in which the holder has no beneficial interest shall be excluded from such disqualification. Further, if a person is not qualified for appointment as PCS of a company for reasons stated above, then he is also disqualified for appointment as PCS of any other body corporate which is that company's subsidiary or holding company or a subsidiary of that company's holding company, or would be so disqualified if the body corporate were a company. If a PCS becomes subject, after his appointment, to any of the disqualifications specified above, he should vacate his office as such.

Format of Diligence Report (ANNEXURE 3 to RBI Circular)*

To

The Manager,

_____ (Name of the Bank)

I/We have examined the registers, records, books and papers of ..... Limited having its registered office at ..... as required to be maintained under the Companies Act, 1956 / 2013 (the Act) and the rules (As contained in RBI Notification No. DBOD. No. BP.BC. 110/08.12.001/2008-09 dated February 10, 2009 read with RBI Notification No. UBD.PCB.No. 49/13.05.000/2008-09 dated February 12, 2009) made thereunder, the provisions contained in the Memorandum and Articles of Association of the Company, the provisions of various statutes, wherever applicable, as well as the provisions contained in the Listing Agreement/s, if any, entered into by the Company with the recognized stock exchange/s for the half year ended on .....

In my/our opinion and to the best of my/our information and according to the examination carried out by me/us and explanations furnished to me/us by the Company, its officers and agents. I/We report that in respect of the aforesaid period:

1. The management of the Company is carried out by the Board of Directors comprising of as listed in Annexure ....., and the Board was duly constituted. During the period under review the following changes that took place in the Board of Directors of the Company are listed in the Annexure ....., and such changes were carried out in due compliance with the provisions of the Companies Act, 1956 (Now Companies Act 2013).
2. The shareholding pattern of the company as on ..... was as detailed in Annexure ..... During the period under review the changes that took place in the shareholding pattern of the Company are detailed in Annexure .....
3. The company has altered the following provisions of
   (i) The Memorandum of Association during the period under review and has complied with the provisions of the Companies Act, 1956 (Now Companies Act, 2013) for this purpose.
   (ii) The Articles of Association during the period under review and has complied with the provisions of the Companies Act, 1956 (Now Companies Act, 2013) for this purpose.
4. The company has entered into transactions with business entities in which directors of the company were interested as detailed in Annexure .....
5. The company has advanced loans, given guarantees and provided securities amounting to Rs. ..... to its directors and/or persons or firms or companies in which directors were interested, and has complied with Section 295 of the Companies Act, 1956. (Now to be in compliance with Section 185 of Companies Act, 2013).
6. The Company has made loans and investments; or given guarantees or provided securities to other business entities as detailed in Annexure ..... and has complied with the provisions of the Companies Act, 1956. (Now to be in compliance with Section 186 of Companies Act, 2013).
7. The amount borrowed by the Company from its directors, members, financial institutions, banks and others were within the borrowing limits of the Company. Such borrowings were made by the Company in compliance with applicable laws. The break up of the Company's domestic borrowings were as detailed in Annexure ..... (Now to be in compliance with Section 180 of Companies Act, 2013).

*https://icmai.in/upload/Institute/Updates_Archives/RBI_Letter_100209.pdf

8. The Company has not defaulted in the repayment of public deposits, unsecured loans, debentures, facilities granted by banks, financial institutions and non-banking financial companies. (Section 73- 76 of Companies Act 2013)

9. The Company has created, modified or satisfied charges on the assets of the company as detailed in Annexure ..... Investments in wholly owned Subsidiaries and/or Joint Ventures abroad made by the company are as detailed in Annexure (Now to be in compliance with Section 77-87 of Companies Act, 2013).

10. Principal value of the forex exposure and Overseas Borrowings of the company as on ..... are as detailed in the Annexure under.

11. The Company has issued and allotted the securities to the persons-entitled thereto and has also issued letters, coupons, warrants and certificates thereof as applicable to the concerned persons and also redeemed its preference shares/debentures and bought back its shares within the stipulated time in compliance with the provisions of the Companies Act, 1956 (now to be in compliance with relevant sections of Companies Act, 2013) and other relevant statutes.

12. The Company has insured all its secured assets. (Now to be in compliance with relevant provisions of Chapter IV of Companies Act, 2013.)

13. The Company has complied with the terms and conditions, set forth by the lending bank/financial institutions at the time of availing any facility and also during the currency of the facility.

14. The Company has declared and paid dividends to its shareholders as per the provisions of the Companies Act, 1956. (Now to be in compliance with relevant sections of Chapter VIII of Companies Act, 2013).

15. The Company has insured fully all its assets.

16. The name of the Company and or any of its Directors does not appear in the defaulters' list of Reserve Bank of India.

17. The name of the Company and or any of its Directors does not appear in the Specific Approval List of Export Credit Guarantee Corporation.

18. The Company has paid all its Statutory dues and satisfactory arrangements had been made for arrears of any such dues.

19. The funds borrowed from banks/financial institutions have been used by the company for the purpose for which they were borrowed.

20. The Company has complied with the provisions stipulated in Section 372A of the Companies Act in respect of its Inter Corporate loans and investments. (Now to be in compliance with Section 186 of Companies Act, 2013).

21. It has been observed from the Reports of the Directors and the Auditors that the Company has complied with the applicable Accounting Standards issued by the Institute of Chartered Accountants in India.

22. The Company has credited and paid to the Investor Education and Protection Fund within the stipulated time, all the unpaid dividends and other amounts required to be so credited.

23. Prosecutions initiated against or show cause notices received by the Company for alleged defaults/ offences under various statutory provisions and also fines and penalties imposed on the Company and or any other action initiated against the Company and /or its directors in such cases are detailed in Annexure .....

24. The Company has (being a listed entity) complied with the provisions of the Listing Agreement (Now to be in compliance with the SEBI (LODR) Regulations, 2015).

25. The Company has deposited within the stipulated time both Employees' and Employer's contribution to Provident Fund with the prescribed authorities.

Note: The qualification, reservation or adverse remarks, if any, are explicitly stated and may be stated at the relevant paragraphs above place(s).

Signature:

Name of Company Secretary/Firm:

C.P. No.:

Place:

Date:

CERTAIN OTHER TYPES OF DUE DILIGENCE

Ethical Due Diligence

Ethical Due Diligence measures ethical character of the company and identify the possibilities of ethical risks, which is a non-financial risk. It may relate to reputation, governance, ethical values etc. It helps an organization to decide whether the partner is ethically viable. This is an effective reputation management tool for any type of business decisions.

Ethical due diligence of management of a company involves assessing employees in terms of their fit with the ethical culture and values of the organization. Ethical performance assessment is also used as one of the parameter of the career development and promotion within the organization.

Carrying out the assessment of a company's ethics as part of a due diligence can add considerably to the depth of insight into the target company. For an ethics assessment to add this value, it is crucial that it is an accurate and reliable assessment.

Strategic Due Diligence

Strategic due diligence tests the strategic rationale behind a proposed transaction and analyses whether the deal is commercially viable, whether the targeted value would be realized. It considers factors such as value creation opportunities, competitive position, and critical capabilities. Strategic due diligence focuses on determining how much adequate, realistic, and attainable is a deal's value. Strategic due diligence is broader and considers micro and macro-environmental factors of a business, connecting the legal and financial consideration with a long-term focus. Essentially strategic due diligence determines the question, "Whether a business plan can hold up to the market realities?"

Operational Due Diligence

Operational Due Diligence diagnoses of the organization's historical and current operational performance, cost structure, map of potential synergies. It aims at the assessment of the functional operations of the target company, connectivity between operations, technological up gradation in operational process, financial impact on operational efficiency etc. Operation due diligence involves verifying operational matters such as the various facilities, office layout, sitting capacity etc. Further in operational due diligence the detailed index of the fixed assets and its locations, age of the assets including all lease agreements relating to various equipment, schedule of sales and purchases of major capital equipment during previous years/ last three years, real estate deeds, mortgages, title policies and other permits also need to be verified in operation due diligence.

Benefits of Operational Due Diligence:

- It also uncovers aspects on operational weakness, inadequacy of control mechanisms etc.
- It also gives a better picture of the kind of cost the buyer is going to incur in case they plan to go for expansion.
- It verifies the various facilities owned by the target company and whether all costs are captured in the financials or not.

Human Resource Due Diligence

Human Resource Due Diligence evaluates the company's organizational structure, HR practices and policies, collective agreements, compensation programs, ratios of labour turnover and demographic analysis of the Company. It aims at people or related issues. Key managers and scarce talent leave unexpectedly. Valuable operating synergies get disturbed when cultural differences between companies are not understood or are simply ignored. It is crucial to consider cultural and employees' issues upfront, for success of any venture.

CASE STUDY

A manufacturing firm that builds components for lithium batteries wants to develop and manufacture entire battery systems autonomously. They are looking at merging with a mid-sized firm that is into manufacturing battery cases and would be interested in conducting strategic diligence to identify firms that align with the vision of the company, and who can enable their manufacturing objectives. They find the best fit for the company and observe that a proper diligence on the human resources of the firm is crucially fundamental, as the operations of the manufacturer are labour intensive.

To understand if the work culture can align with their objectives, the executives from the former firm conduct diligence on the HR policies in place. The results were favourable, as the policies in place were conducive to the merger. They further conduct thorough diligence on the employee demographics for a better understanding of the salaries, tenure, specific skill sets, work hours put in, the average age and the bonuses drawn. There is a thorough assessment of any pending litigations or claims regarding breach of contracts, pensions, and employee's compensation to ensure everything is in order before proceeding with the merger documentation.

Elements of Human Resource Due Diligence

- List of employees, their positions and salaries.
- All employment contracts with non-disclosure, non-solicitation and non-competition agreements between the company and its employees. In case there are few irregularities regarding the general contracts, focus must be given.
- Analysis of total employees, including current positions, vacancy, due for retirement and serving notice period.
- Analysis of employee problems for alleged wrongful termination, harassment, discrimination and any legal case pending about the same.
- Analysis of current salaries, bonuses paid during last three years and years of service.
- A list and description of all employee health benefits and welfare insurance policies or self-funded arrangements.
- HR policies regarding annual leave, sick leave and other forms of leave.

- In case there are labor disputes, requests for arbitration, or grievance procedures currently pending and its financial impact needs to be seen.
- Employee Benefit Schemes and schedule of grants of such scheme.
- Details of options given/vested under ESOP scheme.
- Employee harassment reports if any.
- Cultural issues in case of cross border transactions.

CASE STUDY

Microsoft was running into serious internal problems with its organizational structure and human resources. It wasn't until the new CEO Satya Nadella took charge and started to undertake some major restructuring for this massive company. At a very high level, we can see some of the fruits of Nadella's ideas by looking at Microsoft's stock price.

Even after the phenomenal and long-lived success of Windows and Office products, Microsoft was struggling to keep up with other companies — specifically, with Google becoming dominant in the search and software market and Apple owning the phone market. The tech giant was stagnant and rife with internal wars between major departments that often viewed each other more as competitors than partners within the same company. As a result, innovation was being thwarted by a toxic environment that kept the company increasingly dependent on Windows and Office. While both products are very successful, the stagnation put the company in a dangerous "comfort" zone.

How Microsoft optimized its processes and unified its teams:

After being named CEO in February 2014, Satya Nadella undertook a major restructuring of the tech giant to eliminate its destructive internal competition. Microsoft products and platforms would no longer exist as separate groups. Instead, all employees would start focusing on a limited set of common goals — and bringing them all together. Their new common functions include:

- Reinventing productivity and business processes
- Building an intelligent cloud platform
- Creating more personal computing.

In September 2016, Nadella created a new AI and Research Group by merging their original research group with the Bing, Cortana, and Information Platform teams. This move brought roughly 5,000 engineers and computer scientists together to focus on artificial innovation across all Microsoft product lines.

A new, meaningful mission.

Right at the beginning, Nadella shared a new sense of mission with his employees: "To empower every person and every organization on the planet to achieve more." Prior to the restructuring, employees had been lacking a positive sense of purpose, with the result being low morale and weakened employee engagement.

Impact:

The appointment of Mr. Nadella as Microsoft CEO has brought a positive change in the working culture of Microsoft. Before his appointment, though the company's revenue was increasing, the stock price stagnated for almost a decade but as soon as he took the charge the stock price starts climbing up. Microsoft's cloud service Azure became profitable and it reached a $1 trillion valuation in 2019.

INFORMATION TECHNOLOGY DUE DILIGENCE

Today in era of Technology, it is utmost require to examine all system, policy, process, procedure and policy related to information technology. It provides with the following benefits:

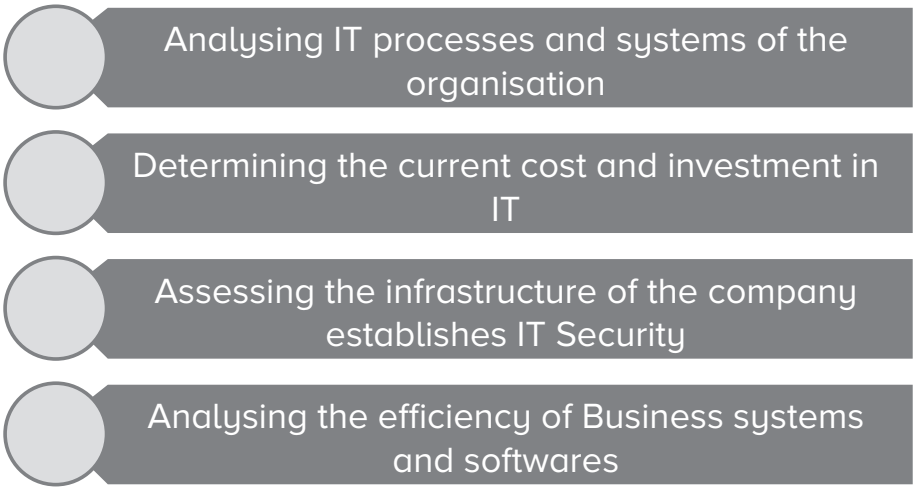
- A clear understanding of technological capability of the organisation.
- Identification and assessment of the risks associated with technology adapted by the organisation.
- Impact of the information technology on the particular business transaction.

Information security due diligence is often undertaken during the information technology procurement process to ensure that risks are uncovered. However, the regular review internal information security system helps to identify security gaps, as well as ensure that the company is acting with an acceptable standard of care elevate existing information security management system.

Information security due diligence apprises the acquirers with the target company's existing security network, it is risk level, and ways to mitigate the risks. The information security due diligence covers the following:

- Information Security Measure
- Data Protection/ sharing policy
- Network and System design
- Wireless and Remote Access facility
- Incident management

Essentials of Information Technology Due Diligence



Information Technology due diligence is important because it protects organizations from risks — risks that can become incredibly costly if left unchecked. A recent report from IBM and the Ponemon Institute found that the average cost of a data breach reached $4.35 million in 2022, which marks a 2.6% increase from 2021."

NON DISCLOSURE AGREEMENT

A non-disclosure agreement is defined as a legally enforceable contract that creates a confidential relationship between a person who holds some kind of trade secret and a person to whom the secret will be disclosed.

The Confidentiality agreements typically serve three key functions:

- To protect sensitive information. By signing an NDA, participants promise to not divulge or release information shared with them by the other people involved. If the information is leaked, the injured person can claim breach of contract.
- In the case of new product or concept development, a confidentiality agreement can help the inventor keep patent rights. In many cases, public disclosure of a new invention can void patent rights. A properly drafted NDA can help the original creator hold onto the rights to a product or idea.
- Confidentiality agreements and NDAs expressly outline what information is private and what's fair game. In many cases, the agreement serves as a document that classifies exclusive and confidential information.

Content of the Non-Disclosure Agreements

1. *Definitions and exclusions of confidential information;*

   Definitions of confidential information spell out the categories or types of information covered by the agreement. This specific element serves to establish the rules-or subject/consideration-of the contract without actually releasing the precise information.

2. *Obligations from all involved people or parties; and time periods.*

   At the same time, nondisclosure agreements often exclude some information from protection. Exclusions might comprise information already considered common knowledge or data collected before the agreement was signed. Additionally, Time periods are also commonly addressed in NDAs and usually require that the party receiving the information stays mum for a number of years. This specific information is usually up for negotiation.

Sample Non-Disclosure agreement is placed below:

XYZ Limited

Non-Disclosure Agreement

This Agreement is entered into effective as of _____ between _____. (the "Company") and _____, ("Recipient"). Recipient is acting as an expert advising the Company in connection with a [_____], and for that purpose, the Company may make certain Confidential Information (as defined below) available to the Recipient (the "Purpose").

As a condition to, and in consideration of, the Company's furnishing of Confidential Information to the Recipient, the Recipient agrees to the restrictions and undertakings contained in this Agreement.

IT IS HEREBY AGREED AS FOLLOWS.

1. Definitions

In this Agreement:

1.1 Confidential Information:

(a) means any information disclosed by one Party (the "Disclosing Party") to any other Party (the "Receiving Party") or which is otherwise communicated to or comes to the attention of the Receiving Party whether such information is in writing, oral or in any other form or media and whether such disclosure, communication or coming to the attention of the Receiving Party occurs prior to or during this Agreement; and

(b) includes without limit:

(i) any information which can be obtained by examination, testing or analysis of any hardware, any component part thereof, software or material samples provided by the Disclosing Party under the terms of this Agreement;

(ii) all information disclosed by one Party to any of the other Parties relating directly or indirectly to the Purpose;

(iii) the fact that the Parties are interested in or assessing the Purpose and/or are discussing the Purpose with each other; and

(iv) the terms of any agreement reached by the Parties or proposed by any of the Parties (whether or not agreed) in connection with the Purpose;

(v) all knowledge, information or materials (whether provided in hardcopy or electronic or other form or media) whether of a technical or financial nature or otherwise relating in any manner to the business affairs of the Disclosing Party (or any parent, subsidiary or associated company of that party) software, samples, devices, demonstrations, know-how or other materials of whatever description, whether subject to or protected by copyright, patent, trademark, registered or unregistered design.

2. Undertakings

Subject to clause 3 below and in consideration of the disclosure of Confidential Information by the Disclosing Party, the Receiving Party agrees:-

(i) to keep confidential and not disclose to any third party, copy, reproduce, adapt, divulge, publish or circulate any part of or the whole of any Confidential Information without the prior written consent of the Disclosing Party; and

(ii) to restrict access to the Confidential Information disclosed to it under this Agreement to those of its employees and officers who need to know the same strictly for the Purpose; and

(iii) not to use Confidential Information disclosed to it under this Agreement for any purpose other than the Purpose; and

(iv) not to combine any part of or the whole of the Confidential Information with any other information; and

(v) not to disclose the whole or any part of the Confidential Information to any third party without (a) the prior written consent of the Disclosing Party and (b) prior to disclosure to such third party procuring that the third party is bound by obligations which are no less onerous than those contained in this Agreement; and

(vi) to procure that each employee and officer to whom Confidential Information is disclosed under this Agreement is, prior to such disclosure, informed of the terms of this Agreement and agrees to be bound by them; and

(vii) to procure that the Confidential Information in its possession is stored securely and that physical access to it is controlled.

3. Exceptions

3.1 The protections and restrictions in this Agreement as to the use and disclosure of Confidential Information shall not apply to any information which the Receiving Party can show:-

(a) is, at the time of disclosure hereunder, already published or otherwise publicly available; or

(b) is, after disclosure hereunder published or becomes available to the public other than by breach of this Agreement; or

(c) is rightfully in the Receiving Party's possession with rights to use and disclose, prior to receipt from the Disclosing Party; or

(d) is rightfully disclosed to the Receiving Party by a third party with rights to use and disclose; or

(e) is independently developed by or for the Receiving Party without reference or access to Confidential Information disclosed hereunder.

3.2 The Receiving Party shall not be in breach of Clause 2 if it can demonstrate that any disclosure of Confidential Information was made solely and to the extent necessary to comply with a statutory or judicial obligation.

4. No title of Use

Nothing contained in this Agreement shall be construed as conferring upon the Receiving Party any right of use in or title to Confidential Information received by it from the Disclosing Party, other than as expressly provided herein:-

(i)

(ii)

5. No Obligation to Disclose, No Representations

Nothing in this Agreement shall be construed as?

(i) creating an obligation on any of the Parties to disclose particular information; or

(ii) creating an obligation on the parties to negotiate; or

(iii) as a representation as to the accuracy, completeness, quality or reliability of the information.

6. Term & Termination

6.1 Subject to clause 3, the obligations contained in clause 2 shall continue to apply for so long as the Receiving Party has in its possession or has procured that any third party authorized under this Agreement has in its possession any Confidential Information.

6.2 The Receiving Party shall, on the request of the Disclosing Party, return to the Disclosing Party (whose property they shall remain) all documents and things containing Confidential Information, together with all relevant samples and models which it has in its possession pursuant to this Agreement.

7. Miscellaneous

7.1 No Party shall assign its rights and/or obligations pursuant to this Agreement without the prior written consent of the other Party.

7.2 No failure or delay by either party in exercising any rights, power or legal remedy available to it hereunder shall operate as a waiver thereof.

7.3 In the event any one or more of the provisions contained in this Agreement shall for any reason be held to be invalid, illegal or unenforceable in any respect, such invalidity, illegality or unenforceability shall not affect any other provision of this Agreement but this Agreement shall be construed as if such invalid, illegal or unenforceable provision had never been set forth herein, and the Agreement shall be carried out as nearly as possible according to its original terms and intent.

7.4 This Agreement shall be construed and governed in all respects in accordance with the laws of India and the Parties hereby submit to the jurisdiction of the Indian courts.

7.5 The signing of this Agreement shall not be construed as the forming of an agency, joint venture, employment or partnership.

Signed for and on behalf "XYZ Limited"

By its duly authorized representative

_____

(Signature) _____

(Name) _____

(Title/position) _____

(Date) _____

Signed for and on behalf "ABC Limited"

By its duly authorized representative

_____

(Signature) _____

(Name) _____

(Title/position) _____

(Date) _____

LESSON ROUND-UP

- The objective of due diligence is to Collection of material of information, Identification of strength and threats and weaknesses, to improving the bargaining position, Identification of areas where representations and warranties are required.
- A due diligence process can be divided into three stages i.e. (i) Pre diligence, (ii) Diligence, and (iii) Post Diligence.
- Operational due diligence aims at the assessment of the functional operations of the target company, connectivity between operations, technological up gradation in operational process, financial impact on operational efficiency etc.
- Due diligence and risk assessment and control represent separate and distinct processes that take place prior to the commencement, and throughout the duration, of a commercial agreement respectively.
- The objective of due diligence is to verify the strategic identification or attractiveness of the target company, valuation, risk associated etc.
- Scope of due diligence is transaction based and is depending on the needs of the people who are involved in the potential investments, in addressing key uncovered issues, areas of concern/ threat and in identifying additional opportunities.
- The first and foremost step for the management of the target company, is that the investor is to sign a Letter of Intent (LOI) or a term sheet which underlines the various terms on which the proposed deal is going to be concluded.
- As regards the process of diligence, as a professional care should be taken to scrutinize every document that is made available and ask for details and clarifications, since the Due diligence is a time bound activity and is needed to be wrapped up at the earliest.
- After the diligence is conducted, the professionals submit a report which in common parlance which is called as Due Diligence report.

- Post diligence sometimes result in rectification of non-compliances found during the course of due diligence. There can be interesting assignments arising out of the diligence made by the team of professionals.
- Due diligence and risk assessment and control represent separate and distinct processes that take place prior to the commencement and throughout the duration of a commercial agreement respectively.
- In business transactions, the due diligence process varies for different types of companies. The relevant areas of concern may include the financial, legal, bank, labour, tax, environment and market/commercial situation of the company.
- A legal Due Diligence is a process of assessing all legal risks associated with organisation structure, its assets, contracts, securities, contracts, intellectual property, etc. of the target company.
- Financial Due Diligence is the process of analysing requiring inquiry, analysis and interpretation of financial and operational data to assist a buyer in assessing certain risks and opportunities involved in a potential transaction.

GLOSSARY

Acquisition : Acquisition means, directly or indirectly, acquiring or agreeing to acquire shares or voting rights in, or control over, a target company.

Business Transaction : Business Transaction includes any corporate action relating to the merger, de-merger, amalgamation, take over, joint venture etc.

Exaggerated credentials : Exaggerated Credentials means overstating and misleading the documents, reports, valuations, company's profile etc to describe it as more impressive than it really is.

Intellectual Property : Intellectual Property is a category of intangible asset and includes trademark, copyright, patent, design and geographical indication.

Joint Venture : A joint venture means a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

SWOT Analysis : A SWOT Analysis is a technique used to determine and define one's Strengths, Weaknesses, Opportunities, and Threats – SWOT.

Target Company : A target company includes a company chosen as an attractive capital restructuring option by a potential acquirer.

Term sheet : A term sheet is a document containing the material terms and conditions of a potential business agreement, establishing the basis for future negotiations between a seller and buyer.

TEST YOURSELF

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation)

1. What are the stages of M&A due diligence?
2. Whether Intellectual Property Due Diligence can be considered as Technical Due Diligence? Prepare a brief note.
4. Draft the confidentiality clause of the non-disclosure agreement?
5. What do you mean by the term Non-Disclosure Agreement (NDA)? Explain its functions and content.
6. Describe various heads of Due Diligence of Competition Law?
7. Prepare a brief note on Right to Access Records and Methodology for Diligence Reporting.
8. Mega Ltd. has identified Helping Hands, a reputed NGO for executing its CSR activities as an implementation agency. However, one of the directors suggested it would be better if the company considers to go for a FCRA due diligence before finalizing and appointing the NGO. Explain in brief about the FCRA due diligence.

LIST OF FURTHER READINGS

- ICSI Publication: Guidance Note Guidance Note On Diligence Report For Banks Diligence Report For Banks
- Background Material on Due Diligence by the Institute of Chartered Accountants of India

OTHER REFERENCES (Including Websites / Video Links)

- https://fcraonline.nic.in/home/index.aspx
- https://www.sebi.gov.in/
- https://www.rbi.org.in/
- https://ipindia.gov.in/
- https://labour.gov.in/
- https://www.cci.gov.in/
- https://www.icsi.edu/media/webmodules/11112021_DUE_DILIGENCE.PDF
- https://economictimes.indiatimes.com/industry/services/consultancy-/-audit/icai-panel-pulls-up-banks-for-not-doing-due-diligence-on satyam/articleshow/5761331.cms
- https://in.indeed.com/career-advice/career-development/due-diligence
- https://www.tinypulse.com/blog/3-examples-of-organizational-change-and-why-they-got-it-right
- https://tradebrains.in/biggest-mergers-acquisition-india/
- https://businesscloud.co.uk/

WARNING

Regulation 27 of the Company Secretaries Regulations, 1982

In the event of any misconduct by a registered student or a candidate enrolled for any examination conducted by the Institute, the Council or any Committee formed by the Council in this regard, may suo-moto or on receipt of a complaint, if it is satisfied that, the misconduct is proved after such investigation as it may deem necessary and after giving such student or candidate an opportunity of being heard, suspend or debar him from appearing in any one or more examinations, cancel his examination result, or registration as a student, or debar him from re-registration as a student, or take such action as may be deemed fit.

It may be noted that according to regulation 2(ia) of the Company Secretaries Regulations, 1982, 'misconduct' in relation to a registered student or a candidate enrolled for any examination conducted by the Institute means behaviour in disorderly manner in relation to the Institute or in or around an examination centre or premises, or breach of any provision of the Act, rule, regulation, notification, condition, guideline, direction, advisory, circular of the Institute, or adoption of malpractices with regard to postal or oral tuition or resorting to or attempting to resort to unfair means in connection with writing of any examination conducted by the Institute, or tampering with the Institute's record or database, writing or sharing information about the Institute on public forums, social networking or any print or electronic media which is defamatory or any other act which may harm, damage, hamper or challenge the secrecy, decorum or sanctity of examination or training or any policy of the Institute.

PROFESSIONAL PROGRAMME
COMPLIANCE MANAGEMENT, AUDIT & DUE DILIGENCE
GROUP 1 • PAPER 3

(This test paper is for practice and self-study only and not to be sent to the Institute)

Time Allowed: 3 Hours *Maximum Marks: 100*

Answer ALL Questions

Answering case study based questions are compulsory.

PART I: COMPLIANCE MANAGEMENT (40 MARKS)

Question No. 1

M/s. ABC Limited was incorporated on 29.11.2018 under the provisions of Companies Act, 2013 and having its registered office at Business Enclave, C-58/14, Basant Kunj, New Delhi as per records maintained in the Registrar of Companies. Whereas a complaint has been received from Mr. "X", who is the owner of premises, where the company is having its registered office w.e.f.01.08.2019; wherein the complainant Mr. "X" has complained about the illegal running of company and involved in unlawful activities at his above-mentioned premises.

After inquiry and examination of records by the Investigating Officer it has been observed that the company has not filed Annual Return for the F.Y. 2019-20, 2020-21, 2021-22. Thus, company and its directors has violated the of provisions of Section 92(4) and liable for action u/s 92(5) of the Companies Act, 2013. During the Inquiry it was pointed out by the Investigating Officer that the turnover of the company exceeds the Rs.1000 Crore. Hence, in compliance of the Section 138 of the Companies Act, 2013, the company shall appoint internal auditor & shall conduct audit in the company. However, the company neither appointed internal auditor and nor conducted audit in the company and failed to comply with requirements of section 138 of the Companies Act, 2013. Mr. "Z" is the Company Secretary of M/s. ABC Limited and was not discharge his professional responsibility as a Key Managerial Person towards the Board or to the company.

Whereas adjudication of penalty for violation of Sections 12, 92, 138 of Companies Act, 2013 was initiated by the Adjudicating Officer against the company and its Key Managerial Personnel and the orders passed by the Adjudicating Officer were served upon them through registered post. The copy of were duly served/ delivered upon the M/s. ABC limited and Ms. Moon, Director; while the same notice addressed to other directors returned undelivered on 01.08.2023 from the address of the directors namely Mr. Jupiter and Mr. Mars. It is transpired that the directors namely Mr. Jupiter and Mr. Mars are not present at their declared address as per particulars filled in DIN application form and that they have failed to intimate their change of address with the MCA in the prescribed form DIR-6 as required under Rule 12 of the Companies (Appointments and Qualifications of Directors) Rules, 2014.

Based on the above facts, answer the following questions:

(a) Whether violation of Sections 12, 92, 138 of Companies Act, 2013 by M/s. ABC Limited is Compoundable Offences? Whether joint application by Company and Key Managerial Personnel in default are allowed?

(b) Whether Mr. Jupiter and Mr. Mars are liable under Section 447 of Companies Act, 2013 for the act of concealment/suppression of material fact to the Registrar of Companies for not disclosing the change of address?

(c) "Though a Company Secretary is entitled to enjoy some rights and powers as laid down in the Companies Act, yet his position is not free from liabilities". Comment.

(d) According to the Companies Act, 2013 read with the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, the Company Secretary must perform the certain functions and duties. Elucidate.

(5 Marks each)

Attempt all parts of either Q. No. 2 or Q. No. 2A

Question No. 2

Luke Graves (Luke) is the long-serving Chief Executive Officer (CEO) of Hornbill Ltd., a listed company. He had a meeting with the newly-appointed Chairman of the company, Ross Plank (Ross). A number of different items were on the agenda for discussion. Luke said that he has decided to insert a Compliance framework as a system designed to assist an Organisation to meet its obligations and to Reduce the risk of non- compliance. He further added that a systematic compliance framework establishes better compliance platform by timely compliances with the provisions of various statutes including, laws, rules & regulations, procedures therein. He had also discussed the company's performance over the past few months. Luke added that he had also discussed the company's main business strategies with executives and had informed them that he intended to establish a strategy committee within the company, consisting of the executive directors and other senior executives for implementing the decision. Luke and Ross later on discussed on Compliance monitoring which is the most essential mechanism of corporate compliance framework because it enables companies to recognize whether their compliance framework has been implemented in practice and whether it is practicable, responsive, and suitable for the characteristics of the company. Deliberation also took place for arranging a strong compliance training and education program which reinforces company compliance culture.

Based on the Luke and Ross meeting and discussions, answer the following questions:

(a) Elucidate the components of corporate compliance framework.

(b) At the time of discussion on corporate compliance framework of the company, Mr. Ross commented that the Compliance Chart is a vital part of the framework and the company must at present first focus on preparation of the Compliance Chart. Explain the activities in preparation of a compliance chart and its contents.

(c) "Compliance monitoring is the most essential mechanism of corporate compliance framework because it enables companies to recognize whether their compliance framework has been implemented in practice and whether it is practicable, responsive, and suitable for the characteristics of the company". Explain.

(d) "A strong compliance training and education program reinforces company compliance culture" Comment.

(5 Marks each)

OR (Alternate Question to Q. No. 2)

Question No. 2A

(i) A complaint of professional misconduct is filed with ICSI against Ravi, a Practicing Company Secretary. The Disciplinary Committee of ICSI is of the opinion that Ravi is guilty of professional misconduct mentioned in the Second Schedule to the Company Secretaries Act, 1980. The Committee, after affording Ravi an opportunity of being heard, ordered for removal of his name from Register permanently and also imposed penalty of Rs.10 lakh. Is the action of the Committee valid? What actions can the Board of Discipline (a separate authority) take if it is of the opinion that a member is guilty of professional misconduct mentioned in the First Schedule to the Act, 1980?

(ii) ABC Ltd. had a paid-up share capital of Rs. 275 crores in the previous year 2022-23. Explain how a Practicing Company Secretary can prepare himself for such a big assignment before undertaking the work relating to pre-certification so that the chances of incorrect certification will not be there.

(iii) 'S' was appointed as Managing Director of VPR Mart Limited recently. During the meeting of the Board, he desires that all agenda files should be sent by email encrypted by password. He also desires that to

protect the file from hacking, there should be some special name to the file. As a company secretary, kindly highlight any eight best practices for file naming.

(iv) Thinking Star Limited, a Public Limited Company was into manufacturing of steel and steel products. The Company wanted to expand its operations and to fund the same, it evaluated various options including bank loan, private placement, etc. However, due to a paucity of time the Company went ahead and funded its operations by issuing shares to a friend of Mr. XY, the Managing Director of the Company on private placement basis. The Company failed to comply with the provisions of the Companies Act, 2013. Mr. XY was not willing to act, unless there was any notice from the regulators. Mr. S, the Corporate Advisor to the Company suggested Mr. XY to compound the offence as it would be in the best interest of the Company.

Under the Companies Act, 2013, where a Company seeks compounding before institution of any prosecution, whether any prosecution shall be instituted in relation to such offences either by Registrar of Companies or any person authorised by the Central Government'?

(5 Marks each)

PART – II: AUDIT & DUE DILIGENCE (60 MARKS)

Question No. 3

Managing Director, Chief Financial Officer and Company Secretary of the ABC Limited were having a meeting on angles of independence of audit and conducted research on top hundred companies for their adaptation of criteria of internal audit.

The Company secretary of the company has conducted detailed research and shown below facts:

Independence of audit refers to the independence of the auditor including statutory auditor, internal auditor, secretarial auditor, cost auditor or any other external auditor from parties that may have a financial interest in the business being audited. The auditor plays a critical role in lending independent credibility to published financial statements

used by investors, creditors and other stakeholders. The company should ensure that the annual audit is conducted by an independent, qualified and competent auditor in accordance with high-quality auditing standards in order to provide an external and objective assurance to the Board and Shareholders that the financial statements fairly represent the financial position and performance of the company in all material respects.

Observation:

Out of the total companies evaluated, in 62% of the company's Internal Audit is conducted by an External Agency and in 38% of the companies it is conducted by the Internal Team.

Independence of audit is the foundation of the auditing profession. An independent, reliable, and ethically sound audit enhance the credibility of a company and allows the public to trust the accuracy of the results and the integrity if the accounting profession.

Based on the above discussion, answer the following questions:

(a) The concept of the internal audit has been recognized as a statutory exercise under Section 138 of the Companies Act, 2013, and has been made mandatory. As per Rule 13 of Companies (Accounts) Rule, 2014, the certain class of companies shall be required to appoint an internal auditor which may be either an individual or a partnership firm or a body corporate. Explain.

(b) Discuss the factors impairing the independence of internal auditors. Elucidate.

(c) "Internal Audit effects the efficiency of internal control, operations, the reliability of financial reporting, deterring and detecting fraud and compliance with laws and regulations". Comment.

(5 Marks each)

Question No. 4

You are a Company Secretary of a manufacturing company; the company has enrolled your name for attending a 2 days residential workshop on the topic "risk management'. You have attended the workshop and prepared below mentioned notes:

In the corporate context, 'Risk' may be defined as the possibility of an occurrence of event that can adversely affect the achievement of a company's objectives and goals. Risk is inherent in every business, whether it is of financial nature or non-financial nature. Thus, management of the risk is very important.

Risk management is a structured, consistent and continues process, applied across the Organisation for the identification and assessment of risks. Control assessment and exposure monitoring.

Risk management begins with the risk identification, analyzing the risk factors, making an assessment of the risk and mitigation of the risk. Better risk management techniques provide early warning signals so that the same may be addressed in time. In a traditional concept, the natural calamities like fire, earthquake, flood etc. were only treated as risk and keeping the safeguard equipment, etc. were assumed to have mitigated the risk.

But now, in the era of fast-changing global economy, the management of various types of risks (for example-industry and service risks, management and operational risks, market risks, political risks, disaster risks, sustainability risks, cyber security risks etc.) has gained utmost importance. The International Organisation for Standardization (ISO) has also identifies principles of risk management.

Based on the above-mentioned notes, answer the following questions:

(a) Risk profiling of a Company may include the certain types of risks. Explain.

(b) Elucidate Risk Assessment considering the existing Internal Control Mechanism.

(c) Risk management begins with the risk identification, analyzing the risk factors, making an assessment of the risk and mitigation of the risk. Analyze.

(5 Marks each)

Question No. 5

(i) M/s S. Core Advisory Services Pvt. Ltd. has submitted its bid invited through International Bidding Process by RE Textiles & Yarns Ltd. Being a lowest bid, the letter of award was issued in favour of M/s S.Core Advisory Services Pvt. Ltd. for providing consultancy services to set up a Knitting Fabric Plant at Maharashtra. M/s S.Core Advisory Services Pvt. Ltd. is already providing consultancy services to various organizations in India and outside India. RE Textiles & Yarns Ltd. asks M/s S.Core Advisory Services Pvt. Ltd. to enter into a Non-Disclosure Agreement. The Agreement is proposed to be signed at Mumbai. The Management of RE Textiles & Yarns Ltd. wants to include the following clauses in the Agreement:

(1) No Title to Use

(2) No Obligation to Disclose, No Representations

Prepare a brief note on above two clauses required to be included in the Non-Disclosure Agreement.

(ii) Z Ltd. is a listed Company, in pharma sector. During the Covid-19, for expansion, it acquired M Ltd., which is an unlisted Company. The medicine in Highly demand named 'ROLO' was produced by M Ltd. in large quantity. During the investigation, it was found that there was big scam, where the merged entity has given huge incentives amounting Rs. 2000 Crore approximately to medical professionals for recommending the ROLO. The government has also constituted a special committee to report on the same. A Company Secretary firm was engaged to report on fraud. In view of this type of cases, what other types of transactions to be noticed under the term of 'Fraud'. Who is considered as an Auditor for fraud reporting?

(iii) Discuss the types of information with respect to 'Maintenance of Professional Skills and Standards' are sought by Quality Review Board during the peer review of Practicing Company Secretary/Firm.

(5 Marks each)

Attempt all parts of either Q. No. 6 or 6A

Question No. 6

(a) X, Y and Z are three partners in JK LLP, a firm of Practicing Company Secretaries. X holds 1% paid-up share capital in ABC Ltd. Y holds shares of nominal value of Rs. 70,000/- in ABC Ltd. Referring the provisions relating to ICSI Auditing Standards, advise whether JK LLP can be engaged for the Secretarial Audit of ABC Ltd.

(5 Marks)

(b) ABC Pvt. Ltd. is a subsidiary company of a XYZ Ltd. having a paid-up capital of Rs. 60 Crore and Turnover of Rs. 180 crores as per the audited balance sheet as on 31st March, 2021. Referring to the provisions of the Companies Act, 2013, answer the following:

(i) Whether the ABC Pvt. Ltd. is obliged for conducting of secretarial audit?

(ii) Whether the Cost Accountant in Practice who is also a Company Secretary can be a competent professional for the appointing as a 'Secretarial Auditor'?

(iii) To whom the secretarial audit report is required to be addressed?

(iv) In which prescribed form secretarial audit report is required to be submitted by the auditor?

(v) What are the penal provisions, if Secretarial Auditor doesn't comply with the provisions of section 143 (12) of the Companies Act, 2013?

(5 Marks)

(c) You as a practicing Company Secretary has been approached by Popular Bank to carry out due diligence regarding the loan of Rs. 50 crores to be given to Weak Ltd. How would you find that the company has misused borrowed funds from banks/ financial institutions from the purpose for which they were borrowed and there has been Siphoning of Fund?

(5 Marks)

OR (Alternate questions to Q. No. 6)

Question No. 6A

Since the last ten years, Vijaya Ltd. has been misreporting its financial accounting accounts, which have been duly audited by the Practicing Chartered Accountants (PCA) Partnership business. Vijaya Ltd. had no choice but to declare itself as bankrupt when the company's financial situation deteriorated to the point that it was unable to pay any current liabilities as well. During the discussion and under pressure from stakeholders, Vijaya Ltd. published a press release claiming that there is a discrepancy between actual and reported earnings over the last decade due to accounting irregularities.

During the course of the forensic audit, it was discovered that the auditing firm's independence had been compromised by a huge audit fee and hefty consultant income. Because Vijaya Ltd. was such a significant client for PCA, it had intentionally signed off on incorrect statements to protect the company's management. The examination also discovered a number of serious internal control flaws, including a lack of effective management oversight of the external reporting process and a disregard for applicable accounting standards.

Assuming the above-mentioned circumstances for the secretarial audit done by Mr. X (PCS) for Vijaya Limited, answer the following questions:

(i) Briefly explain the Procedure of Forensic Auditing Investigation.

(ii) Audit fee which is to be charge by the auditor depends on several factors, Elucidate.

(iii) How Internal Audit effects the efficiency of internal control, operations, the reliability of financial reporting, deterring and detecting fraud and compliance with laws and regulations?

(5 Marks each)

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