

Secretarial Audit – is Form MR 3 Adequate?



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The only constant in life is change”-Heraclitus

In Honduras, Central America, the government built a new bridge over the river Choluteca to connect it to a new bypass road. For a country known for its fiery hurricanes, they should build a bridge in such a way that it should withstand Nature’s fury. And they did it. A Japanese firm built the bridge with the latest technology available.

The construction began in 1996 and ended in 1998. After a few months, Hurricane Mitch hit Honduras and deposited 75 inches of rain in four days, equivalent to what they received in six months. The river Choluteca flooded the country. Over 7000 people lost their lives. The hurricane damaged or destroyed most of the bridges except one. The new Choluteca Bridge remained unaffected. It withstood the hurricane’s fury. But there was a ‘small’ problem.

The river changed course. It formed a new channel. It no longer flowed beneath the bridge. The river flowed beside the bridge. The Choluteca Bridge became a bridge to nowhere.

Moral of the story is that we need to change with the ever changing world, Pandemic Situations, Major companies looking forward to do business in India and the enthusiastic Central government always looking at facilitating ease of doing business

The Secretarial Audit is governed by Section 204(1) of the Companies Act, 2013. The requirement of Rule 9 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 relating to Secretarial Audit Report has come into effect from April 1, 2014

Since then lot of water has flown under the bridge & many a change has occurred for example:

1. Recently the government has mandated private companies with outstanding debts above a certain threshold to undergo a mandatory secretarial audit (which was earlier restricted to only listed companies)
2. Markets regulator SEBI came out with the format for listed entities for preparing their annual secretarial audit and compliance reports. This would also be applicable for the "material unlisted subsidiaries" of the listed entities, the regulator said in a circular.

Therefore, today all listed companies, their unlisted subsidiaries, Public Companies with certain threshold limits, and lately even Private Limited Companies are getting covered.

Under the circumstances it is time we are look & Revisit the concept of Secretarial Audit, Format of the Secretarial Audit Report in Form MR3, and Audit Requirements.

As per the FAQs of the ICSI:

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.

The Secretarial Auditor expresses an opinion as to whether 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.

Secretarial Audit thus provides necessary comfort to the management, regulators, and the stakeholders, as to the statutory compliance, good governance and the existence of proper and adequate systems and processes.

In terms of Form MR-3, the Secretarial Auditor needs to examine and report on the compliance of the following five specific laws:

1. The Companies Act, 2013 (the Act) and the rules made thereunder;
2. The Securities Contracts (Regulation) Act, 1956 („SCRA“) and the rules made thereunder;
3. The Depositories Act, 1996 and the Regulations and Bye-laws framed thereunder;
4. 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;
5. 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; In addition, the form MR-3, point (vi) also refers to „Other laws as may be applicable specifically to the company.“

The Council of the ICSI at its 226th meeting held on November 21, 2014 decided on the Scope of Secretarial Audit as regards “point (vi)(other laws as may be applicable specifically to the company)”, which is placed as under:

1. Reporting on compliance of “Other laws as may be applicable specifically to the company? which shall include 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.
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 law, environmental laws etc.

It is to be noted that nowhere in the Audit Report or guidelines or the formats there is any clear mention of “Labour Laws & HR practices” of the companies which needs to be audited which are more or less common for all types of companies & Factories as the case may be, This area can lead to potential loses & penalties and also imprisonment of the Occupier of the Factories if there is Noncompliance , moreover handling non compliances in the Labour Department or for that matter the Labour Tribunals & Labour Courts is horrendous task with the MD of the company invariably getting harassed

Factories Act - A Draconian Law

Two years simple imprisonment of the Managing Director and General Manager (works) of the TATA steel Limited by the magistrate court for Strict tortuous liability being the OCCUPIER of the company had sent shock Waves in the corporate world.

There are two opinions that the liability for such mishaps must be fixed on the top management otherwise the unscrupulous factory owners will go scot free by cocking the snook to the law, yet the law has twin objectives of facilitating & regulating. If it is merely regulating with spite, it will certainly blow incalculable damage to the growth of the industries with the new advent of MNC’s & other liberalization & opening up of the economy by the government.

Section 2 (n) of the factories act defines “Occupier of a factory means the person who has ultimate control over the affairs of the factory” the words “and where the said affairs are entrusted to a managing agent, such agent shall be deemed to be the occupier of the factory” was omitted by the Factories Amended Act 1987 w.e.f 1-12-1987.

On plain reading of the section it seems that only one of the directors can be occupiers of the factory as they are the only persons who can be said to have ultimate control over the affairs of the factory.

Until the judgment of the Supreme Court in J.K.Industries Vs. the Chief inspector of factories & boilers which laid to rest the controversy as to who can be occupier of the factory there were several judgments upholding the fact that the occupiers need not be directors of the company & they can in fact be the works managers (seems to be somewhat correct considering the practical situation).

With the concept of Corporate Governance & the listing agreement providing that majority of the directors should be independent & non-executive directors, the company has no choice but to nominate the executive director who is in charge of the factory & who can control its affairs as occupier.

The Government to facilitate “Ease of Doing Business” is trying to dilute the Labor Laws to make it more business friendly and in the regard The Ministry of Labor And Employment vide Notification G.S.R. 432(E). have the following draft rules, which the Central Government proposes to make in exercise of the powers conferred by section 67 of the Code on Wages, 2019 (29 of 2019) read with section 24 of the General Clauses Act, 1897 (10 of 1897) and in supersession of the -

- (i) Payment of Wages (Procedure) Rules, 1937; (ii) Payment of Wages (Nomination) Rules, 2009; (iii) Minimum Wages (Central) Rules, 1950; (iv) Minimum Wages (Central Advisory Board) Rules, 2011.

These rules are called the Code on Wages (Central) Rules, 2020, which has completely modified the Payment of Wages under the Employment Laws for ease of Compliance to Maintain Register under various Labor Laws like the Payment of Bonus Rules, 1975; Equal Remuneration Rules, 1

976; and Central Advisory Committee on Equal Remuneration Rules, 1991.

Scope of Secretarial Audit of “other laws” for an Industry which manufactures & deals in Consumer goods

Audit under Labour Laws:

1. PF Act
2. ESIC Act
3. Factories Act
4. Other details to be verified
 - Any notices for conciliation, arbitration or adjudication pending un-attended
 - Reminders to be sent to long absentees (at least to people absenting un-authorize more than a week)
 - Payment of minimum wages to all employees including Contractor roll
 - Payment of wages
 - Environment Audit report - pollution
 - Application for Consent - Pollution
 - Minimum wages
 - Standing Orders
 - Apprentice Act
 - Contract Labour
 - Equal Remunerations
 - Labour Welfare Funds
 - Maternity benefits Act
 - Payment of Gratuity
 - Workmen compensation
 - Industrial Disputes
 - Pollution Control
 - Labour Unions if any & their settlements agreements (wage settlement)
 - Payroll details & process followed to prevent fraudulent transfers
 - HR Handbook & its legalities

Other applicable Labour Laws shall also be verified as applicable depending on the nature of the industry.

Audit under Legal Metrology Laws

The Packaged Commodity Rules OR the Legal Metrology Laws in India, are driven by a simple logic - “protection of a customer’s interests by making the originator (be it the manufacturer, packer or importer) of goods accountable for such products”, which are meant for consumption by the general public.

The numerous and complex compliance requirements for different types of products and vendors, a lack of practical procedures render these laws highly impractical, ambiguous and prone to litigation.

Compliances to be checked:

Sl No	Particulars	Compliances
1.	Maximum Retail Price (MRP):	The commodities to have the Maximum Retail Price (MRP) printed on the packages along with the words “inclusive of all taxes”.
2.	MRP once printed cannot be increased.	Certain items may be packed to offer any free quantity provided it is included in the standard size and the MRP is reduced proportionately.
3.	Principal display panel	Total area of the pack where all the mandatory requirements are specified in one place, on one side of the pack. No separate sticker should be affixed;
4.	Statutory Declarations on Products	The following mandatory declarations shall be made on the packages either at the factory level or at manufacturing level (depot of the factory). <ul style="list-style-type: none"> a. The name and address of the manufacturer or packer or importer. b. The common or generic name of the commodity. c. The net quantity of the content. d. Month and year of manufacturer or packing or import e. Retail sale price: MRP (including all taxes) f. Size/dimension of the commodity when relevant. g. Name, address and telephone no. of the Consumer complaint Cell. h. Marking "GM" for genetically modified food items.
5.	Re-stickering: Re-stickering is not permissible	Packers are not permitted to affix individual stickers or labels on the package for altering or making declarations. However for reducing the MRP, a sticker with revised lower MRP (inclusive of all taxes) may be affixed and the same shall not cover the MRP declaration made by the manufacturer or the packer, on the label of the package.
6.	Import of Products:	To ensure that proper registration is obtained for importing the products. The pre-packed commodities to carry the specific declarations on their labels as specified in the import policy.

		The importer has to comply with all the necessary declaratory compliances before selling, distributing, delivering, displaying or storing the imported goods.
7.	Double stamping	A weight or measure or product manufactured in one state and sold or transferred to another state will require double verification and stamping - both at the end of manufacturing state and at the end of user state.

Consumer Protection Act

The Emergence of a Digital Age and a new era of commerce and digital branding, has brought in new set of customer expectations, to address the new set of challenges faced by consumers in the digital age, the Indian Parliament, on 6 August 2019, passed the landmark Consumer Protection Bill, 2019 which aims to provide the timely and effective administration and settlement of consumer disputes

Key Highlights of the New Act:

1. Covers E-Commerce Transactions
2. Enhancement of Pecuniary Jurisdiction:
3. E-Filing of Complaints:
4. Product Liability & Penal Consequence
5. Penalties for Misleading Advertisement:
6. Establishment of Central Consumer Protection Authority

Audit Checks under the new Act

1. Compliance officer. E-commerce entities are required to appoint a nodal person or senior designated functionary to ensure compliance with the Act and the E-Commerce Rules.
2. Disclosures. E-commerce entities are required to disclose information about: (a) themselves, including their legal name, location of offices, details of website, and contact details of customer care and a grievance officer; and (b) location from where goods are imported, the details of the importer or the seller. Details of goods and services offered for sale (including country of origin, details of grievance officer, and guarantee related to authenticity of products). Marketplace e-commerce entities are required to obtain an undertaking from each seller to confirm that the information provided by such seller is true.
3. Grievance redressal. E-commerce entities are required to establish an adequate grievance redressal mechanism.
4. Records. Marketplace e-commerce entities are also required to record details of sellers where they repeatedly offer goods or services that were previously removed under the Copyright Act, 1957, the Trade Marks Act, 1999, or the Information Technology Act, 2000.
5. Advertisements Sellers offering goods and services through a marketplace e-commerce entity are required to, among other requirements, (a) ensure that advertisements are consistent with the goods or service, (b) there is no misrepresentation of facts, and (c) they do not refuse to accept returns if such goods or services are defective, deficient, or delivered late (other than owing to force majeure), (d) execute a written contract with the marketplace e-

commerce entity; and (e) appoint a grievance officer. The company must follow and adhere to the Advertisement guideline & codes in general

Looking at the above we can see that “Secretarial Audit” cannot be confined to just Compliance under the SEBI OR Companies Act alone & must cover a plethora of other laws some of them may be general in nature & some of them may be specific to particular industry, Therefore the CS engaged in audit must prepare an Audit Requirement Checklist after detailed study of the particular Company & its business activities , the audit report must cover comments under all the acts & rules in general & specific laws, as may be applicable to a particular company.

So, in Conclusion must the audit report be in MR 3 format or does this require a change, ICSI must come out with specific guidelines on these aspects

References:

Mondaq .com - Key Highlights & Compliances - consumer protection Act

Metrology Laws and amendments

ICSI - FAQs on Secretarial Audit