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**TEST
SERIES**



SUGGESTED SOLUTION

CS PROFESSIONAL

**Subject – Secretarial Audit, Compliance
Management & Due - Diligence**

**Topic – Secretarial Audit & Due Diligence
Chp-15 to 20**

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Answer to Q1.A.

The auditors may take some clues from the Reserve Bank of India (Frauds classification and reporting by commercial banks and select FIs) directions, 2016 along with the other reasons which provides an Early Warning Signals (EWS) for to be alert that some of the wrong doing in the company which are as under:

1. Default in undisputed payment to the statutory bodies as declared in the Annual report.
2. Bouncing of high value cheques.
3. Frequent change in the scope of the project to be undertaken by the borrower.
4. Foreign bills remaining outstanding with the bank for a long time and tendency for bills to remain overdue.
5. Delay observed in payment of outstanding dues.
6. Frequent invocation of BGs and devolvement of LCs.
7. Under insured or over insured inventory.
8. Invoices devoid of TAN and other details.
9. Dispute on title of collateral securities.
10. Funds coming from other banks to liquidate the outstanding loan amount unless in normal course.

(5 MARKS)

Answer to Q1.B.

- 1) 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.
- 2) 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.
- 3) 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.
- 4) 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.
- 5) 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.

(5 MARKS)

Answer to Q2.A.

- 1) Section 448 of Companies Act, 2013 deals with penalty for false statements. The section provides 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, –

(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.

- 2) Section 447 deals with punishment for fraud which provides that any person who is found to be guilty of fraud, involving an amount of at least Rs.10,00,000 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. In case, the fraud in question involves public interest, the term of imprisonment shall not be less than three years. In case where the fraud involves an amount less than ten lakh rupees or one per cent. 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 five years or with fine which may extend to fifty lakh rupees or with both.

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 Secretarial Audit Report.

However, a person will be penalised 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 punishment, 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.

- 3) Section 204(4) of the Companies Act, 2013 provides that if company secretary in practice contravenes the provisions of section 204, he shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

(5 MARKS)

Answer to Q2.B.

There are significant benefits which a Practice Unit 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 in favour of 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. The benefits given by the Council to the Peer Reviewed Units are as follows:

- an additional limit of 5 secretarial audits per partner/PCS in case the unit is peer reviewed. (For Secretarial Audit Reports issued for FY 2016-17 onwards)
- an additional limit of 5 (five) Annual Secretarial Compliance Report under Regulations, 2015 individually / per partner in case the unit has been Peer Reviewed. (w.e.f. 1st April, 2020)

(5 MARKS)

Answer to Q3.A.

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:

- an uncertainty relating to the future outcome of exceptional litigation or regulatory action;
- when there is uncertainty about exceptional future events, pending litigations
- early adoption of new accounting standards
- adoption of new technology
- recent changes in the regulatory environment
- when a major catastrophe has had a major effect on the financial position.
- 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; and
- a major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.

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.

(5 MARKS)

Answer to Q3.B.

Prior to acceptance of any engagement, the firm, in order to establish whether the preconditions for a professional assignment are present, shall:

- (a) Determine whether the reporting framework to be applied in the preparation, audit, review of the secretarial/ non-financial statements is acceptable; and
- (b) Obtain the agreement of management that it acknowledges and understands its responsibility:
- (i) For the preparation of the secretarial/ non-financial statements in accordance with the applicable reporting framework, including where relevant their fair presentation;
 - (ii) For such internal control/systems/procedure as management determines is necessary to enable the preparation of secretarial/ non- financial statements that are free from material misstatement, whether due to fraud or error; and
 - (iii) To provide the firm with:
 - 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 firm may request from management for the relevant purpose; and
 - c. Unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

(5 MARKS)

Answer to Q4.A.

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.

(5 MARKS)

Answer to Q4.B.

Due Diligence is the process by which confidential legal, financial and other material information is exchanged, reviewed and appraised by the parties to a business transaction, before entering in to the transaction with the other party.

The necessity of the due diligence can be summarized as under:

- To investigate in to the affairs of business as a prudent business person.
- To confirm all material facts related to the business.
- To access the risks and opportunities of a proposed transaction. | To reduce the risk of post transaction.
- To confirm that the business is what as it appears.
- To create a trust between two unrelated parties.
- To identify potential deal killers defected in the target and avoid a bad business transaction.

- To gain information that will be useful for valuing assets.
- 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.

(5 MARKS)

Answer to Q5.A.

As per the Black's Law Dictionary, to "Compound" means "to settle a matter by a money payment, in lieu of other liability."

This definition thoughtfully represents the concept of Compounding as a Settlement Mechanism, a settlement by paying the penalty in lieu of facing the prosecution for the offence committed. The meaning of word compounding of offence is not defined under Companies Act, 2013, or any other previous company law.

However, if the provisions allowing compounding of offences under the company law are analyzed, it provide clear inference that it is nothing but admission of guilt"

In the process of compounding, the person may either Suo-moto or on receipt of notice of default / initiation of prosecution, admits the commission of default and make an application for compounding of the concern offence. The defaulters agree to pay penalty/fine which may be ordered by the Central Government or Tribunal.

Compounding is essentially a compromise or arrangement between administrator of the enactment and person committing an offence. Compounding crime consists of receipt of some consideration (termed as compounding fees) in return for an agreement not to prosecute one who has committed an offence. Prosecution can be avoided by 'compounding the offence', either before or after the institution of the prosecution.

"To compound" means "to settle a matter by a money payment, in lieu of other liability". In short, compounding of an offence is a settlement mechanism, by which one is given an option to pay money in lieu of his prosecution, thereby avoiding a prolonged litigation.

COMPOUNDING OF CERTAIN OFFENCES UNDER COMPANIES ACT, 2013

Compoundable offence

The offences that are not mandatorily punishable with imprisonment are compoundable, as enlisted below:

- Offences punishable with fine only.
- Offences punishable with fine or imprisonment.
- Offences punishable with fine or imprisonment or both.
- In such types of offences the punishment may or may not include imprisonment.

Effects of Compounding

- 1) If the offence is compounded before the institution of prosecution, the prosecution cannot be launched against the person by the Registrar or by any shareholder of the company or by any person authorised by the Central Government in relation to the offence which has been compounded.
- 2) If the offence is compounded after the institution of prosecution, such compounding shall be brought by the Registrar in writing, to the notice of the Court in which the prosecution is pending. Then the person shall be discharged.

(5 MARKS)

Answer to Q5.B.

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:

- 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.

In regular course of business the environmental audits for each property leased by the company an important one, because if the company violates any major rule, local authorities can exercise their right to penalize and cancel its operational right.

It is important for the management of the company to carefully review the following:

- 1) List of environmental permits and licenses and validities of the same.
- 2) all correspondence and notices with EPA, state, or local regulatory agencies.

- 3) Whether the company's disposal methods of various by products are in sync with the regulated guidelines.
- 4) Whether there are any contingent environmental liabilities or continuing indemnification obligations.

(5 MARKS)