SUGGESTED SOLUTION

CS PROFESSIONAL

Subject – Secretarial Audit, Compliance Management and Due-Diligence

Topic – Secretarial Audit, Chp-8 to 14

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Answer to Q1.A.

1) 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 which is applied to legal matters especially criminal matters. A Forensic Audit is a comprehensive and systematic process involving a series of activities and tasks undertaken for establishing the accuracy and authenticity of the transactions under review.
2) The term Forensic Audit refers to the specific guidance carried out in order to produce evidence. Forensic Audit task involves an investigation into the financial affairs of the entity and is often associated with investigation into the alleged fraudulent activity.
3) The object of forensic auditing is to relate the findings of audit by examining and gathering legally tenable evidence and producing it to the Court. In the process the corporate veil is lifted in case of corporate entities to identify the fraud and the persons responsible for it.
4) Forensic auditing involves application of audit skills to legally determine whether fraud has actually occurred. The entire process includes planning, gathering evidence, reviewing the evidence and reporting of the same. In the process it aims at naming the person(s) involved in the fraud with a view to take legal action.
5) 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.

(5 Marks)

Answer to Q1.B.

In terms of Form MR-3, the Secretarial auditor needs to examine and report the compliance of the following:

(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) 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/ SEBI (Prohibition of Insider Trading) Regulations, 2015;

(c) The Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009/2018;

(d) The Securities and Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999/ SEBI (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 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 (Buy back of Securities) Regulations, 1998/2018;

(i) The Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015.

(vi) 'Other laws as may be applicable specifically to the company.'

Further the 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 ….. Stock Exchange(s), if Applicable/ The Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015;

Further also the Secretarial Audit report also requires reporting on whether –

i. The Board of Directors of the Company is duly constituted with proper balance of Executive Directors, Non-Executive Directors, Independent Directors, and Women Director.

ii. The changes in the composition of the Board of Directors that took place during period under review were carried out in compliance with the provisions of the Act.

iii. 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.

iv. Majority decision is carried through while the dissenting members' views are captured and recorded as part of the minutes.

v. 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.

vi. 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.

(5 Marks)

Answer to Q2.A.

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) <u>Review of Operating Environment-</u> 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) <u>Review Controls-</u> 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) <u>Test Controls-</u> 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) <u>Account Details-</u> 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.

(5 Marks)

Answer to Q2.B.

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.

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.

<u>Purpose of CSR Audit:</u>

1) 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.
2) To facilitate transparent monitoring mechanism and a mentor for the company's CSR activities and implementation of CSR policy.
3) To evaluate internal control and governance framework.
4) To assess the project life cycle.
5) To conduct financial review of projects to confirm the utilization of budgets for achieving desired outcomes.

(5 Marks)

Answer to Q3.A.

As the audit refers to the independent verification and it is most important to maintain the Independence of the Auditor and to avoid such conflict of Interest of the Auditors.

Section 141(3) of the Companies Act, 2013 provides for the eligibility criteria for the appointment of an auditor and section 149(6) of the Companies Act, 2013 provides for the eligibility criteria of independence, a combination of both of provisions may be considered as the guiding criteria for the auditors independence.

<u>Following are certain examples where an auditor shall assumed to have interested in the auditee's business or enterprise</u>:

1) Holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company.
2) Indebtedness to the company, or its subsidiary, or of its holding or associate company or a subsidiary of such holding company.

3) Has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, or its subsidiary, or of its holding or associate company or a subsidiary of such holding company.
4) Having business relationship (direct or indirect) with the company, or its subsidiary, or of its holding or associate company or a subsidiary of such holding company.
5) Any relative of the auditor is a director or is in employment of the company as a director or key managerial personnel.

(5 Marks)

Answer to Q3.B.

The auditing principles defines governing an audit and includes the professional responsibilities, which should be observed by the auditor while carrying out any audit assignments,

Some of these principle are as under:

1) Integrity objectivity and independence: An auditor should be honest, sincere, impartial and free from bias. He should be a man of high integrity and objectivity.
2) Confidentiality: The auditor should respect confidentiality of information acquired during the course of his work and should not disclose the information without the prior permission of the client, unless there is a legal duty to disclose.
3) Skill and competence: The auditor must acquire adequate training and experience. He should be competent, skillful and keep himself abreast of the latest developments including various pronouncements.
4) Work performed by others: If the auditor delegates some work to others and uses work performed by others including that of an expert, he continues to be responsible for forming and expressing his opinion on the financial information.
5) Documentation: The auditor should document matters which are important in providing evidence to ensure that the audit was carried out in accordance with the basic principles.
6) Planning: The auditor should plan his work to enable him to conduct the audit in an effective, efficient and timely manner. He should acquire knowledge of client's accounting system, the extent of reliance that could be placed on internal control and coordinate the work to be performed.
7) Audit evidence: The auditor should obtain sufficient appropriate evidences through the performance of compliance and other substantive procedures to enable him to draw reasonable conclusions to form an opinion on the financial information.
8) Accounting System and Internal Control: The management is responsible for maintaining an adequate accounting system incorporating various internal controls appropriate to the size and nature of business. The auditor should assure himself that the company's internal control system is adequate and all the information which should be recorded has been recorded.

9) Audit conclusions and reporting: On the basis of the audit evidence, the auditor should review and assess the audit conclusions. The auditor should ascertain:

- As whether the policies have been consistently applied;
- Whether the information complies with regulations and statutory requirements; and
- There is adequate disclosure of material matters relevant to the presentation of information subject to statutory requirements.

The auditor's report should contain a clear written opinion on the subject matter. A clean audit report indicates the auditor's satisfaction in all respects and when a qualified, adverse or a disclaimer of opinion is to be given or reservation of opinion on any matter is to be made, the audit report should state the reasons thereof.

(5 Marks)

Answer to Q4.A.

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.

(5 Marks)

Answer to Q4.B.

- APPLICABILITY OF SECRETARIAL AUDIT UNDER 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

1. Every listed company
2. Every public company having a paid-up share capital of fifty crore rupees or more;
3. Every public company having a turnover of two hundred fifty crore rupees or more; or
4. Every Company having 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, a Secretarial Audit Report, given by a Company Secretary in practice, in form MR- 3.

- APPLICABILITY OF SECRETARIAL AUDIT UNDER SEBI (LODR) REGULATIONS, 2015

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.

where Material subsidiary mean a subsidiary, whose income or net worth exceeds ten percent of the consolidated income or net worth respectively, of the listed entity and its subsidiaries in the immediately preceding accounting year.

Exemptions:

As per regulation 15 of the SEBI (LODR) Regulations, 2015 the compliance specified in regulations 24A, shall not apply, in respect of –

(a) the 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

(b) the listed entity which has listed its specified securities on the SME Exchange.

However, in case of other listed entities, which are not companies, but body corporate or are subject to regulations under other statues, the provisions of regulation 24A shall apply to the extent that it does not violate their respective statutes and guidelines or directives issued by the relevant authorities.

(5 Marks)

Answer to Q5.A.

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.

<u>The audit risk has three components:</u>

1) <u>Inherent Risk</u>: 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.
2) <u>Control Risk</u>: 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.
3) <u>Detection Risk</u>: 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.

(5 Marks)

Answer to Q5.B.

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.

(5 Marks)