

How Does Secretarial Audit Ensure Compliance in Share Purchase Deals?

How Does Secretarial Audit Ensure Compliance in Share Purchase Deals?



Introduction

In corporate transactions, particularly share purchase deals, compliance is paramount. When companies buy or sell shares, they must follow strict regulatory frameworks to ensure the transaction is lawful, transparent, and beneficial for all parties involved. A crucial tool to uphold these standards is the secretarial audit. Secretarial audits play a vital role in verifying compliance with company law and ensuring the integrity of a share purchase deal. By addressing aspects of due diligence, verifying agreements, and protecting shareholder interests, secretarial audits help mitigate legal risks and streamline the transaction process.

Understanding Secretarial Audit in Company Law

Secretarial audit is a process that reviews and verifies a company's adherence to various laws, regulations, and standards. This is not limited to just corporate law; it extends to compliance with securities laws, labor laws, and other sector-specific regulations as well. Introduced under Section 204 of the Companies Act, 2013, in India, a **secretarial audit** requires certain companies to undergo an independent audit by a qualified company secretary to ensure they comply with regulatory requirements.

Secretarial audit becomes essential in the context of share purchase deals as it provides an added layer of scrutiny. The secretarial auditor assesses whether the company's records, board decisions,

shareholder agreements, and other legal documentation align with regulatory standards by conducting a detailed review. This is especially important when there is a change in ownership or control, as it could affect the rights and responsibilities of shareholders and alter the company's governance structure.

Importance of Due Diligence in Share Purchase Agreements

A share purchase agreement (SPA) is a legal document that outlines the terms and conditions of a share sale between the buyer and seller. Due diligence is a critical step in executing an SPA, as it involves a thorough review of the target company's legal, financial, and operational records. Due diligence ensures that the buyer is fully aware of any potential liabilities, risks, or issues that might affect the purchase decision.

Secretarial audit plays a crucial role in the **due diligence process** by ensuring that all statutory registers, filings, and disclosures comply with relevant laws. This audit helps uncover any hidden legal liabilities or regulatory violations, providing the buyer with a clear picture of the company's legal standing. This transparency is essential, particularly when dealing with external buyers, as it fosters trust and helps prevent disputes after the transaction.

The Due Diligence Process and Secretarial Audit

The due diligence process is multi-faceted and involves several areas such as financial, operational, and legal analysis. In a share purchase deal, the secretarial audit is a key component of the legal due diligence process. The audit evaluates aspects of corporate governance, board resolutions, compliance with company law, and the overall legality of the transaction. It also assesses if the company has maintained accurate records, filed mandatory disclosures, and complied with statutory obligations, including those related to tax, labor, and environmental regulations.

The primary aim of the secretarial audit in this process is to confirm that the company's documentation aligns with legal standards, protecting both the buyer and seller from future legal challenges. The audit's findings become part of the due diligence report, which is used to negotiate the terms of the share purchase agreement. For instance, if the audit reveals potential regulatory breaches, the buyer may request indemnities or warranties to protect against future liabilities.

Ensuring Compliance in the Share Purchase Agreement

The share purchase agreement is the cornerstone of a share purchase deal. It outlines the terms, conditions, and obligations of both parties, and compliance is critical for the agreement's validity. Secretarial audit ensures that the SPA is structured within the legal boundaries set by corporate laws and regulatory bodies. The audit evaluates the SPA's provisions, ensuring that they are consistent with the company's articles of association, shareholder rights, and other legal requirements.

In cases where the SPA involves an external buyer, secretarial audit becomes even more significant. When a foreign entity or external party is involved, compliance with cross-border laws, foreign

exchange regulations, and industry-specific guidelines becomes essential. The secretarial audit reviews these aspects, ensuring that the transaction does not breach any local or international regulatory standards. This compliance check is crucial in preventing any legal issues that could arise from non-compliance, especially in cross-border deals.

Drafting and Reviewing the Shareholders Agreement in India

In share purchase deals, a shareholders agreement is often drawn up to outline the rights and obligations of the new shareholder(s) in relation to other shareholders and the company itself. This agreement is fundamental in maintaining transparency and aligning expectations between parties post-transaction. In India, a shareholders agreement may cover areas such as governance rights, dividend policies, transfer restrictions, and dispute resolution mechanisms.

The secretarial audit plays a key role in drafting and reviewing this agreement to ensure it aligns with Indian company law. During the audit, the company secretary reviews the **draft shareholders agreement** to confirm that it does not conflict with the Companies Act or the company's articles of association. By identifying potential conflicts or legal gaps, the audit ensures that the shareholder's agreement is enforceable and that it protects the interests of all stakeholders.

In addition, the audit verifies that the shareholder's agreement includes provisions that promote transparency and accountability. This step is particularly important when there are minority shareholders, as the agreement often outlines their rights and protections within the company structure. Through this process, the secretarial audit helps create a balanced and compliant shareholders agreement, ultimately strengthening the company's governance framework.

The Role of Secretarial Audit in Protecting Shareholder Interests

One of the main objectives of a secretarial audit is to protect shareholder interests, particularly during significant transactions like share purchase deals. In addition to verifying compliance with legal requirements, the audit ensures that the rights of existing shareholders are upheld. For example, if the SPA or shareholders agreement includes terms that could dilute shareholder rights, the secretarial auditor will flag these issues, prompting further review and amendments if necessary.

The secretarial audit also reviews shareholder disclosures and resolutions passed by the board, ensuring that any changes in shareholding are documented accurately and that shareholders are duly informed. This protects minority shareholders, who may be vulnerable to changes in company control. By providing a thorough review, the secretarial audit minimizes the risk of shareholder disputes arising from ambiguities or inconsistencies in documentation.

Compliance Assurance through Secretarial Audit in Cross-Border Deals

When a share purchase deal involves an external buyer, particularly in cross-border transactions, regulatory complexity increases. Compliance with foreign exchange laws, international trade

regulations, and tax obligations becomes essential to avoid legal complications. Secretarial audit helps navigate these complexities by ensuring that all aspects of the transaction comply with applicable laws both domestically and internationally.

In cross-border deals, the secretarial audit examines whether the **share purchase agreement** and shareholders agreement comply with foreign investment regulations, such as India's Foreign Exchange Management Act (FEMA). This is especially critical for multinational corporations seeking to acquire stakes in Indian companies, as FEMA governs foreign exchange transactions and investments. The secretarial audit ensures that the transaction adheres to FEMA guidelines, protecting the company from potential penalties or legal action.

Conclusion

In share purchase deals, secretarial audit is essential for ensuring compliance, safeguarding shareholder rights, and reducing legal risks. Through meticulous examination of due diligence processes, share purchase agreements and shareholder agreements, secretarial audit helps companies execute share transactions within the bounds of corporate law. For external buyers and cross-border transactions, the audit adds an extra layer of assurance by verifying adherence to local and international regulations.

By integrating secretarial audit into the share purchase process, companies can ensure that their transactions are legally sound and transparent. The audit protects both buyers and sellers, enabling them to proceed confidently with the deal while fostering trust among shareholders. In a highly regulated business environment, secretarial audit plays a crucial role in enhancing compliance and securing successful outcomes in share purchase agreements.

Connect with **CorpBiz Legal Advisors** www.corpbiz.io or at +91-9121230280.