

17. Special Audit Assignments

Important Point of this chapter

1.

Functions of Stock Exchanges

1. Regulation of Stock exchanges

2. SEBI

- SEB's main function is to regulate the business in securities market. SEBI Act, 1992 empower SEBI to levy monetary fines and penalties on any person incurring a default under the Act in the following cases:
 - a. Failure to furnish any document, information, books, other documents, returns or report called for by the board.
 - b. Failure to maintain books of accounts and records;
 - c. Failure by an intermediary to enter into an agreement with his client, redress the grievance of investors.
 - d. failure by a person sponsoring or carrying any investment scheme, including mutual funds, without obtaining certificate of registration, failure to comply with the terms and conditions of certificate of registration, failure to dispatch unit certificate, failure to refund application moneys within stipulated time etc.
 - e. Failure by a stock broker to issue contract notes in the form and manner specified by the stock exchange, failure to deliver any security or failure to make payment of the amount due to the investor, charging of excess brokerage.
 - f. Any person dealing, communicating, counseling on the basis of some price sensitive information.
 - g. Failure by a person to disclose the aggregate of his shareholding in a body corporate before he acquires any shares of that body corporate and failure to make a public announcement to acquire shares at a minimum price in case of takeovers.

3. Governing Body

4. Membership

- Business at a stock exchange can only be transacted by a member of the stock exchange. A member of NSC can not transact business at BSE unless he is a member of BSE also.
- The members of stock exchanges are also called stock or share broker.
- The members enter into transaction either on their own behalf or on account of their clients, including sub-brokers.
- There are several ways of placing in order that may be directly or indirectly through a sub-broker.
- Since the stock exchanges operations involve considerable financial commitments on the part of its members, its membership is restricted to persons who are financially sound and possess adequate experience.
- The deposits/fee structure of member is depends on the trading segments in which the member is admitted.

5. Classification of Scurrilities traded

- A security which is allowed to be traded on any stock exchange can either be listed with the Exchange or be permitted to be traded without being listed on the exchange.

- The listed companies have to pay listing fees as prescribed by the SEBI.
- Securities traded in BSE are classified in to “A”, “B1”, “B2”, “C”, “F” and “Z” group.

6. Margins

- There can be wide fluctuation at the time of settlement in the prices of securities since the closing rate of the earlier settlement. In order to restrict excessive speculation and also to safeguard the interest of the investors, members are required to keep certain deposits with stock exchanges authorities. These deposits are termed as ‘margins’.
- A member is required to pay or deposit different margins such as Gross exposure Margin, Mark to Market Margin, Volatility Margin, Additional Volatility Margin, Special Margin and Adhoc Margin.
 - Mark to market Margin:* MTM is the notional loss, which a member or his client would incur, of the net cumulative outstanding positions in all securities were closed out at the closing price of the relevant trading day, which is different from the price at which the transaction had been entered into.
 - Volatility Margin:* volatility margin is imposed to curb excessive volatility in the market and to act s a deterrent to building up of excessive outstanding positions. Price variation on accounts of calls, bonuses, rights, mergers, amalgamations and scheme of arrangements are adjusted for determining volatile securities and adjustments in price made for the purpose of computation of volatility. This margin is levied in the net outstanding position of the member, in each security, based on the respective margin rates.
 - Gross exposure margin:* GEM is computed on the aggregate of the net cumulative outstanding positions in each security. Each exchanges determines its own rates of GEM and additional volatility margin bases on its own risk perception of the market and other risk containment measures such as deposits and collaterals in its possession.

7. Trading System

- In the stock exchange non-member trade through the authorized and registered sub-broker. When, therefore, the member receives securities from his client for sale, he is obliged to sell the securities as per instruction and to remit the sell proceeds thereof, after deducting brokerage and other related expenses, to his client.
- Similarly, when on member buys securities for his client, he has to ensure that the shares/securities so purchased are delivered to the client after he has received from the Client the payment which includes his brokerage and other incidental exp. Too.

8. Trading on the NATIONAL STOCK EXCHANGE.

- NSE operates on the ‘National Exchanges for Automated Trading’ system a fully computerized screen-based trading system. It enables members from across the country to trade simultaneously with enormous ease and efficiency by keying the order into the system.

9. Type of market

- Normal Market:** all orders which are of regular lot size or multiples thereof are traded in the normal market. For shares which are traded in the compulsory dematerialized mode the market lot of theses shares is one.
- Odd Lot Market:** an order is called an odd lot if the order size is less than regular lot size; such orders are traded in the odd-lot market. In an odd-lot market, both the price and quantity orders should exactly match for the trade to take place.

- c. Spot Market: spot orders are similar to the normal market orders except that spots orders have different settlement periods.
- d. Auction market: in the auction market, auctions are initiated by the exchanges on behalf of trading members for completing the settlement process.

10. Order books

- Order are first numbered and time-stamped on receipt and then immediately processed for **potential** match. Every order has a distinctive order number and a unique stamp on it. If a match is found, then the orders are stored in different 'books' in price-time priority in the following sequence
 - a. Best Price
 - b. Within price, by time priority

11. Depositories and Dematerialization

- The entire transaction of purchase or sale of securities can be said to be completed only after the buyer becomes the rightful owner of the securities and seller gets the sale consideration. Traditional system on the Indian stock markets gave settlement risk due to the time left that lapse before trades were settled.
- To obviate these problems, the depositories Act, 1996 was enacted to provide for establishment of depositories in securities with the objective of ensuring free transferability of securities with speed and accuracy.
- *Advantages of depository services*
 - a. High liquidity of scrips due to immediate transfer and regulation.
 - b. Receive bonus and right as direct credit to the account thereby eliminating the risk of loss in transit.
 - c. Much lower risk of bad deliveries.
 - d. Reduction in brokerage.
 - e. Saving of stamp duty worth 1% of transaction price.
 - f. Saving of courier, notary charges.
 - g. Saving of expenses to be incurred on obtaining duplicate certificates as no threat of original shares getting mutilated and misplaced.

Conduct of Audit

1. The books of Account and Other documents subject to the Audit

- a. Register of transaction (Sauda book) Daily Transaction List
- b. Clients ledger
- c. General Ledger
- d. Journals
- e. Cash books
- f. Bank Pass book
- g. Documents register/inward-outward register showing full particulars of shares and securities received and delivered.
- h. Member's contract books showing detail of all contracts
- i. Counterfoils or duplicates of contract notes issued to clients
- j. Written consent of clients in respect of contracts entered into as principles
- k. Margin deposit book
- l. Register of accounts of sub-brokers.

- m. An agreement with a sub-broker specifying the scope of authority and responsibilities of the stock-broker and such sub-brokers.
- n. An agreement with the sub-broker and with the client of the sub-broker to establish privities of contract between the stock broker and the client of the sub-broker.

2. Daily Transaction List (Sauda Book)

- All members are required to maintain a 'Sauda book', which contains details of all deals transacted by them on a day-to-day basis. It contains the detail regarding the name of the code of the client whose behalf the deals have been done, rate and quantity brought or sold. These details are maintained date wise. This register contains all the transactions, which may be any of the kind mentioned below:
 - a. Member's own business on the exchange
 - b. Member's business on the exchange on behalf of clients
 - c. Member's business with the clients on principal-to-principal basis
 - d. Member's business with the members of stock exchanges
 - e. Member's business on behalf of his clients with the members of other stock exchanges
 - f. Spot transactions, etc

3. Contract Notes

- Contract note is a document through which a contractual obligation is established between a member and client. Every member of the stock-exchange has to issue contract notes to his clients for the trades executed on their behalf.
- The contract note is required to issue to the client within 24 hours of execution of the trades.
- The auditor should apply appropriate audit procedures to satisfy himself that-
 - a. Contract notes have been serially numbered
 - b. No serial number has been left blank
 - c. Format of the contract note is as prescribed by the regulation of the exchange
 - d. Duplicate copies/ counterfoils of contract notes are maintained
 - e. A brokerage charge in contract notes are within the permissible limits and is included separately including service tax.
 - f. Contract notes have been signed by an authorised person.
 - g. Contract notes have been issued in respect of all transaction
 - h. Transaction identification, trade identification and trade execution time has been printed in the contract note issued.
 - i. SEBI registration number, settlement number, settlement dates have been mentioned.
 - j. PAN number of the member and client has been mentioned on contract note where if required
 - k. All clauses specified by the exchange have been printed in the reverse of the contract.

4. Service Tax

- Service tax is levied on the value of taxable service which shall be the gross amount charged by the service provider if such service provided or to be provided by him at the rate prescribed from time to time by the government.

5. Security Transaction Tax

- As per the provision of finance bill, the stock exchanges have been entrusted with the responsibility of levy, collection and remittance of the STT on all transaction from the date of notification by the government of India.

6. Client Bills

7. Clients ledger

8. Settlement/Vallan Control Account

9. Clearing House Bank Account

10. Brokerage Account

11. Margin Deposit Book

12. Bank Book

13. Document register

14. Maintenance of books of account and other documents

15. *Dematerialized securities*

Dematerialised Securities

- On account of compulsory dematerialization of most of the securities listed on the exchange, all stock brokers are required to maintain two accounts with their depository participants for handling the receipt and delivery of securities in demat.
- One account is 'beneficiary account' wherein the demat securities belonging to the members' for their own account are held and the other is 'pool account' wherein the demat securities of the clients are temporarily lodged for transfer to/from the clients/clearing house in the pay-in/pay-out.
- The members are required to maintain a proper record of all shares received and delivered from their pool account as well as preserve acknowledged copy of the delivery instruction given to their DP's for transferring the securities from pool account to the Client's account after the pay-out.
- The auditor should verify whether the securities received by the member in pool account are regularly transferred to the buying client's demat account within 48 hours of declaration of pay-out of the relevant settlement of the exchange.
- It may be noted that sometimes, the clients instruct the brokers to retain the shares in pool account either because they have not opened a demat account or because they intend to sell the shares they have bought earlier, in the settlement and thereby avoid transaction charges.
- The auditor should check that the shares lying in the pool account have been utilized by the member to meet his own pay-in obligation or used for meeting auction obligations.
- If the auditor discovers something like this then, he should further enquire into the matter.
- Depending upon the nature of the business carried on by the member, the auditor may apply such procedural tests as he considers necessary on major items of income and expenses such as, commission, sub-brokerage, underwriting income, interest and dividends, advisory fees, interest, amounts payable towards transaction charges and other charges to the Exchange or clearing house and other income and expenses.

Audit of Mutual funds

- SEBI regulation 1996, provide that every mutual fund shall have the annual statement of accounts audited by an auditor who is not in any way associated with the auditor of the asset management company.
- Auditor of mutual fund is appointed by trustees.
- 1. Proper books of account
 - The regulation require that every asset management company for each scheme keep and maintain proper books of account, records and documents.
 - Every asset management company shall maintain and preserve for a period 8 years its books of account, records and documents.
 - The AM Company shall follow the accounting policies and standards as specified in Ninth Schedule so as to provide appropriate details of the scheme wise disposition of the asset of the fund at the relevant accounting date.

2. Inspection and Audit

The SEBI may appoint one or more persons as inspecting officer to undertake the inspection of the accounts for following purpose, namely:

- a. To ensure that the books of account are being maintained by the mutual fund, the trustees and asset management company in the manner specified in these regulations;
- b. To ascertain whether the provision of the Act and theses regulations are being complied with by the mutual fund, the trustees and asset Management Company.
- c. To ascertain whether the systems, procedures and safeguards followed by the mutual fund are adequate.
- d. To ascertain whether the provisions of the act or any rules or regulation made there under have been violated.
- e. To investigate into the complaints received from the investors or any other person on any matter having a bearing in the activities if the mutual funds,, trustees and asset management company.
- f. To *suo moto* ensure that the affairs of the mutual fund, trustees or asset Management Company are being conducted in a manner which is in the interest of the investor or the securities market.

Audit of depositories

- Notice
 - a. Before ordering an inspection or investigation under regulation, the boarded shall give not less than 10 days notice to the depository.
 - b. Notwithstanding anything contained in (a), where the board is satisfied that in the interest of the investors no such notice should be given, it may, by an order in writing direct that such inspection be taken up without such notice.
- Obligation
 - a. It shall be duty of the depository, a participant, a beneficial owner, an issuer or its agent whose affairs are being inspected by or investigated, and of every director, office and employee thereof, to produce to the inspecting officer such books, securities, accounts, records and other documents in its custody or control.
 - b. It shall be duty of the depository, a participant, a beneficial owner, an issuer or its agent shall allow the inspecting officer to have reasonable access to the premised occupied by

him or by any other person on his behalf and extend reasonable facility to examining any books, records and computer data in the possession of him.

- c. The inspecting officer, in the course of inspection of investigation, shall be entitled to examine or to record the statements of any director, officer or employee of such person.
- d. It shall be duty of every director, officer or employee of the depository, a participant, a beneficial owner, an issuer or its agent to give to the inspecting officer all assistance in connection with the inspection, which the inspecting officer may reasonably require.

Environmental Auditing

- Environmental reporting is the term now commonly used to describe the disclosure by an entity of environmentally related data, verified or not, regarding environmental risks, environmental impacts, policies, strategies, targets, costs, liabilities or environmental performance to those who have an interest in such information as an aid to enabling/enriching their relationship with the reporting entity.
- The objective of the environmental audit are to evaluate the efficiency of the utilization of resources of man, machines and materials, and to identify the areas of environmental risks and liabilities and weakness of management system and problem in compliance of the directive of the regulatory agencies and control the generation of pollutants and/or waste.

Areas of environmental Audit

- I. Layout and design: the layout to be sketched in the style in which will allow adequate provisions for installing pollution control devices, as well as provision for up gradation of pollution control measures and the meeting of the requirements of the regulation framed by the government
- II. Managing of resources: its include air, water, land, energy, raw materials and human resources besides others. The use of all resources is linked and the best uses in a synchronized manner results the best output and minimum waste
- III. Pollution control system: an effective system of pollution control should be in existence
- IV. Emergent safety Arrangement: the chemical, gas etc., industries which are prone to sudden requirement of safety arrangements, must remain alert all the while. The emergency plan are to be reviewed periodically, sufficient staff along with other required safety amenities should be kept ready.
- V. Medical & healthcare Facilities
- VI. Industries Hygienic: power system should be in vogue to eliminate industrial unhygienic state.
- VII. Occupational health: the requirement for safeguarding against occupational health hazards should be available all the workers.
- VIII. Information assimilation and reporting system: the information system should be strengthened to generate and its reporting system should be proper, keeping in view, the authorities, responsibilities and subsequent delegations.
- IX. EIA methodology: the Environmental Impact Assistance is usually are prerequisites to start and industry. This is done considering the known spheres of activities on the existing environmental condition. But the predictions necessarily deviate from the actual happenings when the industry starts working. But the predictions necessarily deviate from the actual happenings when the industry starts working. To accommodate the deviation in the system is also to be incorporated in EIA report, if it is noticed that the degradation to the environment

caused on the establishment and running of the industry is much higher than what was predicted.

- X. Compliance to the regulatory mechanism
- XI. Concern for the society.

- Audit format: the following are the main aspects which may be covered in the probable format of 'environmental Statement'
 - a. Name and address
 - b. Date of last environmental audit report submitted
 - c. Consumption of water and raw material during P.Y.
 - d. Pollution generated in air and water along with the output and the types of pollution and the deviation from standard
 - e. Generation of hazardous waste in C.Y. and P.Y. from processes or from pollution control facility.
 - f. Quantity of solid waste generated during C.Y. and P.Y. from process from pollution control facility and from recycling or reutilization of waste.
 - g. The disposal practice for different type of waste
 - h. The practice sorted for conservation of natural resources
 - i. The additional investment proposal for environmental protection including abatement of pollution.

Energy Audit

- Energy auditing is an activity that serves the purpose of assessing energy use pattern for factory or energy consuming equipment and identifying energy saving opportunities.
- The function of an energy auditor could be compared with that of a financial auditor. At the moment, while energy auditor is not yet a mandatory requirement on all-India basis, the financial auditor is a pre requisite any organization.
- Energy auditor for the industry is an external party.
- Key function of energy auditor are as follows:
 1. Quantity energy cost and quantities
 2. Correlate trends and production or activity to energy costs
 3. Devise energy database formats to ensure they depict the correct picture- by product,, department, consumer etc.
 4. Advice and check the compliance of the organization for policy and regulation aspects.
 5. Highlights areas that need attention for detailed investigations
 6. Conduct preliminary and detailed energy audits which should include the following:
 - a. Data collection and analysis
 - b. Measurements, mass and energy balances
 - c. Reviewing energy procurement practices
 - d. Identification of energy efficiency projects and techno-economic evaluation.
 - e. Establishing action plan including energy saving targets, staffing requirements, implementation time requirements, procurement issues and cost estimates.
 - f. Recommendations on goal setting for energy saving, record keeping, reporting and energy accounting, organization requirement, communication and public relation.

