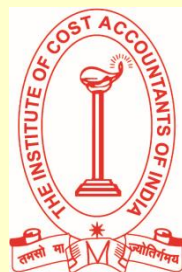


# **GUIDANCE NOTE ON INTERNAL AUDIT OF STOCK BROKERS & DEPOSITORY PARTICIPANTS**



**The Institute of Cost Accountants of India**  
(Statutory body under an Act of Parliament)

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**The Institute of Cost Accountants of India**

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Date: 26<sup>th</sup> August 2014

### **FOREWORD**

*I am very happy that the Professional Development Committee is bringing out the Guidance Note on Internal Audit of Stock Brokers & Depository Participants. Securities and Exchange Board of India (SEBI), in view of protecting the interest of investors and for bringing more transparency and efficiency in the governance of listed companies, prescribed internal audit on half yearly basis, inter-alia from an independent qualified Cost and Management Accountant, who is in practice and does not have any conflict of interest. Also, National Securities Depository Ltd. (NSDL) and Central Depository Services (India) Limited (CDSL) have allowed cost accountants to undertake internal / concurrent audit of the operations of Depository Participants (DPs). Further, the Companies Act 2013 vide Section 138(1) has also given cost accountants a mandate to conduct the internal audit of the companies.*

*The Guidance Note on Internal Audit of Stock Brokers & Depository Participants is a snapshot of the operations of the stock markets and will guide the members who are experienced, as well as those who have just entered into the profession, as the language is comprehensible with lot of practical examples depicted in the Guidance Note.*

*I would like to place on record the tireless efforts of Shri Amit Dedhia, the expert who has prepared the Guidance Note on Internal Audit of Stock Brokers & Depository Participants under the able guidance of Shri Anil Bhandari. This Guidance Note would be a gold mine for all the cost accountants as well as the professionals working in the stock broking & depository participants arena.*

*I would acknowledge the valuable contribution made by the CMA (Dr.) Sanjiban Bandyopadhyaya, CMA (Dr.) Sanjay Bhargava, Immediate past Chairman of the Professional Development Committee, Members of Professional Development Committee and PD Directorate in bringing out the Guidance Note in the present form.*

*I sincerely thank CMA (Dr.) S.C. Mohanty, Immediate Past President and CMA P.V. Bhattad, Vice President of the Institute for their guidance to the Professional Development Directorate in bringing out this Guidance Note in the present form.*

*I am sure that the users of the Guidance Note would find it very useful.*

CMA (Dr.) A.S. Durga Prasad

**CMA (Dr.) Sanjiban Bandyopadhyaya**

**CHAIRMAN**

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### **PREFACE**

*Stock Market Regulator, Securities and Exchange Board of India (SEBI) took many initiatives to protect the interest of investors. SEBI in view of bringing more transparency and efficiency in the governance of listed entities asked its members to carry out complete internal audit on a half yearly basis inter-alia from an independent qualified Cost and Management Accountant who is in practice and does not have any conflict of interest.*

*Two Depository service providers in India, viz., National Securities Depository Ltd. (NSDL) and Central Depository Services (India) Limited (CDSL) have also allowed cost accountants to undertake internal / concurrent audit of the operations of Depository Participants (DPs).*

*The Companies Act 2013 also vide Section 138(1) has given cost accountants a mandate to conduct the internal audit of the companies.*

*In order to enhance the capacity building and to support members of the Institute to carry out the internal audit of members of SEBI, depositories: NSDL and CDSL, the Professional Development Committee is presenting the Internal Audit Guidance Note of Stock Brokers & Depository Participants.*

*I would like to acknowledge tireless efforts of Shri Amit Dedhia, the expert who has prepared the Guidance Note of Internal Audit of Stock Brokers and Depository Participants under the able guidance of Shri Anil Bhandari.*

*CMA J.K. Budhiraja, Director (Professional Development) and his team of Professional Development Directorate have also contributed in providing technical inputs to expert to bring the Guidance Note in present form.*

*I am very thankful to CMA (Dr.) Sanjay Bhargava, Immediate Past Chairman of Professional Development Committee for guiding and providing technical inputs in shaping the Guidance Note in the present form. Acknowledgement is also due to the members of the Professional Development Committee for their valuable contributions and providing necessary inputs in culminating the material for the benefit of the members.*

*I sincerely thank to CMA (Dr.) A.S. Durga Prasad, President, CMA P.V. Bhattad, Vice President and CMA (Dr.) S.C. Mohanty, Immediate Past President of the Institute for providing guidance and able leadership connected with the Professional Development Committee.*

*I am quite hopeful that the Guidance Note would provide useful guidance to Cost Accountants and industry at large.*

**CMA (Dr.) Sanjiban Bandyopadhyaya**  
Chairman, Professional Development Committee

Date: 26<sup>th</sup> August 2014

## **ACKNOWLEDGMENTS**

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CMA Rakesh Sigh	Member
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# **A. Internal Audit**

## **Chapter 1: Introduction to Internal Audit**

### **1.1: Defining Internal Audit**

An independent appraisal function established within an organisation.

Internal control is the organisation, policies and procedures used to help ensure that government/ other programmes achieve their intended results; that the resources used to deliver these programmes are consistent with the stated aims and objectives of the organisations concerned; that programmes are protected from waste, fraud and mismanagement; and that reliable and timely information is obtained, maintained, reported and used for decision making.

Internal audit is an independent and objective appraisal service within an organisation:

Internal audit primarily provides an independent and objective opinion to the CFO/CEO on risk management, control and governance, by measuring and evaluating their effectiveness in achieving the organisation's agreed objectives. In addition, internal audit's findings and recommendations are beneficial to line management in the audited areas. Risk management, control and governance comprise the policies, procedures and operations established to ensure the achievement of objectives, the appropriate assessment of risk, the reliability of internal and external reporting and accountability processes, compliance with applicable laws and regulations, and compliance with the behavioural and ethical standards set for the organisation.

Internal audit also provides an independent and objective consultancy service specifically to help line management improve the organisation's risk management, control and governance. The service applies the professional skills of internal audit through a systematic and disciplined evaluation of the policies, procedures and operations that management put in place to ensure the achievement of the organisation's objectives, and through recommendations for improvement. Such consultancy work contributes to the opinion which internal audit provides on risk management, control and governance.

### **1.2: Necessity of Internal Audit**

Internal audit is an important tool in the hands of the management to help improve its decision making process.

The internal audit can:

- *independently review and appraise the systems of control throughout the organisation (not just the financial controls);*
- *recommend improvements to internal controls;*
- *ascertain the extent of compliance with procedures, policies, regulations and legislation;*
- *provide reassurance to management that their policies are being carried out with adequate control of the associated risks;*
- *facilitate good practice in managing risks;*
- *save money by identifying waste and inefficiency, and by facilitating the spread of good practice;*
- *avoid duplication of effort by an effective partnership with the other review agencies;*

- *by its activities help to ensure that assets and interests are safeguarded from fraud, deter fraudsters and possibly identify fraud.*

Also there is a necessity of conducting the internal audit due to various laws:

- The Central Government, in terms of the power vested under Section 227(4A) of the Companies Act, 1956 had notified the Companies (Auditor's Report) Order, 2003. Clause (vii) of the said 2003 order requires the auditor to report as follows: "whether in case of listed companies and/ or other companies having paid-up capital and reserves exceeding Rs. 50 lakhs as at the commencement of the financial year concerned, or having an average annual turnover exceeding five crore rupees for a period of three consecutive financial years immediately preceding the financial year concerned, whether the company has an internal audit system commensurate with its size and nature of its business." Though the clause does not by itself mandate internal audit in the subjected companies, yet a company to which the same is applicable, would incur a negative remark from the auditor if it does not have an internal audit system.
- Companies Act, 2013, Section 138 seeks to provide that prescribed companies shall be required to conduct internal audit of functions and activities of the company by internal auditor appointed by the company who shall either be a chartered accountant or a cost accountant, or such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the company. Manner of conducting internal audit shall be prescribed by the Central Government.
- The Securities and Exchange Board of India has mandated complete internal audit on a half-yearly basis for stock brokers/trading members/ clearing members.
- The two Depository service providers in India, viz., National Securities Depository Ltd. (NSDL) and Central Depository Services (India) Limited (CDSL) have allowed cost accountants to undertake internal / concurrent audit of the operations of Depository Participants (DPs).

NSDL has vide its circular no. NSDL/SG/II/010/99 dated 26th March 1999 notified amendment of its Bye Law 10.3.1 of Chapter 10 as follows:

10.3.1 "Every Participant shall ensure that an internal audit in respect of the operations of the Depository is conducted at intervals of not more than three\* months by a qualified Company Secretary or a Chartered Accountant\*\* holding a Certificate of Practice and a copy of the internal audit report shall be furnished to the Depository."

\* The period of three months has been raised to six months vide circular no. NSDL / Policy / 2008 /0072 dated 17 October, 2008.

\*\* Cost and Management Accountant has also been included vide Circular No. NSDL/Policy/ 2009/0020 dated 16th March 2009.

CDSL has vide its letter dated September 28, 1999 notified amendment of its Bye Laws 16.3.1 as follows:

16.3.1 "Every Participant shall ensure that an internal audit shall be conducted in respect of the participant's operations relating to CDS by a qualified Chartered Accountant in accordance with the provisions of the Chartered Accountants Act, 1949 or by a Company Secretary in practice in accordance with the provisions of the Company Secretaries Act, 1980, at such intervals as may be specified by CDS from time to time. A copy of Internal Audit report shall be furnished to CDS."

- IRDA (Investment) (Fourth Amendment) Regulations, 2008 has introduced requirements of quarterly internal audit for insurers.
- Companies going in for tapping the international capital market, especially, those seeking listing in US stock exchanges, NASDAQ, NYSE, etc., also need a strong internal audit function to meet the stringent corporate governance and internal control requirements of those stock exchanges. In this context, the US companies, having US public as investor also needs to comply with the requirements of Sections 302 and 404 of the Sarbanes Oxley Act of 2002.

### 1.3: Objectives of an Internal Audit

Internal audit has two main objectives as under:

- i. To ensure that internal control and risk management systems are continually being improved and optimised in response to an ever changing environment;
- ii. To provide reasonable assurance to the relevant the Audit Committee that significant risks in the organisation are being appropriately managed, with an emphasis on the role of internal controls.

### 1.4: Principles of an Internal Audit

COSO PRINCIPLES OF INTERNAL CONTROL “Internal control is broadly defined as a process, effected by an entity’s board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives.”

“While internal control is a process, its effectiveness is a state or condition of the process at one or more points in time.”

Internal control systems operate at different levels of effectiveness. Internal control can be judged effective in each of the three categories, respectively, if the board of directors and management have reasonable assurance that:

- They understand the extent to which the entity’s operations objectives are being achieved.
- Published financial statements are being prepared reliably.
- Applicable laws and regulations are being complied with.

“While internal control is a process, its effectiveness is a state or condition of the process at one or more points in time.” “An internal control system, no matter how well conceived and operated, can provide only reasonable — not absolute— assurance to management and the board regarding achievement of an entity’s objectives. The likelihood of achievement is affected by limitations inherent in all internal control systems. These include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake.

COSO’s internal control framework describes internal controls as consisting of five inter-related components. These are generally called “layers,” and the controls within each must be included in management’s assessment. The five layers are described by COSO as:

- a. **Control Environment** “The control environment sets the tone of an organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure. Control environment factors include the integrity, ethical values, and competence of the entity’s people; management’s philosophy and operating

style; the way management assigns authority and responsibility, and organizes and develops its people; and the attention and direction provided by the board of directors.”

- b. **Risk Assessment** “Every entity faces a variety of risks from external and internal sources that must be assessed. A precondition to risk assessment is establishment of objectives, linked at different levels and internally consistent. Risk assessment is the identification and analysis of relevant risks to achievement of the objectives, forming a basis for determining how the risks should be managed. Because economic, industry, regulatory, and operating conditions will continue to change, mechanisms are needed to identify and deal with the special risks associated with change.”
- c. **Control Activities** “Control activities are the policies and procedures that help ensure management directives are carried out. They help ensure that necessary actions are taken to address risks to achievement of the entity’s objectives. Control activities occur throughout the organization, at all levels and in all functions. They include a range of activities as diverse as approvals, authorizations, verifications, reconciliations, reviews of operating performance, security of assets, and segregation of duties.”
- d. **Information and Communication** “Pertinent information must be identified, captured, and communicated in a form and time frame that enable people to carry out their responsibilities. Information systems produce reports containing operational, financial, and compliance-related information that make it possible to run and control the business. They deal not only with internally generated data, but also information about external events, activities, and conditions necessary to informed business decision-making and external reporting.

Effective communication also must occur in a broader sense, flowing down, across, and up the organization. All personnel must receive a clear message from top management that control responsibilities must be taken seriously. They must understand their own role in the internal control system, as well as how individual activities relate to the work of others. They must have a means of communicating significant information upstream.

There also needs to be effective communication with external parties, such as customers, suppliers, regulators, and they must understand their own role in the internal control system, as well as how individual activities relate to the work of others. They must have a means of communicating significant information upstream. There also needs to be effective communication with external parties, such as customers, suppliers, regulators, and shareholders.”

- e. **Monitoring:** “Internal control systems need to be monitored — a process that assesses the quality of the system’s performance over time. This is accomplished through ongoing monitoring activities, separate evaluations, or a combination of the two. Ongoing monitoring occurs in the course of operations. It includes regular management and supervisory activities, and other actions personnel take in performing their duties. The scope and frequency of separate evaluations will depend primarily on an assessment of risks and the effectiveness of ongoing monitoring procedures. Internal control deficiencies should be reported upstream, with serious matters reported to top.

### 1.5: Internal Audit Strategy and Approaches

There are several different approaches to Internal Audit. International best practice suggests that systems audit is the most effective way that Internal Audit can add value to an organisation. However, it is considered necessary for Internal Audit to complement systems audit with a pre-audit approach. If a pre-

audit approach is adopted the Head of Internal Audit, the Audit Committee and the CFO/CEO should discuss the extent that this is necessary. They should also consider suitable means of reducing the proportion of time that Internal Auditors spend on pre-audit work.

The systems approach to Internal Audit seeks to assess and improve the effectiveness of the organisation's internal control system.

The prime purpose of a systems Audit should be to evaluate the extent to which the system may be relied upon to ensure that the objectives of the system are met.

Where internal controls are not adequate and reliable Internal Audit should make practical recommendations to ensure that these controls are improved.

Internal Audit evidence should be adequate to meet the objectives of Audit assignments.

Internal Auditors should be satisfied with the nature, adequacy and relevance of Audit evidence before placing reliance on that evidence. Information should be collected analysed and documented by the use of appropriate Audit techniques.

The production of Audit evidence should be supervised and reviewed by the Head of Internal Audit. To meet an acceptable standard the evidence should be sufficiently adequate and convincing to the extent that a prudent, informed person would be able to appreciate how the Auditor's conclusions were reached.

Internal Audit may also complement its systems approach with other techniques, for example:

- Performance auditing
- Control self-assessment
- Advice and assistance on control issues
- Helping with risk management.

Conclusions are the Internal Auditor's evaluations of the effects of the findings on the particular system reviewed. They should:

- Put the findings in perspective based on the overall implications and significance of the weaknesses identified
- Identify the extent to which the system's control objectives are being achieved and the degree to which the internal control systems should ensure that the goals and objectives of the organisation are accomplished efficiently.

Management should be required to respond in writing to each Internal Audit report.

Management and Internal Audit should agree officer responsibility and target dates for implementation of agreed recommendations. The responsibility for final editing of Audit reports should remain with the Head of Internal Audit who should always retain the right to issue reports without further editing.

Follow-up activity is the process by which Internal Audit confirms that agreed recommendations have been implemented by line managers. Internal Audit should periodically follow up Audit reports to review and test the implementation of agreed Internal Audit recommendations.

The Head of the Internal Audit should submit to the CFO/CEO and Audit Committee, at agreed intervals, a report of Internal Audit activity and results. The report should compare actual Internal Audit activity against



the annual Internal Audit plan and should clearly indicate the extent to which the total Internal Audit needs of the public sector organisation have been met.

In the annual Internal Audit report the Head of the Internal Audit should give a formal opinion to the CFO/CEO and Audit Committee on the extent to which reliance can be placed on the organisation's internal control system. The attention of the CFO/CEO and Audit Committee should be drawn to any major Internal Audit findings where action appears to be necessary but has not been undertaken.

### **1.6: Terms of Engagement of Internal Auditor**

The internal auditor and the auditee should agree on the terms of the engagement before commencement. The agreed terms would need to be recorded in an engagement letter. Normally, it is the responsibility of the internal auditor to prepare the engagement letter and it is to be signed both by the internal auditors as well as the auditee.

Internal Audit's terms of reference (or charter) should clearly outline the nature, objectives, responsibilities and scope of Internal Audit. Internal Audit's terms of reference should be approved by the Audit Committee subject to applicable legislation.

The written terms of reference for Internal Audit should clearly:

- establish Internal Audit's position within the organisation
- establish Internal Audit's right of access to all records (both electronic or otherwise), assets, personnel and premises, and its authority to obtain such information and explanations, as it considers necessary to fulfil its responsibilities
- define the scope of Internal Auditing activities.

Objectivity is an independent attitude of mind that Internal Auditors should maintain when performing Internal Audit work. It is important that Internal Auditors always retain a critical edge in undertaking their work. Internal Auditors need to be sceptical in discussions with CFO/CEO and to obtain an adequate level of proof from Audit testing.

Objectivity requires Internal Auditors to carry out Audits in such a way that the quality of their work or their honest belief in the results of that work is not compromised.

Internal Auditors should not be placed in situations in which they feel unable to make objective and impartial professional judgments. If any of the situations referred to below arise, Internal Auditors should inform their Head of Internal Audit so that alternative arrangements for the Internal Audit assignment may be made:

- i. Internal Auditors, notwithstanding their employment by the organisation, should be free from any conflict of interest arising either from professional or personal relationships or from pecuniary or other interests in an organisation or activity that is subject to Audit.
- ii. Internal Auditors should be free from undue influences, which either restrict or modify the scope or conduct of his work or overrule or significantly affect judgment as to the content of the Internal Audit report.
- iii. Internal Auditors should not allow their objectivity to be impaired when auditing an activity for which they have had authority or responsibility in the past.

- iv. Internal Audit should be consulted about significant proposed changes to the internal control system or the implementation of new systems. Internal Audit may make recommendations on the standards of control to be applied without prejudicing Internal Audit's objectivity in reviewing those systems at a later date.
- v. Internal Auditors should not normally undertake non-Audit duties, but if they do, exceptionally, they should ensure that management understands that they are not then functioning as Internal Auditors.

International best practice suggests that Audit Committees should be established. Audit Committees are generally considered to improve the independence of Internal Audit. Members of an Audit Committee, especially the chair, should be chosen so that they are sufficiently independent from the senior managers of the public sector organisation and so they are suitably experienced. An Audit Committee may deal with more than one organisation.

The role an Audit Committee with regard to Internal Audit is that it should:

- approve Internal Audit's strategic and operational plans and review performance against them
- discuss with Internal Audit its findings and the responses of management to its major recommendations; and, periodically, its views on the overall quality of internal control
- consider the objectives and scope of any additional (non-audit work) work undertaken by the Internal Auditors to ensure there are no conflicts of interest and that independence is not compromised
- review the adequacy of the Internal Audit function, its adherence to professional standards, particularly independence, standing, scope, resourcing, its liaison with the Auditor- General and other review agencies and its reporting arrangements
- meet regularly two or three times a year and meet with the Internal Auditors at their request as they deem necessary
- be involved in the process of appointment or dismissal of the Head of Internal Audit
- periodically review the Internal Audit terms of reference.

### **1.7: Independence of Internal Auditor**

Independence of an Internal Audit team helps to distinguish it from all other internal controls, systems and procedures. The Internal Audit function is not subject to the authority of the areas of the organization that it audits. Thus, 'operational independence' is ensured and the entire exercise is objective, impartial and free from any conflict of interest, inherent bias or undue external influence. Although the internal audit function is independent in its working, it provides a service to the management, reports to the Audit Committee and is ultimately accountable to the Chief Executive or the Board for the achievement of its set objectives and the utilization of resources.

A conflict of interest can create an appearance of impropriety that can undermine confidence in the internal auditor and the internal audit function. A conflict of interest could impair an individual's ability to perform his or her duties and responsibilities objectively. If independence or objectivity is impaired in fact or appearance, the details of the impairment must be disclosed to appropriate parties. The nature of the disclosure will depend upon the impairment. Impairment of organisational independence and individual objectivity may include, but is not limited to, personal conflict of interest, scope limitations, restrictions on

access to records, personnel, and properties, and resource limitations, such as funding. To ensure operational independence of internal audit function, certain measures need to be undertaken by the management. A general list is given below:

- a) The internal audit function must report directly to the Audit Committee
- b) The lead internal auditor must have direct access to the Chairman of the Audit committee and the Board of Directors
- c) Regular meetings must be held between the lead Internal auditor and the management
- d) Any external consultants approached by the internal audit function must be validated by the management
- e) The internal audit charter should not include any activity which may be or lead to a conflict of interest

The above mentioned steps helps the internal audit function maintain objectivity and undertake judgment based purely on tangible evidence devoid of influence.

### **1.8: Pronouncements on Internal Audit**

The audit report and the working papers of the auditor must provide evidence that the internal audit was carried out in accordance with the requirements of the relevant pronouncements.

## **Chapter 2: Documentation and Working Papers**

Internal audit documentation covers the internal audit charter, the internal audit plan, the type and extent of audit procedures performed, timings and the conclusions drawn from the evidence obtained.

Proper documents act as basis for the planning and performing the internal audit. Documents provide the evidence of the work of the internal auditor. Internal audit documentation should be detailed and comprehensive to obtain an overall understanding of the audit.

The internal auditor should document the issues that are important in providing evidence and support his findings or in preparation of the report. In addition, the working papers also help in planning and carrying out the internal audit, review and control the work and most importantly, provide evidence of the work performed to support his observations/ findings in the report.

Need for Internal audit documentation:

- i. Aid in planning and executing the internal audit.
- ii. Aid in review of the internal audit work.
- iii. As evidence of work performed during the internal audit to support the internal auditor's opinion and findings.
- iv. Assistance to third party while reviewing the internal auditor's work.
- v. Can be used as evidence to verify that the internal audit was performed in accordance with the scope of work as mentioned in the engagement letter

The internal audit documentation should cover all the important aspects of an engagement viz., engagement acceptance, engagement planning, risk assessment and assessment of internal controls, evidence obtained and examination/ evaluation carried out, review of the findings, communication and reporting and follow up. In case the internal audit is outsourced, the documentation should include a copy of the internal audit engagement letter, containing the terms and conditions of the appointment.

Internal audit documentation should be designed in accordance with requirement of specific audit and properly maintained to meet the requirements and circumstances of each audit. All significant issues which require special attention, together with internal auditor's observation thereon should be appropriately included in the internal audit documentation.

Properly designed and maintained internal audit Documentation enables the reviewer to understand:

- a) the nature and extent of audit procedures performed applicable legal and regulatory requirements;
- b) timings of the audit
- c) the outcome of audit procedures and audit evidence obtained;
- d) important issues arising during the course of audit and conclusions drawn; and
- e) terms and conditions of an internal audit engagement, scope of work, reporting requirements and any other special conditions relating to conduct of the internal audit.
- f) Record of the work performed.

### Use of Working Papers as evidence

The internal audit Documents provide the evidence of the work of the internal auditor and are important in providing evidence to his opinion or the findings. Following are the advantages of having sufficient and properly maintained work papers:

- i. Assistance in the performance of the audit.
- ii. Forming basis of the auditor's observations/ findings in his report.
- iii. Providing information for the report.
- iv. Aiding the review and evaluation of the work done.
- v. Aiding cross referencing between audit evidence and decision taken by the internal auditor.
- vi. Providing record of work done

The internal auditor should formulate policies as to the custody and retention of the internal audit documentation within the framework of the overall policy of the entity in relation to the retention of documents and in accordance with the practices prevailing in the profession.

## **Chapter 3: Planning an internal audit and Audit Programme**

The internal audit plan should be inclusive to ensure that it helps in achieving the overall objectives of an internal audit. The internal audit plan should be in line with Internal Audit Charter of the organization and goal and objectives of organization.

Planning requires preparation of overall plan for coverage of entire scope defining nature, duration and degree of audit procedures. Plan to be reviewed on an ongoing basis and any major modifications to be done in consultation of in charge of governance.

The internal auditor before start of the engagement may discuss important aspects of plan including the scope and coverage with all the stake holders. This would help the internal auditor as well as the client to assess whether the internal audit is directed to achieve the objectives as set out in the terms of engagement. The discussion would also help the internal auditor to gauge whether the client's perception of the role and responsibilities of the internal auditor is appropriate. The internal auditor should also assess the client expectations as to the assurance level on different aspect of entity's operations and controls.

### **Factors Affecting the Planning Process**

The internal audit plan should be based on the knowledge of the entity's business. While designing the audit plan, internal auditor should consider critical elements like objective of audit, time, resource requirements, risk management policy of the organization and ensuring that the resultant risk remains within the appetite of the organization. Therefore, the planning process encompasses internal auditor's knowledge and perception of:

- The objectives of the activity being subjected to internal audit.
- The significant risks associated with the above activity.
- The risk management and internal control system instituted in the organization to reduce the above risks to an acceptable level.
- The possible areas in which the internal audit can suggest improvement to the risk management and/ or internal control system associated with the concerned activity.
- The selection of engagement team (including, where necessary, the engagement team quality control reviewer) and the assignment of audit work to the team members, including the assignment of appropriately experienced team members.
- Business developments affecting the entity, including changes in information technology and business processes, changes in key management, and acquisitions, mergers and divestments.
- Industry developments such as changes in industry regulations and new reporting requirements.
- Changes in the financial reporting framework, such as changes in accounting standards.
- Other significant relevant developments, such as changes in the legal environment affecting the entity.

### **Scope of Planning**

Internal audit plan should cover areas such as:



- Obtaining the knowledge of the legal and regulatory framework within which the entity operates.
- Obtaining the knowledge of the entity's accounting and internal control systems and policies.
- Determining the effectiveness of the internal control procedures adopted by the entity.
- Determining the nature, timing and extent of procedures to be performed.
- Identifying the activities warranting special focus based on the materiality and criticality of such activities, and their overall effect on operations of the entity.
- Identifying and allocating staff to the different activities to be undertaken.
- Setting the time budget for each of the activities.
- Identifying the reporting responsibilities.

The internal audit plan should also identify the benchmarks against which the actual results of the activities, the actual time spent, the cost incurred would be measured.

### **Planning Process**

The internal auditor should obtain a level of knowledge of the entity sufficient to enable him to identify events, transactions, policies and practices that may have a significant effect on the financial information. Following are some of the sources wherefrom the internal auditor can obtain such knowledge:

- Previous experience, if any, with the entity and the industry.
- Legislation and regulations that significantly affect the entity.
- Entity's policy and procedures manual.
- Minutes of the meetings of the shareholders, board of directors, and important committees of the board such as the audit committee, remuneration committee, shareholders' grievances committee.
- Management reports/ internal audit reports of prior periods.
- Newspaper/ industry journals.
- Discussion with client's management and staff.
- Visits to entity's plant facilities etc., to obtain first-hand information regarding the production processes of the entity.
- Visits to the entity's department where the accounting and other documents are generated, maintained, and the administrative procedures followed.
- Other documents produced by the entity, for example, material sent to the shareholders and the regulatory authorities, management policy manuals, manuals relating to accounting and internal controls, organizational charts, job description charts, etc.

Knowledge of the entity's business, among other things, helps the internal auditor to identify areas requiring special focus, evaluate the appropriateness of the accounting policies and disclosures, accounting estimates and management representations. Knowledge of the business would also help the auditor to identify the priorities of the business, critical factors or constraints in the smooth running of the business as also understand the trends in respect of various financial and operating ratios, etc.

## **Audit Programme**

The internal auditor should device a documented internal audit programme describing the processes essential to meet the objective of internal audit plan. Internal audit programme to be drawn before the start of the audit in consultation with relevant stake owners.

The internal audit programme identifies, in appropriate details:

- the objectives of the internal audit in respect of each area,
- the staff responsible for carrying out the particular activity,
- the time allocated to each activity as also the sufficiently detailed, and
- Sufficiently detailed instructions to the staff as to how to carry out those procedures.

The internal audit programme may also have provision for information such as:

- The procedures actually performed,
- Reasons for not performing the originally identified procedures,
- Actual time consumed in carrying out the relevant procedure, and
- Reasons for deviations from budgeted time etc.

A well prepared, comprehensive audit programme helps proper execution of the work as well as of the proper supervision, direction and control of the performance of the engagement team.

## **Sample- Information requisition**

### ***Description of Information/Data***

- Copy of existing process flow charts, operating procedures and policies including specifically the following:
  - a. Schedule of authority for expense and payments.
  - b. User manual and process flows used for Oracle.
  - c. Valid circulars/ mails on policies.
- Summary of active projects - Project Description, Nature of Project (commercial/ residential), Location, Project Size (Budget, Duration), Current Completion status, Project Head etc.
- Details of management review committees (Composition, Role, Responsibilities, Frequency of meetings, Agenda, Minutes of meeting for last 1 year etc.)
- Copies of internal audit reports/ management audit reports for last 2 years.
- Copy of Information presented to the Board as part of the Board Agenda (last two months) and copy of Minutes of the meetings (Board, Audit Committee and Executive Committee if any) for last two years.
- Summary of agreements with main service providers and business associates
- Copies of existing statutory and legal compliance checklists and procedures

- Listing of existing MIS Reports by Function/ Company as a whole (Daily/ Weekly/ Monthly/ Quarterly) and copy for last 3 consecutive months
- Details of IT Applications currently in use as follows:
  - a) Name of the application
  - b) Purpose of the application
  - c) Integrated with main financial application - yes / no, (if no is it proposed to be integrated - yes / no)

## **Chapter 4: Audit Sampling**

### **Definition**

"Audit sampling" means the applying audit procedures on such a portion of transactions (i.e. less than 100% of the items within the activity), the outcome of which would represent the entire population.

"Population" means the entire set of data from which a sample is selected and about which the auditor wishes to draw conclusions.

"Sampling risk" means the risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure.

### **Use of Sampling in Risk Assessment Procedures and Tests of Controls**

The internal auditor performs risk assessment procedures to obtain an understanding of the entity, business and its environment, including the mechanism of its internal control. Ordinarily, risk assessment procedures do not involve the use of sampling. However, there are cases, where the internal auditor often plans and performs tests of controls concurrently with obtaining an understanding of the design of controls and examining whether they have been implemented.

Tests of controls are performed when the internal auditor's risk assessment includes an expectation of the operating effectiveness of controls. Sampling of tests of controls is appropriate when application of the control leaves audit evidence of performance (for example, initials of the credit manager on a sales invoice indicating formal credit approval).

Sampling risk can be reduced by increasing sample size for both tests of controls and tests of details. No sampling risk can be reduced by proper engagement planning, supervision, monitoring and review.

### **Design of the Sample**

When designing an audit sample, the auditor shall consider the purpose of the audit procedure and the characteristics of the population from which the sample will be drawn. Audit sampling enables the auditor to obtain and evaluate audit evidence about some characteristic of the items selected in order to form or assist in forming a conclusion concerning the population from which the sample is drawn. Audit sampling can be applied using either non-statistical or statistical sampling approaches.

The auditor shall determine a sample size sufficient to reduce sampling risk to an acceptably low level.

When designing an audit sample, the internal auditor should consider the specific audit objectives, the population from which the internal auditor wishes to sample, and the sample size.

### **Sample Size**

The level of sampling risk that the auditor is willing to accept affects the sample size required. The lower the risk the auditor is willing to accept, the greater the sample size will need to be. The sample size can be determined by the application of a statistically based formula or through exercise of professional judgment applied objectively to the circumstances of the particular internal audit engagement.

## Selection of Sample

The internal auditor should select sample items in such a way that the sample can be expected to be representative of the population. This requires that all items or sampling units in the population have an opportunity of being selected.

While there are a number of selection methods, three methods commonly used are:

- Random selection and use of CAATs
- Systematic selection
- Haphazard selection

## Evaluation of Sample Results

Having carried out, on each sample item, those audit procedures that are appropriate to the particular audit objective, the internal auditor should:

- Analyze the nature and cause of any errors detected in the sample;
- Project the errors found in the sample to the population;
- Reassess the sampling risk; and
- Consider their possible effect on the particular internal audit objective and on other areas of the internal audit engagement.

The internal auditor should evaluate the sample results to determine whether the assessment of the relevant characteristics of the population is confirmed or whether it needs to be revised.

## Documentation

Documentation provides the essential support to the opinion and/ or findings of the internal auditor. In the context of sampling, the internal auditor's documentation may include aspects such as:

- Relationship between the design of the sample *vis a vis* specific audit objectives, population from which sample is drawn and the sample size.
- Assessment of the expected rate of error in the population to be tested *vis a vis* auditor's understanding of the design of the relevant controls
- Assessment of the sampling risk and the tolerable error.
- Assessment of the nature and cause of errors.
- Rationale for using a particular sampling technique and results thereof.
- Analysis of the nature and cause of any errors detected in the sample.
- Projection of the errors found in the sample to the population.
- Reassessment of sampling risk, where appropriate.
- Effect of the sample results on the internal audit's objective(s).
- Projection of sample results to the characteristics of the population.

## **Chapter 5: Audit Evidence**

Audit evidence is all the information used by the auditor in arriving at the conclusions on which the audit opinion is based and includes the information contained in the accounting records underlying the financial statements and other information.

Internal audit evidence is used by the internal auditor to support the facts and opinion contained in his report. It is cumulative in nature and is primarily obtained from audit procedures performed during the course of the internal audit.

### **Sufficient Appropriate Audit Evidence**

Sufficiency is the measure of the quantity of audit evidence. Appropriateness is the measure of the quality of audit evidence, that is, its relevance and its reliability in providing support for, or detecting misstatements in, the classes of transactions, account balances, and disclosures and related assertions. The auditor should consider the sufficiency and appropriateness of audit evidence to be obtained when assessing risks and designing further audit procedures. The internal auditor may often seek evidence from different sources or of different nature to support the same finding.

The internal auditor should evaluate whether he has obtained sufficient appropriate audit evidence before he draws his conclusions therefrom. The internal audit evidence should enable the internal auditor to form an opinion on the scope of the terms of the engagement.

The auditor should obtain audit evidence to draw reasonable conclusions on which to base the audit opinion by performing audit procedures to:

- Obtain an understanding of the entity and its environment, including its internal control, to assess the risks of material misstatement at the financial statement and relevant assertion levels.
- When necessary, or when the auditor has determined to do so, test the operating effectiveness of controls in preventing or detecting material misstatements at the relevant assertion level.
- Detect material misstatements at the relevant assertion level

### **Obtaining Internal Audit Evidence**

The internal auditor obtains evidence by performing one or more of the following procedures:

- Inspection of records and documents
- Inspection of Tangible assets
- Observation
- Inquiry and confirmation
- Re-computation or Recalculation
- Re-performance
- Analytical review

The timing of such procedures will be dependent, in part, upon the periods of time during which the internal audit evidence sought is available.



## **Chapter 6. Analytical Procedures**

“Analytical procedures” means the analysis of significant ratios and trends, including the resulting investigation of fluctuations and relationships in both financial and non-financial data that are inconsistent with other relevant information or which deviate significantly from predicted amounts. Analytical procedures provide the internal auditor with an efficient and effective means of making an assessment of information collected in an audit. The assessment results from comparing such information with expectations identified or developed by the internal auditor.

Analytical procedures include the consideration of comparisons of the entity's financial and non-financial information with, for example:

- Comparable information for prior periods.
- Anticipated results of the entity, such as budgets or forecasts or expectations of the internal auditor.
- Predictive estimates prepared by the internal auditor, such as an estimation of depreciation charge for the year.
- Similar industry information, such as a comparison of the entity's ratio of sales to trade debtors with industry averages, or with other entities of comparable size in the same industry.

Analytical procedures also include consideration of relationships:

- Among elements of financial information that would be expected to conform to a predictable pattern based on the entity's experience, such as gross margin percentages.
- Between financial information and relevant non-financial information, such as payroll costs to number of employees or total production costs to quantity produced.

Analytical procedures are used for the following purposes:

- To assist the internal auditor as risk assessment procedures to obtain initial understanding of the entity and its environment and thereafter in planning the nature, timing and extent of other internal audit procedures;
- As substantive procedures when their use can be more effective or efficient than tests of details in reducing detection risk for specific financial statement assertions;
- As an overall review of the systems and processes in the final review stage of the internal audit; and
- To evaluate the efficiency of various business/ management systems.

### **Analytical Procedures as Risk Assessment Procedures and in Planning the Internal Audit**

The internal auditor should apply analytical procedures as risk assessment procedures to obtain an understanding of the business, the entity and its environment and in identifying areas of potential risk. Application of analytical procedures may indicate aspects of the business of which the internal auditor was unaware and will assist in determining the nature, timing and extent of other internal audit procedures.

Analytical procedures in planning the internal audit use both financial and non-financial information, for example, in retail business, the relationship between sales and square footage of selling space or volume of goods sold.

### **Analytical Procedures as Substantive Procedures**

The internal auditor's reliance on substantive procedures to reduce detection risk relating to specific financial statement assertions and assertions relating to process, systems and controls may be derived from tests of details, from analytical procedures, or from a combination of both. The decision about which procedures to use to achieve a particular internal audit objective is based on the internal auditor's judgment about the expected effectiveness and efficiency of the available procedures in reducing detection risk for specific financial statement assertions or assertions relating to process, systems and controls.

The internal auditor will ordinarily inquire of management as to the availability and reliability of information needed to apply analytical procedures and the results of any such procedures performed by the entity. It may be efficient to use analytical data prepared by the entity, provided the internal auditor is satisfied that such data is properly prepared.

### **Analytical Procedures in the Overall Review at the End of the Internal Audit**

The internal auditor should apply analytical procedures at or near the end of the internal audit when forming an overall conclusion as to whether the systems, processes and controls as a whole are robust, operating effectively and are consistent with the internal auditor's knowledge of the business. The conclusions drawn from the results of such procedures are intended to corroborate conclusions formed during the internal audit of individual components or elements of the financial statements, e.g., purchases, and assist in arriving at the overall conclusion. However, in some cases, as a result of application of analytical procedures, the internal auditor may identify areas where further procedures need to be applied before the internal auditor can form an overall conclusion about the systems, processes and associated controls.

### **Extent of Reliance on Analytical Procedures**

The application of analytical procedures is based on the expectation that relationships among data exist and continue in the absence of known conditions to the contrary. The presence of these relationships provides the internal auditor evidence as to the completeness, efficiency and effectiveness of systems, processes and controls. However, reliance on the results of analytical procedures will depend on the internal auditor's assessment of the risk that the analytical procedures may identify relationships as expected when, in fact, a material misstatement exists.

The extent of reliance that the internal auditor places on the results of analytical procedures depends on the following factors:

- Materiality of the items involved, for example, when inventory balances are material, the internal auditor does not rely only on analytical procedures in forming conclusions. However, the internal auditor may rely solely on analytical procedures for certain income and expense items when they are not individually material;
- Other internal audit procedures directed toward the same internal audit objectives, for example, other procedures performed by the internal auditor while reviewing the credit management

process, in the collectability of accounts receivable, such as the review of subsequent cash receipts, might confirm or dispel questions raised from the application of analytical procedures to an ageing schedule of customers' accounts;

- Accuracy with which the expected results of analytical procedures can be predicted. For example, the internal auditor will ordinarily expect greater consistency in comparing gross profit margins from one period to another than in comparing discretionary expenses, such as research or advertising; and
- Assessments of inherent and control risks, for example, if internal control over sales order processing is weak and, therefore, control risk is high, more reliance on tests of details of transactions and balances than on analytical procedures in drawing conclusions on receivables may be required.

### **Investigating Unusual Items or Trends**

When analytical procedures identify significant fluctuations or relationships that are inconsistent with other relevant information or that deviate from predicted amounts, the internal auditor should investigate and obtain adequate explanations and appropriate corroborative evidence. The examination and evaluation should include inquiries of management and the application of other auditing procedures until the internal auditor is satisfied that the results or relationships are sufficiently explained. Unexplained results or relationships may be indicative of a significant condition such as a potential error, irregularity, or illegal act. Results or relationships that are not sufficiently explained should be communicated to the appropriate levels of management. The internal auditor may recommend appropriate courses of action, depending on the circumstances.

The investigation of unusual fluctuations and relationships ordinarily begins with inquiries of management, followed by:

- Corroboration of management's responses, for example, by comparing them with the internal auditor's knowledge of the business and other evidence obtained during the course of the internal audit; and
- Consideration of the need to apply other internal audit procedures based on the results of such inquiries, if management is unable to provide an explanation or if the explanation is not considered adequate.

## **Chapter 7: Accounting System and Internal Control**

### **Introduction**

While the management is responsible for establishment and maintenance of appropriate internal control and risk management systems, the role of the internal auditor is to suggest improvements to those systems. For this purpose, the internal auditor should:

- Obtain an understanding of the risk management and internal control framework established and implemented by the management.
- Perform steps for assessing the adequacy of the framework developed in relation to the organizational set up and structure.
- Review the adequacy of the framework.
- Perform risk-based audits on the basis of risk assessment process.

Internal auditor may, however, also undertake work involving identification of risks as well as recommend design of controls or gaps in existing controls to address those risks.

### **Internal Control System**

An internal control system is crucial to the successful functioning of any enterprise. It refers to the policies and procedures as well as the attitude of the management to assist in achieving the following overall objectives of the management:

- Orderly and efficient conduct of the business
- Adherence to management's policies and directives
- Safeguarding assets
- Prevention and detection of frauds and errors
- Accuracy and completeness of the accounting records
- Timely preparation of reliable financial information

The absence, inadequacy or malfunctioning of the internal control system could, therefore, have adverse results.

To be able to effectively help the management achieve its above mentioned objectives, it is essential that the internal control system has the following elements:

- Integration with the risk management policy of the entity.
- Constant monitoring of various activities and functions.
- Identification and analysis of variances.
- Determination and implementation of corrective action.
- Revision of objectives and norms where needed and where supported.

In addition, the internal controls must also satisfy the three basic criteria:

- they must be appropriate, i.e., the right control in the right place and commensurate to the risk involved;

- they must function consistently as planned throughout the period, i.e., be complied with carefully by all employees involved and not by-passed when key personnel are away or the workload is heavy; and
- They must be cost effective, i.e., the cost of implementing the control should not exceed the benefits derived.

The internal control system should focus on both accounting and non-accounting operations and functions. Strong accounting controls result in correct, reliable, timely and relevant reporting of financial transactions that have already occurred while strong controls in operational areas improve the overall performance of the enterprise.

The internal auditor should review whether the internal controls are cost effective. Evaluation of cost effectiveness should take into consideration both direct and indirect costs. Review of internal controls may include interviews with personnel at various organizational levels, transaction walkthroughs, review and analysis of documented policies and procedures and mapping the process to determine and rectify existing control gaps and to suggest process improvement. The internal auditor should determine if the controls were in use throughout the period of intended reliance or have there any substantial alterations in the same during the stated period. Different techniques may be used to record information. Selection of a particular technique depends on the auditor's judgment.

### **Evaluation of Internal Control**

Internal auditors should systematically evaluate the nature of operations and system of internal controls in the departments being audited to determine the nature, extent and timing of audit procedures. Internal controls of an organization comprise the plan of organization and methods adopted to safeguard assets, comply with laws, ensure the completeness and correctness of data, promote efficiency and encourage adherence to management policies. It is important that a review of an internal control system be directed primarily towards those controls that have an important bearing on the reliability of the system (i.e., key controls).

### **Internal Control Assessments**

The internal auditor assess the 'as-is' internal control system within the organization and map it against a globally accepted 'standard' which is basically, an Internal Controls framework- COSO being the most widely used.

- Evaluate efficiency and effectiveness of controls
- Recommend new controls where needed – or discontinuing unnecessary controls
- Use of control frameworks
- Control self-assessment (CSA)

The most contentious aspect of SOX is Section 404, which requires management and the external auditor to report on the adequacy of the company's internal control over financial reporting (ICFR). This is the most demanding aspect of the legislation for companies to implement, as documenting and testing important financial manual and automated controls requires enormous effort. Under Section 404 of the Act, management is required to produce an "internal control report" as part of each annual Exchange Act report. The report must affirm "the responsibility of management for establishing and maintaining an

adequate internal control structure and procedures for financial reporting.” The report must also “contain an assessment, as of the end of the most recent fiscal year of the company, of the effectiveness of the internal control structure and procedures of the issuer for financial reporting.” To do this, managers are generally adopting an internal control framework such as that described in COSO. Both management and the external auditor are responsible for performing their assessment in the context of a top-down risk assessment, which requires management to base both the scope of its assessment and evidence gathered on risk. Both the PCAOB and SEC recently issued guidance on this topic to help alleviate the significant costs of compliance and better focus the assessment on the most critical risk areas. The recently released Auditing Standard No. 5 of the Public Company Accounting Oversight Board (PCAOB), which superseded Auditing Standard No 2, has the following key requirement for the external auditor:

- Assess both the design and operating effectiveness of selected internal controls related to significant accounts and relevant assertions, in the context of material misstatement risks;
- Understand the flow of transactions, including IT aspects, sufficiently to identify points at which a misstatement could arise;
- Evaluate company-level (entity-level) controls, which correspond to the components of the COSO framework;
- Perform a fraud risk assessment;
- Evaluate controls designed to prevent or detect fraud, including management override of controls;
- Evaluate controls over the period-end financial reporting process;
- Scale the assessment based on the size and complexity of the company;
- Rely on management's work based on factors such as competency, objectivity, and risk;
- Evaluate controls over the safeguarding of assets; and
- Conclude on the adequacy of internal control over financial reporting.

### **Internal Control Certifications**

Under Sarbanes-Oxley, two separate certification sections came into effect—one civil and the other criminal. Section 302- (civil provision); Section 906- (criminal provision).Section 302 of the Act mandates a set of internal procedures designed to ensure accurate financial disclosure. The signing officers must certify that they are “responsible for establishing and maintaining internal controls” and “have designed such internal controls to ensure that material information relating to the company and its consolidated subsidiaries is made known to such officers by others within those entities, particularly during the period in which the periodic reports are being prepared.” The officers must “have evaluated the effectiveness of the company’s internal controls as of a date **within 90 days prior to the report**” and “have presented in the report their conclusions about the effectiveness of their internal controls based on their evaluation as of that date.”



## **Chapter 8. Control and Risk Assessment**

### **Internal Control Evaluation**

Internal control and Risk Management systems are of paramount importance in the activities of the stock brokers. Internal control is the integration of the activities, plans, attitudes, policies, applicable laws and regulations, and efforts of the people of an organization working together to provide reasonable assurance that the organization will achieve its objective and mission. The internal audit function constitutes a separate component of internal control with the objective of determining whether other internal controls are well designed and properly operated.

The role of the internal auditor encompasses:

- Evaluation of the efficiency and effectiveness of controls
- Recommending new controls where needed – or discontinuing unnecessary controls
- Using control frameworks
- Developing control self-assessment.

Internal control system extends beyond those matters which relate directly to the functions of the accounting system. Timely accounting entries of clients and exchange settlements, correct and timely reporting of margins, timely pay-in and payouts, or other reconciliations, etc. may depict good accounting controls but not sound internal controls. The internal auditor should gather fair understanding of control environments such as,

- Management's philosophy and operating style
- Integrity and ethical values
- Entity's organizational structure and methods of assigning and reviewing authorities
- Organizational policies and procedures are in place and in operation, including policies on Risk Management, Prevention of Money Laundering, HR related policies, IT policies, Data Security Policies, etc.
- There is a regular system of reviewing and updating the policies and procedures.

Internal controls may be either preventive or detective. The internal auditor should ensure that in general, the approval function, the accounting/reconciling function, and the asset custody function is separated among employees of the entity. When these functions cannot be separated due to small department size, the internal auditor should ensure that a detailed supervisory review of related activities is in practice, as a compensating control activity. The internal auditor should use his professional judgment to assess and evaluate the presence and maturity of entity's internal controls. He should use narratives, flowcharts, questionnaires for obtaining understanding of each department and its business and accounting processes. The internal auditor should identify internal control weaknesses that have not been corrected and make recommendations to correct those weaknesses. When internal controls are found to contain continuing weaknesses, the internal auditor should consider whether:

- Management has increased supervision and monitoring;
- Additional or compensating controls have been instituted; and/or

- Management accepts the risk inherent with the control weakness. The internal auditor should communicate significant deficiencies and material weaknesses to management and those charged with governance.

## Risk Management

The underlying premise of enterprise risk management is that every entity exists to provide value for its stakeholders. All entities face uncertainty and the challenge for management is to determine how much uncertainty to accept as it strives to grow stakeholder value. Uncertainty presents both risk and opportunity, with the potential to erode or enhance value. Enterprise risk management enables management to effectively deal with uncertainty and associated risk and opportunity, enhancing the capacity to build value. Value is maximized when management sets strategy and objectives to strike an optimal balance between growth and return goals and related risks, and efficiently and effectively deploys resources in pursuit of the entity's objectives. Enterprise risk management encompasses:

- *Aligning risk appetite and strategy:* Management considers the entity's risk appetite in evaluating strategic alternatives, setting related objectives, and developing mechanisms to manage related risks.
- *Enhancing risk response decisions:* Enterprise risk management provides the rigor to identify and select among alternative risk responses – risk avoidance, reduction, sharing, and acceptance.
- *Reducing operational surprises and losses:* Entities gain enhanced capability to identify potential events and establish responses, reducing surprises and associated costs or losses. Identifying and managing multiple and cross-enterprise risks – Every enterprise faces a myriad of risks affecting different parts of the organization, and enterprise risk management facilitates effective response to the interrelated impacts, and integrated responses to multiple risks.
- *Seizing opportunities:* By considering a full range of potential events, management is positioned to identify and proactively realize opportunities.
- *Improving deployment of capital:* Obtaining robust risk information allows management to effectively assess overall capital needs and enhance capital allocation. These capabilities inherent in enterprise risk management help management achieve the entity's performance and profitability targets and prevent loss of resources. Enterprise risk management helps ensure effective reporting and compliance with laws and regulations, and helps avoid damage to the entity's reputation and associated consequences. In sum, enterprise risk management helps an entity get to where it wants to go and avoid pitfalls and surprises along the way.

**Events – Risks and Opportunities** Events can have negative impact, positive impact, or both. Events with a negative impact represent risks, which can prevent value creation or erode existing value. Events with positive impact may offset negative impacts or represent opportunities. Opportunities are the possibility that an event will occur and positively affect the achievement of objectives, supporting value creation or preservation. Management channels opportunities back to its strategy or objective-setting processes, formulating plans to seize the opportunities.

## **Chapter 9: Internal Audit in ERP Environment and Systems Audit**

### **Introduction**

Now a days, Financial and operational transactions are increasing in volume and it increases complexity every day. In today's business environment, auditors should have knowledge of both accounting and technology. The technical complexity of ERP system has forced auditors to increase their knowledge of information technology. When a company uses an ERP system the audit focus shifts from substantive testing of the books of account to understanding the business processes, testing the systems and applications controls etc. At the same time, auditors must ensure that the system is automating the process correctly.

In ERP systems, operational and financial data are tied together through a complex information flow. Transactions can be automatically entered without review or pre-checking with the ERP system. For this such controls should be designed to prevent inaccurate or false information entering in the system. So auditing must be done through the computer in ERP environment. Accountants and company management need to be aware of the risks involved with an ERP system. Today, with the implementation of integrated ERP systems, internal controls are developing itself to support automated operational management. As a result, finance officers have changing their approach and implementing automated internal controls that allow managers to effectively manage through ERP systems.

An ERP system automatically updates the data throughout the system once a transaction has been entered. Because the information is updated, maintained and stored electronically, auditors need to understand how the modules interact with each other and with the database. Auditors must spend more time with lower-level employees in ERP system to determine what they are doing while entering the data, and especially what to do if a mistake is made.

### **Definition**

Enterprise resource planning (ERP) systems integrate internal and external management information across an entire organization, embracing finance/accounting, manufacturing, sales and service, customer relationship management, etc. ERP systems automate this activity with an integrated software application. Their purpose is to facilitate the flow of information between all business functions inside the boundaries of the organization and manage the connections to outside stakeholders. ERP systems can run on a variety of computer hardware and network configurations, typically employing a database as a repository for information.

### **Characteristics of ERP**

The following are the characteristics of ERP System:

- The database is usually centralized and as the applications reside on multiple users, the system allows flexibility in customization and configuration.
- The processing is real time online whereby the databases are updated simultaneously by minimal data entry operations.
- The input controls are dependent on pre data acceptance validation and rely on transaction balancing; time tested controls such as batch totals etc. are often no longer relevant.

- Since the transactions are stored in a common database the different modules update entries into the database. Thus data-base is accessible from different modules.
- The authorization controls are enforced at the level of application and not the data-base; the security control evaluation is of paramount importance.
- Auditors have to spend considerable time understanding the data flow and transaction processing.
- System heavily dependent on networking on a large scale.
- Vulnerability by increased access is a price that is paid for higher integration and faster processing of data in an integrated manner.
- The risk of single point failures is higher in ERP solutions; Business Continuity and Disaster Recovery should be examined closely.

### **Risks in ERP**

ERP systems are implemented to support the operations of an enterprise and to be successful, must be fully integrated into all the significant processes and procedures that together enable the enterprise to work effectively. Given the integrated nature of ERP systems, they can further add to the enterprise's risks or challenges related to:

- Industry and business environment
- User or management behavior
- Business processes and procedures
- System functionality
- Application security
- Underlying infrastructure
- Data conversion and integrity
- On-going maintenance/business continuity

The risks associated with the implementation and ongoing use of an ERP system cannot be determined or controlled by review of application or technical risks in isolation, but must be considered in conjunction with the business process control objectives of the enterprise being served. The challenge to the audit professional is, obtaining an understanding of the business and regulatory environment in which the enterprise operates and being skilled in the identification of quantifiable application or technical risks and less quantifiable procedural or behavioral risks.

Typically, in a large enterprise where the quantity of data processed by the ERP system is extremely voluminous, the analysis of patterns and trends proves to be extremely useful in ascertaining the efficiency and effectiveness of operations. Most ERP systems provide opportunities including specific tools for such extraction and analysis. The use of data analysis tools within the ERP system can assist the audit professional throughout the ERP system's life cycle (i.e., pre- and post-implementation).

### **Impact on Internal Audit**

Following are the impacts on internal audit:

a. Lack of transaction trails

Some ERP systems are designed so that a complete transaction trail that is useful for audit purposes might exist for only a short period of time or only in computer readable form. Where a complex application system performs a large number of processing steps, there may not be a complete trail. Accordingly, errors embedded in an application's program logic may be difficult to detect on a timely basis by manual procedures.

b. Uniform Processing of Transactions

Computer processing uniformly processes like transactions with the same processing instructions. Thus, the clerical errors ordinarily associated with manual processing are virtually eliminated. Conversely, programming errors (or other systematic errors in hardware or software) ordinarily result in all transactions being processed incorrectly.

c. Lack of Segregation of Functions

Many control procedures that would ordinarily be performed by separate individuals in manual systems may be concentrated in ERP. Thus, an individual who has access to computer program, processing or data may be in a position to perform incompatible functions.

d. Initiation or Execution of Transactions

ERP may include the capability to initiate or cause the execution of certain types of transactions automatically. The authorization of these transactions or procedures may not be documented in the same way as those in a manual system, and management's authorization of these transactions may be implicit in its acceptance of the design of the ERP and subsequent modification.

e. Potential for errors and irregularities

The potential for human error in the development, maintenance and execution of ERP may be greater than in manual systems, partially because of the level of detail inherent in these activities. Also, the potential for individuals to gain unauthorized access to data or to alter data without visible evidence may be greater in ERP than in manual systems. In addition, decreased human involvement in handling transactions processed by ERP can reduce the potential for observing errors and irregularities. Errors or irregularities occurring during the design or modification of application program or systems software can remain undetected for long periods of time.

f. Dependence of Other Controls Over ERP

ERP may produce reports and other output that are used in performing manual control procedures. The effectiveness of these manual control procedures can be dependent on the effectiveness of controls over the completeness and accuracy of computer processing. In turn, the effectiveness and consistent operation of transaction processing controls in computer applications is often dependent on the effectiveness of general ERP controls.

g. Management supervision

ERP can offer management a variety of analytical tools that may be used to review and supervise the operations of the entity. The availability of these additional controls, if used, may serve to enhance the entire internal control structure.

## **Systems audit**

Systems audit is an examination of management's controls within an IT Infrastructure. The evaluation of obtained evidence determines if the information systems are safeguarding assets, maintaining data integrity, and operating effectively to achieve the organization's goals or objectives.

A systems audit is different from a financial statement audit. While a financial audit's purpose is to evaluate whether an organization is adhering to standard accounting practices, the purposes of a systems audit are to evaluate the system's internal control design and effectiveness. This includes, but is not limited to, efficiency and security protocols, development processes, and IT governance or oversight. Installing controls are necessary but not sufficient to provide adequate security. People responsible for security must consider if the controls are installed as intended, if they are effective if any breach in security has occurred and if so, what actions can be done to prevent future breaches. These inquiries must be answered by independent and unbiased observers. These observers are performing the task of information systems auditing. In an Information Systems (IS) environment, an audit is an examination of information systems, their inputs, outputs, and processing.

The broker using IML and Internet Trading facility is required to get their systems audited by a qualified systems auditor (ISA/CISA/CISSP). The audit is to be carried out for the year ending 31st March and the report is required to be submitted in the prescribed format, latest by 30th June. The audit is not required to be conducted for Internet trading facility extended to the client on the BSE Webx platform.

The broker using CTCL and Internet Trading facility is required to get their systems audited by a qualified systems auditor (ISA/CISA/CISSP). The audit is to be carried out for the year ending 30th June and the report is required to be submitted in the prescribed format latest by 31st July.

## **Chapter 10: Relying on External Opinion and Reference of Auditor Expert**

### **Work Performed by Others**

Internal auditor would invariably require delegating work to assistants. At times, services of an expert might also be sought. The internal auditor would, however, continue to be responsible for his opinion on the activities being subject to internal audit or his findings. The internal auditor should carefully direct, supervise and review the work delegated to assistants. The amount of supervision required depends on the skill and experience of the assistant on the job. The supervisory role of the internal auditor includes:

- Providing suitable instructions for the audit.
- Approving or recommending the approval of the audit plan.
- Ensuring that the audit program is completed.
- Ensuring that working papers adequately support the audit findings, conclusions and reports.
- Ensuring that the reports are unambiguous, accurate and concise.
- Ensuring that the audit objectives have been met.

The majority of the matters listed are seldom referred to in auditing texts, and most candidates will not have come across them in real-life audit situations. However, in diverse economies, expert opinions from an array of disciplines are often required by auditors – in particular those involved in the audit of large companies (for example, banks, insurance companies and mining and exploration companies). In this respect, candidates may wish to consider the issues faced by an auditor when auditing the reported liabilities of a company that has made a provision for costs arising as a consequence of an environmental disaster for which the company is culpable. On a more basic level, where companies own expensive jewellery, works of art or antiques – either as trading or as investment assets – auditors may need to rely on the opinion of their own experts if they do not have other sufficient appropriate evidence to support ‘valuation’ assertions made by management.

An auditor’s expert needs to be competent, capable and objective if their services are to be deemed adequate for the audit purpose. Let’s deal with each of these attributes.

- Competence – relates to the nature and level of expertise of the expert. Clearly, any expert employed should have widespread recognition of their expertise in the stated discipline.
- Capability – relates to the expert’s ability to exercise that competence in the circumstance of the audit engagement. For example, the expert must have the time and resources available to perform the task in hand.
- Objectivity – relates to the possible effects that bias, conflict of interest or the influence of others may have on the judgment of the expert.

If an expert has a vested interest in expressing anything other than objective opinion with regard to the subject matter, then their opinion will be of no value to the auditor. If an auditor’s expert does not fulfill the requirement in respect of each of the above attributes, the risk of error or inaccuracy in the work carried out is increased and, therefore, the objective of minimizing the risk of not detecting material misstatement may not be achieved.

Consequently, the auditor's quality control procedures should ensure that internal experts (who are part of the audit engagement team) are capable, competent and objective. Where an audit firm is seeking to engage a new internal expert, or alternatively rely on the services of an external expert, information about the competence, capability and objectivity of the expert may be sought from various sources. These include:

- personal experience with previous work of the expert
- discussion with the expert
- discussion with other auditors who are familiar with the expert's work
- Knowledge of the expert's qualifications, membership of a professional body or industry association, license to practice, or other forms of external recognition published papers or books written by the expert.

An auditor may use to obtain information about the competence, capability and objectivity of a management's expert. When evaluating the findings and conclusions of the auditor's expert for audit purposes, the auditor may carry out various procedures, including:

- inquiries of the auditor's expert
- reviewing the auditor's expert's working papers and reports
- corroborative procedures such as: - observing the auditor's expert's work - examining reputable statistical reports and other authoritative published data - confirming relevant matters with third parties- performing detailed analytical procedures, and - performing calculations
- Discussion with another expert with relevant expertise
- Discussing the auditor's expert's report with management.

### **Relying on External Opinion**

Though the internal auditor will be entitled to rely on the work performed by other auditors and experts, he should exercise adequate skill and care in ascertaining their competence and skills and also in evaluating, analyzing and using the results of the work performed by the experts. He must also look into the assumptions, if any, made by such other experts and obtain reasonable assurance that the work performed by other auditors and experts is adequate for his purposes. He should be satisfied that he has no reasons to believe that he should not have relied on the work of the expert. The reliance placed on the work done by the assistants and/ or other auditors and experts notwithstanding, the internal auditor will continue to be responsible for forming his opinion on the areas/ processes being subject to internal audit or his findings.

If the auditor concludes that the work of the auditor's expert is not adequate for the auditor's purpose and the auditor cannot resolve the matter – by either agreeing that the expert should carry out further work or by the auditor carrying out additional audit procedures as appropriate. With the permission of the expert, it may be appropriate to refer to the auditor's expert in the auditor's report. Conversely, unless there is a legal or regulatory requirement, there should not be any reference to the work of the auditor's expert in an unmodified report.



## **Chapter 11: Audit Conclusion and Corrective Measures**

The goal of an audit is to form and express an opinion on financial statements. The audit is performed to get reasonable assurance on whether the financial statements are free of material misstatement. An audit also includes assessing the accounting principles used and the significant estimates made by the management. Audit conclusions and reporting are one of the principles governing an audit. Reporting is the last procedure of the process of an audit.

### **Steps Involved**

Following are the steps involved in audit conclusion:

a. Gathering of audit evidence

An auditor should be thorough in his efforts to gather the audit evidence, and be impartial in its evaluation. Substantive procedures such as enquiry, information, confirmation, observation, compilation, verification and valuation, etc. are used to substantiate the transactions. Carrying out such procedures on a reasonable number of transactions provides a basis for drawing a conclusion on a particular head of account (line item). Having gathered the audit evidence by substantive procedures, the auditor should ensure that the entity has complied with the necessary requirements such as requirements of law, applicable Accounting Standards issued by the ICAI/ NACAS, accounting policies adapted by the entity from time to time, and internal control systems.

b. Evaluation of audit evidence

Having gathered the audit evidence, the auditor goes through the evidence with a fine-toothed comb to properly evaluate it, judge their reliability and draw logical conclusions. He has to document the reasons for accepting or rejecting certain replies and reports.

c. Analysis of evidence

The auditor uses analytical procedures such as accounting ratios, analyses; intercompany comparisons, comparing the industry norm with the data of the unit, etc. to analyze the data.

d. Audit conclusion

Such analyses help the auditor to draw conclusions regarding various aspects of the line items of the financial statements. These conclusions should be independent and factual, and not based on assumptions. A set of such conclusions leads to forming an opinion.

## **Chapter 12: Report Writing and Audit Report**

### **Introduction**

Reporting is a formal opinion or disclaimer thereof, issued by the internal auditor as a result of evaluations made by him as per the terms of the engagement.

### **Principles of Report Writing**

The internal audit reports should aim at giving clearly the conclusions of the internal auditor and should be so designed that they motivate all to perform better. Normally, ABC principle, i.e., accuracy, brevity and clarity need to be followed while drafting the internal audit report. Following are some of the other characteristics of a comprehensive and useful internal audit report:

- The audit findings contained in the internal audit report should be supported by indisputable facts and reflect verifiable result.
- The report should also contain suggested corrective actions and time plan thereof. The suggested corrective actions should be cost effective and amenable to implementation.
- Observations contained in the report should be classified according to their significance, so that management review can be held at appropriate levels, for instance, critical issues can be reviewed by top management while major/minor issues can be reviewed by respective departmental heads.
- Top management should be given summarized information of audit findings and action plan. An executive summary providing a crisp snapshot of the contents of the report, essentially, the findings and the recommendations is also quite helpful.
- Recommendations should be cost effective and possible to implement.
- Reports should be direct and straight forward written in a consistent style.
- Words should be chosen bearing in mind the sophistication of the addressee.
- Jargons and technical terms should be avoided.

### **Recommended Elements of Report Writing:**

- Addressee
- Scope of the internal audit, including the period covered
- Internal audit methodology
- Observations/ findings of the internal auditors and management's response thereto
- Impact of and risk associated with the observations/ findings
- Recommendations/ opinion of the internal auditor
- Non-rectification of previous observations
- Date and place
- Signature

**Basic Contents of Audit Report:**

- Executive summary
- High, Medium, Low Risk Areas classified separately
- Detailed audit observations, covering Risks, Impact, Recommendations, Auditee Comments, Annexure of evidences
- Audit Implementation Action Plans with time lines and responsibility shall be updated after management discussion.
- Presentation to management and Audit Committee

The auditor discusses his observations with those charged with governance, such as the audit committee of the company, before finalizing the report. The auditor should be firm in his opinion, and exercise his independence at this level. This part of the audit is critical, and calls for resilience on the part of the auditor. An audit report, being a public document, should be drafted skillfully. The code of conduct prohibits an auditor from divulging any information received by him in the course of his professional assignment, unless legally required so to do. Therefore, the auditor shouldn't hesitate to take the help of a legal expert on whether to include certain comments in his report.

## **Chapter 13: Audit follow up**

The Institute of Internal Auditors definition of a follow-up: "A follow-up is defined as a process by which the internal auditors determine the adequacy, effectiveness and timeliness of actions taken by management on reported audit findings."

The value of the audit must be assessed to assure that the findings and recommendations, reflecting cost-conscious, workable and timely solutions, have been achieved to some quantifiable degree and provide value to the organization. Unfortunately, this does not happen as often as it should in practice. More organizations would not outsource their audit function if they gained a thorough understanding of the savings and improvement to operations and processes the audit can bring.

The bottom line is how does audit enhance an organization's value? Follow-up is the answer, if an organization is to understand what value audit can have to improving operational integrity, efficiency and effectiveness. By looking at the prior audit recommendations of earlier work, auditors are able to assess if the agency, company or corporation has taken any action toward the report recommendations. If it has, a process is in place to try to assess what impact those recommendations had and to formally report the assessment and findings. Often, auditors will receive direct feedback from managers, supervisors or staff that their actions were the results of an earlier audit report. In some instances, they may even provide direct information and cost figures on how much is being saved as the result of new controls in place or improvements to the existing processes.

Where agreed action plans are not completely implemented the auditor asks the following questions:

- What remains to be done?
- By whom and when?
- Have alternatives been implemented that may be more appropriate?
- Has the agreed action plan ceased to be of value?
- If no action was taken, why not?
- What is the issue or concern causing inaction?

The end result should be a brief summary of the status of every action plan agreed upon. The final summary is reviewed with the person responsible for clearing the audit report before the follow-up report is issued.



# **B. Stock Broking & Depository Participants**

## 1. Introduction

### Historical Background

The securities markets in India have witnessed several policy initiatives, which have refined the market micro-structure, modernised operations and broadened investment choices for the investors. The irregularities in the securities transactions in the last quarter of 2000-01, hastened the introduction and implementation of several reforms. While a Joint Parliamentary Committee was constituted to go into the irregularities and manipulations in all their ramifications in all transactions relating to securities, decisions were taken to complete the process of demutualisation and corporatisation of stock exchanges to separate ownership, management and trading rights on stock exchanges and to effect legislative changes for investor protection, and to enhance the effectiveness of SEBI as the capital market regulator. Rolling settlement on T+5 basis was introduced in respect of most active 251 securities from July 2, 2001 and in respect of balance securities from December 31, 2001. Rolling settlement on T+3 basis commenced for all listed securities from April 1, 2002 and subsequently on T+2 basis from April 1, 2003.

The Securities and Exchange Board of India (SEBI), which was set up in 1988 as an administrative arrangement, was given statutory powers with the enactment of the SEBI Act, 1992. The broad objectives of the SEBI are to protect the interests of the investors in securities, to promote the development of securities markets and to regulate the securities markets. Regulatory jurisdiction of SEBI extends over companies listed on Stock Exchanges and Companies intending to get their securities listed on any recognised stock exchange on the issuance of securities and transfer of securities, in addition to all intermediaries and persons associated with securities market. The scope and functioning of the SEBI has greatly expanded with the rapid growth of securities markets in India in the last fifteen years.

Following the recommendations of the High Powered Study Group on Establishment of New Stock Exchanges, the National Stock Exchange of India (NSE) was promoted by financial institutions with an aim to provide access to investors all over the country. NSE was incorporated in November 1992 as a tax paying company, the first of such stock exchanges in India, since stock exchanges earlier were trusts, being run on non-profit basis. NSE was recognised as a stock exchange under the Securities Contracts (Regulations) Act, 1956 in April, 1993. The setting up of the National Stock Exchange brought to Indian capital markets several innovations and modern practices and procedures such as, nation-wide trading network, electronic trading, greater transparency in price discovery and process driven operations that had significant bearing on further growth of the stock markets in India.

Faster and efficient securities settlement system is an important ingredient of a successful stock market. To speed up the securities settlement process, the Depositories Act, 1996 was passed that allowed for dematerialisation (and rematerialisation) of securities in depositories and the transfer of securities through electronic book entry. The National Securities Depository Limited (NSDL) was set up by leading financial institutions and it commenced operations in October, 1996. Subsequently, Central Depository Services (India) Limited (CDSL) was promoted by Bombay Stock Exchange and other financial institutions.

### Current Scenario

The growth in capital market has been exponential as measured in terms of amount raised from the market, number of stock exchanges and other intermediaries, the number of listed stocks, market capitalisation, trading volumes and turnover on stock exchanges, and investor population. Simultaneously,

there have been significant changes in the profiles of the investors, issuers and intermediaries. The following table shows Market Participants in Securities Market as on March 31, 2013:

Market Intermediaries	2010-11	2011-12	2012-13\$
1	2	3	4
Stock Exchanges (Cash Market)	19	19	20
Stock Exchanges (Derivatives Market)	2	2	2
Stock Exchanges (Currency Derivatives)	4	4	4
Brokers (Cash Segment)*	10,203	10,268	10,100#
Corporate Brokers (Cash Segment)	4,774	4,877	5,080#
Brokers (Equity Derivative)	2,111	2,337	2,904
Brokers (Currency Derivatives)	2,008	2,173	2,307
Sub-brokers (Cash Segment)	83,808	77,141	70,268
Foreign Institutional Investors	1,722	1,765	1,756
Sub-accounts	5,686	6,322	6,340
Custodians	17	19	19
Depositories	2	2	2
Depository Participants	805	854	868
Merchant Bankers	192	200	198
Bankers to an Issue	55	57	57
Underwriters	3	3	3
Debenture Trustees	29	31	31
Credit Rating Agencies	6	6	6
KYC Registration Agency (KRA)	NA	NA	5
Venture Capital Funds	184	212	211
Foreign Venture Capital Investors	153	174	182
Alternative Investment Funds	NA	NA	32
Registrars to an Issue & Share Transfer Agents	73	74	72
Portfolio Managers	267	250	245
Mutual Funds	51	49	51
Collective Investment Schemes	1	1	1
Approved Intermediaries (Stock Lending Schemes)	2	2	2
STP (Centralised Hub)	1	1	1
STP Service Providers	2	2	2

# Stock Brokers registered on Hyderabad Stock Exchange are not included, as the said stock exchange has been granted exit vide order dated January 25, 2013.

NA: Not Applicable

\$ indicates as on last trading day of Feb. 2013.

\* including brokers on Mangalore SE (57), HSE (298), Magadh SE (189), SKSE (388)

Source : SEBI

## 2. Applicable Government Policies and Rules & Legal and Regulatory Framework

The five main legislations governing the securities market are:

**a. Securities Contracts (Regulation) Act, 1956**

It provides for direct and indirect control of virtually all aspects of securities trading and the running of stock exchanges and aims to prevent undesirable transactions in securities. It gives Central Government regulatory jurisdiction over stock exchanges, contracts in securities and listing of securities. As a condition of recognition, a stock exchange complies with conditions prescribed by Central Government. Organised trading activity in securities takes place on a specified recognised stock exchange. The stock exchanges determine their own listing regulations which have to conform to the minimum listing criteria set out in the Rules.

**b. Securities and Exchange Board of India (SEBI) Act, 1992**

The SEBI Act, 1992 was enacted to empower SEBI with statutory powers for protecting the interests of investors in securities, promoting the development of the securities market and regulating the securities market. It lays down the guidelines with respect to the management, powers and functions of SEBI. It has powers to register and regulate all market intermediaries and also to penalise them in case of violations of the provisions of the Act, Rules and Regulations made there under. It specifies the registration requirements for intermediaries in the securities market, guidelines for prohibition of manipulative and deceptive devices, insider trading, penalties and adjudication powers and various other guidelines with respect to the securities market. SEBI has full autonomy and authority to regulate and develop an orderly securities market.

**c. Depositories Act, 1996**

The Depositories Act, 1996 provides for the establishment of depositories in securities with the objective of ensuring free transferability of securities with speed, accuracy and security by making securities of public limited companies freely transferable subject to certain exceptions; dematerializing the securities in the depository mode; and providing for maintenance of ownership records in a book entry form. In order to streamline the settlement process, the Act envisages transfer of ownership of securities electronically by book entry without making the securities move from person to person. The Act has made the securities of all public limited companies freely transferable, restricting the company's right to use discretion in effecting the transfer of securities, and the transfer deed and other procedural requirements under the Companies Act have been dispensed with.

**d. Companies Act, 2013**

It deals with issue, allotment and transfer of securities and various aspects relating to company management. It provides for standard of disclosure in public issues of capital, particularly in the fields of company management and projects, information about other listed companies under the same management, and management perception of risk factors. It also regulates underwriting, the use of premium and discounts on issues, rights and bonus issues, payment of interest and dividends, supply of annual report and other information.



#### **e. Prevention of Money Laundering Act, 2002**

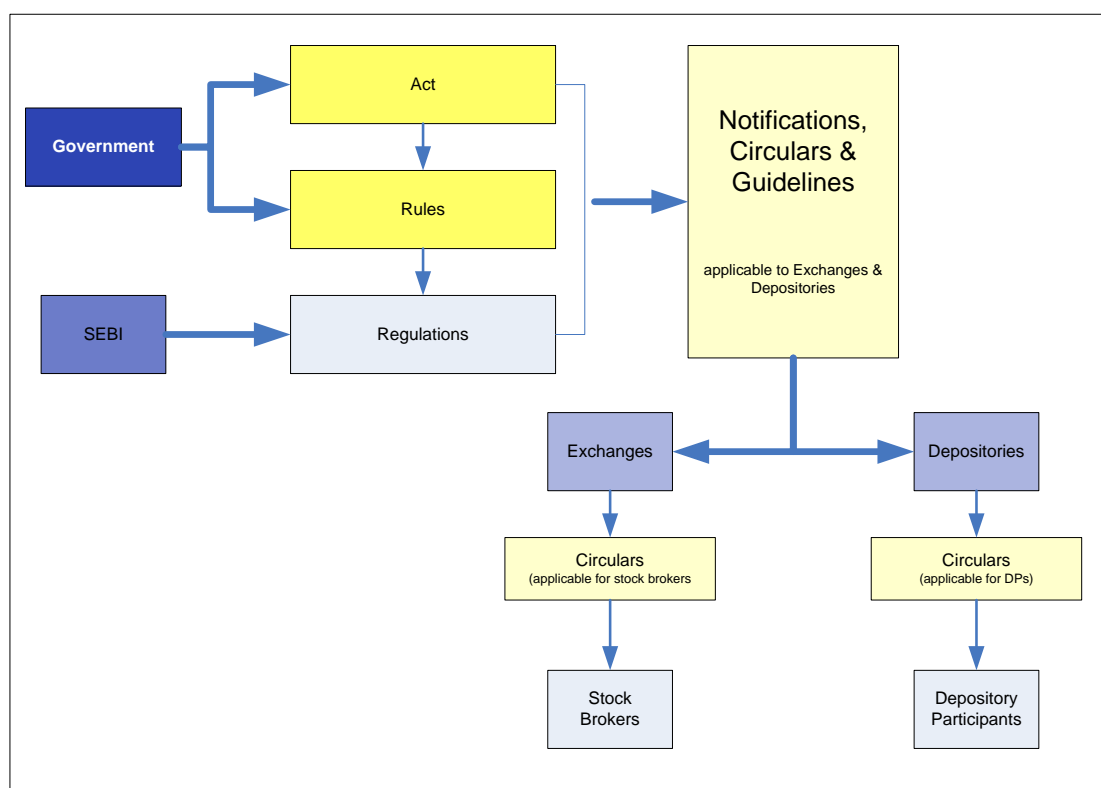
The primary object of the Act is to prevent money laundering and to provide for confiscation of property derived from or involved in money-laundering. The term money-laundering is defined as whoever acquires, owns, possess or transfers any proceeds of crime; or knowingly enters into any transaction which is related to proceeds of crime either directly or indirectly or conceals or aids in the concealment of the proceeds or gains of crime within India or outside India commits the offence of money-laundering. Besides providing punishment for the offence of money laundering, the Act also provides other measures for prevention of Money Laundering. The Act also casts an obligation on the intermediaries, banking companies etc. to furnish information, of such prescribed transactions to the Financial Intelligence Unit- India, to appoint a principal officer, to maintain certain records etc.

The Government has framed rules under the SC(R)A, SEBI Act and the Depositories Act. SEBI has framed regulations under the SEBI Act and the Depositories Act for registration and regulation of all market intermediaries, for prevention of unfair trade practices, insider trading, etc. Under these Acts, Government and SEBI issue notifications, guidelines, and circulars, which need to be complied with by market participants. Some of the important regulations are as follows:

- SEBI (Stock Brokers and Sub-brokers) Regulations 1992
- SEBI (Prohibition of Insider Trading) Regulations 1992
- Securities and Exchange Board of India (Merchant Bankers) Regulations, 1992
- SEBI (Portfolio Managers) Regulations, 1993
- Securities and Exchange Board of India (Registrars to an Issue and Share Transfer Agents) Regulations, 1993
- SEBI (Underwriters) Regulations 1993
- SEBI (Debenture Trustees) Regulations, 1993
- SEBI (Bankers to an Issue) Regulations, 1994
- SEBI (Foreign Institutional Investors) Regulations, 1995
- SEBI (Depositories and Participants) Regulations, 1996
- SEBI (Custodian Of Securities) Regulations, 1996
- SEBI (Venture Capital Funds) Regulations 1996
- SEBI (Mutual Funds) Regulations, 1996
- SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 1997
- SEBI (Buyback Of Securities) Regulations, 1998
- SEBI (Credit Rating Agencies) Regulations, 1999
- SEBI (Collective Investment Schemes) Regulations, 1999
- SEBI (Foreign Venture Capital Investors) Regulations 2000
- SEBI (Procedure For Board Meetings) Regulations, 2001
- SEBI (Issue of Sweat Equity) Regulations, 2002

- SEBI ( Prohibition of Fraudulent and Unfair Trade Practices relating to the Securities Market) Regulations, 2003
- SEBI - Ombudsman Regulations 2003
- SEBI (Self-Regulatory Organizations) regulations, 2004
- SEBI (Issue and Listing of Debt Securities) Regulations, 2008
- Securities and Exchange Board of India (Investor Protection and Education Fund) Regulations, 2009
- Securities and Exchange Board of India (Delisting Of Equity Shares) Regulations, 2009
- Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009
- SEBI (Investment Advisers) Regulations, 2013
- Securities and Exchange Board of India {KYC (Know Your Client) Registration Agency} Regulations, 2011

The legal framework is as explained under:

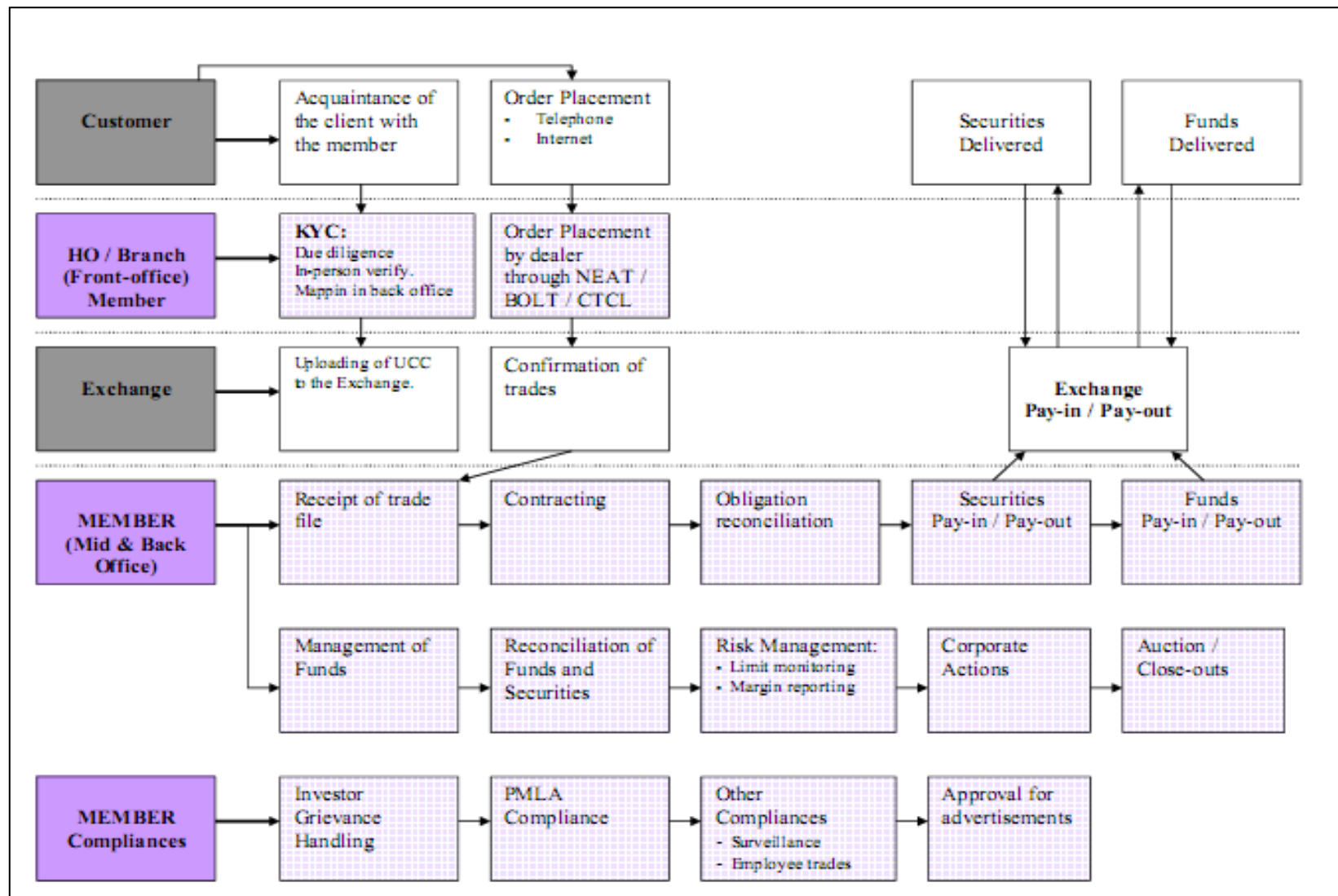


### **3. Stock Broking Technical Peculiarities**

The set-up for a stock broker can be broadly classified into:

- a. Front-office (Client Relation Team & Dealing Desk)
- b. Back-office (Operations, Fund Management & Compliance)

The typical flow of activities for a stock broker is illustrated in the chart below:

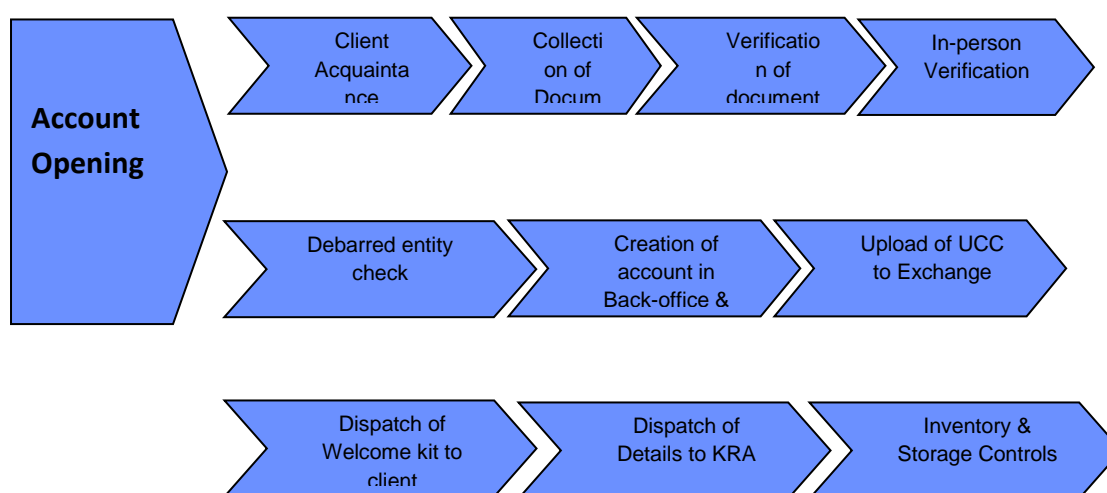


The manual attempts to demystify the activities of a stock broker process-wise. Further, the regulatory requirements for each of them are laid down and against them the relevant check points for audit.

### 3.1 Client Registration

A broker should take reasonable steps to assess the background, genuineness, financial soundness and investment objectives of the client when establishing relationship with a new client. It is expected that the brokers of Stock Exchanges know their clients through a proper introductory procedure and exercise due precaution while dealing with the clients. Broker should ensure that client is personally known or has been introduced to him by a person known to him. A record of introduction of all clients should be kept by brokers.

The flow for client registration is depicted as below:



#### 3.1.1 Client Acquaintance

The Know Your Client (KYC) policy should clearly spell out the client identification procedure to be carried out at different stages i.e. while establishing the member-client relationship, while carrying out transactions for the client or when the member has doubts regarding the veracity or the adequacy of previously obtained client identification data.

Member should ensure that an account is not opened where they are unable to apply appropriate clients due diligence measures / KYC policies. This may be applicable in cases where it is not possible to ascertain the identity of the client, information provided to the intermediary is suspected to be non genuine, perceived non co-operation of the client in providing full and complete information. No account is opened in a fictitious / benami name or on an anonymous basis. Members should develop customer acceptance policies and procedures that aim to identify the types of customers that are likely to pose a higher than the average risk of money laundering or terrorist financing. By establishing such policies and procedures, they will be in a better position to apply customer due diligence on a risk sensitive basis depending on the type of customer business relationship or transaction.

### 3.1.2 Client Account Opening Form & Documentation

SEBI Circular No. MIRSD/ SE /Cir-19/2009 dated December 3, 2009 on Dealings between a client and a stock broker (trading members included) has laid down the requirements governing client registration document:

- a. The stock broker to make available a folder /book containing all the documents required for registration of a client.
- b. The folder/book shall have an index page listing all the documents contained in it and indicating briefly significance of each document.
- c. All the documents in both the mandatory and the non-mandatory parts shall be printed in minimum font size of 11.
- d. The stock brokers having own web-sites shall display all the documents executed by a client, client's position, margin and other related information, statement of accounts, etc. in the web-site and allow secured access by way of client-specific user id and password.
- e. No term of the agreement, other than those prescribed by SEBI, shall be changed without the consent of the client. Such change needs to be preceded by a notice of 15 days.
- f. The stock broker shall frame the policy regarding treatment of inactive accounts which should, inter-alia, cover aspects of time period, return of client assets and procedure for reactivation of the same. It shall display the same on its web site, if any.
- g. Further, the folder/book shall have two parts:
  - i. Mandatory
  - ii. Non-mandatory.

#### a. Mandatory Documents

The mandatory section of the account opening kit to include only the following:

- Account Opening Form
- Rights and Obligation Document
- Risk Disclosure Document
- Policies and Procedures
- Guidance note dealing with Dos and Donts
- Tariff sheet

SEBI has, vide its Circular No. **CIR/MIRSD/16/2011**, dated August 22, 2011, devised standard formats for the Client Registration. In order to bring about uniformity in documentary requirements across different segments and exchanges and to avoid duplication and multiplicity of documents, SEBI has formulated uniform set of documents which are listed below:

- a. Account Opening Form  
KYC Form- Document captures the basic information about the constituent and an instruction/check list. It also captures the additional information about the constituent relevant to trading account and an instruction/check list.

b. Rights and Obligations

Document stating the Rights & Obligation of the stock broker/trading member, sub-broker and client for trading on exchanges (including additional rights & obligations in case of internet/wireless technology based trading).

c. Risk Disclosure Document(RDD)

Document detailing risks associated with dealing in securities market.

d. Policies and Procedures

Document describing significant policies and procedures of the stock broker (to be added by the stock broker).

e. Guidance note

Document detailing do's and don'ts for trading on exchange, for the education of the investors.

f. Tariff sheet

Document detailing the rate/amount of brokerage and other charges levied on the client for trading on the stock exchange(s) (to be added by the stock broker).

**Checklist for filling KYC form are as listed below:**

**A- Important Points:**

- Self-attested copy of PAN card is mandatory for all clients, including Promoters/Partners/Karta/Trustees and whole time directors and persons authorized to deal in securities on behalf of company/firm/others.
- Copies of all the documents submitted by the applicant should be self-attested and accompanied by originals for verification. In case the original of any document is not produced for verification, then the copies should be properly attested by entities authorized for attesting the documents, as per the below mentioned list.
- If any proof of identity or address is in a foreign language, then translation into English is required.
- Name & address of the applicant mentioned on the KYC form, should match with the documentary proof submitted.
- If correspondence & permanent address are different, then proofs for both have to be submitted.
- Sole proprietor must make the application in his individual name & capacity.
- For non-residents and foreign nationals, (allowed to trade subject to RBI and FEMA guidelines), copy of passport/PIO Card/OCI Card and overseas address proof is mandatory.
- For foreign entities, CIN is optional; and in the absence of DIN no. for the directors, their passport copy should be given.
- In case of Merchant Navy NRI's, Mariner's declaration or certified copy of CDC (Continuous Discharge Certificate) is to be submitted.

- For opening an account with Depository participant or Mutual Fund, for a minor, photocopy of the School Leaving Certificate/Mark sheet issued by Higher Secondary Board/Passport of Minor/Birth Certificate must be provided.
- Politically Exposed Persons (PEP) are defined as individuals who are or have been entrusted with prominent public functions in a foreign country, e.g., Heads of States or of Governments, senior politicians, senior Government/judicial/ military officers, senior executives of state owned corporations, important political party officials, etc.

#### **B- Proof of Identity(POI)**

List of documents admissible as proof of identity

- Unique Identification Number (UID) (Aadhaar)/ Passport/ Voter ID card/ Driving license.
- PAN card with photograph.
- Identity card/ document with applicant's Photo, issued by any of the following: Central/State Government and its Departments, Statutory/Regulatory Authorities, Public Sector Undertakings, Scheduled Commercial Banks, Public Financial Institutions, Colleges affiliated to Universities, Professional Bodies such as ICAI, ICWAI, ICSI, Bar Council etc., to their Members; and Credit cards/Debit cards issued by Banks.

#### **C- Proof of Address(POA)**

- List of documents admissible as proof of address
- Passport/ Voters Identity Card/ Ration Card/ Registered Lease or Sale Agreement of Residence/ Driving License/ Flat Maintenance bill/ Insurance Copy.
- Utility bills like Telephone Bill (only land line), Electricity bill or Gas bill - Not more than 3 months old.
- Bank Account Statement/Passbook -- Not more than 3 months old.
- Self-declaration by High Court and Supreme Court judges, giving the new address in respect of their own accounts.
- Proof of address issued by any of the following: Bank Managers of Scheduled Commercial Banks/Scheduled Co-Operative Bank/Multinational Foreign Banks/Gazetted Officer/Notary public/Elected representatives to the Legislative Assembly/Parliament/Documents issued by any Govt. or Statutory Authority.
- Identity card/document with address, issued by any of the following: Central/State Government and its Departments, Statutory/Regulatory Authorities, Public Sector Undertakings, Scheduled Commercial Banks, Public Financial Institutions, Colleges affiliated to Universities and Professional Bodies such as ICAI, ICWAI, ICSI, Bar Council etc., to their Members.
- For FII/sub account, Power of Attorney given by FII/sub-account to the Custodians (which are duly notarized and/or apostilled or consularised) that gives the registered address should be taken.



- The proof of address in the name of the spouse may be accepted.

**D- In case of Non-Individuals, additional documents to be obtained from non-individuals, over and above the POA & POI as mentioned below:**

Types of entity	Documentary Requirements
Corporate	<ul style="list-style-type: none"> <li>• Copy of the balance sheets for the last 2 financial years (to be submitted every year).</li> <li>• Copy of latest share holding pattern including list of all those holding control, either directly or indirectly, in the company in terms of SEBI takeover Regulations, duly certified by the company secretary/Whole time director/MD (to be submitted every year).</li> <li>• Photograph, POI, POA, PAN and DIN numbers of whole time directors/two directors in charge of day to day operations.</li> <li>• Photograph, POI, POA, PAN of individual promoters holding control - either directly or indirectly.</li> <li>• Copies of the Memorandum and Articles of Association and certificate of incorporation.</li> <li>• Copy of the Board Resolution for investment in securities market.</li> <li>• Authorized signatories list with specimen signatures.</li> </ul>
Partnership Firm	<ul style="list-style-type: none"> <li>• Copy of the balance sheets for the last 2 financial years (to be submitted every year).</li> <li>• Certificate of registration (for registered partnership firms only).</li> <li>• Copy of partnership deed.</li> <li>• Authorized signatories list with specimen signatures.</li> <li>• Photograph, POI, POA, PAN of Partners.</li> </ul>
Trust	<ul style="list-style-type: none"> <li>• Copy of the balance sheets for the last 2 financial years (to be submitted every year).</li> <li>• Certificate of registration (for registered trust only).</li> <li>• Copy of Trust deed.</li> <li>• List of trustees certified by managing trustees/CA.</li> <li>• Photograph, POI, POA, PAN of Trustees.</li> </ul>

HUF	<ul style="list-style-type: none"> <li>• PAN of HUF.</li> <li>• Deed of declaration of HUF/ List of coparceners.</li> <li>• Bank pass-book/bank statement in the name of HUF.</li> <li>• Photograph, POI, POA, PAN of Karta.</li> </ul>
Unincorporated association or Body of Individuals	<ul style="list-style-type: none"> <li>• Proof of Existence/Constitution document.</li> <li>• Resolution of the managing body &amp; Power of Attorney granted to transact business on its behalf.</li> <li>• Authorized signatories list with specimen signatures.</li> </ul>
Banks/Institutional Investors	<ul style="list-style-type: none"> <li>• Copy of the constitution/registration or annual report/balance sheet for the last 2 financial years.</li> <li>• Authorized signatories list with specimen signatures.</li> </ul>
Foreign Institutional Investors	<ul style="list-style-type: none"> <li>• Copy of the constitution/registration or annual report/balance sheet for the last 2 financial years.</li> <li>• Authorized signatories list with specimen signatures.</li> </ul>
Army/Government Bodies	<ul style="list-style-type: none"> <li>• Self-certification on letterhead.</li> <li>• Authorized signatories list with specimen signatures.</li> </ul>
Registered Society	<ul style="list-style-type: none"> <li>• Copy of Registration Certificate under Societies Registration Act.</li> <li>• List of Managing Committee members.</li> <li>• Committee resolution for persons authorized to act as authorized signatories with specimen signatures.</li> <li>• True copy of Society Rules and Bye Laws certified by the Chairman/Secretary.</li> </ul>

## E- Additional Checks

### i. For Dealing in Future & Options Segment:

The stock broker shall have documentary evidence of financial details provided by the clients who opt to deal in the derivative segment. In respect of other clients, the stock broker shall obtain the documents in accordance with its risk management system. In respect of clients trading in derivative segment, the member shall collect documentary evidence for financial information. The illustrative list of documents is as under:

- Copy of ITR Acknowledgement
- Copy of Annual Accounts
- Copy of Form 16 in case of salary income

- Net worth certificate
  - Salary Slip
  - Bank account statement for last 6 months
  - Copy of demat account Holding statement.
  - Any other relevant documents substantiating ownership of assets.
  - Self-declaration along with relevant supporting.
- ii. Identification of Beneficial Ownership:
- SEBI has laid down Guidelines on Identification of Beneficial Ownership vide its circular no. CIR/MIRSD/2/2013 dated January 24, 2013.
- The guideline lay down the additional checks to be performed for non-individual clients in order to ascertain the ultimate beneficial owner.
- The guideline is attached as Appendix 1.



**भारतीय प्रतिभूति और विनिमय बोर्ड**  
**Securities and Exchange Board of India**

**CIRCULAR**

**CIR/MIRSD/2/2013**

**January 24, 2013**

**SEBI Registered Intermediaries:**

1. Stock Brokers through Recognized Stock Exchanges
2. Depository Participants (DPs) through Depositories
3. Mutual Funds (MFs)
4. Association of Mutual Funds in India (AMFI)
5. Portfolio Managers (PMs)
6. KYC Registration Agencies (KRAs)
7. Alternate Investment Funds (AIFs)
8. Collective Investment Schemes (CIS)
9. Investment Advisers (IAs)

Dear Sirs,

**Sub: Guidelines on Identification of Beneficial Ownership**

1. SEBI Master Circular No. CIR/ISD/AML/3/2010 dated December 31, 2010 has mandated all registered intermediaries to obtain, as part of their Client Due Diligence policy, sufficient information from their clients in order to identify and verify the identity of persons who beneficially own or control the securities account. The beneficial owner has been defined in the circular as the natural person or persons who ultimately own, control or influence a client and/or persons on whose behalf a transaction is being conducted, and includes a person who exercises ultimate effective control over a legal person or arrangement.
2. SEBI has also prescribed uniform Know Your Client (KYC) requirements for the securities markets vide circular nos. CIR/MIRSD/16/2011 dated August 22, 2011 and MIRSD/SE/Cir-21/2011 dated October 5, 2011. The SEBI KYC Registration Agency (KRA) Regulations, 2011 have been notified and guidelines have been issued under these regulations from time to time.
3. Further, the Prevention of Money Laundering Rules, 2005 also require that every banking company, financial institution and intermediary, as the case may be, shall identify the beneficial owner and take all reasonable steps to verify his identity. The Government of India in consultation with the regulators has now specified a uniform approach to be followed towards

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**b. Non-Mandatory Documents**

In addition to the above mentioned documents a stock broker may seek voluntary documents from clients in order to ensure smooth operation of the business. However, the non-mandatory

documents need to be separated and the authorizations from the client sought in non-mandatory document is separate & do have specific consent of the client

The clauses in the non-mandatory part shall not be in contravention of any of the clauses in the mandatory documents, as also the Rules, Regulations, Articles, Byelaws, circulars, directives and guidelines of SEBI and Exchanges. Any such contravening clause shall be null and void.

Few illustrative voluntary documents include:

**a. Power of Attorney (POA)**

A Power of Attorney (PoA) is executed by the client in favour of the stock broker/stock broker and depository participant to authorize the broker to operate the client's demat account and bank account to facilitate the delivery of shares and pay-in/ pay-out of funds.

It was observed that the clients were compelled to give irrevocable power of attorney to manage their demat account and bank account so that the client is able to pay funds or deliver shares to its broker on time. In some cases, the PoA even allowed the broker to open and close accounts on behalf of the client and to trade on client's account without the consent of the client.

In order to standardize the norms to be followed by stock brokers/ stock broker and depository participants while obtaining PoA from the clients SEBI has issued a circular prescribing guidelines for execution of Power of Attorney(PoA) by the client in favour of the Stock Broker / Stock Broker and Depository Participant.

Standardizing the norms for PoA must not be construed as making the PoA a condition precedent or mandatory for availing broking or depository participant services. PoA is merely an option available to the client for instructing his broker or depository participant to facilitate the delivery of shares and pay-in/pay-out of funds etc. No stock broker or depository participant shall deny services to the client if the client refuses to execute a PoA in their favour.

The SEBI guideline in this regard are mentioned in Appendix 2 & 3.

**b. Running Account Authorisation**

Unless otherwise specifically agreed to by a Client, the settlement of funds/securities shall be done within 24 hours of the payout. However, a client may specifically authorize the stock broker to maintain a running account subject to the following conditions:

- The authorization shall be dated.
- The authorization shall be signed by the client only and not by any authorised person on his behalf or any holder of the Power of Attorney.
- The authorization shall contain a clause that the Client may revoke the authorization at any time.
- The client shall bring any dispute arising from the statement of account or settlement so made to the notice of the broker preferably within 7 working days from the date of receipt of funds/securities or statement, as the case may be.
- For the clients having outstanding obligations on the settlement date, the stock broker may retain the requisite securities/funds towards such obligations and may also retain the funds

expected to be required to meet margin obligations for next 5 trading days, calculated in the manner specified by the exchanges.

- The actual settlement of funds and securities shall be done by the broker, at least once in a calendar quarter or month, depending on the preference of the client. While settling the account, the broker shall send to the client a 'statement of accounts' containing an extract from the client ledger for funds and an extract from the register of securities displaying all receipts/deliveries of funds/securities. The statement shall also explain the retention of funds/securities and the details of the pledge, if any.
- Such periodic settlement of running account may not be necessary:
  - a. for clients availing margin trading facility as per SEBI circular
  - b. for funds received from the clients towards collaterals/margin in the form of bank guarantee (BG)/Fixed Deposit receipts (FDR).
- The stock broker shall transfer the funds / securities lying in the credit of the client within one working day of the request if the same are lying with him and within three working days from the request if the same are lying with the Clearing Member/Clearing Corporation.
- There shall be no inter-client adjustments for the purpose of settlement of the 'running account'.
- These conditions shall not apply to institutional clients settling trades through custodians. The existing practice may continue for them.

The FAQ in this regard are in Appendix 4.

### **c. Authorization for Electronic Contract Notes**

The stock broker may issue electronic contract notes (ECN) if specifically authorized by the client subject to the following conditions:

- The authorization shall be in writing and be signed by the client only and not by any authorised person on his behalf or holder of the Power of Attorney.
- The email id shall not be created by the broker. The client desirous of receiving ECN shall create/provide his own email id to the stock broker.
- The authorization shall have a clause to the effect that that any change in the email-id shall be communicated by the client through a physical letter to the broker. In respect of internet clients, the request for change of email id may be made through the secured access by way of client specific user id and password.

### **3.1.3 In-Person Verification**

It shall be the responsibility of the stock broker to satisfactorily identify his clients and to ensure in-person verification by his own staff while registering clients under KYC norms and keep complete audit trail for the same. SEBI has also stated that it would be stock brokers' responsibility to provide client details as and when required.

Accordingly, members are required to ensure 'in-person' verification only by their own staff while registering the clients, including clients of their branches and sub brokers, and that this function should not be outsourced. Further, the date of verification and name, designation & signature of the official who has done in person verification along with stamp of the member should be incorporated in the Client Registration Form/KYC.

In-person verification done for opening beneficial owner's account by a depository participant (DP) will hold good for opening trading account by a stock broker and vice versa, if the stock broker and DP is the same entity or if one of them is holding or subsidiary company of the other.

In case of 'in-person' verification of non-residents, the members should obtain from such clients KYC documents attested by any one of the following entities - Notary Public, Court, Magistrate, Judge, Local Banker, Indian Embassy/ Consulate General in the country where the client resides. The above requirement is applicable w.e.f. July 4, 2008.

### **3.1.4 PAN (Permanent Account Number)**

As per SEBI circular no MRD/DoP/SE/Cir-18/2006 dated September 26, 2006 PAN no. has been made mandatory w.e.f. January 01, 2007 for dealing in the cash segment. Accordingly, trading members are required to collect copies of PAN cards from their existing as well as new clients and maintain the same in the record after verifying with the original. Trading members can execute transactions in the cash segment on behalf of any entity/person only if the PAN details of such entity/person has been collected, cross-checked with the details on the website of the Income Tax Department, and uploaded by them to the Exchange as part of the Unique Client Code (UCC) details of the respective entity/person.

Trading members will have to ensure that:

1. All new UCC registrations are mandatorily accompanied with the PAN details of the client.
2. Name and PAN details of the clients already uploaded by them in the UCC

Database of the Exchange is correct and verified with the details on the website of the Income Tax Department. Trading members are also requested to ensure that Name and PAN of the client is correctly uploaded by them to the Exchange. Trading members are also required to maintain a photocopy of the PAN card of the client in their records. SEBI vide circular no. MRD/DoP/SE/Cir-05/2007 dated April 27, 2007 has decided that Permanent Account Number (PAN) would be the sole identification number for all participants transacting in the securities market, irrespective of the amount of transaction.

In order to ensure that the requirement of PAN details is effectively implemented by the trading members and correct details have been uploaded in the UCC database the auditor may perform following checks:

- Invalid/wrong PAN details entered in UCC module
- Client Name wrongly entered in the UCC module
- First Name/ middle name/ last name left blank in UCC module

### 3.1.5 Debarred Entity Check

#### a. SEBI Debarred Entity List:

SEBI and the Exchanges have mandated the stock brokers to conduct due diligence of all its clients. For purpose of due diligence various parameters are suggested viz. SEBI debarred entity check, risk based approach, etc. For this purpose Exchanges on a periodic basis issues a consolidated list of entities debarred by from accessing the capital market or from dealing in particular scrip since January 2007 which is based on name / PAN of entities. The same is available on the Exchange websites.

The stock brokers may use the file in 2 ways viz.:

#### - At time of Account Opening:

The stock broker may verify the name, PAN and other details of prospective clients with the SEBI Debarred entity list in order to verify whether the same is debarred or prohibited from dealing in particular scrip. In case of any possible matches the stock broker may escalate the matter to its Compliance Officer and take a view on on-boarding the client.

#### - On-going verification:

The stock broker may verify its existing client list with the SEBI debarred list. In case of any match the stock broker may take action as directed by SEBI against the client.

#### b. FATF List:

The broker may also monitor client list with FATF statements that identify countries that do not or insufficiently apply the FATF Recommendations.

#### c. Internal debarred entity list:

The broker may also maintain an internal debarred company lists for not 'onboarding' any entity who has a negative profile in the past with viz.:

- been debarred by RMS for violating limits
- defaulter client
- history of bounce cheque cases

### 3.1.6 Unique Client Code

Stock Broker has to allot a client code to each of his clients including the clients of his sub-brokers which is unique. The same code shall not be allotted to any other client by the stock broker and not more than one code should be allotted to one client. SEBI has made it mandatory for all stock brokers to use Unique Client Codes (UCC) for all clients. When a broker enters an order on behalf of a client, then such a broker shall at the time of entering orders on behalf of such client, enter the Unique Client Code in respect of such client. Broker should ensure that all details of Unique Client Code have been uploaded after completion of all formalities related to client registration and details of UCC is matching with details produced along with the KYC form. Apart from uploading, every broker is responsible to furnish particulars of Unique Client Code of each of his clients to the Exchange in such form, manner, at such intervals and within such time as may be specified by the Exchange from time to time.



The Exchanges vide Circulars dated 15-Feb-13 and subsequent clarifications and revisions thereafter have revised the format for UCC.

### **3.1.7 Dispatch of Welcome Kit to Client**

A copy of all the documents executed by client shall be given to him, free of charge, within 7 days from the date of execution of documents by the client. The stock broker shall take client's acknowledgement for receipt of the same.

### **3.1.8 Dispatch of Details to KRA**

SEBI simplified the account opening process for investors vide Circular No. CIR/MIRAD/16/2011 dated August 22, 2011. Further, SEBI vide circular MIRSD/SE/Cir-21/2011 dated October 05, 2011 issued guidelines for uniform KYC requirements for investors while opening accounts with any intermediary in the securities market. To avoid duplication of KYC process with every intermediary, a mechanism for centralization of the KYC records in the securities market has been developed. An intermediary shall perform the initial KYC of its clients and upload the details on the system of the KRA. When the client approaches another intermediary, the intermediary can verify and download the client's details from the system of the KRA. As a result, once the client has done KYC with a SEBI registered intermediary, he need not undergo the same process again with another intermediary. Accordingly, SEBI has formulated the KYC Registration Agency (KRA) Regulations, which have been notified vide notification no. LAD-NRO/GN/2011-12/29/36772 dated December 2, 2011 (copy enclosed). The Regulations cover the registration of KRAs, functions and responsibilities of the KRAs and intermediaries, code of conduct, data security, etc.

In this regard, stock brokers are required to check on KRA websites the status of clients KYC. In case the same is not done then the stock broker after doing the initial KYC of the new clients, the intermediary shall forthwith upload the KYC information on the system of the KRA and send the KYC documents i.e. KYC application form and supporting documents of the clients to the KRA within 10 working days from the date of execution of documents by the client and maintain the proof of dispatch.

For Stock broking the practical difficulty is that though the documents may be executed at times due to non-submission of certain other documents the UCC is not opened. Hence, the ideal scenario in this case is that the KRA documents need to be dispatched within 10 working days from date of upload of UCC.

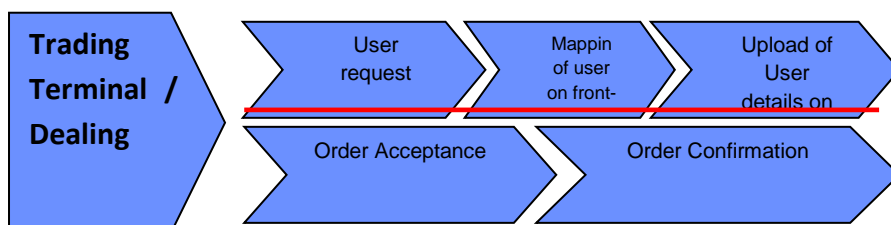
### **3.1.9 Inventory & Storage Controls**

Broker should have inventory controls relating to blank KYC documents given to branches/sub-brokers/clients and lying at Head Office of the broker. Reconciliation of the inventory should be done on periodical basis and discrepancies, if any, should be resolved. It is suggested that Inward/Outward register should be maintained for the purpose of blank documents provided to branches and sub-brokers and also for filled up documents received from branches and sub-brokers. It is further advised that control serial numbers should be printed on KYC docket for better internal controls. This control serial numbers should be noted in Inward/Outward Register and even in Master records of back office software for the purpose of tracking.

Broker should have proper storage facility for keeping registered KYC documents of clients thereby ensuring that retrieval of documents is easy and fast. As the KYC documents are important and permanent records, it should be kept in safe custody of authorized officials.

### 3.2 Trading Terminals / Dealing

The activities involved / related to trading terminals / dealings are as below:



With a view to expand the reach of the markets for exchange traded products, SEBI registered stock brokers of stock exchanges make use of various intermediaries viz.:

a. Sub-brokers:

*“Sub-broker” means any person not being a member of a Stock Exchange who acts on behalf of a member-broker as an agent or otherwise for assisting the investors in buying, selling or dealing in securities through such member-brokers.*

*All Sub-brokers are required to obtain a Certificate of Registration from SEBI without which they are not permitted to deal in securities. SEBI has directed that no broker shall deal with a person who is acting as a sub-broker unless he is registered with SEBI and it shall be the responsibility of the member-broker to ensure that his clients are not acting in the capacity of a sub-broker unless they are registered with SEBI as a sub-broker.*

*It is mandatory for member-brokers to enter into an agreement with all the sub-brokers. The agreement lays down the rights and responsibilities of member-brokers as well as sub-brokers.*

b. Authorised Persons:

*Authorised Person means any person -individual, partnership firm, LLP or body corporate- who is appointed as such by the stock broker and who provides access to trading platform of the Exchange as an agent of the stock broker.*

c. Remisier:

*A Remisier is a person who is engaged by a member-broker primarily to solicit business in securities on a commission basis.*

#### 3.2.1 Location of Trading Terminals

As per SEBI Circular No. SMDRP/Policy/CIR-49/2001 dated October 22, 2001, the member-brokers should install trading terminals only at their registered offices, branch offices and their registered sub-brokers’ offices. Remisier is authorized to operate the trading terminal at member-broker’s office only.

The trading terminals can be installed only at the broker's head office, branch office or sub-broker's office. An office shall be considered as branch office only if it is owned, leased or rented by the broker. In case of derivatives segment the terminals can also be installed at the authorised person's office. The location details of the trading terminal should be intimated through the interface provided by the exchange. It should be ensured that trading terminals located at places other than those intimated to the exchange shall be treated as unauthorised extension of the trading terminal. In case the broker intends to carry on PRO trading from multiple locations, he should take the necessary permission from the exchange.

No trading member shall deal through any unregistered intermediary, Further, trading members shall entrust CTCL terminals only to Approved person and not to any unregistered intermediary or clients. For this purpose, the persons who handle each CTCL terminal of the Trading Member are known as Approved Persons. Approved Person may be an employee of the Trading Member, a registered Sub-broker, an Approved User or an Authorised Person who has been approved by the Exchange. In case the unregistered intermediary is allowed to trade / deal by any trading member, such trading member shall be fully responsible for all the sale and/or purchase contracts, whether contract notes or (purchase / sale notes) issued or not, and for all the acts of commission and/or omission. Further, such trading members shall render themselves liable for noncompliance in terms of fines, penalty and/or other disciplinary action as may be deemed necessary by the relevant authority.

### **3.2.2 Types of Trading Terminals:**

- a. BOLT TWS stands for "BSE On-Line Trading Terminal Work Station".

This is the front end software provided by the BSE with the use of which brokers can execute trade on the trading platform of BSE. These terminals are installed at the desired location by the exchange at the request of the broker.

- b. NEAT stands for "National Exchange for Automated Trading".

This is the front end software provided by the NSE with the use of which brokers can execute trade on the trading platform of NSE. These terminals are installed at the desired location by the exchange at the request of the broker.

- c. IML stands for "Intermediate Message Layer".

BSE offers a facility to brokers by which they can use their own trading front-end software in order to trade on the BSE trading system. This software would be a replacement of the BOLT TWS front-end software otherwise used by brokers to trade on the BSE trading system. Broker can use software customised to meet their specialised needs like, provision of on-line trade analysis, risk management tools, integration of back-office operations, etc. Details of location and users along with other required information is required to be uploaded to the BSE. IML facilitates reduction in operating cost as well as on-line risk management and surveillance of trades.

- d. CTCL stands for "Computer to Computer Link".

NSE offers a facility to brokers by which they can use their own trading front-end software in order to trade on the NSE trading system. This software would be a replacement of the NEAT front-end software otherwise used by brokers to trade on the NSE trading system.

Generally, vendors provide facility to view IML and CTCL on single window of the trading terminal.

### 3.2.3 Internet Trading

In case Internet trading facility is extended to the client, the client is permitted to execute the trades only for himself, i.e., for the ID through which he has logged in. The broker is required to upload to the exchange, the details of ID (IML/CTCL) on which the internet trading facility is being used. However, ID uploading is not required in case of internet trading facility, extended to the client on the BSE Webx platform.

### 3.2.4 Direct Market Access

Direct Market Access (DMA) is a facility which allows brokers to offer clients direct access to the exchange trading system through the broker's infrastructure without manual intervention by the broker. Some of the advantages offered by DMA are direct control of clients over orders, faster execution of client orders, reduced risk of errors associated with manual order entry, greater transparency, increased liquidity, lower impact costs for large orders, better audit trails and better use of hedging and arbitrage opportunities through the use of decision support tools / algorithms for trading.

While ensuring conformity with the provisions of the Securities Contract (Regulations) Act, 1956 (42 of 1956), Stock Exchanges may facilitate Direct Market Access for investors subject to the conditions laid down by SEBI & Exchanges. DMA facility may be used by the client or an investment manager of the client. DMA facility is being permitted only to institutional clients as specified in SEBI circular. Only SEBI registered entity shall be permitted to act as an investment manager on behalf of institutional clients. In case of DMA is used by the clients through an investment manager, the investment manager may execute the necessary documents on behalf of the clients.

### 3.2.5 Terminal User

The terminals can be operated only by the broker (including their employees), sub-broker (including their employees), remisier and authorised person. In case of BSE, remisiers are permitted to operate terminals only at the head office or at the branch office of the broker. However, remisiers are not permitted to operate terminals from their own office or elsewhere. It may be noted that terminals could not be located at the premises of the client nor can it be operated by the client.

The terminal operators are required to obtain certificate as per the specification of the exchange.

### 3.2.6 ID Uploading

The required details of all the IDs created in the IML server of the trading member, for any purpose (viz., administration, branch administration, surveillance, risk management, trading, testing, etc.,) and any changes therein, should be immediately uploaded to the BSE. IML user IDs created in the server of the broker should be mapped to the 16 digit location ID on a one-to-one basis and the records of the same should be maintained. The details are required to be uploaded from BOLT TWS No.1 and are subsequently available for download at any time during the market hours. The 16 digit ID is represented as under:

**Particulars Description:**

First 6 digits Pin code of the place where terminal is located

Next 4 digits Branch Code

Next 3 digits Terminal Code

Next 1 Digit Automated Trading code

Next 2 Digits Vendor Code

For example; digital id 4000230012009001represents:

400023	0012	009	0	01
6 digit pin code representing that the terminal is located in Fort, Mumbai	4 digit branch code representing the Branch No. 12. This code is allotted by the broker	3 digit terminal code representing the terminal No. 9 at Branch No. 12. This code is allotted by the broker	1 digit Automated trading code representing automated trading is disabled	2 digit vendor code representing that software of vendor No. 1 is used by the broker. This code is provided to the empanelled vendor by the exchange

The details of all the Ids created in the CTCL server of the trading member, for any purpose (viz., administration, branch administration, mini-administration, surveillance, risk management, trading, view only, testing, etc.) and any changes therein, should be immediately uploaded to the NSE. CTCL user ids created in the server of the broker should be mapped to the 12 digit location ID on a one-to-one basis and the records of the same should be maintained. The details are required to be uploaded from web based interface - ENIT and are subsequently available for download at any time throughout the day. The 12 digit id is represented as under:

Particulars	Description
First 6 digits	Pin code of the location of terminal
Next 3 digits	Branch Code
Next 3 digits	Terminal Code

The regulations and requirements related to user details are clarified vide NSE Circular No. NSE/MA/22732 on Consolidated Circular on matters relating to User Id request dated 13-Feb-13. The same is attached as Appendix 5.

### 3.3 Operations

#### 3.3.1 Contract Notes

The Contract note is a document through which a contractual obligation is established between a member-broker and his client. This is the prime document on the basis of which all the disputes between the member-broker and his clients are settled.

Every member-broker is required to issue contract notes to all his clients for the securities sold and purchased by him on their behalf within 24 hours of execution of trade and obtain acknowledgement of the clients along with the date of receipt on the duplicates/counterfoils of the contract notes and preserve the same for future reference. The member-brokers shall maintain a proper record for dispatch of contract notes to the clients if the same are dispatched through post, courier etc.

Broker is required to issue Contract notes in duplicate to all his clients within 24 hours of execution of trade, i.e., by next working day. Broker is required to obtain the date and signature of client in case of hand delivery of the Contract notes and in case where the Contract notes are sent by courier/post, adequate dispatch record is required to be maintained. Contract notes are required to be signed by the director/ proprietor/partner/authorised signatory or power of attorney holder as the case may be. The details of the signatory along with necessary board resolution/power of attorney should be submitted to the exchange and the name of such signatory(s) is also required to be printed on the Contract note. Contract notes issued by the broker should be compared with trade files to ensure that contract notes are issued to all the clients and also to ensure that there are no off-market trades executed by the broker.

As per Regulation 14 of BSE, there are various formats of contract notes explained as under:

Format	Particulars	Remarks
Form A	Format of Contract Notes Issued by Members acting as Agents on Behalf of the Clients	This is equivalent to a delivery challan and contains only the quantitative details of trades executed on behalf of clients.
Form AA	Alternative Format to Form A (known as Contract cum Bill)	This is equivalent to an Invoice-cum-Delivery challan and contains quantitative details as well as amount of trades executed on behalf of clients.
Form B	Format of Contract Notes Issued by Members acting as Principals	This is issued for trades executed on principal to principal basis.

#### a. Numbering of Contract Notes

Brokers are required to issue contract notes to clients, which are serially numbered. Such numbering shall be on annual basis and not on daily basis. The contract note issued to client shall be numbered with unique running serial number commencing from 1 which shall be reset at the beginning of every financial year.

**b. Brokerage**

Broker cannot charge brokerage at a rate exceeding 2.5% of the contract value or Rs. 0.25/- per share, whichever is higher. In case of option, contract brokerage should be charged on the premium amount (not on the premium plus strike price) at a rate not exceeding 2.5% or Rs. 100 whichever is higher.

**c. Securities Transaction Tax**

Statement of Securities Transaction Tax (STT) may be issued on annual (financial year) basis, unless required by the client otherwise, within one month from the close of the financial year. However, broker shall continue to give total STT amount on the Contract notes. Format of statement of STT has been prescribed by both the exchanges.

**d. Electronic Contract Note (ECN)**

Broker is allowed to issue contract notes authenticated by means of digital signatures provided that the broker has obtained digital signature certificate from Certifying Authority under the Information Technology Act, 2000. Contract notes issued in electronic format is required to be digitally signed. SEBI circular MRD/DoP/SE/Cir-20/2005 dated September 8, 2005 specifies the conditions for issuance of Contract notes in electronic form which are being discussed in following paragraphs.

**e. Issuing ECNs When Specifically Consented**

The digitally signed ECNs may be sent only to those clients who have opted to receive the contract notes in an electronic form, either in the Member Client agreement / Tripartite agreement or by a separate letter. The mode of confirmation shall be as per the agreement entered into with the clients.

**f. Where to Send ECNs**

The usual mode of delivery of ECNs to the clients shall be through e-mail. For this purpose, the client shall provide an appropriate e-mail account to the broker which shall be made available at all times for such receipts of ECNs.

**g. Requirement of Digital Signature**

All ECNs sent through the e-mail shall be digitally signed, encrypted, non-tamperable and shall comply with the provisions of the Information Technology Act, 2000. In case the ECN is sent through e-mail as an attachment, the attached file shall also be secured with the digital signature, encrypted and non-tamperable.

**h. Requirements for Acknowledgement, Proof of Delivery, Log Report, etc.**

The acknowledgement of the e-mail shall be retained by the broker in a soft and non-tamperable form.

***Proof of Delivery***

The proof of delivery i.e., log report generated by the system at the time of sending the Contract notes shall be maintained by the broker for the specified period under the extant regulations of SEBI/stock exchanges and shall be made available during inspection, audit, etc.



The broker shall clearly communicate to the client in the agreement executed with the client, for this purpose, that non receipt of bounced mail notification by the broker shall amount to delivery of the Contract note at the e-mail ID of the client.

#### ***Log Report for Rejected or Bounced Mails***

The log report shall also provide the details of the Contract notes that are not delivered to the client/e-mails rejected or bounced back. Also, the broker shall take all possible steps (including settings of mail servers, etc.) to ensure receipt of notification of bounced mails by the broker at all times within the stipulated time period under the extant regulations of SEBI/stock exchanges.

#### ***When to Issue or Send in Physical Mode***

***Issue in Physical Mode*** In the case of those clients who do not opt to receive the Contract notes in the electronic form, the broker shall continue to send Contract notes in the physical mode to such clients.

***Send in Physical Mode*** Wherever the ECNs have not been delivered to the client or has been rejected (bouncing of mails) by the e-mail ID of the client, the broker shall send a physical Contract note to the client within the stipulated time under the extant regulations of SEBI/stock exchanges and maintain the proof of delivery of such physical Contract notes.

### **i. General Requirements**

#### ***ECNs through Website***

In addition to the e-mail communication of the ECNs in the manner stated above, in order to further strengthen the electronic communication channel, the broker shall simultaneously publish the ECN on his designated website in a secured way and enable relevant access to the clients.

#### ***Access to the Website***

In order to enable clients to access the ECNs posted in the designated website in a secured way, the broker shall allot a unique user name and password for the purpose, with an option to the client to access the same and save the contract note electronically or take a print out of the same.

#### ***Preservation/Archive of Electronic Documents***

The broker shall retain/archive such electronic documents as per the extant rules/regulations/circulars/guidelines issued by the SEBI or the Stock Exchanges from time to time.

### **j. Straight Through Processing (STP)**

Straight Through Processing (STP) is a mechanism that automates the end to end processing of transactions of financial instruments. It involves use of a system to process or control all elements of the work flow of a financial transaction, what are commonly known as the Front, Middle, Back office and General Ledger. In other words, STP allows electronic capturing and processing of transactions in one pass from the point of order origination to final settlement. STP thus streamlines the process of trade execution and settlement and avoids manual entry and re-entry of the details of the same trade by different market intermediaries and participants. Usage of STP enables orders to be processed, confirmed and settled in a shorter time period and in a more cost effective manner with fewer errors.



**k. Formats of Contracts notes are attached as appendix 6**

BSE Cash	6a
NSE Cash & F&O	6b
MCX-Sx	6c

**3.3.2 Maintenance of Books of Accounts, Records & Documents**

The member-brokers of the Exchange are required to maintain the following books of accounts and records as per Rule 15 of the Securities Contracts (Regulation) Rules, 1957 and Regulation 17 of the SEBI (Stock Brokers and Sub Brokers) Regulations, 1992. These books and records are to be preserved for a minimum period of five years as per the requirements of Regulation 18 of SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992.

It may however, be noted that, in cases where copies of books of accounts have been taken by any of the enforcement agencies during the course of any investigation, it is necessary to preserve the original documents, both in electronic and physical form till the trial is completed. Members may refer to Exchange Notice No. 20050805-20 dated August 5, 2005 & Exchange Notice No. 20051227 – 18 dated December 27, 2005 in this regard.

As per Rule 15 of the Securities Contracts (Regulation) Rules, 1957 and Regulation 17 of the SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992 following books of accounts & documents are required to be maintained by the members.

**a. Register of transactions (Sauda Book);**

All member-brokers are required to maintain a 'Sauda Book', which contains details of all trades transacted by them on a day-to-day basis. This is a basic record, which each member-broker is required to maintain regularly on day to-day basis. It contains the details regarding the name of the scrip, name of the client on whose behalf the deals have been done, rate and quantity of scrip bought or sold. These details are to be maintained date-wise. This register contains all the transactions, which may be of any of the kind mentioned below:

- Member-broker's own business on the Exchange.
- Member-broker's business on the Exchange on behalf of clients.
- Member-broker's business with the clients on principal-to-principal basis.
- Member-broker's business with the members of other Stock Exchanges.
- Member-broker's business on behalf of his clients with the members of other Stock Exchanges.
- Spot transactions, etc.

**b. Clients ledger;**

Every member-broker is required to maintain a clients' ledger in respect of all the clients registered with him. This ledger contains the details of the bills raised by the member-broker on the clients and the payment

received from or made to them. Inspection of this ledger can bring out the cases of delay by a member-broker in making payment to the clients.

**c. General ledger;**

**d. Journal;**

**e. Cash book;**

**f. Bank book;**

**g. Register containing particulars of securities received and delivered.**

Reg. 17(1) of the SEBI (Stock Brokers & Sub Brokers) Rules, 1992 a member-broker is required to maintain a register of securities, client wise and security wise, giving, inter alia, the following details:

- Date of receipt of the security.
- Quantity received.
- Party from whom received.
- Purpose of receipt.
- Date of delivery of the security.
- Quantity Delivered.
- Party to whom delivered.
- Purpose of Delivery, and
- A Separate register or ledger in respect of its own securities.

**h. Counterfoils or duplicates of contract notes issued to clients;**

**i. Written consent of clients in respect of contracts entered into as principals;**

**j. Margin deposit book;**

**k. Register of accounts of sub-brokers;**

Members are required to maintain separate set of books for each Exchange in which they operate. Further, for a particular Exchange a separate set of books is required to be maintained for each particular segment of the Exchange in which the member is operating.

### 3.3.3 Settlement

Once the shares have been bought or sold, the transaction is complete only when the person has received the delivery for the shares purchased, or received money for the shares sold. This process of carrying the transactions to its logical conclusion is called “settlement” in stock market parlance. Further, “Pay-In” means funds and securities receivable by Stock Exchange from the broker towards the obligation and “Pay-Out” means funds and securities payable by Stock Exchange to the broker.

#### – Settlement Cycle for Cash Market

The settlement cycle in the Indian cash market is trade plus two days, i.e., T+2, as per the SEBI directive implementing this new cycle from April 1, 2003. Under rolling settlement, trades done on one day are settled after the specified number of days. So, T+2 will mean that the final settlement of transactions

done on the trade day will take place two days after the trade day (excluding Saturday, Sundays, Bank and Exchange Settlement holidays). If there is a shortfall in securities on the pay-in day, then an auction is conducted to meet it. The settlement cycle is summarized as under:

Trading	Rolling Settlement Trading	T
Clearing	Custodial Confirmation	T+1 working days
	Delivery Generation	T+1 working days
Settlement	Securities and Funds pay in	T+2 working days
	Securities and Funds pay out	T+2 working days
	Valuation Debit	T+2 working days
Post Settlement	Auction	T+2 working days
	Auction settlement	T+3 working days
	Bad Delivery Reporting	T+4 working days
	Rectified bad delivery pay-in and pay-out	T+6 working days
	Re-bad delivery reporting and pickup	T+8 working days
	Close out of re-bad delivery and funds pay-in & pay-out	T+9 working days

Some Important Terms for usage with reference to the settlement procedure are:

**Clearing House:**

Clearing House carries out clearing and settlement functions as per the settlement cycles provided in the settlement schedule.

The clearing function of the clearing corporation is designed to work out

- what members are due to deliver and
- what members are due to receive on the settlement date.

Settlement is a two way process which involves transfer of funds and securities on the settlement date. Clearing is the process of determination of obligations, after which the obligations are discharged by settlement.

There are two categories of clearing members: trading clearing members and custodians.

Trading members can trade on a proprietary basis or trade for their clients. All proprietary trades become the member's obligation for settlement. Where trading members trade on behalf of their clients they could trade for normal clients or for clients who would be settling through their custodians.

Trades which are for settlement by Custodians are indicated with a Custodian Participant (CP) code and the same is subject to confirmation by the respective Custodian. The custodian is required to confirm settlement of these trades on T + 1 day by the cut-off time 1.00 p.m. Non-confirmation by custodian devolves the trade obligation on the member who had input the trade for the respective client.

A multilateral netting procedure is adopted to determine the net settlement obligations (delivery/receipt positions) of the clearing members. Accordingly, a clearing member would have either pay-in or pay-out obligations for funds and securities separately.

In the case of securities in the Trade for Trade – Surveillance segment and auction trades, obligations are determined on a gross basis i.e. every trade results into a deliverable and receivable obligation of funds and securities. Members pay-in and pay-out obligations for funds and securities are determined by 2.30 p.m. on T + 1 day and are downloaded to them so that they can settle their obligations on the settlement day (T+2).

#### – Settlement Cycle for F&O Market

##### ***Daily Mark to Mark settlement***

The settlement of trades is on T+1 working day basis. Members with a funds pay-in obligation are required to have clear funds in their primary clearing account on or before 10.30 a.m. on the settlement day. The payout of funds is credited to the primary clearing account of the members thereafter.

The positions in the futures contracts for each member is marked-to-market to the daily settlement price of the futures contracts at the end of each trade day.

The profits/ losses are computed as the difference between the trade price or the previous day's settlement price, as the case may be, and the current day's settlement price. The CMs who have suffered a loss are required to pay the mark-to-market loss amount to NSCCL which is passed on to the members who have made a profit. This is known as daily mark-to-market settlement.

Theoretical daily settlement price for unexpired futures contracts, which are not traded during the last half an hour on a day, is currently the price computed as per the formula detailed below:

$$F = S * e^{rt}$$

where:

F = theoretical futures price

S = value of the underlying index

e is the mathematical constant for the base of the natural logarithm.

r = rate of interest (MIBOR)

t = time to expiration

Rate of interest may be the relevant MIBOR rate or such other rate as may be specified. After daily settlement, all the open positions are reset to the daily settlement price. CMs are responsible to collect and settle the daily mark to market profits / losses incurred by the TMs and their clients clearing and settling through them. The pay-in and pay-out of the mark-to-market settlement is on T+1 days (T = Trade day). The mark to market losses or profits are directly debited or credited to the CMs clearing bank account.

### ***Option to settle Daily MTM on T+0 day***

Clearing members may opt to pay daily mark to market settlement on a T+0 basis. The option can be exercised once in a quarter (Jan-March, Apr-June, Jul-Sep & Oct-Dec). The option once exercised shall remain irrevocable during that quarter. Clearing members who wish to opt to pay daily mark to market settlement on T+0 basis shall intimate the Clearing Corporation as per the format specified in specified format.

Clearing members who opt for payment of daily MTM settlement amount on a T+0 basis shall not be levied the scaled up margins. The pay-out of MTM settlement shall continue to be done on T+1 day basis.

### ***Final Settlement***

On the expiry of the futures contracts, NSCCL marks all positions of a CM to the final settlement price and the resulting profit / loss is settled in cash.

The final settlement of the futures contracts is similar to the daily settlement process except for the method of computation of final settlement price. The final settlement profit / loss is computed as the difference between trade price or the previous day's settlement price, as the case may be, and the final settlement price of the relevant futures contract.

Final settlement loss/ profit amount is debited/ credited to the relevant CMs clearing bank account on T+1 day (T= expiry day).

Open positions in futures contracts cease to exist after their expiration day.

### ***Settlement Procedure Daily MTM settlement on T+0 day***

Clearing members who opt to pay the Daily MTM settlement on a T+0 basis would compute such settlement amounts on a daily basis and make the amount of funds available in their clearing account before the end of day on T+0 day. Failure to do so would tantamount to non-payment of daily MTM settlement on a T+0 basis. Further, partial payment of daily MTM settlement would also be considered as non-payment of daily MTM settlement on a T+0 basis. These would be construed as non-compliance and penalties applicable for fund shortages from time to time would be levied.

A penalty of 0.07 % of the margin amount at end of day on T+0 would be levied on the clearing members. Further, the benefit of scaled down margins shall not be available in case of non-payment of daily MTM settlement on a T+0 basis from the day of such default to the end of the relevant quarter.

### **3.3.4 Mode of Payment & Delivery**

Broker is also required to maintain clear segregation of the client funds and own funds. SEBI has vide Circular no. SMD/SED/Cir/93/23321 dated November 18, 1993 in respect of maintaining a line of segregation between own funds and clients funds.

It shall be compulsory for all Member brokers to keep the money of the clients in a separate account and their own money in a separate account. No payment for transactions in which the Member broker is taking a position as a principal will be allowed to be made from the client's account. The above principles and the circumstances under which transfer from client's account to Member broker's account would be allowed are enumerated below.

**a. Member Broker Keep Accounts**

Every member broker shall keep such books of accounts, as will be necessary, to show and distinguish in connection with his business as a member –

- (i) moneys received from or on account of and moneys paid to or on account of each of his clients and,
- (ii) the moneys received and the moneys paid on Member's own account.

**b. Obligation to Pay Money into "Clients Accounts"**

Every member broker who holds or receives money on account of a client shall forthwith pay such money to current or deposit account at bank to be kept in the name of the member in the title of which the word "clients" shall appear (hereinafter referred to as "clients account"). Member broker may keep one consolidated clients accounts for all the clients or accounts in the name of each client, as he thinks fit. Provided that when a Member broker receives a cheque or draft representing in part money belonging to the client and in part money due to the Member, he shall pay the whole of such cheque or draft into the clients account and effect subsequent transfer as laid down in para D (ii).

**c. What Moneys to be Paid into "Clients Account"**

No money shall be paid into clients account other than –

- i) money held or received on account of clients;
- ii) such money belonging to the member as may be necessary for the purpose of opening or maintaining the account;
- iii) money for replacement of any sum which may by mistake or accident have been drawn from the account in contravention of para D given below;
- iv) a cheque or draft received by the Member representing in part money belonging to the client and in part money due to the Member.

**d. What Moneys to be Withdrawn from "Clients Account"**

No money shall be drawn from clients account other than–

- (i) money properly required for payment to or on behalf of clients or for or towards payment of a debt due to the member from clients or money drawn on client's authority, or money in respect of which there is a liability of clients to the Member, provided that money so drawn shall not in any case exceed the total of the money so held for the time being for such each client;
- (ii) such money belonging to the Member as may have been paid into the client account under para 1C(ii) or 1C(iv) given above;
- (iii) Money which may by mistake or accident has been paid into such account contravention of para C above.

**e. Right to Lien, Set-off etc., Not Affected**

Nothing shall deprive a Member broker of any recourse of right, whether by way of lien, set-off, counter-claim charge or otherwise against moneys standing to the credit of clients account.”

SEBI has vide Circular no. SMD/SED/Cir/93/23321 dated November 18, 1993, further specified that:

- In case of purchases on behalf of client, brokers shall be at a liberty to close out the transactions by selling the securities, in case the clients fails to make the full payment to the broker for the execution of the contract within two days of contract note having been delivered for cash shares and seven days for specified shares or before pay-in day (as fixed by the Stock Exchange for the concerned settlement period), whichever is earlier; unless the client already has an equivalent credit with the Member. The loss incurred in this regard, if any, will be met from the margin money of that client.
- In case of sales on behalf of clients, brokers shall be at liberty to close out the contract by effecting purchases if the client fails to deliver the securities sold with valid transfer documents within 48 hours of the contract note having been delivered or before delivery day (as fixed by the Stock Exchange authorities for the concerned settlement period), whichever is earlier. Loss on the transaction, if any, will be deductible from the margin money of that client.

**Cash Dealings**

SEBI vide its circular no. SEBI/MRD/SE/Cir- 33/2003/27/08 dated August 27, 2003, regarding cash transactions between stock brokers and their clients, specifies that the brokers should not accept cash from the client whether against obligations or as margin for purchase of securities and/or give cash against sale of securities to the clients. However, in exceptional circumstances the broker may receive the amount in cash, to the extent not in violation of the Income Tax requirement as may be in force from time to time.

**Running Account**

As per the prevalent market practise and for the purpose of convenience, the client may instruct the broker to maintain a running account. Such instruction should be in writing and in that case, the amount may not be paid by the broker within one working day. However, it is suggested that the accounts should be settled on timely and regular basis.

**Receipts and Payments of Funds from/to Third Party**

As per the SEBI directives, all payments shall be received/ made by the brokers from/to the clients strictly by account payee crossed cheques/demand drafts or by way of direct credit into the bank account through EFT, or any other mode allowed by the RBI. The broker shall accept cheques drawn only by the clients and also issue cheques in favour of the clients only, for their transaction. The bank account details of the clients should preferably be mapped in the back office at the time of opening the account. This shall facilitate tracking of receipt and payment of funds from other than client's account, i.e., from third party.

### **Checks & Balances**

Stock Broker is required to prepare bank reconciliation statement on a regular basis, preferably on a daily basis. It should be ensured that unreconciled/pending entries are thoroughly scrutinised, especially those entries which are pending for unreasonably long period. While scrutinising bank reconciliation statement, auditor should also verify that dishonoured cheques of clients are properly accounted and are not pending in bank reconciliation statement.

### **3.3.5 Margin**

#### **a. Margin Collection**

SEBI has decided that, the Members should have a prudent system of risk management to protect themselves from client default and the quantum, form and mode of collection of margins from the clients is left to the discretion of the member broker.

As per SEBI Circular No.MRD/SE/CIR-12/2005 dated May 13, 2005 members are therefore required to have a prudent system of risk management which has to be well documented in writing and be made accessible to the clients and the Exchange.

In order to provide a level playing field to all the investors in the Cash Market as in the case of Derivatives Market, SEBI has provided that all the Institutional Trades in the Cash Market would be subject to payment of margins as applicable to transactions of other investors. To begin with, from April 21, 2008, all institutional trades in the cash market would be margined on a T+1 basis with margin being collected from the custodian upon confirmation of the trade. (SEBI Circular No. MRD/DoP/SE/Cir-06 /2008 dated March 19, 2008).

#### **Margins for Derivative segment**

In the Derivative segment the initial and exposure margin is payable upfront by Clearing Members. Initial margins can be paid by members in the form of Cash, Bank Guarantee, Fixed Deposit Receipts and approved securities.

Clearing members who are clearing and settling for other trading members can specify the maximum collateral limit towards initial margins, for each trading member and custodial participant clearing and settling through them.

Such limits can be set up by the clearing member, through the facility provided on the trading system upto the time specified in this regard. Such collateral limits once set are applicable to the trading members/custodial participants for that day, unless otherwise modified by clearing member.

Non-fulfillment of either whole or part of the margin obligations will be treated as a violation of the Rules, Bye-Laws and Regulations of Clearing house and will attract penalty.

In addition Clearing house may at its discretion and without any further notice to the clearing member, initiate other disciplinary action, inter-alia including, withdrawal of trading facilities and/ or clearing facility, close out of outstanding positions, imposing penalties, collecting appropriate deposits, invoking bank guarantees/ fixed deposit receipts, etc.



## **b. Margin Reporting**

Clearing Members (CMs) and Trading Members (TMs) are required to collect upfront initial margins from all their Trading Members/ Constituents.

CMs are required to compulsorily report, on a daily basis, details in respect of the margin amount due and collected, from the TMs/ Constituents clearing and settling through them, with respect to the trades executed/ open positions of the TMs/ Constituents, which the CMs have paid to NSCCL, for the purpose of meeting margin requirements.

Similarly, TMs are required to report on a daily basis details in respect of the margin amount due and collected from the constituents clearing and settling through them, with respect to the trades executed/ open positions of the constituents, which the trading members have paid to the CMs, and on which the CMs have allowed initial margin limit to the TMs.

CMs/ TMs are required to report details of initial margins collected from their TMs/ Constituents by uploading files to the /FAOFTP/F<CODE>/COLAT/UPLD directory on the Extranet Server or by uploading the files through the Collateral Interface for Members (CIM).

- For TMs, the <CODE> specified in the directory is the 5 digit Trading Member Code allotted by NSCCL (e.g. 09999)
- For CMs the <CODE> specified in the directory is the 5 digit Primary Member Code allotted by NSCCL (e.g. 09999 and not M12345 or C23456)

CMs who do not clear trades for other trading members (self- clearing members), need to report only the file as applicable to TMs and are not required to report the file as applicable to CMs.

A return file is generated for all client margin reporting files uploaded by members

## **c. Due date for Margin Reporting**

The cut off day upto which a member may report client margin details to NSCCL is referred to as the sign off date. It is 5 working days after the trade day.

## **d. Short reporting of margins in Client Margin Reporting Files**

Penalty is levied in case of short reporting by trading/clearing member as specified by SEBI. The penalty structure for the same is available in circular. Appendix 7.

## **e. Margin statements**

In order to ensure transparency at the client level, SEBI has made it mandatory for members to send margin related information to their clients on a daily basis.

Such information may include the following details:

- Client code and name, Trade day (T)
- Total margin deposit placed by the client upto day T-1 (with break-up in terms of cash, FDRs, BGs and securities)
- Margin utilised upto the end of day T-1

- Margin deposit placed by the client on day T (with break-up in terms of cash, FDRs, BGs and securities)
- Margin adjustments for day T
- Margin status (balance with the member / due from the client) at the end of day T

**The format for same is attached as Appendix 8.**

**The related circulars to margin are as Appendix 9.**

### **3.3.6 Quarterly / Monthly Settlement of Funds and Securities**

For clients who have opted for running accounts, the broker needs to settle the accounts of funds and securities on monthly / quarterly basis as per the request of the client.

The NSE FAQ on Settlement of funds and securities provides comprehensive clarity to brokers for settling the accounts (Appendix 10).

### **3.3.7 Statement of Accounts for Funds & Securities**

A large number of disputes arise between the member-brokers / sub-brokers and their clients pertaining to payments due to/from the clients. This may be due to non-submission of statement of accounts of funds / securities by the member brokers to the clients on a regular basis.

In order to avoid such incidences, member-brokers are advised to adopt the following practice:

- a. While settling the account on a monthly or quarterly basis, the broker shall send to the client a 'statement of accounts' containing an extract from the client ledger for funds and an extract from the register of securities displaying all receipts/deliveries of funds/securities.
- b. The statement shall also explain the retention of funds/securities and the details of the pledge, if any.
- c. The statements will have to be sent to the clients within a month of the expiry of the relevant month or quarter.
- d. The statement shall also include error reporting clause stating that the client shall report errors, if any, to the member-broker.
- e. In respect of institutional clients, the said requirement is applicable in case the member-brokers pay or receive funds and receive or deliver securities from or to the institutional clients directly and not through custodians.
- f. Member-broker should maintain an acknowledgement/confirmation record of dispatch of 'Statement of Accounts' to the clients.

In the case of brokers providing Internet Trading facility and providing an access to an on-line accounting viewing and print-out facility, it would be treated as sufficient compliance, if they send the 'Statement of Accounts' by email or where a facility has been given to the clients to verify the above statements on the Internet trading terminal itself.

### 3.3.8 Client Funding

Securities and Exchange Board of India (SEBI) vide its letter dated July 16, 2004 addressed to the BSE, the members of the BSE are required to disclose their peak client funding details during the month to the Exchange in the prescribed format through the DUS system provided by the Exchange within the first 8 days of next month.

NSE vide its circulars no.: NSE/CMO/0271/2005 and NSE/CMO/0272/2005 dated December 19, 2005, required members to upload the details of client funding done by them of the previous month by the 7<sup>th</sup> day of the subsequent month. The Exchange had also specified the format of one time letter for members who have no details to be furnished in terms of the said circular.

Client funding disclosure to the Exchange should contain the break-up of funding to Institutional / Non-Institutional clients, towards Settlement / Margin Obligation, Margin Trading etc., the details of which are as under: -

Item	Description
No. Of Clients for Temporary Funding	The number of clients who have been funded during the reporting month.
Temporary Funding of Margin on behalf of Clients	The amount funded means and includes member's own money put towards client's margin obligations.
Temporary Funding of Settlement Obligations of Institutional Clients	The member has to enter the amount funded towards settlement obligations of the Institutional Clients who have been funded by him for the reporting month. If this column is not applicable then the member has to enter "0".
Temporary Funding of Settlement Obligations of Non-Institutional Clients	The member has to enter the amount funded towards settlement obligations of the Non-institutional clients who have been funded by him for the reporting month. If this column is not applicable then the member has to enter "0".
No. of Clients under Margin Trading	The number of clients who have been funded towards margin trading during the reporting month.
Funding extended to Clients under Margin Trading facility	Amount funded by the member to clients under the option of Margin Trading. If this

	column is not applicable then the member has to enter "0".
Total Funding	It will be the sum total of Temporary Funding of Margin on behalf of Clients + Temporary Funding of Settlement Obligations of Institutional Clients + Temporary Funding of Settlement Obligations of Non-Institutional Clients + Funding extended to Clients under Margin Trading facility

### 3.4 Other Compliances

#### 3.4.1 Bulk & Block Deal Reporting

##### Bulk Deal Reporting

A "bulk" deal constitutes all transactions in a scrip (on an exchange) where the total quantity of shares bought/sold is more than 0.5% of the number of equity shares of the company listed on the exchange. The quantitative limit of 0.5% can be reached through one or more transactions executed during the day in the normal market segment.

##### Disclosures

- The disclosure shall be made with respect to all transactions in a scrip where total quantity of shares bought/sold is more than 0.5% of the number of equity shares of the company listed on the stock exchange.
- The brokers shall disclose to the stock exchange the name of the scrip, name of the client, quantity of shares bought/sold and the traded price.
- The disclosure shall be made by the brokers immediately upon execution of the trade.
- The Stock exchanges shall disseminate the aforesaid information on the same day after market hours to the general public.

##### Block Deal Reporting

Block deal is execution of large trades through a single transaction without putting either the buyer or seller in a disadvantageous position. For this purpose, stock exchanges are permitted to provide a separate trading window.

Block deal will be subject to the following conditions:

- The said trading window may be kept open for a limited period of 35 minutes from the beginning of trading hours i.e. the trading window shall remain open from 9.55 am to 10.30 am.
- The orders may be placed in this window at a price not exceeding +1% from the ruling market price/previous day closing price, as applicable.
- An order may be placed for a minimum quantity of 5,00,000 shares or minimum value of Rs.5 crore.

- iv. Every trade executed in this window must result in delivery and shall not be squared off or reversed.
- v. The stock exchanges shall disseminate the information on block deals such as the name of the scrip, name of the client, quantity of shares bought/sold, traded price, etc. to the general public on the same day, after the market hours.
- vi. Disclosure of trade details of "bulk deals" as specified in para 1.1 shall be continued to be made by the stock exchanges to the general public on the same day after the market hours.

All appropriate trading and settlement practices as well as surveillance and risk containment measures, etc., as applicable to the normal trading segment, shall be applicable and implemented in respect of this special window as well.

### **3.4.2 Proprietary Trading**

#### **I. Disclosure**

With a view to increase the transparency in the dealings between the broker and the client, every broker shall disclose to his client whether he does client based business or proprietary trading as well.

- i. The broker shall disclose the aforesaid information to his existing clients within a period of one month from the date of this circular.
- ii. Further, the broker shall disclose this information upfront to his new clients at the time of entering into the Know Your Client agreement.

In case of a broker who at present does not trade on proprietary account, chooses to do so at a later date, he shall be required to disclose this to his clients before carrying out any proprietary trading.

#### **II. Pro-Account trading terminal**

Pro-account should be used by the broker to place orders of member of the broking firm. It has been observed that certain members are putting large number of orders on pro-account from various locations rather than using "proaccount" at the terminals located at the corporate office from where the owner / directors normally function. It has further been observed that these trades executed from various locations under "pro-account" are, many a time, transferred subsequently to the respective clients in the back office of the members. This practice is in clear violation of the requirement of putting the orders of clients under the appropriate client code through trading terminals.

In order to prevent any misuse if this facility, if any, stock exchanges should ensure the following:-

- i. Facility of placing orders on "pro-account" through trading terminals shall be extended only at one location of the members as specified / required by the members
- ii. Trading terminals located at places other than the above location shall have a facility to place orders only for and on behalf of a client by entering client code details as required / specified by the Exchange / SEBI.
- iii. In case any member requires the facility of using "pro-account" through trading terminals from more than one location, such member shall be required to submit an undertaking to the stock exchange stating the reason for using the "pro-account" at multiple locations and the stock exchange may, on

case to case basis after due diligence, consider extending the facility of allowing use of “pro-account” from more than one location.

### 3.4.3 Short Selling & Securities Lending & Borrowing Scheme

#### Broad Framework for Short Selling and Securities Lending and Borrowing

Pursuant to the recommendations of the Secondary Market Advisory Committee (SMAC) of SEBI it was decided to permit all classes of investors to short sell. In order to provide a mechanism for borrowing of securities to enable settlement of securities sold short, it has also been decided to put in place a full-fledged securities lending and borrowing (SLB) scheme for all market participants in the Indian securities market under the over-all framework of “Securities Lending Scheme, 1997” of SEBI. The Securities Lending Scheme was notified by SEBI on February 06, 1997. The guidelines for this facility of short selling and framework for securities lending and borrowing are specified below.

To enable the mechanism of short selling, the facility of securities lending and borrowing (SLB) scheme, was put in place for all market participants, under the overall framework of “Securities Lending Scheme, 1997” of SEBI.

#### Broad framework for short selling

- a. “Short selling” shall be defined as selling a stock which the seller does not own at the time of trade.
- b. All classes of investors, viz., retail and institutional investors, shall be permitted to short sell.
- c. Naked short selling shall not be permitted in the Indian securities market and accordingly, all investors would be required to mandatorily honour their obligation of delivering the securities at the time of settlement.
- d. No institutional investor shall be allowed to do day trading i.e., square-off their transactions intra-day. In other words, all transactions would be grossed for institutional investors at the custodians’ level and the institutions would be required to fulfill their obligations on a gross basis. The custodians, however, would continue to settle their deliveries on a net basis with the stock exchanges.
- e. The stock exchanges shall frame necessary uniform deterrent provisions and take appropriate action against the brokers for failure to deliver securities at the time of settlement which shall act as a sufficient deterrent against failure to deliver.
- f. A scheme for Securities Lending and Borrowing (SLB) shall be put in place to provide the necessary impetus to short sell. The introduction of a full-fledged securities lending and borrowing scheme shall be simultaneous with the introduction of short selling by institutional investors.
- g. The securities traded in F&O segment shall be eligible for short selling. SEBI may review the list of stocks that are eligible for short selling transactions from time to time.
- h. The institutional investors shall disclose upfront at the time of placement of order whether the transaction is a short sale. However, retail investors would be permitted to make a similar disclosure by the end of the trading hours on the transaction day.
- i. The brokers shall be mandated to collect the details on scrip-wise short sell positions, collate the data and upload it to the stock exchanges before the commencement of trading on the following trading

day. The stock exchanges shall then consolidate such information and disseminate the same on their websites for the information of the public on a weekly basis. The frequency of such disclosure may be reviewed from time to time with the approval of SEBI.

### **Broad framework for securities lending and borrowing**

- a. The stock exchanges shall put in place, a full-fledged securities lending and borrowing (SLB) scheme, within the overall framework of “Securities Lending Scheme, 1997” (the scheme), that is open for all market participants in the Indian securities market.
- b. To begin with, the SLB shall be operated through Clearing Corporation/Clearing House of stock exchanges having nation-wide terminals who will be registered as Approved Intermediaries (AIs) under the SLS, 1997.
- c. The SLB shall take place on an automated, screen based, order-matching platform which will be provided by the AIs. This platform shall be independent of the other trading platforms.
- d. To begin with, the securities traded in F&O segment shall be eligible for lending & borrowing under the scheme.
- e. All categories of investors including retail, institutional etc. will be permitted to borrow and lend securities. The borrowers and lenders shall access the platform for lending/borrowing set up by the AIs through the clearing members (CMs) (including banks and custodians) who are authorized by the AIs in this regard.
- f. The AIs, CMs and the clients shall enter into an agreement (which may have one or more parts) specifying the rights, responsibilities and obligations of the parties to the agreement. The agreement shall include the basic conditions for lending and borrowing of securities as prescribed under the scheme. In addition to that, AIs may also include suitable conditions in the agreement to have proper execution, risk management and settlement of lending and borrowing transactions with clearing member and client. Given the nature of the client base, while the major responsibility of ensuring compliance with “Know Your Client” (KYC) norms in respect of the clients rests with CMs, the exact role of AIs/CMs vis-à-vis the clients in this regard needs to be elaborated in the aforesaid agreement between the AI/CMs/clients. In this regard, there would be one master agreement with two individual parts to the same. The first part of the agreement would be between the AIs and the CMs and the second part of the agreement would be between the CMs and the clients. There would be adequate cross referencing between the two parts of the agreement so that all the concerned parties, viz., the AIs/CMs and the clients agree completely and are aware of all the provisions governing the SLB transactions between them. However, there shall be no direct agreement between the lender and the borrower. The CM will attach a certified copy of the first part of the agreement signed with the AI in the second part of the agreement signed with each client. The model agreements in this regard would be devised by the stock exchanges.
- g. The AIs shall allot a unique ID to each client which shall be mapped to the Permanent Account Number (PAN) of the respective clients. The AIs shall put in place appropriate systemic safeguards to ensure that a client is not able to obtain multiple client IDs.



- h. The tenure of contracts in SLB may be upto a maximum period of 12 months. The Approved Intermediary (Clearing corporation/ Clearing House) shall have the flexibility to decide the tenure (maximum period of 12 months).
- i. The settlement cycle for SLB transactions shall be on T+1 basis. The settlement of lending and borrowing transactions shall be independent of normal market settlement.
- j. The settlement of the lending and borrowing transactions shall be done on a gross basis at the level of the clients i.e. no netting of transactions at any level will be permitted.
- k. Als would frame suitable risk management systems to guarantee delivery of securities to borrower and return of securities to the lender. In the case of lender failing to deliver securities to the AI or borrower failing to return securities to the AI, the AI shall conduct an auction for obtaining securities. In the event of exceptional circumstances resulting in non-availability of securities in auction, such transactions would be financially closed-out at appropriate rates, which may be more than the rates applicable for the normal close-out of transactions, so as to act as a sufficient deterrent against failure to deliver securities.
- l. Position limits at the level of market, CM and client shall be decided from time to time by AIs in consultation with SEBI. To begin with (a) the market– wide position limits for SLB transactions shall be 10% of the free-float capital of the company in terms of number of shares (b) No clearing member shall have open position of more than 10% of the market-wide position limits or Rs. 50 crore (base value), whichever is lower (c) For a FII/MF, the position limits shall be the same as of a clearing member (d) The client level position limits shall be not more than 1% of the market-wide position limits.
- m. There shall be no lending/borrowing activity during the periods of corporate action in the security and shall be disclosed by AI to the market.
- n. Details of treatment of corporate actions during the tenure, such as Dividend, stock split etc., are specified as below:
  - Dividend: The dividend amount would be worked out and recovered from the borrower on the book closure/ record date and passed on to the lender.
  - Stock split: The positions of the borrower would be proportionately adjusted so that the lender receives the revised quantity of shares.
- h. Other corporate actions such as bonus/ merger/ amalgamation / open offer etc.: The transactions would be foreclosed from the day prior to the ex-date. The lending fee would be recovered on a prorata basis from the lender and returned to the borrower.
- i. Any borrowing/lending and return of securities would not amount to purchase/disposal/transfer of the same for the purpose of compliance with the extant FDI/FII limits and the norms regarding acquisition of shares/disclosure requirements specified under the various Regulations of SEBI.
- j. Adequate systems shall be put in place by the stock exchanges/Depositories to distinguish the SLB transactions from the normal market transactions in the demat system.
- k. Als shall provide suitable arbitration mechanism for settling the disputes arising out of the SLB transactions executed on the platform provided by them.



- l. AIs shall disseminate in public domain, the details of SLB transactions executed on the platform provided by them and the outstanding positions on a weekly basis. The frequency of such disclosure may be reviewed from time to time with the approval of SEBI.
- m. The time for SLB session may be extended to the normal trade timings of 9:15 am to 3:30 pm.

#### **3.4.4 Compliance Officer**

Member-brokers are required to appoint a Compliance Officer as per Regulation 18A of the SEBI (Stock Brokers and Sub-brokers) Regulations, 1992. The concerned Compliance Officer shall be responsible for monitoring the compliance of the concerned member-broker in respect of the SEBI Act, 1992, Rules, Regulations, notifications, guidelines, instructions, etc. issued by SEBI / Central Government. Monitoring redressal of the grievances of the investors is also the responsibility of the Compliance Officer. Members are required to keep the Exchange informed of the appointment of compliance officer and also of the changes, if any and maintain an Exchange acknowledged copy for the same.

Compliance Officer shall immediately and independently report to SEBI any noncompliance observed by him.

#### **3.4.5 Prevention of Anti-Money Laundering Guidelines**

Prevention of Money Laundering Act, 2002 (PMLA) has been brought into force w.e.f. July 01, 2005. The Guidelines on Prevention of Money Laundering Standards, inter-alia require the members to:

- appoint Principle Officer & informed to FIU-India.
- have documented procedures to implement the Anti Money Laundering provisions as envisaged under Prevention of Money Laundering Act, 2002.
- ensure Customer Due Diligence.
- classify clients into high, medium & low risk categories as per the risk perceived.
- have system in place for generation of alerts for identifying suspicious transactions.
- monitor and report Suspicious Transactions (STRs) to FIU-India.
- impart training to staff & educate clients about objectives of PMLA.

The requirements of PMLA were re-enforced with the introduction of SEBI Master Circular on PMLA dated December 31, 2010. Appendix 11.

#### **3.4.6 Display of SEBI Registration Certificate and Notice Board**

Trading members should place a permanent notice board, as per the prescribed format, at all their offices including the offices of sub-brokers, or any other offices where the trading terminals are located which should prominently display the following information: -

- Name of the Trading Member
- Address & Tel. No. of the main office of the trading member (also Name & Tel. No of the contact person in the main office)
- SEBI Registration No. of the trading member

- Investor Service Tel. No.

Apart from the notice board, a list of general Do's and Don'ts, as per the prescribed format, to be observed by the investors while investing/trading in the stock markets should be prominently displayed.

Trading Members are also required to ensure that a copy of their SEBI Registration Certificate is prominently displayed in all their offices. Trading Members should also ensure that the SEBI Registration Certificate issued to the sub-broker is prominently displayed at all their sub-broker's offices.

### 3.4.7 INTERNAL AUDIT

SEBI Circular No. MIRSD / DPSIII / CIR26 / 08 dated August 22, 2008 brought in the requirement of Internal Audit for stock brokers/trading members/clearing members on half yearly basis. All the stock brokers/trading members/clearing members are required to carry out complete internal audit on a half yearly basis by Chartered Accountants, Company Secretaries or **Cost and Management Accountants who are in practice** and who do not have any conflict of interest. Members are required to submit the internal audit report and internal audit certificate along with management comments for negative observations, if any with to the Exchange within three months from the end of the relevant half yearly period.

The minimum sample size required to be verified for the internal audit is prescribed by the Exchanges and it needs to be adhered to and mentioned in the audit report. Whenever any negative observation is reported by the auditor, the management of the member is required to give their comments on the negative observation. The audit report is required to be submitted by the auditor to the member, who will place it before the board for its consideration and then shall forward it to the Exchanges. The half yearly period would be from April to September and from October to next March.

### 3.4.8 SYSTEM AUDIT

In order to ensure the reliability of the CTCL / IML / Internet Trading Systems used by the trading members, SEBI along with Exchanges has decided to make it obligatory on the part of the trading members to get their CTCL / IML / Internet Trading Systems audited by Certified Systems Auditor and submit a System Audit Report to the Exchanges.

Accordingly, the trading members who have availed of the CTCL / IML / Internet Trading Systems facility from the Exchanges are required to submit a Systems Audit Report electronically in the prescribed format every Financial Year within one month of completion of financial year.

The Trading Members are required to note the followings with regard to the Systems Audit:

1. The system audit should be carried out by CISA / ISA / CISSP Certified Systems Auditor and their name & registration number should be mentioned on the report submitted.
2. The System Audit would have to be carried out for all the branches where IML facility is provided and one consolidated report for all the branches should be submitted to the BSE in the electronic form only.

Along with system audit report, the trading members are also required to submit the SSL (Secured Socket Layer) Certificate or any other similar mechanism for BSE, which adequately protects the confidentiality of

trade data (BSE notice no. 20070517-26 dated May 17, 2007 & notice no. 20100625-29 dated June 25, 2010).

### **3.4.9 Algo Audit**

The Exchanges are directed by SEBI that all members having approved algorithmic trading facility are required to undertake Algorithmic System's audit every six months through Exchange empanelled system auditors & submit the report to the Exchange. The first such audit period for members ends on 31st March 2013 and members were required to submit the half yearly audit report by 30th April 2013. Subsequently this half yearly audit shall be following April to Sep and Oct to Mar period with reports to be submitted by 31st Oct and 30th April respectively.

The period of annual system audit for NNF facility shall henceforth be April to March, starting from April 2013 onwards instead of July to June. Members are advised to note that the system audit of the NNF facility must be carried out for the period July 2012 to March 2013 and the system audit report must be submitted by 30th April 2013.

The audit needs to be carried out by Exchange empanelled auditors.

### **3.4.10 Sub-brokers / Remisier / Authroised Persons**

#### **i. Sub-Broker**

"Sub-broker" means any person not being a member of a stock exchange who acts on behalf of a stock broker as an agent or otherwise for assisting the investors in buying, selling or dealing in securities through such stock broker. Sub-broker needs to register himself as sub-broker under the stock broker and has to obtain a certificate of registration from the SEBI in accordance with SEBI (Stock brokers and sub-brokers) Rules and Regulations, 1992. SEBI has directed that no broker shall deal with a person who is acting as sub-broker unless he is registered with SEBI, and it shall be the responsibility of the broker to ensure that his clients are not acting in the capacity of a sub-broker unless they are registered with SEBI as a sub-broker.

Broker of a stock exchange transacting, on behalf of the client, through broker of another stock exchange are to be treated as sub-broker. It is mandatory for such person to obtain a certificate of registration from SEBI to act as a sub-broker.

#### **Regulatory Directives**

Following are the regulatory directives applicable to a sub-broker:

- a. A sub-broker shall be affiliated only with one broker of an exchange.
- b. Director of a corporate broker shall not act as a sub broker of the same corporate broker.
- c. Sub-broker shall not be entitled to commence business unless he has been granted certificate of registration by the SEBI.
- d. A sub-broker shall enter into a tripartite agreement with his clients and with the main broker specifying the scope of rights and obligations of the broker, sub-broker and such client of the sub-broker.
- e. A sub-broker shall not issue confirmation memos but the broker shall issue contract note directly to the client introduced by his sub-broker.

- f. The delivery of securities and payment of funds relating to the transaction shall be made directly between the broker and the client and the same should not be routed through the sub-broker.

### **Audit Requirement**

As per the requirement of BSE, 20% of the sub-brokers should be inspected every year. In case of NSE, 10% of the active sub-brokers/branches should be inspected every year. For this purpose, an active sub-broker/branch means one whose turnover is above 1/10th of the turnover of the trading member during the previous financial year (*viz*, April to March).

#### **ii. Remisier**

A remisier is a person who is engaged by a broker primarily to solicit business in securities on a commission basis. Rule 216 to 235 of the Rules, Bye-laws and Regulations of the Bombay Stock Exchange Limited (BSE) provides for the appointment and regulation of remisiers. The concept of remisier is prevalent only in BSE. The remisier appointed by the broker is required to be registered with the exchange.

Remisier should not be an employee of any broker or any organisation other than the broker under whom he is registered. A remisier shall not be or act as a sub-broker anywhere so long as he is registered as a remisier. A remisier shall not act as a remisier for his personal business. Broker shall be responsible to ensure that remisiers do not return the brokerage, directly or indirectly, to the clients introduced by them or to any other person or agent.

#### **iii. Authorised Person**

Broker of NSE can appoint Authorised Person(s), in the Futures & Options (F&O) segment, who is an individual/ registered partnership firm/ body corporate / company as defined under the Companies Act.

Following are the regulatory directives applicable to an authorised person:

- (i) The authorised person may introduce clients to the broker for whom they may receive remuneration/commission/ compensation from the broker and not from the clients.
- (ii) The authorised person shall not be allowed to have any trading relationship with the clients. The clients introduced by the authorised person will have a direct relationship with the broker, i.e., the Member Client Agreement, Know Your Client Forms, Risk Disclosure Document, etc., shall be executed between the client and the broker.
- (iii) The authorised person shall not issue contract notes, confirmation memo and/or bills in their name, i.e., the broker shall issue the contract notes and/or bills directly to the clients of the authorised person.
- (iv) The clients introduced by the authorised person would be required to deliver securities and make payments directly to the broker. Similarly, the broker shall deliver securities and make payments directly to the clients.
- (v) The authorised person appointed by the broker is required to be registered with the NSE.

(vi) The authorised person of F&O segment should be registered as sub-broker in the Capital Market segment under the same broker. Approval for appointment of authorised person in the F&O segment is subject to his registration as a sub-broker by the SEBI in the Capital Market segment through the same broker.

### **3.1.1 Advertisements**

Stock brokers, while issuing advertisements in the media, have to comply with the guidelines for advertisement prescribed by the respective exchanges. The Code of Conduct has been specified in Schedule II of Regulation 7 and 15 of SEBI (Stock Brokers and Sub-brokers) Regulations, 1992. Further, every advertisement issued by BSE broker shall be in conformity with Regulation 17 and Bye-Law 358 of BSE Rules, Bye Laws and Regulations. Similarly, NSE has specified Code of Advertisement which is required to be followed by each member.

SEBI has advised the Stock Exchanges to ensure that their brokers/sub-brokers do not advertise their business, including in their internet sites, by subsidiaries, group companies etc., in prohibition of the Code of Conduct specified in the Schedule II of the SEBI (Stock Brokers and Sub-brokers) Regulations, 1992. The Code of Conduct in the Regulations requires a broker not to advertise his business publicly, unless permitted by the exchange, and not to resort to unfair means inducing clients from other brokers. Advertisement means and includes any document, pamphlets, circulars, brochures, notice or any research reports, material published, or designed for use in a newspaper, magazine or other periodical, radio, television, telephone or tape recording, video tape, display signs or bill boards, motion pictures, telephone directories (other than routine listings) or other public media, whether in print or audio visual form.

#### **Code of Advertisement**

Some of the salient points with respect to the Code of Advertisement issued by the NSE that are required to be complied by every NSE broker are given hereunder:

- a. The broker should designate and authorize a person to ensure the correctness of the information given in any advertisement.
- b. The broker issuing any such advertisement should inform the name of such authorised person to the Exchange.
- c. The advertisement should be related to the nature of services that the broker can offer. If the broker is engaged in any other business then any advertisement, if permissible for such business, should not indicate the name of the broker as a member of the exchange.
- d. The advertisement should be written in clear language and should not be such which may prejudice interest of the investors in general.
- e. The advertisement should not contain any confusing, misleading or offensive information.
- f. It should be free from inaccuracies.
- g. The advertisement should not contain a recommendation regarding purchase or sale of any particular share or security of any company. It should not make any promise including guaranteeing of any return to the investing public.

- h. The material should not contain anything which is otherwise prohibited.
- i. The advertisement shall contain :-
  - Name and/or his logo, code of NSE membership;
  - Registration Number allotted by the SEBI.
- j. The advertisement may be issued, individually or jointly, with other brokers provided that the broker shall not allow its name to be advertised or caused to be published in the advertisement of other brokers, unless such advertisement is issued by it.
- k. In the event of suspension of any broker by NSE, the broker so suspended shall not issue any advertisement, either singly or jointly, with any other broker during the period of suspension.
- l. In the event of any proceeding/action initiated against a broker by a regulatory body other than NSE, NSE reserves the right to direct the trading member to refrain from issuing any advertisement for such a period as it may deem fit.
- m. NSE reserves the right to call for the advertisement and/or such other information/explanation, as it may require, after the publication of the said advertisement. NSE shall have cease and desist powers in this behalf.
- n. The copy of such advertisement should be retained for a period of three years.
- o. A copy of the advertisement must be submitted to NSE within 7 days before its issue. If the advertisement is found to violate any provisions of the rules and bye-laws of the Exchange or rules framed by the SEBI on this behalf, the broker shall be subject to disciplinary proceedings by NSE.
- p. These norms will apply to any other investment/consultancy agencies associated with the broker concerned.
- q. The above norms shall also apply to an advertisement, T.V or Cable T.V. or any other such media of audio/visual nature.
- r. The broker should check with NSE in case of any doubt for advice prior to the issue of any such material or advertisement.
- s. The advertisement should not have any adverse reference regarding the reputation of any other broker and also of the exchange. While preparing any advertisement, a broker should keep in mind that any information if found to be incorrect, will affect not only the reputation of the particular broker but also the reputation of the brokers of the exchange, in general, and also on the exchange itself.
- t. In the event of any broker of the exchange having any grievance against any other broker, consequent upon the publication of an advertisement of the other broker, the exchange shall be informed of the same in writing, within a period of seven days from the date of such publication for necessary remedial measure from the exchange.

Regulation 17 of BSE specifies the guidelines for advertisement by brokers and some of the salient points with respect to the guidelines are given hereunder:

- a. The content of the advertisements, brochures, etc., should be related only to the nature of services that the broker can offer in respect of sales and purchase of shares and securities only. The advertisement should not contain recommendations regarding purchase or sale of any particular share or security of any company and/or any recommendation regarding any company.
- b. The advertisement can be published by a broker, individually or jointly, with other brokers so as to enable small brokers to pool their resources for publicity.
- c. The advertisement should mention the name/title as recorded for the membership of the exchange along with the code number allotted by the SEBI. It can also include the names of the sub-brokers affiliated with the broker. The broker should also designate, authorize and name the authorised person in the publication to ensure the correctness of the information given in the advertisement, and prior approval of the exchange should have been obtained in respect of such authorised person. The authorised person will be specifically responsible when two or more brokers jointly advertise for brokerage business.
- d. The broker should ensure that any information given in the advertisement must be correct and accurate. It should contain matters of objectivity and ascertainable facts which should be capable of substantiation.
- e. Advertisement should not have any adverse reference, direct or indirect, regarding the reputation of the other brokers of the exchange and also of the exchange itself.
- f. The advertisement should not contain anything which is otherwise prohibited for publication under the relevant Act, unwarranted, misleading information or make any promises.
- g. The advertisement should not include publicity for any party other than the broker himself, and it should not contain any reference to any person, firm or institution except as provided for in Point band c above.
- h. The broker should not allow his or his firm's name to be advertised by others or allow his or his firm's name to be published in the advertisement of others, except as provided for in Point (b) and (c) above.
- i. The broker should submit a copy of the advertisement to the exchange authorities as soon as it is published. The exchange authorities will have the cease and desist powers in this behalf.
- j. If a broker violates any of the above Regulations for the advertisement, he is liable to be penalized for the same by the exchange authorities and/or the SEBI.
- k. If the exchange authorities levy any penalty or take any disciplinary action against the broker, e.g. by way of suspension or declaring him as defaulter etc., then the concerned broker should not advertise during the period of suspension.

#### 4. Internal Audit Checklist

Particulars
<b>Client registration and documentation /Anti Money Laundering compliance</b>
Whether all relevant Client Registration Documents and supporting's as applicable are maintained?
Whether UCC is allotted to the client & the same is uploaded to the Exchange with PAN?
Whether any clause or document is not included in the account opening kit- <ul style="list-style-type: none"> <li>a. which dilutes responsibility of member or</li> <li>b. is in conflict with any of the clauses in mandatory documents, Rules, Bye-laws, Regulations, Notices, Guidelines &amp; Circulars issued by SEBI &amp; Exchanges or</li> <li>c. is not in the interest of the Investor</li> </ul>
Whether all the mandatory clauses as stipulated by SEBI/Exchanges have been included in Rights and Obligation document?
In case, if KYC is done by the member, in-person verification is done by Employee, Sub broker or Authorised person only?
In case in-person verification of non-resident clients not done, whether attestation of KYC documents done by Notary Public, Court, Magistrate, Judge, Local Banker, Indian Embassy/ Consulate General in the country where the client resides?
Whether date of verification, name, designation and signature of the official who has done in-person verification and the Rubber Stamp is incorporated in the client registration form?
Whether change in address, bank account or demat account is carried out on receipt of written request along with documentary proof from the respective client?
Whether client details including financial details are reviewed periodically and updated?
Whether trading code and the unique client code allotted to a client and the e-mail furnished by the client for the purpose of receiving ECN and other details, are communicated by the trading member through the client account opening form or otherwise in writing to the client?
Whether sufficient information is obtained in order to identify persons who beneficially own or control securities account?
Whether member have taken reasonable measures to verify the identity of such persons who beneficially own or control the securities as per SEBI Circular CIR/MIRSD/2/2013 dated January 24, 2013?
Whether members have reviewed their KYC and AML policies in line with SEBI Circular CIR/MIRSD/2/2013 dated January 24, 2013?
Whether the Member has process to verify the identity of the customer and/or the person on whose behalf a transaction is being conducted?



Particulars
Whether risk profiling of the clients has been done as per the written down policy of the trading member?
Whether Member has adopted enhanced due diligence process for High risk clients?
Whether continuous due diligence and scrutiny is being conducted for the clients?
Whether member is having clearly defined policy for acceptance of clients and whether it has been ensured that an account is not opened where the member is unable to apply appropriate client due diligence measures/KYC Policies?
Whether Member has identified clients of special category (CSC)?
Whether Member has identified client's identification procedures & programs at various stages?
Whether the Trading Member has prominently displayed in its account Opening kits , notice / display boards, advertisements, publications, portal /web site, if any, the following details- <ul style="list-style-type: none"> <li>i. name of the member as registered with SEBI,</li> <li>ii. its own logo, if any,</li> <li>iii. its registration number and</li> <li>iv. its complete address with telephone numbers?</li> </ul>
Whether Client has countersigned against stock exchange as well as market segment where he intends to trade?
Whether all the documents in both the mandatory & non-mandatory parts are printed in minimum font size of 11 and are legible for Investors to read?
Whether copies of duly completed account opening form ,Rights and obligations document, RDD, Policies and Procedures document, Guidance note detailing Do's and Don'ts for trading on Exchanges and any other document executed by the client, was delivered to the client free of charge and within 7 days of upload of UCC?
Whether trading member has taken documentary evidence in support of financial information provided by the client for equity derivatives segment?
Whether authorizations from the client sought in non-mandatory document is separate & do have specific consent of the client?
Whether trading members had displayed the set of standard documents on their own website for information
Whether trading member do have a specific policy regarding treatment of Inactive account and the same is displayed on the web-site (If any)

Particulars
Whether mandatory section of the account opening kit include only account opening form, Rights and Obligation document , RDD, Policies and Procedure, Guidance note dealing with Dos and Donts and tariff Sheet?
Whether trading member is adhering to all guidelines which are stipulated in policies and procedures?
Whether member has uploaded mobile numbers/Email address of each client who has opted for the service and adhered to the provisions of SEBI Circular (CIR/MIRSD/15/2011) dated August 2, 2011?
Whether member has complied with the requirement of uploading the KYC information with the SEBI registered KRAs for the clients registered on or after January 1, 2012 within the prescribed time limit as per SEBI circular MIRSD/Cir-26/2011 dated December 23, 2011 and complied with the provisions of the Circular?
Whether members are complying with the uploading of the existing clients KYC details in the KRA system as per the schedule provided by SEBI in its circular no. MIRSD/ Cir-5 /2012 dated April 13, 2012?
<b>Order management and risk management systems</b>
Whether checks are in place to ensure that no unauthorized orders are executed from any of the terminals?
Whether control reports like orders executed away from market price, client-wise / scrip-wise / terminal-wise volumes / exposures are generated to monitor any manipulation or unwarranted activity?
In case of dormant accounts, if the account is reactivated then are there any checks in place to ensure that account is operated by the relevant client only?
Whether initial and other margins are collected from respective clients in the prescribed form of funds, fixed deposit receipts, bank guarantees and approved/liquid securities with appropriate haircut?
Whether the member has a proper system for reporting the correct client margin collection to Clearing House / Clearing Corporation, in Derivatives segment?
Verify whether the margin reported by the member to the Exchange in Derivate segment is actually collected and available in the books of accounts of the member. In case of any irregularity observed, mention the instances wherein false reporting of margin collected from clients/trading members was observed.
Whether Risk Management System (RMS) includes policy on margin collection from clients/trading member and the RMS is well documented?
Whether proper systems are in place to ensure timely collection for pay-in from the respective client as per settlement schedule?
Whether proper monitoring mechanism is in place to review long outstanding debit balances in clients' account and recovery of the same? Give age wise analysis of debts outstanding for more than 30 days and the recovery pattern for the same

Particulars
Whether member has reported details of client funding, if any, to the exchange within prescribed time limit?
What are the sources of funds in case client funding is observed?
Whether the trading member has not undertaken or was not party to or has not facilitated any fund based activity through financier?
Whether all institutional trades are routed through custodians by following Straight Through Processing (STP)?
In case Institutional trades have not been routed through custodian, what are the reasons for the same? Whether any specific pattern is observed for the same?
Whether member has obtained prior approval from the exchange before providing terminal to the clients under DMA facility?
Whether member has complied with regulatory requirements related to DMA?
Whether the trading member has implemented proper internal code of conduct and adequate internal controls to ensure that proper checks and balances are in place with respect to SEBI Circular Cir/ISD/1/2011, dated March 23, 2011 and Cir/ISD/2/2011 dated March 24, 2011 on the subject 'Unauthenticated news circulated by SEBI registered market intermediaries through various modes of communication'?
Confirm whether trading member has not outsourced their core business activities and compliance functions.
In case the trading member has outsourced any activities, it has adhered to the provisions of SEBI circular CIR/MIRSD/24/2011?
In case the member has passed on the penalty to the clients on account of failure on part of client to pay the required margins in equity derivatives segment, whether the member has provided the relevant supporting documents to the clients?
Whether the trading member has adequate systems to capture IP details of trades done using the IBT/wireless technology platform?
Whether Stock broker indemnity policy with standard cover/clauses has been taken?
<b>Contract notes, Client margin details and Statement of accounts</b>
Whether contract notes are sent within prescribed time limit?
Whether the trading member did not issue contract notes for fictitious transactions?
Whether all prescribed details including name and signature of authorized signatory, dealing office details and brokerage are contained in contract note?

Particulars
Whether Daily Margin statement is issued to the respective clients with the details as specified?
Whether Proof of delivery / dispatch is maintained?
Whether contract notes bear running serial number?
In case contract notes and margin details are sent in electronic form, whether sent log is maintained?
Whether trail of bounced mails is maintained and physical delivery is ensured in case of bounce mails?
Whether member has complied with regulatory requirements related to Electronic contract notes (ECN)?
Whether complete statement of accounts for funds and securities are issued on a quarterly basis to clients (wherever applicable), with error reporting clause?
Whether proof of sending the same is maintained?
Whether the details regarding appointment of Compliance Officer and changes there in, if any, has been informed to the Exchange?
Whether Trading Member has prominently displayed on contract notes, statement of funds and securities, and correspondences with the clients the following details- <ul style="list-style-type: none"> <li>i) name of the member as registered with SEBI,</li> <li>ii) its own logo, if any,</li> <li>iii) its registration number,</li> <li>iv) its complete address with telephone numbers,</li> <li>v) the name of the compliance officer, his telephone number and e-mail address?</li> </ul>
Whether trading member has not created/provided e-mail ids for clients?
Whether the authorization for receiving electronic contract note is in writing and is signed by client only, not by power of attorney holder?
Whether member has collected physical letters from the clients who have opted for change in e-mail id?
<b>Dealing with clients' funds and securities</b>
Whether no cash dealings with clients are done in violation of the prescribed norms?
Whether in case where aggregate value of banker's cheque / demand draft/ pay order is of Rs 50,000 or more per client per day, then the same are accompanied with name of bank account holder and number of bank account debited , duly certified by issuing bank as per the provisions of SEBI Circular CIR/MIRSD/03/2011, dated June 9, 2011?
Whether member maintains audit trail of the funds received through electronic fund transfers to ensure that the funds are received from their respective clients only?

Particulars
Whether pay-in / pay out was received from / made to account from the respective client account and systems are in place to ensure compliance in this regard by the member?
Whether client's funds / securities are transferred to respective clients within one working day of payout from Exchange?
Whether Payments to clients is not made from own bank account?
Whether Constituent securities received as margin is not deposited in own beneficiary account?
Whether the Delivery of securities to constituent is not made from own beneficiary account?
Whether Excess Brokerage was not charged on trades executed on the Exchange?
Whether client's funds and securities are not misutilised? If misutilised, instances to be provided
Whether collaterals of clients were not pledged with banks / other entities for raising funds? Instances to be given in case collaterals are pledged with banks / other entities?
Whether funds raised by pledging client securities were utilised for respective client only? List of instances to be provided in case of non-utilisation of proceeds for respective client?
Whether Bank books and bank statements for each bank account are reconciled and reconciliation statement for the same is prepared periodically?
Whether Register of Securities and Holding statement from depositories for each DP account are reconciled and reconciliation statement for the same is prepared periodically?
Whether bank book and register of securities are in alignment with bank statements and transaction statements provided by banks and depositories respectively?
Whether dividend and other corporate benefits received on behalf of clients is paid/credited/passed on to the respective clients account without any delay?
Whether Trading member has taken consent from the client regarding monthly/quarterly settlement?
Whether Trading member has done actual settlement of funds & securities as consented by the client (monthly/quarterly)?
Whether trading member has sent statement of accounts for funds containing an extract from the client ledger for funds displaying all receipts/deliveries of funds while settling the account explaining retention of funds?
Whether trading member has sent statement of accounts for securities containing an extract from the register of securities displaying all receipts/deliveries of securities while settling the account explaining retention of securities & pledge (if any)?
Whether trading member has not done any inter-client adjustment for the purpose of settlement?

Particulars
<p><b>NSE</b></p> <p>Whether any of the following statutory levies/ fee/ charges are not collected from clients in excess of actual? Such as-</p> <ul style="list-style-type: none"> <li>i) Securities Transaction Tax,</li> <li>ii) Service Tax,</li> <li>iii) SEBI turnover fees,</li> <li>iv) Exchange Transaction Charges</li> </ul> <p>If Excess is collected, please give complete details.</p>
Whether the running account authorization taken by trading member from client(s) is dated and contains a clause which explicitly allows a client to revoke the said running account authorization at any time?
Whether running account authorization taken by trading member from client is signed by client only and not by PoA holder?
Whether the trading member has mentioned the clause in the periodical statement of accounts sent to the clients that, the running account authorization would continue until it is revoked by clients?
In cases where member is acting as investment advisers, whether member has complied with INVESTMENT ADVISERS REGULATIONS, 2013 (SEBI Notification No. LAD-NRO/GN/2012-13/31/1778 on 21 <sup>st</sup> January 2013)?
Whether separate code for buy and sell for NRI clients is used?
Whether one client code for order entry for each client is maintained?
<p><b>Banking and Demat account operations</b></p> <p>Whether member maintains separate bank account for client funds and own funds.</p> <p>Also whether member maintains separate beneficiary account for clients securities and own securities?</p> <p>Whether clients funds and securities are segregated from own funds and securities?</p> <p>Whether constituent beneficiary account or client bank account are used for authorized purposes only?</p> <p>In case of any irregularity observed, mention the instances in detail.</p>
<p><b>Terminal operations and systems</b></p> <p>Whether terminals are provided by the member in its head office, branch office or the office of sub broker only?</p> <p>Whether no terminal is allotted for unauthorized purposes?</p> <p>Whether periodic audit of systems and software including internet trading is conducted by certified system auditor (wherever applicable) and submitted the system audit report to the Exchange within prescribed time limit?</p>

Particulars
Whether terminals are operated by approved persons/approved users with valid NCFM/BCSM/NISM certification?
Whether correct User name, terminal location are reported to the Exchange?
Whether member have ensured that all associated person as defined in SEBI Notification LAD-NRO/GN/2010-11/21/29390 dated December 10, 2010 have valid NISM series VII certification – (Securities Operations and Risk Management Certification Examination)?
Whether internal controls are in place to ensure that the certification of approved users has not expired?
Whether prior permission is obtained by member for providing CTCL/ <b>Algorithmic trading</b> ? Whether member has complied with applicable provision of CTCL?
Whether back up facilities are in place and followed?
Whether sufficient system for data security is in place?
In case where members who have opened terminals abroad, whether member has complied with the provisions pertaining to 'Terminals Abroad' as given under Exchange Circular no. NSE/MA/22732 dated February 13, 2013
Whether members have implemented appropriate checks for value and / or quantity based on the respective risk profile of their clients as per the provisions of SEBI Circular CIR/MRD/DP/34/2012 dated December 13, 2012?
Whether members have put-in place a mechanism to limit the cumulative value of all unexecuted orders placed from their terminals to below a threshold limit set by them as per the provisions of SEBI Circular CIR/MRD/DP/34/2012 dated December 13, 2012?
Whether member have ensured that all approved users and sales personnel have valid NISM Series - IV certification (as applicable for Currency Derivatives and IRF Segment vide SEBI notification LAD-NRO/GN/2010-11/12/10230 dated June 29, 2010)?
<b>Management of branches / sub brokers and internal control</b>
Whether survey is conducted by the member for opening / closing of branches?
In case of closure of branch, whether advance notice of the same is sent to clients?
Whether there is monitoring mechanism to identify sudden increase / decrease in client level turnover from any specific branch?
Whether periodic inspection of branch / sub broker is conducted and reports are maintained? What is the follow-up mechanism?
Whether trading member has not dealt with unregistered intermediaries for transactions on the Exchange?

Particulars
Whether the member has not shared commission/brokerage with entities with whom trading members are forbidden to do business / another trading member / employee in the employment of another trading member?
<b>Investor grievance handling</b>
Number and value of investor complaints pending at the beginning of half year
Number and value of investor complaints received during half year
Number and value of investor complaints resolved during half year
Number & value of investor complaints pending as on the last day of half year
Give breakup of the pending investor complaints from branch/Head office/sub broker
Comment on investor grievance handling mechanism of the member.
Summary on nature of complaints received and action taken by the member.
What is the duration of the longest pending investor complaint?
Whether specific action plan is framed by the member in respect of long pending complaints?
Whether designated email id for investor grievance is created and informed to the investors?
Whether complaints received on the designated email ID are being looked into to address the same?
Whether the stock broker and sub broker has taken adequate steps for redressal of grievances within one month from the date of receipt of complaint?
Whether the member has informed the Stock Exchange/Investor about the action taken thereon for the grievances?
<b>Maintenance of Books of Accounts</b>
Whether prescribed books of accounts, registers and records are maintained with the required details and for the stipulated period as per regulatory requirement?
Whether register of securities is maintained client wise-scrip wise?
Whether exchange wise separate books of accounts are maintained?
Whether trading member has not dealt with suspended/ defaulter/expelled members and entities prohibited from accessing market?
Confirm that Trading member has adequate systems and checks in place to ensure that SEBI debarred entities are unable to trade?
Whether prior approval has been obtained by member for change in shareholding/directors/constitution?
Whether prior approval has been obtained in case the member has dealt with another member of the Exchange?



Particulars
Whether member has intimated the Exchange in case of they have dealt with member of another stock exchange?
Whether advertisements are issued after prior permission of the Exchange?
Whether member maintains and update client master in its back office?
Whether Notice board of the Trading Member was displayed at the location of audit?
Whether SEBI registration certificate of the Trading Member was displayed at location of audit?
Whether Trading Member maintains all records which relate to the terms and conditions with respect to the opening and maintenance of such account after the closing of any constituents account?
Whether Member has made arrangements for an internal review, at least annually, of the business designed to detect and prevent violations of and to achieve compliance of, the Byelaws, Rules and Regulations of the Exchange?
Comments of the auditor on the analysis of financial reports of the member.
<b>Systems &amp; Procedures pertaining to Prevention of Money Laundering Act, PMLA, 2002</b>
Whether details of appointment of Principal Officer and change in Principal Officer, if any, is intimated to FIU-India?
Whether member has adopted and implemented written guidelines prescribed under PMLA, 2002?
Whether Member has adequate system in place that allows continuous monitoring of transactions and generate alerts based on set parameters for suspicious transactions?
Whether Member has adequate systems & procedures in place to ensure screening of employees while hiring?
Whether member has adequate systems in place to scrutinize the alerts and arrive at suspicious transactions?
Whether member has appropriate procedures for reporting of suspicious transactions to FIU
Total no. of alerts generated during the half year
No. of STRs filed by the member during half year.
As per provisions of Prevention of Money Laundering Act, 2002 whether record of transactions, it's nature and it's value are maintained and preserved as prescribed under Rule 3 of PMLA?
Whether Member has ongoing training program for employees so that members of the staff are adequately trained in AML and CFT (Combating Financing of Terrorism) procedure?
<b>Transfer of trades</b>
Whether trades were executed in respective clients account and are not transferred from one client code

Particulars
to another client code or from client code to pro or vice-versa in the back office of the member. In case of such transfers, if any specific pattern is observed instances to be provided
Whether Modifications of Client codes of Non- Institutional trades on the Exchange platform, if any, are done only to rectify a genuine error in entry of client code at the time of placing/ modifying the related order as per the provisions of Circular Ref. No.: NSE/INVG/2011/670, dated August 26, 2011
Whether any pattern is not observed on analysis of client code modification carried out on the exchange platform? If any pattern is observed, please give details.
Whether system is put in place to monitor/ prevent the use of client code modification facility for purposes other than correcting mistakes arising out of client code order entry? Please give details of such preventive system.
Whether the trades modified by the member to the "ERROR" code has been settled in ERROR account? If no, please provide the details.
Whether Trading Member has a well-documented error policy to handle client code modifications, approved by their board/ management?
<b>Margin Trading</b>
Whether member has obtained specific approval from the exchange, in case he is providing margin trading facility to his clients?
Whether member has complied with regulatory requirements related to margin trading?
<b>Proprietary Trading</b>
If member is doing pro trading, whether member has disclosed this information to his clients?
If member is doing pro trading from multiple locations, whether member has obtained prior approval from the Exchange in this regard?
<b>Internet Trading</b>
Whether member has obtained specific approval from the exchange, in case he is providing internet trading facility to his clients?
Whether member has complied with regulatory requirements related to internet trading?
<b>Execution of Power of Attorney (POA)</b>
If trading member obtains POA from any of their clients, mention no. of clients from whom the member has obtained POA
Whether the POA is in the name of the member and it is not in the name of any of its employees or representatives or sub-brokers?

Particulars
Whether Power of Attorney executed in favour of trading member is only limited to the purposes as allowed and adheres to the Provisions of SEBI Circular CIR/MRD/DMS/13/2010 and CIR/MRD/DMS/28/2010?
Whether PoA executed consists of details of beneficial owner account(s) and bank account (s) of the client that trading member is entitled to operate?
Whether POA executed comprises of list of clients & trading members demat account/bank account where securities and funds can be moved?
Whether POA is adequately stamped as per law prevailing in the place where the POA is executed?
Whether POA executed is revocable any time without notice?
Whether POA executed does not allow off market transactions, transfer of funds from the bank account(s) of the clients for trades executed by clients through another stock broker, opening of trading account, execution of trades without client's consent, merging of dues under various accounts, opening of e-mail account on behalf of client(s) and renouncing of liability for any losses arising due to blocking of funds on account of erroneous instruction of trading member to the designated bank?
Whether PoA executed does not prohibit operation of trading account by client(s)?
Whether Duplicate copy of PoA is provided to client(s) after execution?
What are the internal controls adopted by the member to ensure that POA is not misutilised?
<b>Operations of Professional Clearing member/ Members clearing trades of other trading members</b>
Whether all the mandatory clauses have been included in CM - TM agreement (wherever applicable)?
Whether Clearing member custodial participant agreements are executed in prescribed formats (wherever applicable)?
Whether statement of accounts has been sent to trading member/custodial participants/?
Whether clearing members had collected appropriate and adequate margins in prescribed forms from respective trading members?
Whether Margin collection reported to Exchange is in accordance with margins actually collected from trading member?
Whether exposure allowed to trading members were based on requisite margins available with the clearing member?
If interest is charged to the trading member, what is the basis of interest with complete details like percentage of interest, periodicity of interest charged
<b>Securities Lending &amp; Borrowing Scheme</b>
Whether member has obtained specific approval from the exchange for offering SLBS?
Whether member has complied with regulatory requirements related to SLBS ?

Particulars
<b>Compliance status of last inspection carried out by SEBI/Exchanges/Internal Auditor</b>
Whether member has complied with the qualifications/violations made in last SEBI inspection report?
Whether member has complied with the qualifications/violations made in last Exchange inspection report?
Whether member has complied with the qualifications/violations made in latest half yearly Internal Audit report?



## 5. Data Requirement and checkpoints

Sr. No.		Data Requirement	Approach for IA Team
<b>I</b>		<b>Client Registration and Documentation</b>	
	1	List of <b>new clients</b> registered for <b>all Exchanges &amp; Segments</b> during the audit period along with: -UCC and back office code; -Date of creation of Unique Code Creation(UCC) -Constitution (Individual, Ltd. Co., Partnership, Proprietorship, Trust, NRI) -Segment -Exchange	(a) Identification of samples for KYC / KRA
	2	List of all Qualified Foreign Investors (QFI) clients during audit period	QFI is a new category of investors added. The same was brought into effect by SEBI vide its Circular dated Jan 13, 2012 on Investment by Qualified Foreign Investors (QFI) in Indian equity shares.  Check the adequacy of documents from KYC point of view Reference: SEBI Circular on Sub Investment by Qualified Foreign Investors (QFI) in Indian equity shares dated 13-Jan-12



3	<p>Client master dump (from back-office application) of <u>all clients</u> containing <u>minimum</u> following details:</p> <ul style="list-style-type: none"><li>- UCC</li><li>- Account type (individual, company, FII, institution, trust, etc.)</li><li>- Client Name</li><li>- Client Address</li><li>- Mobile No.</li><li>- PAN No.</li><li>- Email id</li><li>- Date of activation</li><li>- Date of closure</li><li>- Risk categorisation (High, Medium, Low, CSC)</li><li>- Exchange</li><li>- Status of activation for Cash, F&amp;O, Currency</li></ul>	<p>(a) Check if client opted for ECN, email id is mapped to all the clients</p> <p>(b) Check if same email id is mapped to multiple clients</p> <p>(c ) Check if email id is created by the broker and mapped to clients for sending ECN</p> <p>(d) PAN is valid 10 digit</p> <p>(e) Risk categorization is done for all the clients as per PMLA policy of the member</p> <p>(f) Co-relate closed account dump / close account requests with client master to verify whether account is deactivated in back-office on receipt of request from client.</p> <p>(g) Do a V-lookup on client master dump of SEBI Debarred entity list. In case any debarred entity found (based on PAN, name, etc.) then check if any trades executed in that account post date of SEBI order. Also, get the date of deactivation from process owner to ensure that process is in place. How is file updated. Logs maintained of file. Audit Trail.</p> <p>(h) Multiple Clients accounts having same PAN No.</p> <p>(i) Whether internal debarred list maintained.</p> <p>(j) Whether UN list FATF list verified with existing client database</p> <p>The SEBI debarred entity list as on April 5, 2013 is attached herewith.</p>
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4	UCC upload return file from Exchange for all Exchanges (as on date)	1. Compare client master dump with UCC file to check whether all accounts created in back-office are uploaded to Exchange. In case of exceptions analyse the reasons for accounts which are not reported to Exchange.
5	UCC file uploaded to Exchanges at time of account creation UCC success files received from Exchange (day-wise)	1. To verify whether UCC uploaded on date of activation 2. to check whether trades executed before uploading UCC
6	Blank KYC form (KRA and KYC) - in case any change in KYC format from last audit	(a) check format if same is as per KYC guidelines (b) Adherence of revised format as well as regulatory changes. (c ) Check whether any contravening clauses included in tariff sheet / voluntary agreement - terms and conditions. Attached are standard / sample account opening forms.
7	Sample KYC forms - Individual - Non individual - Institutional	(a) Verify forms and update in KYC checklist for various categories. (For Institutional Clients - Refer SEBI Circular No. Know Your Client Requirements dated 5_Sep-12.) (b) Whether client not opted for F&O in KYC and activated in F&O as per UCC file and front-end application file KYC Checklist (c ) Check process for identifying beneficial owner in line with SEBI guidance on same



	8	Communication by Account Opening team to Front-office / RMS / User Maintenance Team for creating new client accounts in front-office	<p>1. To check whether account creation in front-end happens not earlier than back-office creation and UCC upload.</p> <p>2.To check whether in front end correct Exchanges and segments are uploaded</p>
	9	POD's for dispatch of KYC and other forms	<p>Copy of Executed KYC and agreements need to be communicated to client within 7 working days of client activation.</p> <p>- Compare Date of activation and dispatch date from POD to check whether same is dispatched <b><u>within 7 working</u></b> days of activation</p>
	10	<p>Details of dispatch / PODs of of KYC and supporting details submitted to KRA agency</p> <ul style="list-style-type: none"> <li>- Client Name</li> <li>- Client Code</li> <li>- Date of disptach</li> </ul>	<p>Ensure that KYC application form and supporting documents of the clients to the KRA within 10 working days from the date of execution of documents (UCC upload) by the client and proof of dispatch for same is available.</p> <p>Note: the requirement for sending original forms to KRA has been done away w.e.f 22-Mar-13</p>





1.2	11	<p>List of all modification requests</p> <ul style="list-style-type: none"> <li>- Address</li> <li>- Bank details</li> <li>- Demat details</li> <li>- Email address</li> </ul> <p>received during audit period along with proof of updations made in system</p>	<p>(a) Check necessary supporting are provided and changes are done only on written request from client.</p> <p>(b) Check date of request, date of change made in system</p> <p>(c ) <b><u>How is modification handled with respect to KRA.</u></b></p> <p><b><u>How is intimation done</u></b></p> <p><b><u>(d)Whether member has collected physical letters from the clients who have opted for change in e-mail id</u></b></p>
	12	<p>List of all account closure requests received during audit period. Provide:</p> <ul style="list-style-type: none"> <li>- Closure request</li> <li>- Snapshot of deactivation in back-office and application</li> <li>- Confirmation letter sent to client for closure</li> </ul>	<p>(a) Check closure request dump with front-end application file to check whether client is Active or Suspended for trading. If client is still active then its an Exception and needs to be reported.</p> <p>(b) Similarly check if closure request dump with back-office application file to check whether client account is Active or Closed. if it is still active then its an observation.</p> <p>(c) Check necessary supporting are provided and changes are done only on written request from client.</p> <p>(d) Check date of request, date of deactivation made in system.</p> <p>(e ) Whether communication made to client after account deactivated</p>
	13	<p>Logic of generating client codes viz.</p> <ul style="list-style-type: none"> <li>a) Generated serial no. wise</li> <li>b) Branch prefix and serial no. etc.</li> </ul>	<p>To understand no. of clients registered branch-wise</p>
	14	<p>List of existing clients (registered prior to 1-Jan-12) and have traded / invested during the period 1-Apr-2012 to 28-Feb-2013</p>	



	15	Status of: (a) data upload to KRA for clients mentioned in point above (I-14) as on 31-Mar-13 (b) Physical document sent to KRA for above mentioned clients as on 31-Mar-13	To check status of data upload and dispatch to KRA for existing clients
	16	Proof of updation of Financial details & Shareholding pattern for existing corporate clients as part of updation of details	Take clients registered prior to audit period and check the process for financial updation for them
1.2	17	Measures taken to verify the identity of such persons who beneficially own or control the securities as per SEBI Circular CIR/MIRSD/2/2013 dated January 24, 2013	Verify whether beneficial ownership is identified in line with SEBI Circular_ Guidelines on Identification of Beneficial Ownership _ 24-Jan-13 (copy enclosed)
<b>II</b>		<b>Policies and Procedures</b> <i>(to be provide only in case it was not shared last time or there is any updation)</i>	
	1	<b>Copy of Policies and Procedures detailing the following:</b>	Mandatory policy which needs to be framed by the member and check whether all the points mentioned here are covered in the policy.  Ideally these policies are covered in KYC and communicated to the client. Ensure the same is communicated to client.
		a. refusal of orders for penny stocks,	
		b. setting up client's exposure limits,	
		c. applicable brokerage rate,	
		d. imposition of penalty/delayed payment charges by either party, specifying the rate and the period	
		e. the right to sell clients' securities or close clients' positions, without giving notice to the client, on account of non-payment of client's dues	
		f. shortages in obligations arising out of internal netting of trades,	
		g. conditions under which a client may not be allowed to take further position or the broker may close the existing position of a client,	
		h. temporarily suspending or closing a client's account at the client's request, and	



		i. deregistering a client.	
	2	Risk Management Policy	<p>(a) Mandatory policy.</p> <p>(b) Ensure that policy has version no. and date of approval.</p> <p>(c) Needs to detail the following:</p> <ul style="list-style-type: none"> <li>- Cash market margins</li> <li>- Futures &amp; Options margin</li> <li>- Adhoc margins</li> <li>- Margin collection from client</li> <li>- Valuation of collaterals</li> <li>- Criteria of selection and Securities eligible for Trading, etc.</li> </ul>
1.2	3	PMLA Policy	<p>Mandatory policy.</p> <p>Ensure that policy has version no. and date of approval.</p> <p>Needs to cover details as per SEBI Master Circular on AML dated Dec 31, 2010.</p> <p><b>Ensure that provisions of SEBI Circular_ Guidelines on Identification of Beneficial Ownership _ 24-Jan-13 are updated in the policy</b></p>
	4	Insider Trading Policy / Employee Trading policy	Mandatory policy which needs to be framed by the member
	5	Error Trade Policy (approved by Board / Management)	<p>(a) Mandatory policy.</p> <p>(b) Requirement as per Client Code Modification Circular of SEBI &amp; Exchanges</p>
	6	Investor Grievance Policy	Mandatory policy.



	7	Outsourcing (if applicable) : - Policy document - Risk Assessment of existing vendors	In case member has outsourced any activity, the member needs to have: - a Policy document on Outsourcing. - Risk Assessment of existing vendors. The same is as per SEBI Circular on Guidelines on Outsourcing of Activities by Intermediaries dated Dec 15, 2011.
	8	Surveillance Policy	<b>New Requirement</b>
<b>III</b>		<b>Power of Attorney:</b>	
	1	List of all clients whose POA is taken by member	
	2	# Total no. of clients registered till Mar 31, 2013 (since commencement of business - with & without POA) # Total no. of clients registered till Mar 31, 2013 (since commencement of business) from whom POA is taken # Total no. of clients who have opted for POA during audit period i.e. Oct 2012 to Mar 2013	



	3	Sample POA's of clients	<p>(a) Whether POA is as per format of BSE / NSE</p> <ul style="list-style-type: none"> <li>- POA is in the name of the member and it is not in the name of any of its employees or representatives or sub-brokers</li> <li>- PoA executed consists of details of beneficial owner account(s) and bank account (s) of the client that trading member is entitled to operate</li> <li>- POA executed comprises of list of clients &amp; trading members demat account/bank account where securities and funds can be moved</li> <li>- POA is adequately stamped as per law prevailing in the place where the POA is executed</li> <li>- POA executed is revocable any time without notice</li> <li>- POA executed does not allow off market transactions, transfer of funds from the bank account(s) of the clients for trades executed by clients through another stock broker, opening of trading account, execution of trades without client's consent, merging of dues under various accounts, opening of e-mail account on behalf of client(s) and renouncing of liability for any losses arising due to blocking of funds on account of erroneous instruction of trading member to the designated bank</li> <li>- PoA executed does not prohibit operation of trading account by client(s)</li> </ul>
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	4	Copy of POA's given to client (Copy of covering letter enclosing POA may be shown as a proof for same)	(a) Ask whether copy of POA is given to the client and proof of the same is maintained if any. (b) Mode through which the copy of POA is given to the client
<b>IV</b>		<b>Order management and risk management systems</b>	
	1	Broker trade files for sample period (BSE, NSE, NSE FO, NSE CURR, MCX-Sx) - (in excel format) Trade Register containing: - Brokerage - Contract note No. - STT - Stamp Duty - Service Tax	(a) Check brokerage rate does not exceed 2.5% (b) Check structure of brokerage charged whether inclusive / exclusive of ST and other charges (b) Check whether Service Tax, Stamp duty, STT, SEBI Turnover fees, Exchange transaction charges are levied appropriately (c) Contract notes are in serial no. In case they are not, do a root-cause analysis for same
	2	Exchange trade files for sample period (BSE, NSE, NSE FO, NSE CURR, MCX-Sx)	Objective: To ensure that no fraud sauda is generated in back-office  (a) Compare Exchange trade file with Trade / Sauda Register (b) Whether any trade not found in exchange file but found in Trade register
	3	Brokerage slabs configured in back-office	Brokerage slabs are configured in back-office application. We can analyse the dump or take screenshot of configuration and check sample KYC as to what is the brokerage agreed upon and what brokerage is configured in the system.



4	PS03, PS04, TR01 & TR02 files for sample period (F&O segment)	<p>(a) Refer Excel file detailing NSE type of reports (b) Position file to be mapped with daily client margin summary (at client level)</p> <p>PS03: Detailed position file for Trading member PS04: Detailed position file for Clearing member TR01: Detailed trades report for trading member TR02: Detailed trades report for clearing member</p>
5	MG 13 / MG 12 return files to the Exchange for audit period	<p>MG13: Client Level Margin File of Trading member MG12: Detail Margin file of Clearing member</p> <p>(a) Check short / non-collection of margin (b) check with daily client margin report, client ledger</p>
6	Client collaterals summary for sample period (CLO1 file from NSE)	Ask for the CLO1 file which will provide details of collaterals submitted by clearing member
7	List of all Bank accounts with segregation of Client and OWN Accounts	Check whether segregation done for OWN and Client accounts



8	All Client Bank Account Statements for sample period (kindly provide statements for accounts wherein no transactions have taken place also)	(a) Check whether no Overdraft facility is taken in Client Bank account (b) Check payment and receipt done in the client bank account is done for the client only (c ) No payments towards expenses / levies is made from client bank account. (d) Receipts from / transfer to third parties, of funds and securities should not be effected in client bank account (e) Funds are received from / paid to clients by way of crossed cheques / demand drafts or by way of direct credit into the bank account through EFT or any other modes allowed by RBI only. (f) No cash dealings is done with the client
9	All OWN Bank Account Statements for sample period (kindly provide statements for accounts wherein no transactions have taken place also)	(a) No payment is done to the client through OWN account (b) Check whether any payment / receipt is done from third party if any ask reason for the same
10	List of all Exceptional reports (control reports like orders executed away from market price, client-wise / scrip-wise / terminal-wise volumes / exposures to monitor any manipulation or unwarranted activity) generated with a brief write-up on same All above mentioned exceptional reports for trade dates 1) Oct 2012 to Mar 2013	Ask for the surveillance report generated by the member for the audit period and analyse all alerts generated.  Further the necessary actions taken in order to address the alerts.





11	Monthly ageing report of client receivables as on 31-Oct-12 30-Nov-12 31-Dec-12 31-Jan-13 28-Feb-13 31-Mar-13	Analyse receivables outstanding. In case of long outstanding check whether any securities taken as collateral.  What is the action taken in order to receive the same
12	Client funding reports uploaded to BSE & NSE for Oct 2012 to March 2013	Whether client funding is done within: - 7 days of the subsequent month for NSE - 8 days of the subsequent month for BSE
13	Proof of uploading of Client Funding reports to BSE & NSE for Oct 2012 to March 2013	Whether client funding is done within: - 7 days of the subsequent month for NSE - 8 days of the subsequent month for BSE
14	Sources of funds in case client funding activity is done. Please provide write-up on same.	Ask for the write up for sources of fund in case of client funding
15	Details of all DVPs occurred during the audit period	Ask for the DVP trades for the audit period. DVP is Delivery versus Payment transactions. All Institutional transactions which custodians do not confirm result in DVP i.e. obligation for settlement of these transactions rests with member.
16	Details of all pledge / re-pledged securities and utilisation of same	(a) Take details of pledge and re-pledged details and report same



17	Details of all client code modification during audit period: BSE : Screenshot from BFSS showing details of all client code modification for period NSE : MOD_DDMMYYYY_TMCode.txt	(a) Whether reported to Exchange (b) Understand pattern of client code modification (c ) Check approvals for client code modifications whether same are as per Client Code Modification policy
18	List of all error trades	Check approvals for error trades
19	Details and supportings of penalty on account of client code modification	(a) Whether reported to Exchange (b) Understand pattern of client code modification (c ) Check approvals for client code modifications whether same are as per Client Code Modification policy
20	Ledger extract of - STT (BSE, NSE & NSEF) - SEBI Turnover Fees (BSE & NSE) - Exchange transaction charges (BSE & NSE) - Service Tax	Compare with Trade register and ledgers. Whether same are as per regulatory requirements
21	STT, Service tax, Transaction charges slab configured in back-office application	Check the details in the back office software
22	Ledger extract of Dividend	Ask for the dividend ledger for the audit period and check where the credit has been given to the client as and when the same is received from Company.
23	Ledger extract of Delayed Payment Charges (if any) levied to client	Check whether any extra exposure is provided to clients after levying DPC
24	Trade details of transactions executed in BSE F&O segment (if applicable)	For updation of relevant points for F&O in BSE Report



	25	Trial Balance from Back-office application (viz. LD, TCS, Class, Soham - whichever applicable)	Trail balance from back-office will give details about all clients having an Opening balance and Closing balance during audit period. It will also give details of all other accounts which are used to debit, credit client ledgers viz. Delayed payment, dividend and additional fees levied to client, etc.
	26	List of penalties levied by the Exchange/s during the audit period - NSCCL: Consolidated Debit Advice For Penalty Charges for the Month - BSE : penalty Reports	Analyse types of penalties levied by Exchange
	27	BSE Penalty Report for modification of Client Codes of non-institutional trades PM310812.Clg no. & PM300912.Clg.no. in DLOAD 32	Analyse the file for client code modification pattern
1.1	28	List of traded clients Exchange and Segment-wise based on Turnover	Analyse the pattern of trading - ledgers, margin collection, etc.
<b>V</b>		<b>Dormant Accounts</b>	
	1	List of dormant accounts as on 30-Sep-12 & 31-Mar-13	(a) Compare list as on Sep 30, 2012 and Mar 31, 2013 and identify list of accounts re-activated during audit period. (b) Verify reactivation is done only on receipt of requests from client (c ) Check front-end application status for dormant client whether same is active / suspended. (d) In case of F&O ensure that for reactivation financial proof is collected.



	2	Reactivation requests received from client for dormant accounts	(a) Compare list as on Sep 30, 2012 and Mar 31, 2013 and identify list of accounts re-activated during audit period. (b) Verify reactivation is done only on receipt of requests from client (c ) Check front-end application status for dormant client whether same is active / suspended. (d) In case of F&O ensure that for reactivation financial proof is collected.
<b>VI</b>		<b>Contract notes, Client margin details and Statement of accounts</b>	
	1	Contract notes for NSE, BSE, NSE FO & MCX-Sx for sample trade dates & proof of dispatch of same*  <i>* In case of ECN provide logs for dispatch &amp; in case of physical provide proof of dispatch of courier agency.</i>	(a) Check hardcopy of the contract note along with Pod copy (b) If the member issues contract notes through ECN ask for the logs and verify the same with Exchange trade file whether the contract note has been issued to the clients
	2	Copy of blank contract note for all segments and Exchange	Whether same is as per regulatory requirements
	3	Client margin statements for NSE, BSE & NSE FO for sample trade dates & proof of dispatch of same	Ask member how client margin statement is issued to the client (a) If hard copy is issued ask for the Pod copy (b) If it is issued in ECN ask for the log (c ) check if margin statement details client collateral available and utilised.
	4	Proof of Digital Signature	Ask for the digital signature and check the validity of the same.
	5	List of clients whose quarterly / monthly settlement done during audit period	Pick-up samples from the list and track settlement of



			funds and securities and dispatch of statements for same
	6	Quarterly statement for the quarter ended Dec 31, 2012 & Mar 31, 2013 or Statement of accounts for funds and securities sent to client on quarterly / monthly settlement (all Clients - NSE, BSE, MCX-Sx) and proof of dispatch of same	(a) Ensure that periodical statement of accounts to the clients, shall mention therein that their running account authorisation would continue until it is revoked by the clients.  (b) ensure that client accounts are settled on quarterly / monthly basis in case of running account authorisations.  (c ) Ensure same is as per format prescribed by NSE
	7	Institutional contract note for sample trade date - STP's. Also, please provide client-wise end of day reports for institutional clients for sample trade dates.	(a) Check logs for STP to see if STP is delivered correctly to clients
	8	List of trades wherein special brokerage request (other than mapped in back-office master for a client) request was received	(a) Ask for the list of trades wherein special brokerage rate has been charged to the client other than the rate specified in the back office software (b) Check approvals for same
<b>VII</b>		<b>Dealing with Client Funds' and Securities</b>	
	1	Ledger extract of cash Book	(a) Whether any cash receipts exists from client. Report exceptions



	2	List of all DD's, NEFT & RTGS received and accepted from client above Rs. 50,000/- during Oct 2012 to Mar 2013	(a) Check Implementation of SEBI Circular Pre- funded instruments / Electronic fund transfers dated Jun 9, 2011. Verify audit trail received from client by way of screenshots, bank statement , etc. (b) Check the bank statement whether the payment has been received from the client only
	3	BSE & NSE Pool account statements for the sample period (NSDL & CDSL)	(a) Ask for the transaction statement for the audit period and verify the same with the trade files
	4	OWN & Client Beneficiary account statements	Ask for client beneficiary statement and own account beneficiary statement for the audit period and verify with the trade register
	5	Pledge account (OWN / Client) account statement	(a) Ask for the pledge account details and also ask them to provide pledge details (b) Verify whether any client securities has been pledge and written authorisation has been taken from the client regarding the same
	6	All instances of pledging of collaterals of clients	Same as point above
	7	Bank reconciliation and beneficiary reconciliation as on Mar 31, 2013	Ask for the reconciliation statement for the audit period and verify the same.
	8	Instances of Overdraft facility taken in Client Bank Account during audit period	Check the Client bank account and bank statement for the same
	9	Register of security for Dec 2012 & Mar 2013 (from Back-office)	Register of securities will provide you the details of securities received from the exchange and securitized paid to the Exchange for the audit period



	10	List of all DP accounts	Ask for the DP accounts details from the member
	11	Client ledger for sample clients	Verify the client ledger for the sample clients whether any exceptional items exists or any charges levied which are beyond regulatory requirements
<b>VIII</b>		<b>Terminal operations and systems</b>	
	1	List of all CTCL / IML terminals uploaded to Exchange as per ENIT & BSE urg file	Reconcile terminals - Check if pin code uploaded correctly as in address
	2	List of front-end applications used for trading	So that any mis-match in CTCL / IML file can be detected in case details not provided for any application
	3	List of all NEAT & BOLT users uploaded to Exchange (ACTIVE & INACTIVE)	Reconcile terminals
	4	List of all DMA users (if any)	Reconcile terminals
	5	List of all terminals uploaded in Front-end Application (From Admin Application) (ACTIVE & INACTIVE with trading rights assigned)	Reconcile terminals
	6	List of NCFM / BCFM certification for all registered users	(a) Whether valid and whether reminder mails sent for renewal (b) cash 5:1 and F&O 1:1
	7	Reminder emails sent to NCFM / BCFM users in case of certificate expiry	
	8	List of clients with trading rights assigned on front-end application / Client Master Dump from Front-end Admin e.g. For Client A: - Cash NSE, Cash BSE & Cash F&O, - Active / Suspended status, - Date of activation / suspension	To be used for analysing client master dump, modifications, closure and dormant account dump.



	9	Whether client has access to contract notes through any client interface. Is that through secured means? Demonstrate the process.	Process-walkthrough of same
	10	Chat forums / Messenger sites used for communicating by employees / dealers.	
	11	Logs of chat / messenger sites	Whether logs maintained for same.
1.2	12	List of all approved users and sales personnel and details of NISM Series - IV certification (as applicable for Currency Derivatives and IRF Segment)	Obtain the list of person who are approved users and sales personnel in the currency derivatives and IRF segment. Based on the data check whether NISM certificate has been obtained
1.2	13	List of all terminals opened abroad	1. Ask for the list of Terminals opened abroad 2. If yes, check for regulatory approval is taken from Exchange, RBI and Foreign Regulatory Authorities 3. Check whether any terminal opened abroad is not done through any Sub-Broker 4. Terminals opened abroad should be a branch office of the member (Check for Rent agreement for the branch)
1.2	14	Details of all checks for value and / or quantity based on the respective risk profile of their clients as per the provisions of SEBI Circular CIR/MRD/DP/34/2012 dated December 13, 2012	Check the quarterly confirmation provided by Compliance to Exchange for Dec 2012 and Mar 2013 quarters
1.2	15	Whether member has put-in place a mechanism to limit the cumulative value of all unexecuted orders placed from their terminals to below a threshold limit set by them as per the provisions of SEBI Circular CIR/MRD/DP/34/2012 dated December 13, 2012?	We may rely on System Audit Report, as the same is covered in that
<b>IX</b>		<b>Management of branches / sub brokers and internal control</b>	
	1	List of all Branches	Ask for the list of own branches





	2	Intimation letter to Exchange/s for new branches	verify the letters send to the exchange regarding intimating for opening of new branches
	3	List of all branches closed during period	(a) Ask for the list of branches closed and also ask them to provide how they have intimated to the clients regarding the closure and also the details of the nearby branch details where they can continue to trade and avail other services (b) if they don't wish to continue check for letters sent to client giving 30 day notice to close their account
	4	Latest Branch Inspection / audit reports	Ask for the branch audit reports and ask the periodicity of the same
	5	Documentation of Internal controls and comments on Internal controls in place	SOP and internal controls
	6	Schedule for inspection / branches for period Jan 2012 to Mar 31, 2013	Ask whether any schedule has been in place for carrying out the inspection
<b>X</b>		<b>Investor grievance handling</b>	
	1	Investor grievance register (Exchange-wise) - Oct 2012 to Mar 2013 - Complaint unresolved as on 31-Mar-13 - No. of complaints received during the audit period with details of same	Ask for the investor grievance register and also verify the Exchange website whether any client complaint has been registered against the member
<b>XI</b>		<b>Maintenance of Books of Accounts</b>	
	1	Trial Balance extract for the audit period viz. Oct 2012 to Mar 2013 (From Tally or other accounting software used by broker)	Check credit items in TB
	2	Unaudited / Audited financial statements for year ended March 2013	Any adverse remarks by statutory auditor in financials
	3	List of all OWN & Client Fixed Deposits for the audit period	Verify the FD receipts



<b>XII</b>		<b>Systems &amp; Procedures pertaining to Prevention of Money Laundering Act, PMLA, 2002</b>	
	1	Intimation to FIU for appointment / change of Principal Officer	Ask for the principal officer appointment letter
	2	Total no of alerts for suspicious transactions generated during the half year	Ask whether any STR has been generated during the audit period
	3	No. of STRs filed by the member during the audit period	Ask whether any STR has been reported to FIU during the audit period
	4	As per provisions of Prevention of Money Laundering Act, 2002 whether record of transactions, it's nature and it's value are maintained? Please provide details of same.	Ask whether any STR has been reported to FIU their transaction details, nature of txn and its value has been maintained
	5	<b>List of all training programs and names of employees who have obtained trained in AML and CFT( Combating Financing of Terrorism) procedures during audit period</b>	Check whether any training programs has been conducted for the new employees during the audit period and records of the same has been maintained
<b>XIII</b>		<b>Margin Trading</b>	
	1	Whether specific approval from the exchange is obtained for providing margin trading facility to clients	Check Exchange approval letter has been obtained and also check other compliances pertaining to Margin Trading facility
	2	Margin Trading Compliance Certificate for the period ended Mar 31, 2013	To be submitted to Exchange by April 30, 2012 in case margin trading facility availed. In case not availed then, Compliance officer to sign declaration and provide to Exchange
<b>XIV</b>		<b>Proprietary Trading</b>	
	1	List of all pro trading terminals	Verify List



	2	Approval taken from Exchange for providing Activation / Deactivation of Proprietary trading facility	Check approval and compare with list provided
	3	Disclosure made to clients about dealing in PRO account by member (proof of same)	Check disclosure
<b>XV</b>		<b>Internet Trading</b>	
	1	Approval taken from Exchange for providing Internet Trading	Check approval letter received from the exchange
	2	In cases wherein you have generated e-mail id for clients, please confirm whether you had taken duly signed physical confirmation letter confirming the e-mail id and exercising choice to receive documents on that e-mail id.	
	3	Whether the authorization of electronic contract note contains a clause that any change in the e-mail id shall be communicated by the client through a physical letter to the trading member.	
	4	Whether Mobile Trading implemented. Details of approval for same.	
<b>XVI</b>		<b>Operations of Professional Clearing member/ Members clearing trades of other trading members (only if applicable)</b>	
	1	TM-CM agreements for 25 members or 100% whichever is lower	
	2	Clearing member custodial participant agreements for 25 members or 100% whichever is lower	
	3	Statement of accounts sent to trading members / custodial participants for sample trade dates	
	4	a) Margins available in books for period: b) Exposure provided to trading members for the period:	



	5	a) Summary of Interest charged to trading members for audit period b) Basis of charging of interest	
	6	Margin Statement of Clearing Members : MG-09	
	7	Margin Statement of Trading Member/ Custodial Participant : MG-10	
	8	Margin Payable Statement of Clearing Member : MG-11	
	9	Bank Transaction Report for Clearing Member (F_BK03)	
<b>XVII</b>		<b>Securities Lending &amp; Borrowing Scheme</b>	
	1	SLB approval from Exchange (BSE / NSE)	Ask for SLB approval letter from the Exchange
	2	Whether SLB activity done only in OWN account or client account.	Ask for the list of clients who has opted for SLB
	3	List of clients opted for SLB Trading	Check whether Debit notes has been issued to the clients
	4	List of all SLB trades (BSE / NSE) during audit period	Ask for the SLB sauda summary
	5	SOTD file	
<b>XVIII</b>		<b>Other Compliance Requirements</b>	
	1	Last inspection questionnaire and inspection report of BSE / NSE	Check for observations and whether same have been complied and update in Internal Audit Report
	2	List of all ads issued during audit period and approval taken from Exchange for same (please provide copy of Exchange approval letters)	Approvals for same from BSE & NSE
	3	Proof of submission of last audit report to Exchange/s. Whether any follow-up query/ letter received from the Exchange. Kindly provide a copy of same	
	4	List of all authorised signatories approved by Management for Contract Notes	Verify authroised signatory list with contract notes
	5	Net worth Certificate as on Dec 31, 2012 (BSE, NSE, MCX-Sx)	Whether same is submitted by Jun 30, 2012
	6	Internal Code of Conduct and Controls	



	7	Acknowledged letter of appointment of Compliance Officer (BSE & NSE) or change in Compliance Officer	Check whether intimation is done to Exchanges. Also, check board resolution date and date of change in details on correspondences with client.
	8	Latest Status report received from NSE & BSE (if any)	Check if any penalty / complaints pending with Exchanges
	9	Whether Change in Control has taken approval? If yes, provide approval copy	Check whether approval taken
	10	List of sub-brokers (if any)	Check if same is submitted to NSE by 30-Sep-12 and for BSE by 31-Oct-12
	11	List of Authorised Persons (if any)	
	12	Process followed for reviewing existing client list for SEBI debarred entities Please provide process as well as frequency for same.	
	13	SEBI Certifications for new Exchange and new segment (whether any new registration received during audit period)	
1.2	14	In cases where member is acting as investment advisers, whether member has complied with INVESTMENT ADVISERS REGULATIONS, 2013 (SEBI Notification No. LAD-NRO/GN/2012-13/31/1778 on 21st January 2013)	Check for SEBI certificate for same
	15	Whether an arrangements for an internal review, at least annually, of the business designed to detect and prevent violations of and to achieve compliance of, the Byelaws, Rules and Regulations of the Exchange is made	
	16	Stock Broker Indemnity Policy	
	17	Approval for change in directors / constitution / shareholding (if any)	



1.2	18	List of employees who have completed NISM-Series-VII: Securities Operations and Risk Management Certification Examination as the requisite standard for associated persons of a registered stock-broker / trading member / clearing member	<p>1. As per the regulation the following list of person who are involved in, or deal with, any of the following, namely:-</p> <p>(a) assets or funds of investors or clients,</p> <p>(b) redressal of investor grievances,</p> <p>(c) internal control or risk management, and</p> <p>(d) activities having a bearing on operational risk are required to obtain the NISM certificate.</p> <p>2. obtain the list of person who are handling the above the profile. and check whether all the employees have taken the NISM certificate</p>
	19	Proof of Submission of compliance certificate for the quarter ended December 2012 & March 2013 ( for Order entry)	
<b>XIX</b>		<b>HR Related</b>	
	1	Employee Details: - List of Employees (with date of joining) as on Mar 31, 2013 with Department - List of Employees resigned during period Oct 2012 to Mar 2013	Verify list of employees with point no. XVIII - Compliance on certification on NISM Services VII.
	2	Write-up on types of due diligence checks done for new employees	

## 6. Depository Participants (DP) Technical Peculiarities

The manual attempts to demystify the activities of a depository participant process-wise. Further, the regulatory requirements for each of them are laid down and against them the relevant check points for audit.

### 6.1 DP Client Registration

#### 6.1.1 Client Acquaintance

A depository should take reasonable steps to assess the background, genuineness, financial soundness and investment objectives of the client when establishing relationship with a new client. It is expected that depositories to know their clients through a proper introductory procedure and exercise due precaution while dealing with the clients.

The Know Your Client (KYC) policy should clearly spell out the client identification procedure to be carried out at different stages i.e. while establishing the DP-client relationship, while carrying out transactions for the client or when the member has doubts regarding the veracity or the adequacy of previously obtained client identification data.

DP should ensure that an account is not opened where they are unable to apply appropriate clients due diligence measures / KYC policies. This may be applicable in cases where it is not possible to ascertain the identity of the client, information provided to the intermediary is suspected to be non genuine, perceived non co-operation of the client in providing full and complete information. No account is opened in a fictitious / benami name or on an anonymous basis. DP should develop customer acceptance policies and procedures that aim to identify the types of customers that are likely to pose a higher than the average risk of money laundering or terrorist financing.

#### 6.1.2 Client Account Opening Form & Documentation

NSDL and CDSL vide its Master circular on account opening has laid down the requirements governing client registration document:

- a. **Checklist for filling KYC form are as listed below:**
  - i. Copies of all the documents submitted by the applicant should be self-attested and accompanied by originals for verification. In case the original of any document is not produced for verification, then the copies should be properly attested by entities authorized for attesting the documents, as per the specified procedure. However, in case of PAN, Participants may verify the PAN of their Clients online at the Income Tax website without insisting on the original PAN card, provided that the Client has presented a document for Proof of Identity other than the PAN card.
    - a. If any proof of identity or address is in a foreign language, then translation into English is required.
    - b. Name & address of the applicant mentioned on the Know Your Client (KYC) Application Form, should match with the documentary proof submitted.
    - c. If correspondence & permanent address are different, then proofs for both have to be submitted.
    - d. Sole proprietor must make the application in his individual name & capacity.
    - e. For non-residents and foreign nationals, (*allowed to trade subject to RBI and FEMA guidelines*), copy of passport/PIO Card/OCI Card and overseas address proof is mandatory.

- f. For foreign entities, CIN is optional; and in the absence of DIN no. for the directors, their passport copy should be given.
- g. In case of Merchant Navy NRI's, Mariner's declaration or certified copy of CDC (*Continuous Discharge Certificate*) is to be submitted.
- h. For opening an account with Depository participant or Mutual Fund, for a minor, photocopy of the School Leaving Certificate/Mark sheet issued by Higher Secondary Board/Passport of Minor/Birth Certificate must be provided.
- i. Politically Exposed Persons (PEP) are defined as individuals who are or have been entrusted with prominent public functions in a foreign country, e.g., Heads of States or of Governments, senior politicians, senior Government/judicial/ military officers, senior executives of state owned corporations, important political party officials, etc.
- j. Politically Exposed Persons (PEP) are defined as individuals who are or have been entrusted with prominent public functions in a foreign country, e.g., Heads of States or of Governments, senior politicians, senior Government/judicial/ military officers, senior executives of state owned corporations, important political party officials, etc.

**b. Proof of Identity(POI)**

- i. Unique Identification Number (UID) (*Aadhaar*)/ Passport/ Voter ID card/ driving license.
- ii. PAN card with photograph.
- iii. Identity card/ document with applicant's Photo, issued by any of the following: Central/State Government and its Departments, Statutory/Regulatory Authorities, Public Sector Undertakings, Scheduled Commercial Banks, Public Financial Institutions, Colleges affiliated to Universities, Professional Bodies such as ICAI, ICWAI, ICSI, Bar Council etc., to their Members; and Credit cards/Debit cards issued by Banks.

**c. Proof of Address(POA)**

*Following is the list of documents admissible as Proof of Address: (Documents having an expiry date should be valid on the date of submission.)*

- i. Passport/ Voters Identity Card/ Ration Card/ Registered Lease or Sale Agreement of Residence/ Driving License/ Flat Maintenance bill/ Insurance Copy /Aadhaar Letter issued by Unique Identification Authority of India.
- ii. Utility bills like – (Not more than 3 months old– as on date of receipt for documents). a) Telephone Bill (only land line) b) Electricity bill or c) Gas bill
- iii. Bank Account Statement/Passbook – (Not more than 3 months old – as on date of receipt for documents)
- iv. Depending on the type of bank statement issued the following checks must be done:
  - Original bank statement: The original bank statement is printed on the stationery of the bank, carries logo & name of the bank, and displays the name and address of the Client.



- Copy of bank statement, the authorised official of the Participant should verify the photocopy of the bank statement submitted with the corresponding original.
- v. Original Bank statement on plain paper (Computer generated): (i) The bank statement clearly mentions the name and address of the Client. (ii) The bank statement is duly attested (signed and stamped) by the authorised official of the bank mentioning the name and designation of such authorized official. (iii) Obtain a cancelled cheque leaf in original OR a photocopy of cheque and the authorized official of Participant should verify the same with the original cheque
- vi. Bank statement issued in electronic form: (i) Print out of the bank statement clearly mentions the name and address of the Client. (ii) Obtain a cancelled cheque leaf in original OR a photocopy of cheque with the name of the Client preprinted on it. However, in case of a photocopy of cheque it can be accepted provided the authorized official of Participant verifies the same with the original cheque.
- vii. Self-declaration by High Court and Supreme Court judges, giving the new address in respect of their own accounts.
- viii. Proof of address issued by any of the following: Bank Managers of Scheduled Commercial Banks/Scheduled Co-Operative Bank/Multinational Foreign Banks/Gazetted Officer/Notary public/Elected representatives to the Legislative Assembly/Parliament/Documents issued by any Govt. or Statutory Authority.
- ix. Identity card/document with address, issued by any of the following: Central/State Government and its Departments, Statutory/Regulatory Authorities, Public Sector Undertakings, Scheduled Commercial Banks, Public Financial Institutions, Colleges affiliated to Universities and Professional Bodies such as ICAI, ICWAI, ICSI, Bar Council etc., to their Members.
- x. For FII/sub account, Power of Attorney given by FII/sub-account to the Custodians (which are duly notarized and/or apostilled or consularised) that gives the registered address should be taken.
- xi. The proof of address in the name of the spouse may be accepted.
- xii. Acceptance of third party address as correspondence address in depository account [SEBI Circular No. CIR/MRD/DP/ 37 /2010 dated December 14, 2010 (Circular No.: NSDL/POLICY/2010/0132 dated December 15, 2010)]
  - Client can also provide third party address as correspondence address in depository account provided Participant ensures that all prescribed 'Know Your Client' norms are fulfilled for the third party also. The Participant shall obtain proof of identity and proof of address for the third party. The Participant shall also ensure that customer due diligence norms as specified in Rule 9 of Prevention of Money Laundering Rules, 2005 are complied with in respect of the third party.
  - Participant should further ensure that the statement of transactions and holding are sent to the Client's permanent address at least once in a year.
  - However, the above provision shall not apply in case of PMS (Portfolio Management Services) clients as informed earlier vide letter no. IMD/ MT/165502/ 2009 dated June 05, 2009.

**d. PAN**

- i. The name(s) of depository account holder(s) should be compared with the name appearing on the website of the Income Tax Department (ITD). Alternatively, subscribe to the internet based service of NSDL (NSDL/POLICY/2007/0048 dated August 14, 2007) so that the name can be sought against the given PAN.
- ii. In case the name(s) do not match or the PAN is not present in the Income Tax database, Participants should seek necessary clarification from the account holder(s) and activate such accounts in the DPM System only after the discrepancy is resolved.
- iii. After verifying the details of PAN as mentioned above, the staff of the Participant should affix a stamp as 'PAN verified', on the photocopy of the PAN card(s).
- iv. With respect to PAN, Clients may have reported the following problems: (a) PAN card has been lost / misplaced or PAN card was never received but has the PAN allotment letter from the ITD; (b) Change in the name of the Client due to marriage or voluntary action etc., (in case of individuals) or due to merger, amalgamation etc. (in case of a corporate entity).
- v. In this regard, Participants are advised that the ITD issues a new PAN card with the same PAN with changes in PAN data, for the above reported problems. For detailed procedure, Participants may refer <http://www.incometaxindia.gov.in> or <http://www.tinnsdl.com> (NSDL/POLICY/2006/0024 dated July 7, 2006).
- vi. In cases where there is minor mis-match in the name of Client as is mentioned in the account opening form and the name displayed on the ITD website, the Participants can collect the PAN card proof as submitted by the account holder. However, this would be subject to the Participants verifying the veracity of the claim of such Clients by collecting sufficient documentary evidence in support of the identity of the investors. The Participant should call for any additional documents and / or clarification to ascertain and satisfy itself about the identity of the entity.

➤ **Exemption from PAN**

- i. In case of transactions undertaken on behalf of Central Government and/or State Government and by officials appointed by Courts e.g. Official liquidator, Court receiver etc.
- ii. Investors residing in the state of Sikkim.
- iii. UN entities/multilateral agencies exempt from paying taxes/filing tax returns in India.
- iv. In case of institutional clients, namely, FIIs, MFs, VCFs, FVCIs, Scheduled Commercial Banks, Multilateral and Bilateral Development Financial Institutions, State Industrial Development Corporations, Insurance Companies registered with IRDA and Public Financial Institution as defined under section 4A of the Companies Act, 1956, Custodians shall verify the PAN card details with the original PAN card and provide duly certified copies of such verified PAN details to the intermediary.
- v. Participants may verify the PAN of their Clients online at the Income Tax website without insisting on the original PAN card, provided that the Client has presented a document for Proof of Identity other than the PAN card.

**e. List of persons authorized to attest the documents:**

- i. Notary Public,
- ii. Gazetted Officer,
- iii. Manager of a Scheduled Commercial/ Co-operative Bank or Multinational Foreign Banks (*Name, Designation & Seal should be affixed on the copy*).
- iv. In case of NRIs, authorized officials of overseas branches of Scheduled Commercial Banks registered in India, Notary Public, Court Magistrate, Judge, Indian Embassy /Consulate General in the country where the client resides are permitted to attest the documents.

**f. Bank details:**

Any one or more of the documents given below can be accepted as proof of bank details:

- i. Specimen copy of cheque/cancelled cheque
- ii. Copy of Bank Statement
- iii. Copy of Bank Passbook
- iv. Letter from Bank

The aforesaid documents must contain the following information to be acceptable as proof for bank details:

- Bank Name
- Branch Address
- IFSC/MICR code
- Name of account holder
- Account Number

Participant need not seek from their Clients the proof of the bank details for capturing the bank details in the depository account, if they have direct access to the bank records for verification of the bank details provided by their Clients.

**g. In-person Verification (IPV):**

It is mandatory for all Participants to carry out IPV of their Clients. At the time of opening depository accounts, the Participant should establish the identity of the applicant(s) (*including guardian in case of minor account*) by verifying the photograph(s) affixed in the KYC Application Form as well as proof of identity document(s), **with the person** concerned. Further, in case of joint accounts, '**in-person**' verification needs to be carried out for all the holders of the account. Participants may use 'web-camera' for carrying out '**in-person**' verification for opening of depository accounts subject to compliance with other SEBI guidelines/circulars relating to opening of depository accounts including verification of documents.

Participants shall ensure that the following details are recorded on the KYC Application Form at the time of IPV:

- i. name of the person doing IPV,
- ii. his designation,
- iii. organization
- iv. his signature and
- v. date

**In case of Non-Individuals, additional documents to be obtained from non-individuals, over and above the POA & POI as mentioned below:**

Types of entity	Documentary Requirements
Corporate	<ul style="list-style-type: none"> <li>• Copy of the balance sheets for the last 2 financial years (to be submitted every year).</li> <li>• Copy of latest share holding pattern including list of all those holding control, either directly or indirectly, in the company in terms of SEBI takeover Regulations, duly certified by the company secretary/Whole time director/MD (to be submitted every year).</li> <li>• Photograph, POI, POA, PAN and DIN numbers of whole time directors/two directors in charge of day to day operations.</li> <li>• Photograph, POI, POA, PAN of individual promoters holding control - either directly or indirectly.</li> <li>• Copies of the Memorandum and Articles of Association and certificate of incorporation.</li> <li>• Copy of the Board Resolution for investment in securities market.</li> <li>• Authorized signatories list with specimen signatures.</li> </ul>
Partnership Firm	<ul style="list-style-type: none"> <li>• Copy of the balance sheets for the last 2 financial years (to be submitted every year).</li> <li>• Certificate of registration (for registered partnership firms only).</li> <li>• Copy of partnership deed.</li> <li>• Authorized signatories list with specimen signatures.</li> <li>• Photograph, POI, POA, PAN of Partners.</li> </ul>
Trust	<ul style="list-style-type: none"> <li>• Copy of the balance sheets for the last 2 financial years (to be submitted every year).</li> <li>• Certificate of registration (for registered trust only).</li> </ul>

	<ul style="list-style-type: none"> <li>• Copy of Trust deed.</li> <li>• List of trustees certified by managing trustees/CA.</li> <li>• Photograph, POI, POA, PAN of Trustees.</li> </ul>
HUF	<ul style="list-style-type: none"> <li>• PAN of HUF.</li> <li>• Deed of declaration of HUF/ List of coparceners.</li> <li>• Bank pass-book/bank statement in the name of HUF.</li> <li>• Photograph, POI, POA, PAN of Karta.</li> </ul>
Unincorporated association or Body of Individuals	<ul style="list-style-type: none"> <li>• Proof of Existence/Constitution document.</li> <li>• Resolution of the managing body &amp; Power of Attorney granted to transact business on its behalf.</li> <li>• Authorized signatories list with specimen signatures.</li> </ul>
Banks/Institutional Investors	<ul style="list-style-type: none"> <li>• Copy of the constitution/registration or annual report/balance sheet for the last 2 financial years.</li> <li>• Authorized signatories list with specimen signatures.</li> </ul>
Foreign Institutional Investors	<ul style="list-style-type: none"> <li>• Copy of the constitution/registration or annual report/balance sheet for the last 2 financial years.</li> <li>• Authorized signatories list with specimen signatures.</li> </ul>
Army/Government Bodies	<ul style="list-style-type: none"> <li>• Self-certification on letterhead.</li> <li>• Authorized signatories list with specimen signatures.</li> </ul>
Registered Society	<ul style="list-style-type: none"> <li>• Copy of Registration Certificate under Societies Registration Act.</li> <li>• List of Managing Committee members.</li> <li>• Committee resolution for persons authorized to act as authorized signatories with specimen signatures.</li> <li>• True copy of Society Rules and Bye Laws certified by the Chairman/Secretary.</li> </ul>

#### h. Minor Account:

SEBI has intimated to DPs clarifying the position on operation of the depository accounts held in the name of minors as follows:

"Under [The] Hindu Minority and Guardianship Act, 1956, permission of court is required in the case of transfer by a natural guardian of immovable property of a minor. However, shares are not immovable property. Section 2 (7) of Sale of Goods Act, 1930 includes shares within the definition of "goods". Neither the Indian Contract Act nor the Sale of Goods Act provide for transfer by sale or otherwise by guardian/natural guardian of goods/movable property in the name of minor to the effect that

permission of court is required in the matter of such transfer. In the case of accounts of minor in banks also, the guardian is entitled to open, operate and even close the account also. The depository account can, therefore, be operated by a natural guardian without any order from the court though the same is neither expressly permitted nor prohibited" (NSDL/PI/2000/323 dated March 17, 2000).

Account opened in the name of minor should not have joint holdings. Two KYC Application Forms must be filled i.e. one for the guardian and another for the minor (to be signed by guardian).

**i. Illiterate person:**

DPs has prescribed the procedure for affixing thumb impression while filling an account opening form by an illiterate person. In this context, Participants are advised to follow the below mentioned procedure:

- i. Illiterate person(s), at the time of opening an account with a Participant must affix the thumb impression (*left hand thumb in case of a male and right hand thumb in case of a female*) on the agreement as well as on the KYC Application Form and Account Opening Form.
- ii. All accounts opened by illiterate person(s) must be either introduced by an existing account holder or must be attested by applicant's bank.
- iii. The Client(s) must come in person to open the account and submit instruction forms and affix his/her thumb impression in the presence of the official of the Participant. The Participant should identify the Client(s) by verifying the photograph submitted by the Client(s) and read out/explain the contents of the KYC Application Form and Account Opening Form, Participant-Client agreement and delivery instruction form to the Client(s). The official of the Participant should then put his signature and remarks "Details explained to the Client(s)", on the account opening form, copy of the agreement and delivery instruction form.
- iv. In case such Client(s) is/are temporarily or permanently disabled due to which he/she cannot come in person to submit the instruction form as mentioned in point (c) above, the thumb impression of the Client(s) on the instruction forms must be attested by a Magistrate or a Notary Public or a Special Executive Magistrate or a similar authority holding a Public Office and authorised to use the Seal of his office or a manager of the account holder's bank. The Client should also produce a medical certificate about his/her disability.
- v. The instruction forms issued to such Client(s) should be pre-stamped as "Thumb Impression" on the Account Opening Form
- vi. At the time of opening of account, the aforesaid rules should be explained to the Client(s) in the presence of a witness, who will have to sign the agreement and the account opening form, as a witness.
- vii. Participants should note that the aforesaid guidelines are in addition to the existing guidelines with regard to opening of an account and executing instructions.

**j. Blind person:**

- i. The Participant should read out and explain to the Client, the contents of the KYC Application Form and Account Opening Form and Participant-Client agreement whenever so requested by the Clients.
- ii. If the Client is illiterate, then Participant should put in the remark as "Visually Challenged and Thumb Impression" on the Account Opening Form.
- iii. For issuance, re-issuance and processing of Delivery Instruction Slips (DIS) of such Clients, Participants are advised to follow the procedure laid down in NSDL Circular No. NSDL/PI/2004/1401 dated August 5, 2004. Participants would also be required to comply with NSDL Circular No. NSDL/POLICY/2007/0011 dated February 15, 2007 regarding SEBI circular on DIS. It is also added that the DIS issued to such Clients should be pre-stamped as "Visually Challenged" or "Visually Challenged and Thumb Impression" as the case may be. Further, these Client(s) should visit the office of the Participant to deliver the DIS, only if they are illiterate.

**6.1.3 Audit of Client registration**

100% verification needs to be carried out in respect of account opening by the Concurrent Auditor of the Participant. The Concurrent Auditor should conduct the audit in respect of all accounts opened during the day, by the next working day. In case the audit could not be completed within the next working day due to large volume, the auditor should ensure that the audit is completed within a week's time. Participants would be required to appoint a firm of qualified Chartered Accountant(s) or Company Secretary(ies) or a Cost and Management Accountant, holding a certificate of practice for conducting the concurrent audit. Participants in case they so desire, may entrust the Concurrent Audit to their Internal Auditors. (NSDL/POLICY/2006/0021 dated June 24, 2006, NSDL/POLICY/2007/0017 dated March 22, 2007 and NSDL/POLICY/2009/0020 dated March 16, 2009).

**6.1.4 Identification of Beneficial Ownership:**

SEBI has laid down Guidelines on Identification of Beneficial Ownership vide its circular no. CIR/MIRSD/2/2013 dated January 24, 2013.

The guideline lay down the additional checks to be performed for non-individual clients in order to ascertain the ultimate beneficial owner.

**6.1.5 Dispatch of Welcome Kit to Client**

A copy of all the documents executed by client shall be given to him, free of charge, within 7 days from the date of account opening. The DP shall maintain POD's of the same.

**6.1.6 Dispatch of Details to KRA**

SEBI simplified the account opening process for investors vide Circular No. CIR/MIRAD/16/2011 dated August 22, 2011. Further, SEBI vide circular MIRSD/SE/Cir-21/2011 dated October 05, 2011 issued guidelines for uniform KYC requirements for investors while opening accounts with any intermediary in the securities market. To avoid duplication of KYC process with every intermediary, a mechanism for centralization of the KYC records in the securities market has been developed. An intermediary shall perform the initial KYC of its clients and upload the details on the system of the KRA. When the client

approaches another intermediary, the intermediary can verify and download the client's details from the system of the KRA. As a result, once the client has done KYC with a SEBI registered intermediary, he need not undergo the same process again with another intermediary. Accordingly, SEBI has formulated the KYC Registration Agency (KRA) Regulations, which have been notified vide notification no. LAD-NRO/GN/2011-12/29/36772 dated December 2, 2011 (copy enclosed). The Regulations cover the registration of KRAs, functions and responsibilities of the KRAs and intermediaries, code of conduct, data security, etc.

In this regard, DP's are required to check on KRA websites the status of clients KYC. In case the same is not done then the DP after doing the initial KYC of the new clients, the intermediary shall forthwith upload the KYC information on the system of the KRA and send the KYC documents i.e. KYC application form and supporting documents of the clients to the KRA within 10 working days from the date of execution of documents by the client and maintain the proof of dispatch.

#### **6.1.7 Issuance and Re-issuance of DIS booklets:**

All DIS must bear pre-stamped Client ID and pre-printed unique identification number (serial number). Participants may consider printing the name(s) of account holder(s) as well, on the DIS. Further, if the DIS booklet is issued to an illiterate person, the same should be pre-stamped as "Thumb Impression", in case of blind person, DIS booklet should be pre-stamped as "Visually Challenged" and in case of blind illiterate person, DIS booklet should be pre-stamped as "Visually Challenged and Thumb Impression".

DIS issued to joint account holders and accounts operated by Power of Attorney holder (POA) may be distinguished either by different coloured stationery or by any other method as the Participant deems fit.

All DIS booklets must contain a Requisition form that should bear pre-stamped Client ID and a provision to attest the signature of the person to whom the account holder wishes to authorise to collect the booklet on his/her behalf. Participants may consider printing the name(s) of account holder(s) as well on the Requisition form.

Re-issuance of DIS booklet should strictly be on receipt of Requisition form duly signed by all account holder(s). In case a Client reports that the Requisition form has been lost/misplaced/stolen, the Client should make a written request on a plain paper signed by all the account holders(s) and submit the latest Transaction Statement, for issuance of DIS booklet.

A "DIS Issuance Register" should be maintained, which should have details such as Client's name, Client ID, unique identification number (serial number) of DIS (start and end), date of issue and mode of issue. In case the DIS booklet is delivered by hand, name of the person to whom it is handed-over (address as well as contact telephone number(s) in case of authorised person) along with his/her signature should be obtained on the DIS Issuance Register.

The inside back cover of the DIS booklet should be printed with information on Grievances Redressal Mechanism as intimated vide NSDL Circular No. NSDL/PI/2004/1286 dated July 19, 2004.

#### **a. Mode of providing DIS booklets to Clients:**

Participants are advised as follows:

- i. When a Client's request for DIS booklet is received through post/courier.

Send DIS booklet through registered post/courier, to the address of the Client captured in the DPM System after duly verifying the signature(s) of the Client(s).



- ii. When a Client (sole holder or either of the holders) comes in person and submits the Requisition form for re-issuance of DIS.

Hand-over DIS booklet to the Client, only after satisfying about the identity of the Client.

- iii. When a Client authorises a representative to collect DIS.

Hand-over the DIS booklet to the authorised person, only after establishing the identity of the authorised person (refer Circular no. NSDL/POLICY/2009/0029 dated April 16, 2009 for list of identity documents, which can be obtained by Participant). However, in case the Participant is not in a position to establish the identity of the authorised person, DIS booklet should be sent through registered post/courier, to the address of the Client.

- iv. In case a Client reports (in writing) that the Requisition form (slip) has been lost / misplaced / stolen.

Send DIS booklet through registered post/courier, to the address of the Client registered with the Participant. However, in case the Client or its authorised person comes in person to collect the DIS, it may be handed-over only after the identity of the person is established as mentioned above.

- v. In case a request for issuance of DIS booklet is received through post/courier immediately (i.e. within 30 days) after change in the address in the depository account of the Client.

Participant should obtain an independent confirmation (by way of letter/email/telephone) from the Client(s) in this regard, before issuing the DIS.

**b. Issuance of Loose leaf DIS:**

In case a Client (all the holders in case of joint holding) wishes to submit an instruction but does not have the DIS, the Participants are advised as follows:

- i. The Client visits the Participant's office in person;
- ii. Participant satisfies itself about the identity of the Client and issues loose leaf DIS; and
- iii. The Client signs the DIS in the presence of authorized official of the Participant.

Participants must ensure that the DIS issued to the Client also bears pre-printed unique identification number (serial number), which should be from a different series, and a record thereof is maintained by the Participant in a "Loose-leaf DIS Register". The Loose-leaf DIS Register should contain Client's name, Client ID, serial number of loose-leaf DIS, date of issue and his/her signature. Further, the Participant shall not issue more than 10 loose DIS to one account holder in a financial year (April to March). In addition to the existing process of verification, another staff of Participant should also verify the signature(s) separately.

**c. Checks and Controls required in case Participant is using back office system /Manual controls:**

- i. **Automated checks in the back office system of the Participant:**

- Participants must record the serial numbers and run an automatic check while executing transactions based on DIS.

- Ensure that the system has in-built controls for matching of serial numbers with the respective Client IDs and that the system blocks the DIS permanently that have been used.
- In case any Client reports (in writing) that DIS(s) has/have been lost/ misplaced/ stolen or the account is closed, unused serial number(s) should be permanently blocked.
- In case any DIS is presented for execution that has already been used or is part of the series of DIS which have been reported as lost/misplaced/stolen then the system should give automatic alert, in which case, Participant should contact the Client(s) immediately.

**ii. Manual controls:**

- Participants must ensure that a "DIS Control Register" is maintained for recording details of serial numbers and Client IDs with which the serial numbers are associated. Participants should verify the same at the time of receipt of DIS and make a remark that it has been used.
- In case a Client reports (in writing) that DIS is lost/misplaced/stolen or the account is closed, the same should be cancelled in the DIS Control Register.
- In case any DIS is presented for execution that has already been used or is part of the series of DIS, which have been reported as lost/misplaced/stolen then there should be a mechanism to raise an alert, in which case, Participant should contact the Client(s) immediately.

In case a DIS is received from a dormant account (i.e. where no transaction has taken place for a period of six months or any other lesser time period as may be decided by the Participant), in addition to the existing process of verification, another employee of the Participant should also verify the instruction. The Participant should obtain an independent confirmation from the Client(s) in this regard before processing the DIS. However, in case of active accounts, such verification is mandatory only if the account has five or more ISINs and all such ISIN balance are transferred at a time. The authorized official of the Participant verifying such transactions with the Client, shall record the details of the process, date, time, etc. of the verification on the instruction slip under his signature.

Further, in order to facilitate identification of dormant accounts, an alert has been provided in the DPM System when Participant captures / verify releases instruction in the Client accounts where the system has not performed any of the transactions with relation to Account transfer (Debits), Inter Depository transfer (Debits), Remat and Pledge in any of the ISINs for a defined period of time through manual data entry in the DPM System or uploading the instructions through Back-office. Participant can override this warning message and continue capture/ verify-Release operation. In case aforesaid instructions are being executed using DPM import, an error file (".err") will be generated containing warning message.

**d. General compliance**

- i. Participants must ensure compliance with the prevailing guidelines mentioned above regarding the requirements of time & date stamping and deadline for submission of electronic instructions received from Client.

- ii. Participants are advised to ensure compliance with respect to the requirements mentioned below regarding details to be obtained from Clients in respect of „Consideration“ and „Reasons/Purpose“ for off-market transactions.
- iii. Participants should be able to provide the details of the instructions to the NSDL inspection team based on the relevant details provided to the Participants by NSDL.
- iv. The internal auditors as appointed by Participants will be required to verify that necessary audit trails and checks have been implemented in conformity with prescribed guidelines / circulars and the deviations, if any, may be reported in the internal audit report. In case no deviations have been reported, it will be treated that the aforesaid requirements have been duly complied with by Participant.

**e. Processing of DIS :**

**i. Acknowledgement of instruction at the time of accepting physical / electronic DIS.**

**– Physical DIS:**

In view of the time-criticality of execution of Clients' instructions, especially those relating to market trades, all Participants are advised that the delivery / receipt instruction forms submitted by the Clients should be time-stamped. The time and date of receipt of the form should be put on both the portions of the form i.e., Participant's copy & Client's copy which should be duly signed & stamped by the Participant.

**– Electronic submission of instruction:**

The Participants should be able to conclusively prove the origin, destination, date and time of receipt of dispatch electronic instructions received by it.

Participants are advised to take note of the procedure given here below:

- Participants shall accept instructions from the Clients, in physical form upto 4 p.m. (in case of electronic instructions upto 6.00 p.m.) on T+1 for pay-in of securities, viz.; instructions to transfer securities from Client account to CM Pool account, Inter Settlement Instructions, CM Pool to CM Pool account transfers and Delivery-Out Instructions, etc. For example, pay-in for trades executed on 'Monday' will be on Wednesday. Clients will have to submit instructions to their Participants upto 4 p.m. (in case of electronic instructions upto 6.00 p.m.) on Tuesday.
- Settlement instructions received from any Client beyond the aforementioned deadlines would be received by the Participants at Clients' risk and acknowledgment thereof should be issued by Participants to the Clients, with suitable remarks.
- Participants should complete execution of pay-in instructions (i.e., *Delivery-Out instructions*) and ensure that they are in status "Instruction ready for Settlement" well before the pay-in deadline time on T+2.
- In case the Client account does not have sufficient balance, the Client to CM Pool account transfer instructions will reflect the status "Overdue" (*provided in the target CM Pool Account, the standing instruction indicator is enabled or receipt instructions initiated is matched*), irrespective of the execution date and will remain valid till the pay-in for the requisite settlement number and market

type, during the pay-in process; i. if partial balance is available in the Client account, then the same will be debited and transferred to the CM Pool Account. The status of the instruction will get updated as "Partially Settled". if no balance is available in the Client account, then the instruction will get rejected. The status of the instruction will get updated as "Rejected".

**f. Deadline time for accepting non pay-in related instructions:**

SEBI has clarified that Participants can decide their own time frame for submission of such instructions by their Clients (i.e. one or two days before the execution date). However, Participants should execute the instruction not later than one day from the date of submission of instruction by the Client. Further, if the date of submission and the execution date are same, Participants may execute such instructions on the same day on a "*best effort basis*".

**g. Precautions to be taken at the time of accepting market related instructions:**

- i. The instructions relating to settlements should be segregated for each stock exchange, market type and settlement number. These instructions include delivery-out instructions, Client to CM Pool Transfer, inter-settlement transfers, CM Pool to CM Pool transfers and Inter Depository transfers with the target settlement pertaining to which pay-in is due. Priority should be given to the instructions relating to the settlements for which Pay-in date is current date or next date.
- ii. The execution of the instructions in DPM System for each stock exchange, market type and settlement number should be prioritized in a logical manner. Instructions that have the effect of crediting the CM Pool Accounts for a settlement, such as Client to CM Pool Transfer, inter-settlement transfers, CM Pool to CM Pool transfers and Inter Depository transfers should be given priority.
- iii. Instructions such as CM Pool transfer to client, client to client and pledge closure that have the effect of crediting those Clients account from where the securities have to be moved to CM Pool Accounts for the target settlement should be executed well in advance.
- iv. Participants should ensure that IDT instructions are verified & released well before the deadline so that the status of the instruction become "Acknowledgement awaited from other Depository"\* at NSDL deadline time. However, future dated instructions can be verified & released without any time restriction as per the current practice. In case any IDT instruction is received by NSDL after NSDL deadline time, then the same will fail with the status "Rejected" with the reason 'Deadline time has passed'. If CDSL rejects NSDL's inter depository debit instructions (IDDs) in case it receives IDD after the deadline time of the current business date, the status of IDT instructions will change from "Acknowledgement awaited from other Depository" to "Rejected by other Depository".
- v. In case the Participant has verified/released many future dated instructions or many accounts are opened after EOD or there are multiple pay-ins on the next day the Participants are requested to ensure that the BOD of next business day should be received early (say at 7.30 a.m.) on such days in order to process all pending instructions.

- vi. Non-settlement related instructions like account opening, dematerialisation, rematerialisation, etc. should not be captured/verified & released or exports should not be taken during settlement timings.

#### 6.1.8 Change in demographic details:

##### i. Change of address

While processing requests for change of address received from Clients, Participants should obtain the following documents:

- Written application for change of address from the Client
- Proof of identity
- latest transaction statement of the account received from the Participant. In case a Client (*sole holder or either of the holders*) personally visits the Participant's office to submit an application (*signed by all holders in case of joint holdings*) for change of address along with necessary documents (*POI / proof of address*), the Participant need not obtain the transaction statement from such Client
- Proof of new address along with the original documents of the new address for verification.
- In case the Client expresses inability to personally visit the office of the Participant, the application for change of address along with other documents can be submitted through an authorised representative, whose identity the Participant must verify by collecting any of the proof of identity documents
- The Client or its authorised representative should sign the application once again in the presence of the officials of the Participant.
- The Participant should verify the signature of the Client on the application and the identity documents with the signature of the Client available with the Participant. Further, the document pertaining to new address should be verified and attested
- After effecting the change of address in the DPM System, the Participant should send a communication to the Client, confirming the change of address, to the old and the new addresses.

##### ii. Change of Signature

Participants are advised to follow the below mentioned procedure for effecting change of signature of Clients:

- The Client should make a request in writing specifying reasons for change in signature.
- New signature should be duly attested by Client's banker.
- Client should visit the Participant's office personally and produce valid POI.
- In the presence of officials of Participant, Client should affix his/her new signature.

- An authorised official of the Participant shall, under his signature, verify the identity proof with the proof and photograph that were furnished at the time of opening of account and thereafter, if found satisfactory, make necessary changes in its records.
- In case of non individual client, client should provide a fresh board resolution mentioning authorised signatories who shall operate the depository account along with the specimen signature and photograph of the new authorised signatory. Participants need not obtain the details of the existing authorised signatories if they remain unchanged.

### **iii. Change in bank details**

Participant should obtain written request signed by the authorised signatories. Participant should ensure that the request submitted by the Client is completely filled, including the bank account particulars of the Client and properly signed (signed by all the holders in case of joint holdings and by authorised signatories in case of body-corporate).

Any one or more of the documents given below can be accepted as proof of bank details:

- Specimen copy of cheque/cancelled cheque
- Copy of Bank Statement
- Copy of Bank Passbook
- Letter from Bank

### **iv. Change in SMS flag and / or mobile numbers**

Participant must obtain a written request from the Client for change in mobile number and/or SMS flag and verify signature in system

## **6.1.9 Nomination**

The nomination can be made only by individuals holding beneficiary accounts on their own behalf singly or jointly. Non-individuals including society, trust, body corporate, partnership firm, karta of HUF, holder of power of attorney cannot nominate. If the account is held jointly, all joint holders will sign the nomination form.

A minor cannot nominate. However, a minor can be a 'nominee'. In that event, the name and address of the Guardian of the minor nominee shall be provided by the beneficiary owner. The details with respect to date of birth of the minor nominee and the flag to indicate such nominee should be captured in the DPM System.

The Nominee shall not be a trust, society, body corporate, partnership firm, karta of HUF or a power of attorney holder. A non-resident Indian can be a Nominee, subject to the exchange controls in force, from time to time.

The cancellation of nomination can be made by individuals only holding beneficiary accounts on their own behalf singly or jointly by the same persons who made the original nomination. On cancellation of the nomination, the nomination shall stand rescinded and the depository shall not be under any obligation to transfer the securities in favour of the Nominee.

In case the Clients request to make a nomination / cancel the nomination in their depository accounts, Participants should carry out the changes in the DPM System after obtaining written request, which is duly signed by the Client (*signed by all the holders in case of joint holdings*).

#### 6.1.10 Dematerialisation

- i. BOs (Beneficial owner i.e. Client), who are the registered holders of the securities of an Issuer, will approach the DP for dematerialization of securities held by them in physical form.
- ii. The DP shall hand over a Demat Request Form (DRF) to the BO.
- iii. The BO shall fill up the following details in the DRF: -
  - BO Account Number
  - Name(s) of the account holder(s)
  - ISIN
  - Name of the Company
  - Nature of Security
  - Type of Security
  - Number of Certificates
  - Total quantity to be dematerialized
  - Certificate Details: Folio No., Distinctive Nos., Certificate Nos., Number of Securities, Face Value.
  - Lock-in reason & Lock-in release date, if any.
- iv. A separate DRF should be filled up for free securities and lock-in securities. If certificates with different lock-in reason / lock-in release date exist, then a separate DRF should be filled for each lock-in reason / expiry date combination.
- v. The BO account holder(s) shall sign the DRF: -
  - ☐ As per the specimen signature(s) recorded with the DP, and
  - ☐ As per the specimen signature(s) recorded with the Issuer/RTA.
- vi. The BO shall also surrender the physical certificates to be dematerialised along with the duly filled DRF to the DP.
- vii. The DP shall verify the following before accepting the DRF :-
  - Whether the securities intended for Dematerialisation have been admitted in CDSL. If the securities intended for dematerialisation are not admitted in CDSL, the DP shall inform the same to BO and return the documents to the BO.
  - Whether the certificate details mentioned on the DRF and on the certificates enclosed, tally.
  - Whether the name(s) of the account holder(s) and the name(s) of the holder(s) appearing on the certificates tally exactly with those recorded under the BO account

- In case the BO's name on the DRF is not matching with that on the certificate (e.g. the holder of the securities may have opened the demat account in the name of Sushil Ramesh Shah but his name on the certificate may appear as Sushil R. Shah or S. R. Shah, etc.), the dematerialisation request could be accepted by the DP, if the BO's signature on the DRF matches with specimen signature available on record with the DP.
  - Whether all the holders have signed the DRF and the signatures of the account holders tally with those recorded by the DP.
  - If there is any discrepancy in any of the details, the DP shall get it rectified and duly authenticated by all the holders.
  - The error-free DRF shall be taken up for further processing by the DP.
- viii. If the DRF is complete in all respects, then the DP should give an acknowledgement to the BO. Date of receiving the DRF should be written on the DP's copy of the DRF and on the acknowledgement given to the BO. The authorised official of the DP should sign it.
- ix. The DP shall capture the details from the DRF & Certificates in the system and shall generate the Demat Request Number (DRN). The DP shall write down the DRN on the DRF. The DP should ensure that the correct ISIN is selected where the Issuer has more than one ISIN.
- x. The DP shall deface the certificates by affixing a rubber stamp.
- xi. The DP shall capture the dispatch details in the system, such as the dispatch reference number, dispatch date, name of courier, etc. **The DP must dispatch the physical documents to the Issuer / RTA within 7 days from the date of receiving physical documents from the BO.**
- xii. After receiving the physical documents, Issuer/RTA shall compare the physical documents with the electronic data. If the details do not tally between electronic and physical request, the Issuer/RTA shall inform the DP. The DRF and certificates shall be sent back to the DP under a Rejection Memo, specifying the reason for rejection.
- xiii. **The Issuer/RTA should complete processing of the demat request within 15 days of receiving the physical documents.** The BO Account is credited for the number of securities confirmed by the Issuer/RTA.
- xiv. The reasons under which a dematerialisation request can be rejected by an Issuer/RTA shall be as provided in the DP system from time to time. **The DP shall arrange to return the certificates along with the rejection letter sent by the Issuer/RTA to the concerned BO within 7 days from receipt of rejected certificates.**

#### 6.1.11 Pledge

- i. The pledgor BO shall fill up the Pledge Request Form (PRF), in duplicate for pledging the securities from his account and submit the same to its DP.
- ii. On receipt of the PRF from the pledger BO, the pledger DP will check the PRF for completeness, correctness and validity and subsequently setup the request only if the securities to be pledged are unencumbered i.e. which are not earmarked for settlement or not already pledged or frozen.



- iii. On committing the transaction, a unique Pledge Sequence Number (PSN) is generated. The Pledger DP shall record the PSN generated by the system on the PRF
- iv. Pledgee DP can access the PSN only after pledger checker has verified it.
- v. System generates a letter giving details of the pledge setup. The Pledger DP shall print this letter. An authorized official of the pledger DP shall sign and stamp this letter and send the same to the pledger. \$ After pledge request is verified by the Pledger DP, acknowledgement copy is generated during EOD for pledgee BO, at the pledgee DP's end.
- vi. The Pledgee BO shall submit duly signed PRF to its DP with PSN. If the pledgee is a bank that also functions as a DP, then signature of the pledgee need not necessarily be taken on the PRF for acceptance of pledge.
- vii. Based on instructions received from the pledgee, the pledgee DP shall either accept or reject the request.
- viii. After the transaction is verified, system generates a letter giving details of the ledge. Pledgee DP shall print this letter. An authorized official of the pledgee DP shall sign and stamp the letter and send it to the pledgee.
- ix. After pledge request is accepted/rejected by the Pledgee DP, acknowledgement copy is generated during EOD for Pledger at the pledger DP's end.

#### **6.1.12 Account Closure**

##### **i. Account Closure initiated by BO**

In case of a closure initiated by the BO, the BO shall give a written request to the DP, the DP shall verify the following:

- Whether the form is filled completely in all respects
- Whether the signature(s) of the holder(s) tally with the signature(s) recorded in the system.
- Whether the details filled in the ACRF tally with the details recorded in the system.
- The Account Closure Request should be entered in the system within 7 days of receipt of the Closure Request.
- DP should provide the BO with a Transaction Statement for the quarter in which the request has been received.
- The words “Account Closed / To be Closed” should be prominently written, by the DP, on the Transaction Statement
- The proof of despatch of such Transaction Statement to the BO should be kept on record by the DP.

##### **ii. BO account closure initiated by the DP**

A DP can initiate the closure of a BO account for reasons such as:

- Non-payment of dues

- Violation of agreement with the DP
- Transfer to another DP/Main DP due to closure of Branch/Main DP.

The DP shall give a notice of minimum 30 days to the BO intimating the BO of DP's intention to close the account, citing the reason for initiating closure of the account.

The hard copy or soft copy of this letter and proof of dispatch should be preserved by the DP.

If no response is received from the BO within 30 days from dispatch of the letter, the DP shall initiate closure of the account.

The DP will generate a final statement of account showing the balance as zero. This statement should be sent to the BO. The DP should preserve proof of dispatch of this statement.

#### 6.1.13 Statement of Accounts

A BO, while opening a demat account can specify frequency at which statement of accounts is required from the DP with whom the BO maintains the demat account. Frequencies specified in the account opening forms are Daily, Weekly, Fortnightly, Monthly. A BO can select a frequency from the specified ones.

Notwithstanding the frequency of statement specified by the BO while opening the demat account, the DP should send statement of account to BOs, at least once at the end of every month, or any such frequency as specified by regulators, in respect of every account, if there has been even a single transaction during the month and in any event at the end of each quarter, or any such frequency as specified by regulators, in respect of all accounts.

It is mandatory for the main DPs should print and dispatch transaction statements of BOs directly to the BOs. Branches, including back office connected branches, should not send transaction statements directly to the BOs. The main DP must maintain record of dispatch of statements to BOs.

#### **Exemption from sending quarterly transaction statements to BOs in respect of demat accounts with no transactions and no security balances**

DPs may not send the quarterly transaction statements to BOs in respect of DEMAT accounts with no transactions and no security balances, subject to the following:-

- The BO is informed, in advance, that he/she will not be receiving transaction statements for such accounts till there are any transactions or security holdings in the DEMAT account.
- KYC and PAN requirement, in respect of all such depository accounts, are complied.
- No annual maintenance charges are levied for such an account.
- Information which is required to be disseminated by DPs by way of a note in the transaction statements will be required to be communicated to such BOs separately.

#### 6.1.14 Other Compliance Requirements

##### i. Net worth Certificate

DPs are required to submit Net worth Certificate, duly certified by Statutory Auditors to Regulator within six months from the last date of their financial year.

**ii. SUBMISSION / DISSEMINATION OF DP TARIFF / CHARGES STRUCTURE TO CDSL/NSDL EVERY YEAR**

Reference SEBI Circular no. MRD/Dep/Cir-20/06 dated December 11, 2006 regarding the submission / dissemination of DP tariff / charges structure to CDSL **latest by April 30 every year.**

**iii. SUBMISSION OF DETAILS OF BACK-OFFICE CONNECTED BRANCHES**

Reference: Communiqué no. **CDSL/AUDIT/DP/1333** dated October 31, 2008. Details of the DP's back office connected branches to be submitted along with the half yearly Internal Audit Report.

**iv. BO GRIEVANCE REPORT**

Every DP is required to submit a **BO Grievance Report** to CDSL on a monthly basis by the **10<sup>th</sup> of the following month**. A consolidated report is to be submitted by the Main DP for all its branches, if any. In case the DP does not have any grievance to report, a **"NIL" report has to be submitted.**

**v. REQUIREMENT OF TRAINED PERSONNEL AT MAIN DP / LIVE CONNECTED BRANCHES / SERVICE CENTRES**

In order to empower DP staff to have full knowledge of the depository system with a view to serve their clients better, the requirement of maintaining adequately trained staff at the Main DP / Live connected branches / all service centers of the DP (back office collection centers) is mandatory.

- i. At Main DPs and their live connected branches (that is, DP-branches having direct connectivity with Regulator):
  - **two persons** who have attended the five-day training programme conducted by regulator and certified; or
  - **one person** who has attended the five-day training programme conducted by regulator and certified and **one person** who has either obtained the BCCD certification from BSE; or obtained the NISM-Series-VI: Depository Operations Certification; or
  - who has attended the one-day training programme conducted by Regulator and certified..
- ii. At service centers of DPs, one person who is either Regulator-trained and certified or BCCD-certified or NISM-Series-VI: Depository Operations certified.

**vi. Supervision of Branches of Depository Participants**

DPs are advised to note that with effect from **November 01, 2009**, prior approval of regulator should be obtained for opening a DP Service Centre including back office connected branches and collection centres. For this purpose, an application is required to be submitted to regulator along with the requisite information in the prescribed formats.

Further to the guidelines as mentioned above, DPs are advised to keep on record, identification documents (including photo-identification) of all the persons engaged in DP operations –

- at their Main Office
- at all live-connected branches, and
- at service centres.

To ensure that all live connected branches as well as service centers display the types of services provided by each of them. The display board/chart should be prominently visible to the investors/clients. The “**SIMPLE DO’s and DON’Ts**” list should also be displayed similarly.

### 6.1.15 Risk Prone Areas of DP Operations

#### **CDSL**

##### **Account Opening and Maintenance:**

- i. Whether proof of identity and proof of address is collected from all holders as per SEBI & CDSL requirement and the same are verified against original? If correspondence address of third party is accepted, whether proof of identity of such third party is on record?
- ii. “Whether SEBI guidelines for implementation of KRA Regulations have been followed to the extent applicable?”
- iii. Whether "In person verification" as per operating instruction 2.4.8 is done and record of in-person verification maintained.
- iv. Whether necessary documents / information as prescribed by CDSL (as per DP Operating Instructions) have been collected from different types of clients such as individual investors, CMs, Corporate, HUF, NRIs, OCBs, trusts, etc.
- v. Whether special care is taken to check genuineness of the client if disproportionately large numbers of accounts (say, above 20) are opened with the same or similar names and/or same address and/or with the same bank account details?
- vi. In case of change of address of the BO, whether proof of new address is obtained and a confirmation letter is sent to the BO at old as well as at the new address?

##### **Account Closure initiated by the DP:**

Whether DP gives 30 days notice to BO before closing accounts and follows operating instructions in this regard?

##### **Modifications in Power of Attorney (including Setup in existing demat account / Revocation of POA):**

- i. Whether modification of Power of Attorney is recorded in CDAS within prescribed time limit.
- ii. Whether necessary documents have been collected for modification of POA?
- iii. Whether entries done in POA register are up-to-date?
- iv. Whether the BO is registered for SMS (in case of POA given to Broker / DP)

### **Issuance of Instruction Slips**

- i. Whether a proper inventory control mechanism for instruction slip booklets is being used? Whether physical inventory is reconciled with the inventory records at prescribed intervals?
- ii. Whether DIS issued to BOs have pre-stamped BO ID and pre-printed serial number?
- iii. Whether there is a system to issue delivery instruction booklets to the BOs based ONLY on the requisition slip which forms part of the earlier issued instruction slip booklet? Whether such requisition slip has preprinted instruction slip serial number range of the booklet of which it forms a part? If any instruction slip booklet is not issued on the basis of requisition slip, whether the procedure prescribed under operating instruction is followed?
- iv. Whether loose delivery instruction slips, if any, are issued as per the prescribed procedure to the BOs?
- v. Whether there is control over issue of instruction slips to the BOs e.g. proper records of instruction slip serial numbers vis-à-vis account number?

### **Execution of Instruction slips:**

- i. Whether there is a system to verify the instruction slip number against the issue details at the time of receipt from the BO?
- ii. Whether there is a system for blocking of DIS serial numbers that are already used or reported lost/misplaced/stolen?
- iii. Whether there is a system to ensure that while entering the transactions of value exceeding ` 5 lakhs, a senior official verifies the transaction?
- iv. Whether the DP has systems and procedures to double check transactions originating from dormant accounts as a risk containment measure?
- v. Whether all debit transactions pertaining to the government securities have been executed only after receipt of authorization from the BO?

### **Investor Grievances received by the DP:**

- ii. Whether there is a system in place to record and redress all grievances of BOs arising at the DP and at its service centres within the stipulated time of 30 days, including grievances received through e-mails, depository, and SEBI?
- iii. Whether any BO grievance was pending for more than 30 days for reason other than 'pending demats' and whether the same was appropriately reported to CDSL?

### **Others**

- i. Whether Main DP sends the statement of account (transaction / holding statements) at intervals as prescribed by CDSL to all its BOs including branch BOs?
- ii. Whether the transmissions effected, if any, have been done in accordance with the procedure stipulated by CDSL like obtaining duly filled TRF and notarized copy of death certificate, etc.?

# APPENDIX

## Appendix 1 – SEBI Circular on Guidelines on Identification of Beneficial Ownership



भारतीय प्रतिभूति और विनिमय बोर्ड  
Securities and Exchange Board of India

### CIRCULAR

CIR/MIRSD/2/2013

January 24, 2013

SEBI Registered Intermediaries:

1. Stock Brokers through Recognized Stock Exchanges
2. Depository Participants (DPs) through Depositories
3. Mutual Funds (MFs)
4. Association of Mutual Funds in India (AMFI)
5. Portfolio Managers (PMs)
6. KYC Registration Agencies (KRAs)
7. Alternate Investment Funds (AIFs)
8. Collective Investment Schemes (CIS)
9. Investment Advisers (IAs)

Dear Sirs,

#### Sub: Guidelines on Identification of Beneficial Ownership

1. SEBI Master Circular No. CIR/ISD/AML/3/2010 dated December 31, 2010 has mandated all registered intermediaries to obtain, as part of their Client Due Diligence policy, sufficient information from their clients in order to identify and verify the identity of persons who beneficially own or control the securities account. The beneficial owner has been defined in the circular as the natural person or persons who ultimately own, control or influence a client and/or persons on whose behalf a transaction is being conducted, and includes a person who exercises ultimate effective control over a legal person or arrangement.
2. SEBI has also prescribed uniform Know Your Client (KYC) requirements for the securities markets vide circular nos. CIR/MIRSD/16/2011 dated August 22, 2011 and MIRSD/SE/Cir-21/2011 dated October 5, 2011. The SEBI KYC Registration Agency (KRA) Regulations, 2011 have been notified and guidelines have been issued under these regulations from time to time.
3. Further, the Prevention of Money Laundering Rules, 2005 also require that every banking company, financial institution and intermediary, as the case may be, shall identify the beneficial owner and take all reasonable steps to verify his identity. The Government of India in consultation with the regulators has now specified a uniform approach to be followed towards.

#### A. For clients other than individuals or trusts:

4. Where the client is a person *other than an individual or trust*, viz., company, partnership or unincorporated association/body of individuals, the intermediary shall identify the beneficial owners of the client and take reasonable measures to verify the identity of such persons, through the following information:

- a. The identity of the natural person, who, whether acting alone or together, or through one or more juridical person, exercises control through ownership or who ultimately has a controlling ownership interest.

Explanation: Controlling ownership interest means ownership of/entitlement to:

- i. more than 25% of shares or capital or profits of the juridical person, where the juridical person is a company;
  - ii. more than 15% of the capital or profits of the juridical person, where the juridical person is a partnership; or
  - iii. more than 15% of the property or capital or profits of the juridical person, where the juridical person is an unincorporated association or body of individuals.
- b. In cases where there exists doubt under clause 4 (a) above as to whether the person with the controlling ownership interest is the beneficial owner or where no natural person exerts control through ownership interests, the identity of the natural person exercising control over the juridical person through other means.

Explanation: Control through other means can be exercised through voting rights, agreement, arrangements or in any other manner.

- c. Where no natural person is identified under clauses 4 (a) or 4 (b) above, the identity of the relevant natural person who holds the position of senior managing official.

**B. For client which is a trust:**

5. Where the client is a *trust*, the intermediary shall identify the beneficial owners of the client and take reasonable measures to verify the identity of such persons, through the identity of the settler of the trust, the trustee, the protector, the beneficiaries with 15% or more interest in the trust and any other natural person exercising ultimate effective control over the trust through a chain of control or ownership.

**C. Exemption in case of listed companies:**

6. Where the client or the owner of the controlling interest is a company listed on a stock exchange, or is a majority-owned subsidiary of such a company, it is not necessary to identify and verify the identity of any shareholder or beneficial owner of such companies.

**D. Applicability for foreign investors:**

7. Intermediaries dealing with foreign investors' viz., Foreign Institutional Investors, Sub Accounts and Qualified Foreign Investors, may be guided by the clarifications issued vide SEBI circular CIR/MIRSD/11/2012 dated September 5, 2012, for the purpose of identification of



beneficial ownership of the client.

**E. Implementation:**

8. The provisions of this circular shall come into force with immediate effect.

Intermediaries are directed to review their Know Your Client (KYC) and Anti- Money Laundering (AML) policies accordingly.

9. The Stock Exchanges and Depositories are directed to:

- a. bring the provisions of this circular to the notice of the Stock Brokers and Depository Participants, as the case may be, and also disseminate the same on their websites;
- b. make amendments to the relevant bye-laws, rules and regulations for the implementation of the above decision in co-ordination with one another, as considered necessary;
- c. monitor the compliance of this circular through half-yearly internal audits and inspections; and
- d. communicate to SEBI, the status of the implementation of the provisions of this circular.

10. In case of mutual funds, compliance of this circular shall be monitored by the Boards of the Asset Management Companies and the Trustees and in case of other intermediaries, by their Board of Directors.

11. This circular is issued in exercise of powers conferred under Section 11(1) of the Securities and Exchange Board of India Act, 1992 to protect the interests of investors in securities and to promote the development of, and to regulate the securities markets.

Yours faithfully,

**Krishnanand Raghavan**  
**Deputy General Manager**  
**022-26449632**

Email: [krishnanandr@sebi.gov.in](mailto:krishnanandr@sebi.gov.in)



भारतीय प्रतिभूति और विनिमय बोर्ड  
Securities and Exchange Board of India

CIR/MRD/DMS/13/2010

April 23, 2010

To

The Managing Directors of Stock Exchanges and Depositories Dear Sir(s),

**Sub: Execution of Power of Attorney (PoA) by the Client in favour of the Stock Broker/ Stock Broker and Depository Participant**

1. A Power of Attorney is executed by the client in favour of the stock broker /stock broker and depository participant to authorize the broker to operate the client's demat account and bank account to facilitate the delivery of shares and pay – in/ pay – out of funds.
2. Generally, the PoA is taken from the clients who want to avail internet based trading services. For offering internet based trading services, a Stock Broker requires necessary authorizations for seamless trading, collection of margins as well as settlement of funds and securities. Further, some of the Stock Brokers also obtain authorizations from their clients to offer non-internet based services.
3. It has come to SEBI's notice that the clients are compelled to give irrevocable power of attorney to manage client's demat account and bank account so that the client is able to pay funds or deliver shares to its broker on time. In some cases, the PoA even allows a broker to open and close accounts on behalf of the client and to trade on client's account without the consent of the client.
4. In order to standardize the norms to be followed by stock brokers/ stock broker and depository participants while obtaining PoA from the clients guidelines have been finalized based on discussions in Secondary Market Advisory Committee of SEBI (SMAC) and feedback from market participants, investor associations, major stock exchanges and depositories on discussion paper on the captioned subject put on SEBI website. It has been decided that the guidelines as set out in the annexure shall be made applicable to stock brokers/ stock broker and depository participants.
5. Standardizing the norms for PoA must not be construed as making the PoA a condition precedent or mandatory for availing broking or depository participant services. PoA is merely an option available to the client for instructing his broker or depository participant to facilitate the delivery of shares and pay-in/pay-out of funds etc. No stock broker or depository participant shall deny services to the client if the client refuses to execute a PoA in their favour.
6. The Stock Brokers shall take necessary steps to implement this circular latest by May 31, 2010 for the new clients and ensure to take necessary steps latest by September 01, 2010 to revoke those authorizations given by the existing clients to the stock brokers/ stock broker and depository participants through PoA that are inconsistent with the present guidelines.

7. The Stock Exchanges/ Depositories are directed to:
- a) bring the provisions of this circular to the notice of the Stock Brokers/Depository Participants and also disseminate the same on their websites;
  - b) make necessary amendments to the relevant bye-laws, rules and regulations for the implementation of the above decision;
  - c) communicate to SEBI, the status of the implementation of the provisions of this circular in their Monthly Development Reports.
8. This circular is issued in exercise of powers conferred under Section 11(1) of the Securities and Exchange Board of India Act, 1992 to protect the interests of investors in securities and to promote the development of, and to regulate the securities markets.

Yours faithfully,

**MANOJ KUMAR**  
General Manager  
+91-22-26449260  
[manojk@sebi.gov.in](mailto:manojk@sebi.gov.in)

**Encl: Guidelines for execution of Power of Attorney by Clients favouring Stock Brokers / Stock Broker and Depository Participants**

## **Guidelines for execution of Power of Attorney by Clients favouring Stock Brokers / Stock Broker and Depository Participants**

### **PoA favouring Stock Brokers**

PoA executed in favour of a Stock Broker by the client should be limited to the following:

#### **1. Securities**

- i. Transfer of securities held in the beneficial owner account(s) of the client(s) towards stock exchange related margin / delivery obligations arising out of trades executed by the Client(s) on the stock exchange through the same Stock Broker.
- ii. Pledge the securities in favour of Stock Broker for the limited purpose of meeting the margin requirements of the client(s) in connection with the trades executed by the clients on the stock exchange through the same Stock Broker. Necessary audit trail should be available with the Stock Broker for such transactions.
- iii. To apply for various products like Mutual Funds, Public Issues (shares as well as debentures), rights, offer of shares, tendering shares in open offers etc. pursuant to the instructions of the Client(s). However, a proper audit trail should be maintained by the Stock Broker to prove that the necessary application/act was made/done pursuant to receipt of instruction from Client.

#### **2. Funds**

- i. Transfer of funds from the bank account(s) of the clients for the following:
  - a. For meeting the settlement obligations of the client(s)/ margin requirements of the client(s) in connection with the trades executed by the clients on the stock exchange through the same Stock Broker.
  - b. For recovering any outstanding amount due from the client(s) arising out of clients trading activities on the stock exchanges through the same Stock Broker.
  - c. For meeting obligations arising out of the client subscribing to such other products/facilities/services through the Stock Broker like Mutual Funds, Public Issues (shares as well as debentures), rights, offer of shares in etc.
  - d. Towards monies/fees/charges, etc. due to the Stock Broker/Depository Participant/ Principal payable by virtue of the client using/subscribing to any of the facilities/services availed by the Client at his/her instance.

Necessary audit trail should be available with the Stock Broker for such transactions.

### **POA favouring Stock Brokers and Depository Participants**

PoA executed in favour of a Stock Broker and Depository Participant by the client should:

3. identify/provide the particulars of the beneficial owner account(s) and the bank account(s) of the client(s) that the Stock Broker is entitled to operate.
4. provide the list of clients' & brokers' Bank accounts & demat accounts where funds and securities can be moved. Such bank & demat accounts should be accounts of related party only.

5. be executed in the name of the concerned SEBI registered entity only and not in the name of any employee or representative of the Stock Broker/Depository Participant.
6. not provide the authority to transfer the rights in favour of any assignees of the Stock Broker/Depository Participant.
7. be executed and stamped as per the rules / law prevailing in the place where the PoA is executed or the place where the PoA is kept as a record, as applicable.
8. contain a clause by which the Stock Broker would return to the client(s), the securities or fund that may have been received by it erroneously or those securities or fund that it was not entitled to receive from the client(s).
9. be revocable at any time, without notice.
10. be executed by all the joint holders (in case of a demat account held jointly). If the constitution of the account is changed for whatever reason, a new PoA should be executed.
11. authorize the Stock Broker/Depository Participant to send consolidated summary of Client's scrip-wise buy and sell positions taken with average rates to the client by way of SMS / email on a daily basis, notwithstanding any other document to be disseminated as specified by SEBI from time to time.

#### **General Guidelines**

**The POA shall not facilitate the stock broker to do the following:**

12. Transfer of securities for off market trades.
13. Transfer of funds from the bank account(s) of the Clients for trades executed by the clients through another stock broker.
14. Open a broking / trading facility with any stock broker or for opening a Beneficial Owner account with any Depository Participant.
15. Execute trades in the name of the client(s) without the client(s) consent.
16. Prohibit issue of Delivery Instruction Slips (DIS) to beneficial owner (client).
17. Prohibit client(s) from operating the account.
18. Merging of balances (dues) under various accounts to nullify debit in any other account.
19. Open an email ID/ email account on behalf of the client(s) for receiving statement of transactions, bills, contract notes etc. from stock broker / Depository Participant.
20. Renounce liability for any loss or claim that may arise due to any blocking of funds that may be erroneously instructed by the Stock Broker to the designated bank.

#### **Stock Broker / Depository Participant should ensure that:**

21. A duplicate/ certified true copy of the PoA is provided to the Client(s) after execution.
22. In case of merger/ demerger of the Stock Broker/Depository Participant with another entity/ into another entity, the scheme of merger/ demerger should be approved by High Court and one month prior intimation given to the client about the corporate restructuring to facilitate investor/ client to continue or discontinue with the broker.



**CIRCULAR**

CIR/MRD/DMS/28/2010

August 31, 2010

To

The Managing Directors of Stock Exchanges and Depositories Dear Sir (s),

**Sub: Execution of Power of Attorney (PoA) by the Client in favour of the Stock Broker/ Stock Broker and Depository Participant - Clarifications**

1. SEBI vide circular no. CIR/MRD/DMS/13/2010 dated April 23, 2010 issued guidelines regarding execution of Power of Attorney (PoA) by the client in favor of Stock Broker / Stock Broker and Depository Participant.
2. SEBI has received representation from Market Participants seeking guidance and clarifications on process to be followed for implementation of the provisions of the circular.
3. Based on the examination of the issues highlighted in the representations and so as to facilitate the implementation of the provisions of the aforesaid Circular, attached clarifications are issued for immediate implementation.
4. All other clauses/ provisions of the aforesaid PoA circular, except those mentioned in the annexure, shall remain unchanged.

Yours faithfully,

**MANOJ KUMAR**  
General Manager  
+91-22-26449260  
manojk@sebi.gov.in

Encl: Clarification to Guidelines for execution of Power of Attorney by Clients favouring Stock Brokers / Stock Broker and Depository Participants (2 Pages)

**Clarification to Guidelines for execution of Power of Attorney by Clients favouring Stock Brokers / Stock Broker and Depository Participants**

SI No	Clauses/ Provisions of the PoA Circular	Clarifications
1	Standardizing the norms for PoA must not be construed as making the PoA a condition precedent or mandatory for availing broking or depository participant services. PoA is merely an option available to the client for instructing his broker or depository participant to facilitate the delivery of shares and pay-in/pay-out of funds etc. No stock broker or depository participant shall deny services to the client if the client refuses to execute a PoA in their favour.	Only internet based trading exempted.
2	The Stock Brokers shall take necessary steps to implement this circular latest by May 31, 2010 for the new clients and ensure to take necessary steps latest by September 01, 2010 to revoke those authorizations given by the existing clients to the stock brokers/ stock broker and depository participants through PoA that are inconsistent with the present guidelines.	Stock Broker/ DP may revoke those authorizations that are inconsistent with the present guidelines by communicating the inconsistent clauses to the existing clients. In the event, the deleted clauses are not accepted by the client, Stock Broker/ DP may be required to either obtain fresh PoA or close the account. In case of any addition to the existing PoA, Stock Broker / DP shall be required to obtain a new PoA from clients.
3	PoA executed in favour of a Stock Broker by the client should be limited to the following: “(i) Transfer of securities held in the beneficial owner account(s) of the client(s) towards stock exchange related margin / delivery obligations arising out of trades executed by the Client(s) on the stock exchange through the same Stock Broker.”	Margin / Delivery obligations shall also include settlement obligations, if any.

4	PoA executed in favour of a Stock Broker by the client should be limited to the following: “(iii) To apply for various products like Mutual Funds, Public Issues.	Redemptions are also included in PoA pursuant to client’s instructions.
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Sl No	Clauses/ Provisions of the PoA Circular	Clarifications
	(shares as well as debentures), rights, offer of shares, tendering shares in open offers etc. pursuant to the instructions of the Client(s). However, a proper audit trail should be maintained by the Stock Broker to prove that the necessary application/act was made /done pursuant to receipt of instruction from Client.”	
5	PoA executed in favour of a Stock Broker and Depository Participant by the client should provide the list of clients’ & brokers’ Bank accounts & demat accounts where funds and securities can be moved. Such bank & demat accounts should be accounts of related party only.	The list of clients’ & brokers’ Bank accounts & demat accounts may be updated / amended by proper communication without executing a new PoA every time. Copies of such communications may be preserved as annexure to the PoA.
6	PoA executed in favour of a Stock Broker and Depository Participant by the client should be revocable at any time, without notice.	PoA executed in favour of a Stock Broker / Stock Broker and Depository Participant by the client should be revocable at any time. However, such revocation shall not be applicable for any outstanding settlement obligation arising out of the trades carried out prior to receiving request for revocation of PoA. Further, the PoA revocation requests should be dated and time stamped by the brokers for ensuring proper audit trail.
7	The POA shall not facilitate the stock broker to do the following:	The PoA shall not facilitate off-market trades between parties other than the related parties as mentioned in the PoA.



Appendix 4 – NSE FAQ on Actual Settlement on Funds and Securities



DEPARTMENT : INSPECTION	
Download Ref. No: NSE/INSP/21651	Date: September 07, 2012
Circular No.: 144/2012	

To,  
All Members

**Sub: FAQs – Actual Settlement of Funds and Securities**

Based on representations and queries received from members, Exchange is pleased to issue frequently asked questions (FAQs) on Actual Settlement of funds and securities. The same is made available in [http://www.nseindia.com/content/members/faq\\_ACT\\_SETT.pdf](http://www.nseindia.com/content/members/faq_ACT_SETT.pdf)

Members are requested to take note and comply with the same.

**For and on behalf of  
National Stock Exchange of India Limited**

C N Upadhyay  
Asst. Vice President

Telephone No	Fax No	Email id
+91-22-26598196	+91-22-26598194	compliance_assistance@nse.co.in



## NATIONAL STOCK EXCHANGE OF INDIA LIMITED

### FREQUENTLY ASKED QUESTIONS (FAQs)

#### 1. To whom is Internal audit applicable?

All the stock brokers and clearing members, who have transacted or cleared even a single trade during the period of audit, are required to conduct the internal audit. It is applicable for Capital Market, Derivatives (F&O and CDS) and WDM segment of the Exchange.

#### 2. When are the half yearly Internal audit report required to be submitted?

Members shall conduct Internal audit on a half yearly basis. For half year ending March 31<sup>st</sup>, audit reports along with management comments are required to be submitted by June 30<sup>th</sup> and for half year ending September 30<sup>th</sup>, same is required to be submitted by December 31<sup>st</sup>.

#### 3. Who can conduct the Internal audit?

Internal audit can be conducted by Independent qualified Chartered Accountants, Company Secretaries, or Cost and Works Accountants, who are in practice and who do not have any conflict of interest with the member.

#### 4. What is the scope of Internal audit?

Every half year Exchange stipulates minimum guidelines for Internal Audit. Scope of audit shall include areas such as:

- a) Review of Order and Risk Management system.
- b) Verification and review of Constituent Registration Documents.
- c) Verification of systems for Margins collection from clients.
- d) Verification/Review of Procedures and systems pertaining to dispatch of contract notes/Margin Statement/Statement of accounts.
- e) Verification of systems and procedures in place for receipt/payments of funds/securities from/to clients.
- f) Review of operations at branch and subbroker location.
- g) Verification of internal controls of Terminal Operations at members office.
- h) Review of documentation and implementation of Provisions pertaining to Anti Money Laundering (AML) Compliance.
- i) Review/Verification of Systems in place to prevent and monitor code changes.

j) Verification and review of Investor Handling Mechanism etc.

Review of clearing activities in case of Professional Clearing member/ Members clearing trades of other trading members.

Guidelines prescribed by the Exchange does not limit the scope of Internal Audit.

**5. Can Auditor verify any additional area other than defined in scope of Internal audit Report?**

If in the opinion of the Auditor, it thinks that review is required for any other area it may undertake further examination for the same.

If any noncompliance is observed by the auditor, the same shall form part of the Internal Audit Report and commented under the head "Other Areas" as given in the format of Audit Report.

**6. What is the format of the audit report?**

The format for each half year is specified by the exchange in its circular for the respective half year. Such format/guidelines is updated/reviewed every half year by the Exchange. The report consists of Annexure I which is the Format of Audit Certificate and Annexure II which is the Format of Audit report. Annexure to the observations/adverse comments shall form part of the audit report. Member shall ensure that Management comments are given for adverse observations given by the auditor.

Format of Internal Audit Report for the half year ended September 30, 2011 is available at <http://www.nseindia.com/content/circulars/INSP19173.zip>

**7. What should be the sample size to be adopted?**

Internal Auditor has to at least select minimum Sample size as prescribed under the guidelines issued by the Exchange. While conducting audit, wherever auditor feels appropriate it may take decision to increase the sample size.

**8. What are the areas to be taken care of while finalization of Internal audit report?**

While finalizing report certain basic areas to be taken care of are as given as under:

- a. Each page of the Audit Report should be stamped by the auditors.
- b. The Audit certificate should be on letterhead of the auditors containing the address and contact details of the auditors.
- c. Minimum sample size should be adhered to and mentioned in the audit report.
- d. The Audit Report must contain Management comments.
- e. The Audit Reports should come through Members of the Exchange only (i.e. the audit report should be accompanied by a covering letter on the letterhead of the member).
- f. The Audit Report should contain observations pertaining to the respective Exchange to which the report is submitted.

**9. Is it necessary to indicate whether management accepts comments given by the auditor?**

In case of any non – compliance, the management comments are necessary clearly specifying whether the management accepts the non – compliance or otherwise. Management is required to indicate the tentative timeliness to comply with the non-compliance reported by the auditor.

**10. How to submit the Internal audit report?**

Internal Audit report shall be submitted in original hard copy or Soft Copy. If member wishes to submit report in soft copy then the same has to be in scanned pdf format / digitally signed by auditor and shall form part of an attachment through ENIT.

Detailed procedure for the same is explained in the Exchange circular no. NSE/INSP/2009/ 86 dated December 9, 2009.

User manual for upload of Internal Audit Report is available at <https://www.enit.co.in>.

**11. In case of Members having multiple branches/sub brokers, is it necessary to cover all braches/subbrokers for audit?**

Auditor shall perform audit of branches/sub brokers on sample basis. Factors such as Volumes generated from such location (branch/sub broker), geographical coverage, number of terminals allotted by the broker, number of years of operation, periodicity of last visit etc. may be guiding factors for sample selection.

**12. What is the penalty for non-submission/delayed submission of Internal audit reports?**

As per exchange Circular No. NSE/INSP/2011/116, dated April 19, 2011, following shall apply in case of non-submission/late submission of Internal Audit Reports by due date.

## Appendix 5 – NSE Circular on Consolidated Circular on matters relating to User ID request



### NATIONAL STOCK EXCHANGE OF INDIA LIMITED

DEPARTMENT : MARKET ACCESS	
Download Ref No : NSE/MA/22732	Date : February 13, 2013
Circular Ref. No : 001/2013	

To All Members

#### Sub: Consolidated Circular on matters relating to User Id request

Exchange has, from time to time, issued various circulars regarding User id request. This consolidated circular replaces all earlier circulars on the captioned subject.

In event of any further queries or information relating to User Ids, kindly contact Mr Amey Daptardar / Mr Bharat Gandhi / Ms Prerana Nair on 022-26598428 / or mail us at [marketaccess@nse.co.in](mailto:marketaccess@nse.co.in)

For and on behalf of  
National Stock Exchange of India Limited

Suprabhat Lala  
Vice President

Telephone No	Fax No	Email id
+91-22-2659 8428 / 8150	+91-22-26598447	<a href="mailto:marketaccess@nse.co.in">marketaccess@nse.co.in</a>

Regd. Office : Exchange Plaza, Bandra Kurla Complex, Bandra (E), Mumbai – 400 051 Page 1



## Appendix 6a – BSE Contract Note format

<sup>1</sup> APPENDIX - B TO REGULATION 14  
Contract Note - Form AA [Regulation 14.2.1]

FORM AA

**Contract Note Issued by Members acting for constituents as Brokers and Agents**

Name of Member/Firm  
Address of the Member  
Clearing Number of the Member  
SEBI Registration Number .

To: Name of the Constituent  
Address of the Constituent  
Unique Client Code  
PAN No. of Constituent:

Contract Note No:  
Trade Date :  
Settlement No :  
Settlement Date :

To be Stamped as per the provisions applicable under the Relevant Stamp Act.

Sir(s),

I/We have done today the following transactions against your order:

Order No.	Order Time	Trade No.	Trade Time	BOUGHT FOR YOU							SOLD FOR YOU							
				Security	Quantity	Gross Rate Per Security (Purchase rate) (Rs.)	Total (Rs.)	Brokerage (Rs.)	Service Tax (Rs.)	Securities Transaction Tax (Rs.)	Security	Quantity	Gross Rate Per Security (Sale rate) (Rs.)	Total (Rs.)	Brokerage (Rs.)	Service Tax (Rs.)	Securities Transaction Tax (Rs.)	

Add/less other charges/levies:

**Net Amount Due from you/to us: \_\_\_\_\_**

- This Contract is made subject to the Rules, Bye-laws and Regulations and usages of Bombay Stock Exchange Limited.
- Brokerage has been charged as stated above at rates not exceeding the official scale of brokerage.
- The Courts in Mumbai shall have exclusive jurisdiction in respect of all proceedings to which the Exchange is a party, and in respect of all other proceedings, the Courts having jurisdiction over the area in which the respective Regional Arbitration Centre is situated, shall have jurisdiction.
- In the event of any claim (whether admitted or not) difference or dispute arising between you and me/us out of these transactions the matter shall be referred to arbitration in the concerned Regional Arbitration Centre as provided in the Rules, Bye-laws and Regulations of Bombay Stock Exchange Limited.
- This contract constitutes and shall be deemed to constitute as provided overleaf an agreement between you and me/us that all claims (whether admitted or not), differences and disputes in respect of any dealings, transactions and contracts of a date prior or subsequent to the date of this contract (including any question whether such dealings, transactions or contracts have been entered into or not) shall be submitted to the concerned Regional Arbitration Centre and decided by arbitration in accordance with and as provided in the Rules, Bye-laws and Regulations of Bombay Stock Exchange Limited.
- The provisions printed overleaf form a part of the contract.

Place :  
Dated:

Yours faithfully,  
Trading Member(s) of the Bombay Stock Exchange Limited  
PAN No. of Trading Member  
Name of the Partners / Proprietor / Authorized Signatory

## Appendix 6b – NSE Contract Note Format

### Exhibit-2

#### i) CONTRACT NOTE FORMAT FOR CM SEGMENT

##### CONTRACT NOTE (Capital Market Segment of NSE) (Pursuant to Regulation 3.5)

Dealing Office Address of the Member  
Tel. No.  
Fax. No.

Name of the Member  
Address of the Member  
SEBI Regn. No. of the Member  
Trading Member Code No.

To

To be stamped as per the  
provisions applicable under the  
relevant Stamp Act

CONTRACT NOTE NO.  
TRADE DATE  
SETTLEMENT NO.  
SETTLEMENT DATE

Name of the Constituent  
Address of the Constituent  
Unique Client Code No.  
Trading Code No. of the Constituent  
PAN of Constituent

Sir/ Madam,

I / We have this day done by your order and on your account the following transactions :

Order No.	Order Time	Trade No.	Trade Time	Security (Description)	Quantity	Buy / Sell	Gross Rate per Security	Total (Rs)	Brokerage * (Total)	Service Tax * (Total) (Rs)	Securities Transaction Tax *	Total (inclusive / net of brokerage,
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## Appendix 6c – MCX-Sx Contract Note format

### CONTRACT NOTE (Currency Derivatives Segment of MCX Stock Exchange Limited) (Regulation 3.6)

Dealing Office Address of the Trading Member  
Tel. No.  
Fax. No.  
Names of authorised signatories

Name of the Trading Member  
Address of the Trading Member  
SEBI Regn. No. of the Trading Member  
Trading Member Code No.

To  
Name of the Constituent  
Address of the Constituent  
Unique Client Code No.  
Trading Code No. of the Constituent

CONTRACT NOTE NO.  
TRADE DATE

PAN of Constituent

Sir/ Madam,

I / We have this day done by your order and on your account the following transactions:

Order No.	Order Time	Trade No.	Trade Time	Contract Description	Quantity	Buy / Sell	Gross Rate per contract (Rs)	Total (Rs)	Brokerage * (Total) (Rs)	Service Tax * (Total) (Rs)	Total (Inclusive / net of brokerage & service tax) (Rs)

\* OTHER STATUTORY LEVIES (as applicable)

NET AMOUNT DUE TO US/ YOU – Rs. (In words)

\* Alternatively, these details may be furnished separately as annexure to the Contract Note.

- Brokerage has been charged as stated and has been at rates not exceeding the official scale of brokerage and indicated separately.
- This contract is subject to the Rules, Bye-laws and Regulations and usages of the MCX Stock Exchange Limited.
- In the matters where the Exchange is a party to the dispute, the Civil Courts at Mumbai shall have exclusive jurisdiction and in all other matters, proper courts within the area covered under the Regional Arbitration Centre shall have jurisdiction in respect of the arbitration proceedings falling under or conducted in that Regional Arbitration Centre.
- This contract constitutes and shall be deemed to constitute as provided overleaf an agreement between you and me/us, and in the event of any claim (whether admitted or not), difference or dispute in respect of any dealings, and contracts of a date prior or subsequent to the date of this contract (including any question whether such dealings, transactions or contracts have been entered into or not) shall be referred to arbitration as provided in the Rules, Bye-laws and Regulations of the MCX Stock Exchange Limited.
- Any grievance related to your dealings with us may be sent to our email id \_\_\_\_\_ and/or to the Exchange's email id: [investorcomplaints@mcx-sx.com](mailto:investorcomplaints@mcx-sx.com).
- Compliance Officer's details: Name/contact no./email id \_\_\_\_\_

The provisions printed overleaf form part of the contract.

Date :  
Place:

Yours faithfully,

For \_\_\_\_\_ (Name of Trading Member)  
Name & Signature of Partner / Proprietor / Authorised Signatory

P.T.O.

**Appendix 7- NSCCL Circular on Client Margin Reporting dated 29-Aug-11**

**NATIONAL SECURITIES CLEARING CORPORATION LIMITED  
FUTURES & OPTIONS SEGMENT  
Circular No. 1293**

**Download No: NSE/CMPT/18739**

**August 29, 2011**

Dear Members,

**Sub: Client Margin Reporting**

This circular is in continuation to our circular no. NSE/CMPT/18591 dated August 10, 2011 intimating SEBI circular CIR/DNPD/7/2011 dated August 10, 2011 and in partial modification of our consolidated circular no NSE/CMPT/16104 dated October 25, 2010.

With reference to Item number 14 of the above mentioned consolidated circular members are hereby informed to take note of the details specified in Annexure in view of the change in penalty structure as specified vide SEBI circular CIR/DNPD/7/2011 dated August 10, 2011

The above circular shall be effective from the trade date September 01, 2011

Members are advised to take note of the same.

For any further clarifications please contact the following officials of the Clearing Corporation:

Mr. Abhijeet Sontakke, Mr. Onkar Phadnavis & Mr. Sharad Sharma

Phone Nos: 022-26598214 / 64

Fax: 022-26598242

Email: [risk\\_group@nse.co.in](mailto:risk_group@nse.co.in)

Yours Sincerely,  
For National Securities Clearing Corporation Limited

Rana Usman  
Asst. Vice President  
[rusman@nse.co.in](mailto:rusman@nse.co.in)

## Appendix 8 – Daily Margin Statement format

### Exhibit-3

#### Format – Daily Margin Statement to be issued to clients

Client Code:  
Client Name:  
Exchange:

Segment	Trade day	Margins available till T day					Margin required by Exchange/NSCCL end of T day			Excess / Shortfall w.r.t. Requirement by Exchange / NSCCL	Additional Margin required by member as per RMS	Margin Status (Balance with Member / Due from client)
		Funds	Value of Securities (after haircut)	Bank Guarantees / FDR	Any other approved form of Margins*	Total Margins Available	Initial Margin	Exposure Margin	Total Margin			
		A	B	C	D	E=(A+B+C+D)	F	G	H=(F+G)	I=E-H	J	K=(I-J)

\*approved form as may be specified by the Exchange/NSCCL from time to time

#### Notes:

1. Daily Margin Statement to be issued within one working day from T day
2. Daily Margin statement to mention the name, email id, telephone number and address of compliance officer
3. Detailed exhibits for the margin collected may be provided to the clients. In case of securities (scrip name, qty, value ) Bank Guarantee (BG no, amount, expiry date) and FDR's (FDR No., Amount and Maturity date)



## Appendix 9 – NSE Circular on Client Margin Information dated 11-Feb-2008

### NATIONAL STOCK EXCHANGE OF INDIA LIMITED INSPECTION DEPARTMENT CIRCULAR

DOWNLOAD REF. NO: NSE/INSP/10239

Circular no. NSE/INSP/2008/64

Dated: 11<sup>th</sup> February 2008

To  
All Members

#### Sub : Client margin information

On a daily basis, the National Securities Clearing Corporation Limited downloads to all members

- the Detailed Margin File for Capital Market segment (MG02) providing client wise, security wise margin and mark to market records
- the Detailed Margin File in respect of clearing member (MG12) and the Detailed Margin File in respect of trading member (MG13) for F & O segment, providing SPAN margin and net buy premium.

In order to ensure transparency at the client level, SEBI has made it mandatory for members to send margin related information to their clients on a daily basis.

Such information may include the following details:

- Client code and name, Trade day (T)
- Total margin deposit placed by the client upto day T-1 (with break-up in terms of cash, FDRs, BGs and securities)
- Margin utilised upto the end of day T-1
- Margin deposit placed by the client on day T (with break-up in terms of cash, FDRs, BGs and securities)
- Margin adjustments for day T
- Margin status (balance with the member / due from the client) at the end of day T

Members are advised to implement the same with effect from 18<sup>th</sup> February 2008. For any clarifications, members may contact any of the following officials:

Mr. Ankit Badalia or Ms Sania Surve

Phone Nos. 2659 8196 ( Direct )

2659 8100 – 8114 Extn. – 5127 / 5128

For National Stock Exchange of India Limited

**A. Sebastin**  
Assistant Vice-President  
Inspection Department

## Appendix 10 – NSE FAQ on Actual Settlement of Funds and Securities dated Sep 7, 2012



DEPARTMENT : INSPECTION	
Download Ref. No: NSE/INSP/21651	Date: September 07, 2012
Circular No.: 144/2012	

To,  
All Members

### **Sub: FAQs – Actual Settlement of Funds and Securities**

Based on representations and queries received from members, Exchange is pleased to issue frequently asked questions (FAQs) on Actual Settlement of funds and securities. The same is made available in [http://www.nseindia.com/content/members/faq\\_ACT\\_SETT.pdf](http://www.nseindia.com/content/members/faq_ACT_SETT.pdf)

Members are requested to take note and comply with the same.

**For and on behalf of**  
**National Stock Exchange of India Limited**

C N Upadhyay  
Asst. Vice President

Telephone No	Fax No	Email id
+91-22-26598196	+91-22-26598194	compliance_assistance@nse.co.in



## Appendix 11 – SEBI Master Circular on PMLA dated Dec 31, 2010

**OFFICER ON SPECIAL DUTY**  
**INTEGRATED SURVEILLANCE DEPARTMENT**  
**EMAIL – [ramanns@sebi.gov.in](mailto:ramanns@sebi.gov.in)**  
**Tel : 022 26449450**  
**Fax : 022 2644902**

CIR/ISD/AML/3/2010

December 31, 2010

**To all Intermediaries registered with SEBI under Section 12 of the SEBI Act. (Through the stock exchanges for stock brokers and sub brokers, depositories for depository participants, AMFI for Asset Management Companies.)**

**Sub: Master Circular on AML/CFT**

**Anti Money Laundering (AML) Standards/ Combating the Financing of Terrorism (CFT) /Obligations of Securities Market Intermediaries under the Prevention of Money Laundering Act, 2002 and Rules framed there under.**

Dear Sir / Madam,

1. The Prevention of Money Laundering Act, 2002 (PMLA) was brought into force with effect from 1<sup>st</sup> July 2005. Necessary Notifications / Rules under the said Act were published in the Gazette of India on July 01, 2005.

As per the provisions of the PMLA, intermediary (includes a stock- broker, sub-broker, share transfer agent, banker to an issue, trustee to a trust deed, registrar to an issue, asset management company, depository participant, merchant banker, underwriter, portfolio manager, investment adviser and any other intermediary associated with the securities market and registered under Section 12 of the Securities and Exchange Board of India Act, 1992 (**SEBI Act**) shall have to adhere to client account opening procedures and maintain records of such transactions as prescribed by the PMLA and Rules notified there under.

2. SEBI has issued necessary directives vide circulars, from time to time, covering issues related to Know Your Client (**KYC**) norms, Anti- Money Laundering (**AML**), Client Due Diligence (**CDD**) and Combating Financing of Terrorism (**CFT**). The directives lay down the minimum requirements and it is emphasized that the intermediaries may, according to their requirements, specify additional disclosures to be made by clients to address concerns of money laundering and suspicious transactions undertaken by clients. Reference to applicable statutes and reporting guidelines for intermediaries is available at the website of the Financial Intelligence Unit– India (**FIU-IND**). Directives to all intermediaries under Section 12 of the SEBI Act are also issued in the context of compliance with the standards set by the Financial Action Task Force (**FATF**) on AML and CFT.

### 3. List of key circulars/directives issued with regard to KYC, CDD, AML and CFT

Following is a list of key circulars on KYC/CDD/AML/CFT issued by SEBI from 1993:

	Circular Number	Date of	Subject	Broad area covered
1	CIR/MRD/DP/37/2010	December 14, 2010	Acceptance of third party address as correspondence address	Capturing of address other than that of the BO as the correspondence address.
2	CIR/MRD/DMS/13/2010	August 31, 2010	Guidelines on the Execution of Power of Attorney by the Client in favour of Stock Broker/ DP	Clarifications on the Execution of the POA by the client
3	CIR/MRD/DMS/13/2010	April 23, 2010	Guidelines on the Execution of Power of Attorney by the Client in favour of Stock Broker/ DP	Guidelines on the Execution of Power of Attorney by the Client
4	CIR/MRD/DP/11/2010	April 06, 2010	Master Circulars for Depositories	Opening of BO Accounts
5	CIR/ISD/AML/2/2010	June 14, 2010	Additional Requirements for AML/CFT	Additional Requirements on retention of documents, monitoring, tipping off, updation of records and other clarifications.
6	CIR/ISD/AML/1/2010	February 12, 2010	Master Circular – AML/CFT	Framework for AML/ CFT including procedures for CDD, client identification, record keeping & retention, monitoring and reporting of STRs

7	<a href="#">SEBI/MIRSD/Cir No.02/2010</a>	January 18, 2010	Mandatory Requirement of in-person verification of clients.	In-person verification done for opening beneficial owner's account by a DP will hold good for opening trading account for a stock broker and vice versa, if the DP and the stock broker is the same entity or if one of them is the holding or subsidiary.
8	<a href="#">SEBI / IMD / MC No.1 /189241/ 2010</a>	January 01, 2010	Master Circular for Mutual Funds	Compliance with AML/CFT CDD directives of SEBI stipulated in Master Circular dated December 19, 2008
9	<a href="#">ISD/AML/CIR-2/2009</a>	October 23, 2009	Directives on CFT under Unlawful Activities (Prevention) Act, 1967	Procedure to be followed for the freezing of assets of individual or entities engaged in terrorism
10	<a href="#">ISD/AML/CIR-1/2009</a>	September 01, 2009	Additional AML/CFT obligations of Intermediaries under PMLA, 2002 and rules framed	Additional AML/CFT requirements and clarifications thereon
11	<a href="#">ISD/AML/CIR-1/2008</a>	December 19, 2008	Master Circular on AML/CFT directives	Framework for AML/CFT including procedures for CDD, client identification, record keeping & retention, monitoring and reporting of
12	MIRSD/DPS-II/130466/2008	July 2, 2008	In-Person verification of clients by stock-brokers	Responsibility of stock-brokers to ensure in-person verification by its own staff.



13	<a href="#">MRD/DoP/Cir-20/2008</a>	June 30, 2008	Mandatory Requirement of PAN	Exception for certain classes of persons from PAN being the sole identification number for all participants trading in the securities market.
14	F.No.47/2006/ISD/SR/12 2539	April 4, 2008	In-person verification of BO's when opening demat accounts	In-person verification to be carried out by staff of depository participant.
15	<a href="#">MRD/DoP/Cir-20/2008</a>	April 3, 2008	Exemption from Mandatory requirement of PAN.	Exemption for investors residing in the State of Sikkim from PAN being the sole identification number for trading in the securities market.
16	F.No.47-2006/ISD/SR/118153/20 08	February 22, 2008	In-Person verification of clients by depositories	clarification on various topics relating to 'in- person' verification of BOs at the time of opening demat accounts
17	<a href="#">MRD/DoP/Dep/Cir-12/2007</a>	September 7, 2007	KYC Norms for Depositories	Proof of Identity (POI) and Proof of Address (POA) for opening a Beneficiary Owner (BO) Account for
18	<a href="#">MRD/DoP/Cir-05/2007</a>	April 27, 2007	PAN to be the sole identification number for all transactions in the securities market	Mandatory requirement of PAN for participants transacting in the securities market.
18	<a href="#">ISD/CIR/RR/AML/2/06</a>	March 20, 2006	PMLA-Obligations of intermediaries in terms of Rules notified there under	Procedure for maintaining and preserving records, reporting requirements and formats of reporting cash transactions and suspicious transactions

20	<a href="#">ISD/CIR/RR/AML/1/06</a>	January 18, 2006	Directives on AML Standards	Framework for AML and CFT including policies and procedures, Client Due Diligence requirements, record keeping, retention, monitoring and reporting
21	<a href="#">SEBI/MIRSD/DPS-1/Cir-31/2004</a>	August 26, 2004	Uniform Documentary Requirements for trading	Uniform KYC documentary requirements for trading on different segments and exchanges
22	<a href="#">MRD/DoP/Dep/Cir-29/2004</a>	August 24, 2004	Proof of Identity (POI) and Proof of Address (POA) for opening a Beneficiary Owner	Broadening the list of documents that may be accepted as Proof of Identity (POI) and/or Proof of Address (POA) for the
23	SEBI/MRD/SE/Cir-33/2003/27/08	August 27, 2003		Mode of payment and delivery
24	SMDRP/Policy/Cir-36/2000	August 4, 2000	KYC Norms for Depositories	Prohibition on acceptance/giving of cash by brokers and on third party transfer of securities
25	SMD/POLICY/CIRC ULARS/5-97	April 11, 1997	Client Registration Form	Documentary requirements for opening a beneficiary account.
26	SMD-1/23341	Nov. 18, 1993	Regulation of transaction between clients and members	Formats of client Registration Form and broker clients agreements

**4. This Master circular consolidates all the requirements/instructions issued by SEBI with regard to AML/CFT till January 31 2010 and supersedes the earlier circulars, dated September 01, 2009, December 19, 2008, March 20, 2006 and January 18, 2006 referenced at S.Nos. (10, 11, 19 and 20) respectively of the abovementioned table.**

This Master Circular is divided into two parts; the first part is an overview on the background and essential principles that concern combating money laundering (ML) and terrorist financing (TF). The



second part provides a detailed account of the procedures and obligations to be followed by all registered intermediaries to ensure compliance with AML/CFT directives. This Circular is being issued to all the intermediaries as specified at Para 2 above. The circular shall also apply to their branches and subsidiaries located abroad, especially, in countries which do not or insufficiently apply the FATF Recommendations, to the extent local laws and regulations permit. When local applicable laws and regulations prohibit implementation of these requirements, the same shall be brought to the notice of SEBI. In case there is a variance in CDD/AML standards prescribed by SEBI and the regulators of the host country, branches/overseas subsidiaries of intermediaries are required to adopt the more stringent requirements of the two.

5. This Master circular is being issued in exercise of powers conferred under Section 11 (1) of the Securities and Exchange Board of India Act, 1992 (SEBI Act), and Rule 7 and Rule 9 of Prevention of Money-laundering (Maintenance of Records of the Nature and Value of Transactions, the Procedure and Manner of Maintaining and Time for Furnishing Information and Verification and Maintenance of Records of the Identity of the Clients of the Banking Companies, Financial Institutions and Intermediaries) Rules, 2005 (PML Rules) to protect the interests of investors in securities and to promote the development of, and to regulate the securities market.
6. All the registered intermediaries are directed to ensure compliance with the requirements contained in this Master Circular on an immediate basis. Stock exchanges, Depositories and AMFI are also directed to bring the contents of this circular to the attention of their members/depository participants and verify compliance during inspections.

Yours faithfully,

S. Ramann



## Central Depository Services (India) Limited

Convenient  $\Rightarrow$  Dependable  $\Rightarrow$  Secure

### COMMUNIQUE TO DEPOSITORY PARTICIPANTS

CDSL/A,I&C/DP/POLCY/3581

March 26, 2013

### REVISED FORMAT FOR REPORT ON INTERNAL AUDIT AND CONCURRENT AUDIT OF RISK PRONE AREAS OF DEPOSITORY PARTICIPANTS

DPs are advised to refer to Communiqué no. CDSL/A,I &C/DP/POLCY/3233 dated September 20, 2012, prescribing checklist for internal and concurrent audit, mentioning the scope, objectives and mandatory contents of the report of depository participants. **The checklist for internal and concurrent audit of risk prone areas for the half year ended 30<sup>th</sup> September 2012 will be applicable for the half year ended 31<sup>st</sup> March 2013.**

2. The scope, objectives, mandatory contents and the revised checklist of the internal and concurrent audit report is enclosed. If the internal & concurrent auditor of risk prone areas are the same, then the consolidated report should be submitted in the format specified in **Annexure-A** and if they are different, then internal audit report should be submitted in the format as per Annexure-A and report on concurrent audit should be submitted as per format [see **Annexure-B**].

The schedule for submission of internal audit report to CDSL is mentioned below: -

Half year	Period of Internal Audit	Due date for submission of the report
2 <sup>nd</sup>	1 <sup>st</sup> October 2012 to 31 <sup>st</sup> March 2013	15 <sup>th</sup> May 2013
1 <sup>st</sup>	1 <sup>st</sup> April 2013 to 30 <sup>th</sup> September 2013	15 <sup>th</sup> November 2013

3. DPs are advised to note that the guidelines provided in this communiqué will come into effect from the Internal Audit Report for the period starting from **1<sup>st</sup> April, 2013 to 30<sup>th</sup> September 2013**. Please note that for the purpose of compliance with Bye Law 16.3.1, the internal audit report must be in accordance with these guidelines. **Submission of internal audit report not as per prescribed format will be treated as non-submission.**

Further, the DPs which have been activated during the half-year ending **31<sup>st</sup> March, 2013** should submit the internal audit report and concurrent audit report of the risk prone areas pertaining to the period from the date of activation till the end of the half year.

4. DPs which have been imposed 100% concurrent audit by CDSL and which submit concurrent audit report on monthly basis to CDSL, should not submit the internal audit report for the half year ended **31<sup>st</sup> March, 2013**.

DPs may email their complaints to: [helpdesk@cdsindia.com](mailto:helpdesk@cdsindia.com)

KEYWORD : Audit

CDSL : your *depository*  
Page 1 of 2

## Appendix 13- NSDL Audit Report Format

Cover page	
Internal / Concurrent Audit Report for Depository Operations	
Name of the auditee	
DP ID(s)	INXXXXXX
	INXXXXXX
Audit period	DD-MMM-YY to DD-MMM-YY
Name of the auditor	
Membership No. of the auditor	
Name of the audit firm	
I / We hereby declare that Circular no. NSDL/Policy/2013/0068 dated May 7, 2013 was read, understood and this report is based on the guidelines given in this Circular. I / We hereby further declare that I / we have no conflict of interest with the Participant.	
Signature of the auditor	
Stamp of the auditor / audit firm	
Date	DD-MMM-YY