

Technical Guide on Internal Audit of Stock Brokers

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The Institute of Chartered Accountants of India
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FOREWORD

During the last decade, there have been substantial regulatory, structural, institutional and operational changes in the securities industry. These have been brought in with the objective of improving market efficiency, enhancing transparency, preventing unfair trade practices and bringing the Indian market up to the international standards. Introduction of mandatory half-yearly internal audit for stock brokers and clearing members is one such step taken by the Securities and Exchange Board of India which would contribute towards strengthening controls and also reducing risks under volatile market conditions.

I am happy to note that the Internal Audit Standards Board is issuing this Technical Guide on Internal Audit of Stock brokers for the guidance of the members and other readers. I congratulate CA. Shanti Lal Daga, Chairman, Internal Audit Standards Board and members of the Board on issuance of this Technical Guide. This Technical Guide comprehensively deals with the peculiar aspects of stock broking business, including various regulatory aspects, and provides a step-wise approach for internal audit.

I am sure that this Technical Guide will assist the members and others in efficiently discharging their responsibilities.

March 20, 2009
New Delhi

CA. Uttam Prakash Agarwal
President, ICAI

PREFACE

As the global economy surged forward full steam, the need for having a full fledged, strategically directed internal audit emerged as an inevitable service that could provide assurance that there is transparency in reporting, as a part of good governance. With the very same objectives the Securities Exchange Board of India, being the capital market regulator, has mandated half-yearly internal audit of the stock brokers. This would not only ensure compliance with the legal and regulatory norms but would also prove instrumental in making the system more efficient.

Internal audit is core competence area of chartered accountants. It is an important assignment being undertaken both by practising members of the Institute as well as those in industry. This demands the internal auditor to have requisite skills and high level of knowledge of the organisation as well as its interrelationship with the variables in its operating environment.

The Internal Audit Standards Board of the Institute issues not only Standards on Internal Audit to codify the best practice in the field of internal audit but also a number of generic as well as industry specific technical guides. The Board is issuing this Technical Guide on Internal Audit of Stock Brokers as a part of series of the publications on Internal Audit. This Guide would provide to the members of the Institute as well as others an in-depth understanding of the activities undertaken by the stock broker and the regulatory and legal framework in which they operate.

This Technical Guide has been divided into three parts. The first part deals with legal framework, technical and operating aspects of the stock broking business. It gives a brief overview on various aspects like, client registration, settlement of funds and securities, margins, trading terminals, money laundering, advertisement, brokerage and revenue leakage, sub-brokers, etc. The second part of the Guide explains the internal audit process and also deals with internal control evaluation and risk assessment. It also contains detailed checklist on internal audit that would help the readers in understanding the various technicalities arising during

the internal audit of a stock broker. The third part of the Guide contains Appendices which includes Illustrative Engagement Letter and also a compilation of various rules and bye-laws applicable to stock-broking business.

I must, at this juncture, express my deep gratitude to CA. Sanjeev K. Maheshwari, Central Council member and convenor of the study group and its member, CA. Bhavesh R. Vora, CA. Hiren N. Mehta, CA. Kinjal Shah and CA. Sandeep Maheshwari for squeezing time out of their pressing pre-occupations to share their wealth of knowledge and experience with us and preparing the basic draft of the Guide. I am also thankful to CA. Uttam Prakash Agarwal, President, ICAI and CA. Amarjit Chopra, Vice President, ICAI for their continuous vision and encouragement. I am also thankful to my colleagues at the Internal Audit Standards Board for providing valuable guidance on making the Technical Guide more useful. I also wish to express my appreciation for the support of CA. Jyoti Singh, Secretary, Internal Audit Standards Board and her team of officers, CA. Arti Aggarwal and CA. Gurpreet Singh, Sr. Executive Officers in finalisation of the publication.

I am sure that this Guide would help the readers in understanding all the techniques and methodologies required to carry out the internal audit of stock broker.

*March 20, 2009
Hyderabad*

CA. Shanti Lal Daga
*Chairman,
Internal Audit Standards Board*

CONTENTS

Foreword	iii
Preface	v
Abbreviations	ix
Part I		
Chapter 1:	Historical Background of Capital Market.....	1
Chapter 2:	Legal Framework.....	5
Chapter 3:	Books of Accounts, Records and Documents	13
Chapter 4:	Client Registration and Unique Client Code (UCC).....	17
Chapter 5:	Margins.....	28
Chapter 6:	Register of Transaction (Sauda Book) and Contract Note	34
Chapter 7:	Settlement	42
Chapter 8:	Settlement of Funds	49
Chapter 9:	Settlement of Securities.....	55
Chapter 10:	Statement of Funds, Securities and Margins.....	63
Chapter 11:	Brokerage and Revenue Leakage.....	65
Chapter 12:	Trading Terminals and Approved Users	68
Chapter 13:	Sub-Broker/Remisier/Authorised Person	74
Chapter 14:	Advertisement.....	77
Chapter 15:	Margin Trading Facility	82
Chapter 16:	Prevention of Money Laundering.....	86

Part II

Chapter 1:	Internal Audit	97
Chapter 2:	Internal Control Evaluation and Risk Management.....	105
Chapter 3:	Auditing in an Information Technology Environment	109
Chapter 4:	Internal Audit Checklist.....	114

Appendices

Appendix I:	Illustrative Internal Audit Engagement Letter for a Stock Broking Entity	151
Appendix II:	Illustrative Flowchart of the Business Process of a Stock Broking Entity	155
Appendix III:	Indicative Compliance Due Dates for Stock Brokers	156
Appendix IV:	Indicative Fines and Penalties – BSE.....	159
Appendix V:	Indicative Fines and Penalties – NSE	167
Appendix VI:	Commonly Observed Irregularities/ Violations/ Deficiencies.....	173
Appendix VII:	List of Important BSE/SEBI Rules, Bye-Laws, Regulations and Circulars.....	180
Appendix VIII:	List of Important NSE Rules, Bye-Laws, Regulations and Circulars	195

Stop Press

ABBREVIATIONS

ABC	Additional Base Capital
AML	Anti-Money Laundering
BG	Bank Guarantee
BOLT TWS	BSE On Line Trading Terminal Work Station
BSE	Bombay Stock Exchange Limited
CC	Clearing Corporation
CDSL	Central Depository Services (India) Limited
CISA	Clearing Member Investor's Securities Account
CM	Clearing Member
CRF	Client Registration Form
CSC	Clients of Special Category
CTCL	Computer to Computer Link
CTR	Cash Transaction Report
DCA	Department of Company Affairs
DEA	Department of Economic Affairs
DP	Depository Participant
ECN	Electronic Contract Note
ETF	Exchange Traded Fund
F&O	Futures and Options
FATF	Financial Action Task Force
FIU	Financial Intelligence Unit
HNI	High Net Worth Individuals
IBT	Internet Based Trading
IML	Intermediate Message Layer
KYC	Know Your Client
LAN	Local Area Network
MCA	Member Client Agreement

MTF	Margin Trading Facility
MTM	Mark to Market
NCFM	National Stock Exchange's Certification on Financial Markets
NEAT	National Exchange for Automated Trading
NSCCL	National Securities Clearing Corporation Limited
NSDL	National Securities Depository Limited
NSE	National Stock Exchange of India Limited
PAN	Permanent Account Number
PEP	Politically Exposed Persons
PMLA	Prevention of Money Laundering Act, 2002
RDD	Risk Disclosure Document
SEBI	Securities and Exchange Board of India
SIA	Standard on Internal Audit
SPAN	Standard Portfolio Analysis of Risk
SRO	Self-Regulatory Organisation
STP	Straight Through Processing
STR	Suspicious Transaction Reporting
STT	Securities Transaction Tax
T to T	Trade to Trade
T-Day	Trading Day
TM	Trading Member
UCC	Unique Client Code
UIN	Unique Identification Number
VaR	Value at Risk
VSAT	Very Small Aperture Terminal

PART I

Historical Background of Capital Market

Early Years

1.1 The equity brokerage industry in India is one of the oldest in the Asia region. The roots of a stock market in India began in the 1860s during the American Civil War that led to a sudden surge in the demand for cotton from India, resulting in setting up of a number of joint stock companies that issued securities to raise finance. This trend was akin to the rapid growth of securities markets in Europe and the North America in the background of expansion of rail roads and exploration of natural resources and land development.

1.2 In the aftermath of the 1865 crash, banks, on whose building steps share brokers used to gather to seek stock tips and share news, disallowed them thus, forcing them to find a place of their own, which later turned into the Dalal Street. A group of about 300 brokers formed the stock exchange in July 1875, which led to the formation of a trust known as the "Native Share and Stock Brokers Association".

A unique feature of the stock market development in India was that it was entirely driven by local enterprise. Following the establishment of the first stock exchange in Mumbai, other stock exchanges came into being in major cities in India, namely Ahmedabad (1894), Calcutta (1908), Madras (1937), Uttar Pradesh (1940), Nagpur (1940) and Hyderabad (1944). The stock markets gained from surge and boom in several industries such as, jute, tea, coal etc, at different points of time.

Beginning of a New Equity Culture

1.3 A new set of economic and financial sector reforms that began in the early 1990s gave further impetus to the growth of the stock markets in India. As a part of the reform process, it

Technical Guide on Internal Audit of Stock Brokers

became imperative to strengthen the role of the capital markets that could play an important role in efficient mobilisation and allocation of financial resources to the real economy. Towards this end, several measures were taken to streamline the processes and systems, including setting up of an efficient market infrastructure to enable Indian finance to grow further and mature.

1.4 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.

1.5 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.

1.6 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

Historical Background of Capital Market

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.

Rapid Growth

1.7 Stock markets became intensely technology and process driven, giving little scope for manual intervention that has been the source of market abuse in the past. Electronic trading, digital certification, straight through processing, electronic contract notes, online broking have emerged as major trends in technology. Risk management became robust reducing the recurrence of payment defaults. Product expansion took place in a speedy manner. Indian equity markets now offer, in addition to trading in equities, opportunities in trading of derivatives in futures and options in index, stocks and currency derivatives. Exchange Traded Funds (ETFs) are showing gradual growth.

Current Scenario

1.8 Presently, besides Regional Stock Exchanges, there are two main stock exchanges, i.e., National Stock Exchange (NSE) and Bombay Stock Exchange (BSE). Stock exchange reforms brought in professional management separating conflicts of interest between brokers as owners of the exchanges and traders/dealers.

1.9 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, 2008:

Market Participants in Securities Market

Particulars	Number as on March 31, 2008
Securities Appellate Tribunal	1
Regulators*	4
Depositories	2
Stock Exchanges with equity trading	19
Brokers	9,487
Sub-brokers	44,073
FIIIs	1,319
Portfolio Managers	205
Custodians	15
Registrars to an Issue and Share Transfer Agents	76
Merchant Bankers	155
Bankers to an Issue	50
Debenture Trustees	28
Underwriters	35
Venture Capital Funds	106
Mutual Funds	40
Collective Investment Schemes	0
* DCA, DEA, RBI & SEBI	

Source: SEBI

Legal Framework

Legislation

2.1 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, 1956

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.

Rules and Regulations

2.2 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:

- (a) SEBI (Stock Brokers and Sub-Brokers) Rules, 1992
- (b) Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992
- (c) Securities and Exchange Board of India (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002
- (d) Securities and Exchange Board of India (Ombudsman) Regulations, 2003
- (e) Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices relating to the Securities Market) Regulations, 2003
- (f) SEBI (Interest Liability Regularisation) Scheme, 2004
- (g) Securities and Exchange Board of India (Certification of Associated Persons In The Securities Markets) Regulations, 2007

Technical Guide on Internal Audit of Stock Brokers

The Self-regulatory Organisations (SROs) like stock exchanges have also laid down their rules and regulations for market participants.

Regulators

2.3 The regulators ensure that the market participants behave in a desired manner so that the securities market continue to be a major source of finance for corporate and government and the interest of investors are protected. The responsibility for regulating the securities market is shared by Department of Economic Affairs (DEA), Department of Company Affairs (DCA), Reserve Bank of India (RBI) and Securities and Exchange Board of India (SEBI) as shown in the following Table:

Regulation of the Securities Market

Acts	Section	Powers	Exercisable by
Securities Contracts (Regulation) Act, 1956	4A	Corporatisation and demutualisation of stock exchanges	SEBI
	4B	Procedure for Corporatisation and demutualisation	
	6	Call for periodical returns or direct inquiries to be made	
	8A	Clearing Corporation	
	9	Approval of byelaws of recognised stock exchanges	
	10	Make or amend bye-laws of recognised stock exchanges	
	12A	Power to issue directions	
13A	Additional trading floor		

Legal Framework

Acts	Section	Powers	Exercisable by
	17	Licensing of dealers in securities in certain areas	
	3	Application for recognition of stock exchanges	Central Government and concurrently exercisable by SEBI
	4	Grant of recognition to stock exchanges	
	5	Withdrawal of recognition	
	7	Submission of Annual Report	
	7A	Rules restricting voting rights	
	8	Direct rules to be made or to make rules	
	11	Supersede governing body of a recognized stock exchanges	
	12	Suspend business of Recognised Stock Exchanges	
	13	Contracts in notified areas illegal in certain circumstances	
	14	Contracts in notified areas void in certain circumstances	
	16	Prohibition of contracts	
	18	Exclusion of spot delivery contracts	
	22	Right of Appeal against refusal to list	

Technical Guide on Internal Audit of Stock Brokers

Acts	Section	Powers	Exercisable by
	28	Inapplicability of the SC(R)A in certain cases	
	21A	Appeal against the decision of recognized stock exchange to delist the securities	SAT
	22A	Appeal against refusal by stock exchanges to list securities of public companies	
	22B	Procedures and Powers of SAT	
	16	Prohibition of Contracts	Central Government and concurrently exercisable by SEBI and RBI
	22F	Appeal against the decision of SAT	Supreme Court
	All other powers under the Act		Central Government
	Securities Contracts (Regulation) Rules, 1992		SEBI
Rules, Regulations and Bye-Laws		Stock Exchanges	
SEBI Act, 1992	3, 5 & 6 13 14 15	Establishment and Management of SEBI	Central Government

Legal Framework

Acts	Section	Powers	Exercisable by
	15K to 15S	Establishment of SAT	
	16	To issue directions	
	17	To supersede SEBI	
	18	SEBI to submit returns and reports	
	20		
	24B		
	29	To make rules	
	31	Rules and Regulations to be laid before Parliament	
	34		
	15T & 15U	Appellate powers	SAT
	24A	Composition of certain offences	
	4	Management of Board	Central Government and RBI
	15Z	Appeal to Supreme Court	Supreme Court
	All other powers		SEBI
Depositories Act, 1996	22B	Power to grant immunity	Central Government
	23	Appeals	
	24	To make rules	
	27	Rules and Regulations to be laid before the Parliament	

Technical Guide on Internal Audit of Stock Brokers

Acts	Section	Powers	Exercisable by
	29	Removal of difficulties	
	23A & 23B	Appellate powers	SAT
	22A	Composition of certain offences	
	23F	Appeal against order or decision of SAT	Supreme Court
	26	To make bye-laws	Depositories
	All other powers		SEBI
Companies Act, 1956	55 to 58, 59 to 81, 108 to 110, 112, 113, 116 to 122, 206, 206A, 207	Issue of securities, transfer of securities, and non-payment of dividend in case of listed public companies and in case of those public companies which intend to get their securities listed on any recognised stock exchange in India.	SEBI
	108A to 108E, 108I		Central Government

** Government has issued notifications providing that the contracts for sale and purchase of government securities, gold-related securities, money market securities and securities derived from these securities and ready forward contracts in debt securities shall be regulated by RBI. Such contracts, if executed on stock exchanges, shall, however, be regulated by SEBI in a manner that is consistent with the guidelines issued by RBI.*

Books of Accounts, Records and Documents

3.1 Securities Contracts (Regulation) Rules, 1957 and the Securities and Exchange Board of India (Stock Brokers and Sub-Brokers) Regulations, 1992 specifies maintenance of proper books of accounts. The stock broker should maintain separate set of books of accounts for each of the stock exchanges.

3.2 The various provisions dealing with maintenance of books and records are as follows:

(a) Rule 15 of the Securities Contracts (Regulation) Rules, 1957

- 1) Every member of a recognised stock exchange shall maintain and preserve the following books of account and documents for a period of five years:
 - i) Register of transactions (Sauda book).
 - ii) Clients' ledger.
 - iii) General ledger.
 - iv) Journals.
 - v) Cash book.
 - vi) Bank pass-book.
 - vii) Documents register showing full particulars of shares and securities received and delivered.
- 2) Every member of a recognised stock exchange shall maintain and preserve the following documents for a period of two years:

Technical Guide on Internal Audit of Stock Brokers

- i) Member's contract books showing details of all contracts entered into by him with other members of the same exchange or counterfoils or duplicates of memos of confirmation issued to such other members.
- ii) Counterfoils or duplicates of contract notes issued to clients.
- iii) Written consent of clients in respect of contracts entered into as principals.

(b) Regulation 17 and 18 of SEBI (Stock Brokers and Sub-Brokers) Regulation, 1992

It specifies maintenance of proper books of accounts, records, etc. as under for a period of 5 years:

Regulation 17

Every stock broker shall keep and maintain the following books of accounts, records and documents namely; -

- i) Register of transactions (Sauda Book);
- ii) Clients ledger;
- iii) General ledger;
- iv) Journals;
- v) Cash book;
- vi) Bank pass book;
- vii) Documents register containing, *interalia*, particulars of securities received and delivered in physical form and the statement of accounts and other records relating to receipt and delivery of securities provided by the Depository Participants in respect of dematerialised securities.

Books of Accounts, Records and Documents

- viii) Members' contract books showing details of all contracts entered into by him with other members of the same exchange or counterfoils or duplicates of memos of confirmation issued to such other member;
- ix) Counterfoils or duplicates of contract notes issued to clients;
- x) Written consent of clients in respect of contracts entered into as principals;
- xi) Margin deposit book;
- xii) Registers of accounts of sub-brokers;
- xiii) An agreement with a sub-broker specifying the scope of authority and responsibilities of the Stock-Broker and such sub- broker.
- xiv) An agreement with the stock broker and with the client of the sub-broker to establish privity of contract between a stock broker and the client of the sub-broker.

Every stock-broker shall intimate to the SEBI the place where the books of accounts, records and documents are maintained.

Regulation 18

Every Stock Broker shall preserve the books of accounts and other records maintained under Regulation 17 for a minimum period of 5 years.

In case where copies of the records / documents have been collected by enforcement agencies like, CBI, Police, Crime Branch, etc., during the course of their investigation, then the originals of such documents, both in electronic and physical form, shall be required to be preserved till the trial is completed.

The broker should maintain and preserve for a period of 7 years mapping of client IDs used at the time of order entry in the trading system with those unique client IDs along with client

Technical Guide on Internal Audit of Stock Brokers

name, address and other particulars given in the Know Your Client Form.

(c) Rule 6 of the Prevention of Money Laundering Rules, 2005

Under Rule 6 of the Prevention of Money Laundering Rules, 2005, the records referred to in Rule 3 shall be maintained for a period of 10 years from the date of cessation of the transactions between the client and the intermediary.

Client Registration and Unique Client Code (UCC)

4.1 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.

4.2 Stock broker has to enter into agreements with the each of their clients in the specified format before accepting or placing orders on their behalf. The said agreement shall be executed on non-judicial stamp paper of adequate value, duly signed by both the parties on all the pages.

4.3 Classification of the client should be done into high, medium or low risk category depending on parameters such as, the client's background, type of business relationship, transactions, etc. Broker should apply each of the clients due diligence measures on a risk sensitive basis and adopt an enhanced client due diligence process for high risk categories of client and *vice versa*.

Uniform Document Requirement

4.4 SEBI has, vide its Circular No. SEBI/MIRSD/DPS-1/Cir-31/2004, dated August 26, 2004, 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

Technical Guide on Internal Audit of Stock Brokers

documents, SEBI has formulated uniform set of documents which are listed below:

- i) Client Registration Form (CRF) - It is uniform across all the segments and exchanges where the broker is trading on different segments and exchanges.
- ii) Member Clients Agreements (MCA) - It is uniform across all the segments of an exchange. However, a separate agreement in the same format would be required for each of the exchanges where the broker is trading on different exchanges.
- iii) Model Tripartite Agreement between Broker, Sub-broker and Clients- It is applicable only in cash segment and a separate agreement in the same format would be required for each of the exchanges.
- iv) Uniform Risk Disclosure Documents (RDD) - It is uniform across all the segments and exchanges.
- v) Broker and Sub-broker agreement.

4.5 The requirement of obtaining Client Registration Form may be waived for SEBI registered Foreign Institutional Investor, Mutual Funds, Venture Capital Funds and Foreign Venture Capital Investors, Scheduled Commercial Banks, Multilateral and Bilateral Development Financial Institutions, State Industrial Development Corporations, Insurance Companies registered with the Insurance Regulatory Development Authority of India or Section 4A of the Companies Act, 1956. Further, the Stock Broker and the above-mentioned clients may at their discretion, decide about the requirement of entering into broker-client agreement and bringing the contents of Risk Disclosure Document to the notice of such clients.

4.6 NSE has, vide its Circular No. NSE/INSP/7657 dated July 5, 2006 and BSE has, vide its Notice No. 20060704-6 dated July 4, 2006, drawn the attention of the broker to contents of SEBI Circular No. SEBI/MIRSD/DPS-I/Cir-31/2004 dated August 26, 2004. SEBI has vide such circular prescribed uniform document

Client Registration and Unique Client Code (UCC)

requirement for trading. Trading members are further advised by the said NSE and BSE circulars to ensure the following:

- (i) At the time of registering a client, the client shall be informed in writing that only the documents stated above are mandatory and any additional clause or documentation shall be voluntary and at the discretion of member and client.
- (ii) Additional documents shall state at the beginning in bold that the document is voluntary.
- (iii) However, if such documents are required in order to ensure smooth functioning of special facility such as, internet trading offered by the trading member, the client shall be informed in writing clearly that such documents are voluntary and the client need not execute such documents if he/she does not wish to use that facility.
- (iv) Such documents, if any, shall also recognise specifically the right of the client to terminate the document. In such an eventuality, the trading member may terminate the special facility.
- (v) The docket or folder containing draft mandatory documents for signing and the checklist containing mandatory documents shall not include draft voluntary documentations, if any. Further, these mandatory documents should relate to only opening the account for stock trading and not for any other additional business/activity like, opening of Bank Account, DP Account, etc.
- (vi) No documentation shall give any exclusive right or control to the trading member or third party over the demat account or ledger account or bank account of the client except to the extent of and restricted to the client (including family members who have given authorisation) obligation to the trading member in respect of the transactions done or to be done (like upfront margin) by the trading member on behalf of the client on the Exchange.

Technical Guide on Internal Audit of Stock Brokers

4.7 Further, NSE has, vide its Circular No. NSE/INVG/2006/7236 dated March 3, 2006 and BSE has, vide its Notice No. 20060704-6 dated July 4, 2006, advised the brokers to ensure that all client registration details as mentioned in the Client Registration Form/Know Your Client (KYC) form are complete in all respect and are reviewed and updated periodically. The brokers were also advised to monitor the trading activities of their clients based on the financial details as contained in the client's KYC. Further, financial details as contained in the client's KYC should be used to monitor the trading activities of the clients. Brokers are also advised to periodically review their database to ensure its completeness and accuracy.

4.8 Upon registration of a client, trading members shall deliver to the client a copy of the duly completed client registration documents viz., Client registration form/KYC, Member Client Agreement/Tripartite Agreement, Risk Disclosure Document and a copy of any other document executed with the client. The Unique Client Code (UCC) allotted to a client for trading and the e-mail id furnished by the client for the purpose of receiving electronic contract notes and other relevant details, shall be communicated by the trading member through the client registration documents or otherwise in writing to the client. Proof of such delivery/communication is to be maintained along with the registration documents pertaining to the clients. In respect of clients registered prior to June 24, 2008, the above-mentioned documents and details shall be provided upon request from such clients.

PAN – Sole Identification Number

4.9. Obtaining PAN Card details of the client is compulsory for all categories of clients. PAN is the sole identification number for all participants transacting in the securities market, irrespective of the amount of transaction. The broker official accepting the account opening form should verify the photocopy of the PAN Card against the original. Also, PAN is required to be cross checked with the Income Tax website. It is suggested that after verification of original, the broker official should sign and stamp the copy and write "verified with original" on the copy. The broker

Client Registration and Unique Client Code (UCC)

official should also take care that the copy obtained as a proof of PAN should be legible.

Documents Required for Account Opening

4.10 The documents/information to be submitted by various categories of investors as per SEBI Model KYC documents are as follows:

(A) In Case of Individual Client:

- (i) Photocopy of PAN Card
- (ii) Proof of ID (any one of the following):
 - (a) PAN Card
 - (b) MAPIN/UIN Card
 - (c) Passport
 - (d) Driving License
 - (e) Election Card
 - (f) Photo ID Card issued by employer registered under MAPIN
- (iii) Proof of Address (any one of the following)
 - (a) Passport
 - (b) Election Card
 - (c) Driving License
 - (d) Bank Passbook
 - (e) Rent Agreement
 - (f) Ration Card
 - (g) Flat Maintenance Bill
 - (h) Telephone Bill
 - (i) Electricity Bill

Technical Guide on Internal Audit of Stock Brokers

- (j) Certificate issued by employer registered under MAPIN
- (k) Insurance Policy
- (iv) Proof of Bank Account (copy of a canceled Cheque leaf containing pre-printed name of the Client or pass book/bank statement containing name of the Client)
- (v) A passport size photograph (preferably with signing across the photograph).

(B) Non-Individual Clients

(I) In Case of HUF Client

- (i) Photocopy of Id Proof of Karta
- (ii) Photocopy of PAN Card of HUF
- (iii) Proof of Bank Account of HUF (copy of a canceled Cheque leaf containing pre-printed name of the Client or pass book/bank statement containing name of the Client)
- (iv) Copies of the balance sheet (Annual Report) for the last two financial years (copies of annual balance sheet to be submitted every year).

(II) In Case of Partnership Firm Client

- (i) Photocopy of PAN Card of the Firm
- (ii) Copy of Partnership Deed
- (iii) Proof of Bank Account (Copy of a canceled Cheque leaf containing pre-printed name of the Client or pass book/bank statement containing name of the Client)
- (iv) Photograph of Partners
- (v) Copies of the balance sheet (Annual Report) for the last two financial years (copies of annual balance sheet to be submitted every year).

Client Registration and Unique Client Code (UCC)

(III) In Case of Corporate Client

- (i) Photocopy of PAN Card of the company.
- (ii) Copies of the balance sheet (Annual Report) for the last two financial years (copies of annual balance sheet to be submitted every year)
- (iii) Copy of latest share holding pattern including list of all those holding more than 5% in the share capital of the company, duly certified by the company secretary/ Whole-time director/MD. (Copy of updated shareholding pattern to be submitted every year, and should be on the Letter head of the client)
- (iv) Duly certified Copies of the Memorandum and Articles of Association
- (v) Copy of the Resolution of board of directors' approving participation in equity/derivatives/debt trading and naming authorized persons for dealing in securities
- (vi) Photographs of Whole time directors, individual promoters holding 5% or more, either directly or indirectly, in the shareholding of the company and of persons authorised to deal in securities
- (vii) Proof of Bank Account (Copy of a canceled Cheque leaf containing pre-printed name of the Client or pass book/bank statement containing name of the Client).

(IV) In Case of Trust

- (i) Photocopy of PAN Card of Trust
- (ii) Copy of Trust deed duly certified by trustee
- (iii) Resolution authorising one or more trustee to deal with the broker
- (iv) Proof of Bank Account (Copy of a canceled Cheque leaf containing pre-printed name of the Client or

Technical Guide on Internal Audit of Stock Brokers

pass book/bank statement containing name of the Client)

- (v) In case of Trust is a corporate then additional detail as given in 'In case of Corporate Client' will be applicable.

4.11 Apart from the abovementioned documents prescribed by SEBI, the following documents may be obtained from the client for better compliance and internal controls.

(A) In Case of Individual Client

- (i) Proof of Demat Account (Copy of Client Master/Status report containing account details or latest transaction/holding statement containing name of the Client).

(B) Non-Individual Clients

(I) In Case of HUF Client

- (i) Photocopy of PAN Card of Karta
- (ii) Proof of Address of Karta
- (iii) Proof of Demat Account (Copy of Client Master/Status report containing account details or latest transaction/holding statement containing name of the Client)
- (iv) Consent Letter of HUF members with specimen signature of all co-parceners stating about authorising one or more members of HUF to involve in the trading activity with Broker.

(II) In Case of Partnership Firm Client

- (i) Proof of Demat account of Authorised Partner (Copy of Client Master/Status report containing account details or latest transaction/holding statement containing name of the Client)
- (ii) Consent Letter from all Partners stating about authorising one of the Partners to involve in trading activity with Broker

Client Registration and Unique Client Code (UCC)

- (iii) Photocopy of ID proof of authorised Partner (who is allowed to deal with the broker according to consent letter)
- (iv) List of Partners with addresses on the letterhead of Firm.

(III) In Case of Corporate Client

- (i) Details of the Directors along with proof of Identity
- (ii) Proof of Demat Account.

(IV) In Case of Trust

- (i) Proof of Demat Account
- (ii) Details of the trustee along with ID proof of trustee.

Broker may also seek additional information, if any, so as to satisfy himself about the antecedents of the client. It would be broker's responsibility to provide clients details as and when required by SEBI or stock exchanges.

In - Person Verification

4.12 Broker should ensure 'in-person' verification by their own staff while registering the clients, including clients of their branches and sub brokers, and that this function is not outsourced. Further, the date of verification, name and signature of the official who has done in-person verification and the stamp of the member should be incorporated in the client registration form. 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.

Remisier to Act as Introducer

4.13 Broker should ensure remisier has signed as an introducer in the KYC form for clients introduced by him for dealing on BSE (applicable w.e.f. August 1, 2008).

Inventory Controls

4.14 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 authorised officials.

Unique Client Code (UCC)

4.15 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.

4.16 For certain categories of investors who are required by applicable regulations not to buy or sell without adequate funds

Client Registration and Unique Client Code (UCC)

or securities to their credit before execution of transaction and whose transactions are to be settled by delivery only, for such entities the brokers may be permitted to allot up to two trading client codes (*i.e.*, for their buy and sell transactions separately so that each leg of transaction is treated separately and not netted). Both the trading client codes should be mapped to the same Unique Client Code allotted to that client.

Chapter I - 5

Margins

5.1 Margins are important elements of a Risk Management System. In case of capital market, the broker is required to prepare a well documented Risk Management System and collect margin according to organisation's policy. The quantum of these margins and also form and mode of collections are left to the discretion of the brokers. However, in case of futures and options market, the broker shall collect the initial margins as stipulated by the exchanges.

Collection of Margins from Clients

5.2 SEBI vide its circular no. MRD/DoP/SE/CIR-07/2005 dated February 23, 2005 has stated that, brokers should have a prudent system of Risk Management to protect themselves from the client default. Margins are likely to be an important element of such a system. The same shall be well documented and be made accessible to the clients and the stock exchanges. It is suggested that such well documented policy should be adopted by passing the requisite resolution by the broker. However, the quantum of margins and the form and mode of collection of margins from the clients are left to the discretion of the broker.

Cash Segment

5.3 In Cash Segment, broker has to pay 'Daily Margin' to the exchange. Daily Margin comprises of the sum of Value at Risk (VaR) Margin, Extreme Loss Margin and Mark-to-Market Margin.

Value at Risk (VaR) Margin

5.4 The Value at Risk (VaR) margin shall be collected by the exchange on an upfront basis by adjusting against the total liquid assets of the broker at the time of trade. The VaR margin shall be collected on the gross open position of the broker. The gross open position, for this purpose, would mean the gross of all net positions across all the clients of a broker including his

proprietary position. There would be no netting off of positions across different settlements. For example, in case of a broker, if client A has a buy position of 1000 in a security and client B has a sell position of 1000 in the same security, the net position of the broker in the security would be taken as 2000. It would be summed up to arrive at the broker's open position for the purpose of margin calculation. The VaR Margin so collected shall be released on completion of pay-in of the settlement.

Extreme Loss Margin

5.5 The Extreme Loss Margin shall be collected/ adjusted against the total liquid assets of the broker on a real time basis. It shall be collected on the gross open position of the broker. The gross open position, for this purpose, would mean the gross of all net positions across all the clients of a broker including its proprietary position. There would be no netting off of positions across different settlements. The Extreme Loss Margin collected shall be released on completion of pay-in of the settlement.

Mark-to-Market (MTM) Margin

5.6 Mark-to-market loss shall be calculated by marking each transaction in security to the closing price of the security at the end of trading. In case the security has not been traded on a particular day, the latest available closing price at the exchange shall be considered as the closing price. In case the net outstanding position in any security is nil, the difference between the buy and sell values shall be considered as notional loss for the purpose of calculating the mark to market margin payable.

5.7 The mark-to-Market (MTM) margin shall be collected from the broker before the start of the trading of the next day. The MTM margin shall also be collected/adjusted from/against the cash/cash equivalent component of the liquid net worth deposited with the Exchange. The MTM margin shall be collected on the gross open position of the broker. The gross open position, for this purpose, would mean the gross of all net positions across all the clients of a broker including its proprietary position. For this purpose, the position of a client would be netted across its various securities and the positions of all the clients of a broker would be grossed. There would be no netting off of the

positions and set off against MTM profits across two rolling settlements, i.e., T day and T-1 day. However, for computation of MTM profits/losses for the day, netting or set off against MTM profits would be permitted. In case of Trade to Trade Segment (T-to-T segment) each trade shall be marked to market based on the closing price of that security. The MTM margin so collected shall be released on completion of pay-in of the settlement.

Derivatives Segment

5.8 Exchange charges and collects the following types of Margins from the Broker:

(I) Initial Margin

- (i) The Exchange collects initial margin upfront for all the open positions of a clearing member based on the margins computed by Standardised Portfolio Analysis of Risk (SPAN).
- (ii) Initial Margins can be paid by members in the form of cash, bank guarantee, fixed deposit receipts and approved securities.
- (iii) A clearing member is in turn required to collect the initial margin from the trading members and his respective clients. Similarly, a trading member should collect upfront margins from his clients.
- (iv) For client positions, Initial Margin shall be netted at the level of individual client and grossed across all clients, at the trading/ clearing member level, without any set-offs between clients.
- (v) For proprietary positions, Initial Margin shall be netted at trading/ clearing member level without any set-offs between client and proprietary positions.
- (vi) In case a trading member wishes to take additional trading positions his clearing member is required to provide Additional Base Capital (ABC) to Clearing Corporation. ABC can be provided by the members in the form of cash, bank guarantee, fixed deposit receipts and approved securities.

(II) Mark-to-Market (MTM) Margin

- (i) The Exchange debits/credits Mark-to Market margin loss/profit from or in the clearing members' accounts with designated banks on T+1 day basis.
- (ii) The MTM margin is computed by marking the daily net open position of a member in all series to the closing price of the respective series to find out the notional profit/loss a broker would incur in case his net open position in all series at the end of the day in consideration were to be closed out.
- (iii) All notional profits made in some series and all notional losses in other series as well as all realised profit and losses incurred by the brokers on the positions squared up are netted and net amount is collected or paid as MTM margin.
- (iv) MTM Margins is payable in cash only.
- (v) A clearing member is in turn required to collect the MTM margin from his clients in cash only.

(III) Premium Margin

- (i) In addition to Initial Margin, Premium Margin would be charged to members. The Premium Margin (i.e., the premium on call and put option) is the client-wise margin amount payable for the day and will be required to be paid by the buyer till the settlement is complete.

(IV) Assignment Margin

- (i) Assignment Margin (i.e., option margin on call and put option) is levied on a clearing member in addition to SPAN margin and Premium Margin. It is required to be paid on assigned positions of clearing members towards interim and final Exercise Settlement obligations for option contracts on individual securities, till such obligations are fulfilled.

Technical Guide on Internal Audit of Stock Brokers

- (ii) The margin is charged on the Net Exercise Settlement Value payable by a clearing member towards interim and final Exercise Settlement and is deductible from the effective deposits of the clearing member available towards margins.
- (iii) Assignment margin is released to the clearing members on exercise of settlement pay-in.

Client Margin

5.9 Clearing members and trading members are required to collect initial margins from all their clients. The collection of margins at client level in the derivatives market is essential as derivatives are leveraged products and non-collection of margins at the client level would provide zero cost leverage. In the derivatives market, all money paid by the client towards margins is kept in trust with the Clearing House/ Clearing Corporation and in the event of default of the trading or clearing member the amount paid by the client towards margins are segregated and not utilised towards the default of the broker. Therefore, clearing members are required to compulsorily report on a daily basis, details in respect of such margin amount due and collected, from their trading members/clients, clearing and settling through them. Trading members are also required to report on a daily basis details of the amount due and collected from their clients.

5.10 The reporting of the collection of the margins by the clients is done electronically through the system at the end of each trading day. The reporting of collection of client level margins plays a crucial role not only in ensuring that brokers collect margin from clients but it also provides the clearing corporation with a record of the quantum of funds it has to keep in trust for the clients. Brokers are required to collect initial margin from clients in one or more of the following mode(s):

- (a) Cash;
- (b) Fixed Deposit Receipts (FDRs) issued by any one or more of the approved commercial banks;
- (c) Bank Guarantee issued by any one or more of the approved commercial banks;

Margins

- (d) Deposit of approved securities in dematerialised form or such other collateral form, with the applicable hair cut. The list of approved securities and applicable hair cut thereon is specified by the Clearing Corporation from time to time.

Client Margin Reporting

5.11 The cut-off day up to which a broker may report client margin details to clearing corporation is within 2 working days after the trade day, i.e., within T+2 day basis.

Register of Transaction (Sauda Book) and Contract Note

Register of Transaction (Sauda Book)

6.1 Broker is required to maintain a 'Sauda Book', which contains details of all deals transacted by them on a day-to-day basis. These details are maintained settlement-wise. This register normally contains the transactions both for member's own business and member's business on behalf of clients on the exchange. The Sauda Book is prepared by importing data into the back office accounting system from the 'trade file' (NSE) or 'BRK file' (BSE) received from the exchange on a daily basis. The Sauda Book is equivalent to purchase register maintained by the trading/ manufacturing entity in regular parlance. It, generally, contains the following details:

- Name of the scrip
- Scrip Code
- Order number
- Order Time
- Trade number
- Trade Time
- Name of the client on whose behalf the deals have been done
- Client code
- Market Rate
- Net rate
- Quantity of scrip bought or sold
- Settlement number
- Date

Register of Transaction (Sauda Book) and Contract Note

6.2 Trade file or BRK file is a statement provided by exchange and downloaded by the broker on a daily basis. This statement reflects all the transactions executed by a broker from all his terminals for that day on the exchange. Trade file/ BRK file generally provides the following details:

- Name of the scrip
- Scrip Code
- ISIN
- Terminal number
- Order number
- Order Time
- Trade number
- Trade Time
- Client code
- Rate
- Quantity of scrip bought or sold
- Settlement number
- Date

Checks and Balances

6.3 This file serves as an external confirmation of the trades reflected in the Sauda Book and, hence, is very useful in the audit process. It helps to establish whether all the trades reflected in the Sauda Book are executed on the exchange and also helps to detect the off-market trades, if any executed by the broker. Similarly any changes w.r.t. the following could be detected by matching the trade file/ BRK file and the Sauda Book:

- Client code modification
- Market rate modification
- Cross deals

Technical Guide on Internal Audit of Stock Brokers

- Off-market trades
- Principal to Principal trades
- Front Running.

Contract Note

6.4 If Sauda Book is similar to purchase register, contract notes is equivalent to an invoice issued by the trading/manufacturing entity in regular parlance. The content of the contract notes are extracted from the data in the Sauda Book. Contract note is a document which establishes contractual obligation between the broker and the client. This is an important document which is normally relied upon in case of disputes between the broker and the client. The format of contract note has been prescribed by the respective exchanges as under:

Sr. no.	Exchange	Segment	Regulations	Circular No. and Date
(i)	BSE	Cash Market	14	20060627-18 dated June 27, 2006
(ii)	NSE	Capital Market	3.5	NSEIL /LEGAL /7036 dated January 5, 2006
(iii)	NSE	F&O	3.6	NSEIL /LEGAL /7037 dated January 5, 2006 and NSEIL/LEGAL/ 8319 dated January 2, 2007

Register of Transaction (Sauda Book) and Contract Note

6.5 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.

Contents of Contract Note

6.6 As per the generally accepted market practice, contract notes–cum-bill is issued for cash segment, however for the F&O segment broker is required to issue separately the Contract note and the bill. In addition to the prescribed information, broker can provide other additional details/ information as he may deem fit. Broker is also required to attach details of trades if a summary Contract note (with average rate) has been issued to the client. Generally, the Contract note also contains details of other charges, levies, taxes, etc., to the extent recoverable from client. The stock exchange facilitates viewing of trades details on their website up to 5 days from the date of execution of trade. This ensures transparency in the execution of trades and discourages modification of trade by broker with any malafide intentions. PAN of client is required to be printed on the Contract note in case the contract value exceeds Rs. 1 Lac.

Issuance of Contract Note

6.7 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.

Numbering of Contract Notes

6.8 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.

Brokerage

6.9 Broker can not 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.

Securities Transaction Tax

6.10 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

Register of Transaction (Sauda Book) and Contract Note

the Contract notes. Format of statement of STT has been prescribed by both the exchanges.

Electronic Contract Note (ECN)

6.11 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.

Issuing ECNs When Specifically Consented

6.12 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.

Where to Send ECNs

6.13 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.

Requirement of Digital Signature

6.14 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.

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

Acknowledgement

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

Proof of Delivery

6.16 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

6.17 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

6.18 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

6.19 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

Register of Transaction (Sauda Book) and Contract Note

within the stipulated time under the extant regulations of SEBI/stock exchanges and maintain the proof of delivery of such physical Contract notes.

General Requirements

ECNs through Website

6.20 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

6.21 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

6.22 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.

Straight Through Processing (STP)

6.23 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.

Chapter I - 7

Settlement

7.1 The clearing and settlement mechanism in Indian securities market has witnessed significant changes and several innovations during the last decade. These include use of the state-of-art information technology, clearing corporations to assume counterparty risk, shorter settlement cycle, dematerialisation and electronic transfer of securities, fine tuned risk management system, etc.

7.2 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.

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

(i) Clearing Corporation or Clearing House - Clearing Corporation or Clearing House (hereinafter referred to as Clearing Corporation (CC)) means the clearing corporation or clearing house of a recognised stock exchange to clear and settle trades in securities. CC is responsible for post trade activities of a stock exchange. Clearing and settlement of trades and risk management are its central functions.

CC clears all trades, determines obligations of members, collects funds/securities, processes for shortages in funds/securities, arranges for pay-out of funds/securities to members, guarantees settlement, and collects and maintains margins/collateral/base capital/other funds. The clearing and settlement operations of the NSE are managed by its wholly owned subsidiary, the National

Securities Clearing Corporation Limited (NSCCL). The clearing and settlement operations of the BSE are managed by BOI Shareholding Limited, which is a subsidiary of Bank of India and BSE.

- (ii) **Clearing Members** - A member of a clearing corporation or clearing house of the derivatives exchange or derivatives segment of an exchange, who shall clear and settle transactions in securities. In the capital market segment, all trading members of the Exchange are required to become the Clearing Member of the Clearing Corporation. They are responsible for settling their obligations as determined by the CC of the respective exchanges. They have to make available funds and/or securities in the designated accounts with clearing bank/depository participant, as the case may be, to meet their obligations on the settlement day.
- (iii) **Trading Member** - A member of the derivatives exchange or derivatives segment of a stock exchange who settles the trade in the clearing corporation or clearing house through a clearing member. Trading Member can trade on his own behalf and/or on behalf of his clients.
- (iv) **Custodians** - A custodian is an entity appointed by the client for safekeeping the property like, shares, etc. belonging to the original holder. It settles trades assigned to them by trading members. A custodian can act as clearing member but not as trading member. On confirmation from the custodian to settle a particular trade, the CC assigns settlement obligation to that custodian and the custodian is required to settle it on the settlement day. If the custodian rejects the trade, the obligation is assigned back to the trading/clearing member for settlement which is then called DVP trade (Delivery vs. Payment).
- (v) **Clearing Bank** - Clearing bank facilitates the settlement of funds. Every clearing member is required to open a dedicated settlement account with one of the clearing banks. The clearing member makes funds available for

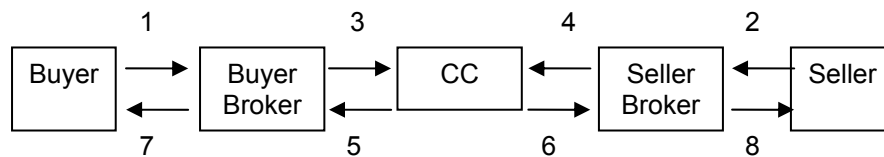
Technical Guide on Internal Audit of Stock Brokers

the pay-in or receives funds in case of a pay-out in the settlement account maintained with the Clearing Bank.

- (vi) **Depositories** - A depository is an entity where the securities of an investor are held in electronic form. Depositories facilitate the settlement of the dematerialised securities. Every clearing member is required to maintain settlement account with each of the depositories. Clearing Member makes available the required securities on settlement day for the pay-in or receives securities in case of a pay-out in the designated settlement account with the depositories.

Settlement Process

7.4 While the stock exchange provides a platform for trading to its trading members, the Clearing Corporation (CC) determines the funds/securities obligations of the trading members and ensures that clearing members meet their obligations. CC becomes the legal counterparty to the net settlement obligations of every member. CC is obligated to meet all settlement obligations, regardless of member defaults, without any discretion. The diagram hereunder shows the CC acting as legal counterparty:



Explanation

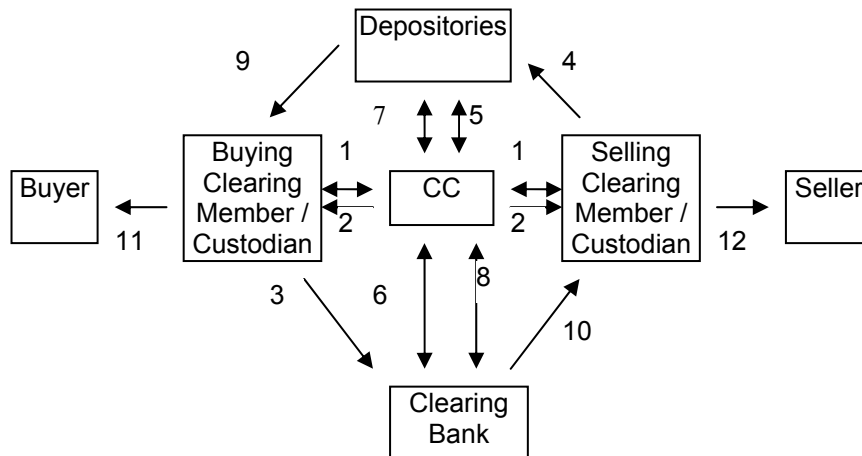
- (1) Buyer interacts with its broker (buyer broker) and gives the funds to the broker.
- (2) Seller interacts with its broker (seller broker) and gives the shares to the broker.
- (3) The Buyer Broker interacts with the Clearing Corporation and makes the pay-in of funds

Settlement

- (4) The Seller Broker interacts with the Clearing Corporation and makes the pay-in of shares.
- (5) The movement of Shares from Clearing Corporation to the Buyer Broker on pay-out of shares.
- (6) The movement of Funds from Clearing Corporation to the Seller Broker on pay-out of funds.
- (7) The Buyer Broker makes the delivery of shares to the buyer within one working day after the pay-out is received from the Clearing Corporation.
- (8) The Seller Broker makes the payment of funds to the seller within one working day after the pay out is received from the Clearing Corporation.

7.5 The clearing banks and depositories provide the necessary interface between the custodians/clearing members and CC for settlement of funds/securities. The settlement process is a very critical activity and, hence, it is very necessary that an auditor understands the whole process flow and internal control before commencement of a settlement audit.

7.6 The diagrammatic representation of the Settlement Process in Capital Market segment of Stock Exchange is given hereunder:



Explanation

The Exchange informs the CC on real-time basis relating to the trades of the broker and final trade file is provided by the end of the day.

- (1) CC notifies the consummated trade details to clearing members/brokers/custodians who affirm back. Based on the affirmation, CC applies multilateral netting and determines obligations.
- (2) Download of obligation and pay-in advice of funds/securities.
- (3) Instructions to clearing banks to make funds available by pay-in time.
- (4) Instructions to depositories to make securities available by pay-in-time.
- (5) Pay-in of securities (CC advises depository to debit pool/principal account of custodians/clearing member and credit its account and depository executes it).
- (6) Pay-in of funds (CC advises clearing banks to debit account of custodians/clearing members and credit its account and clearing bank executes it).
- (7) Pay-out of securities (CC advises depository to credit pool account of custodians/brokers and debit its account and depository executes it).
- (8) Pay-out of funds (CC advises clearing banks to credit account of custodians/brokers and debit its account and clearing bank executes it).
- (9) Depository informs custodians/brokers through DPs about delivery of securities.
- (10) Clearing banks inform custodians/brokers about receipt of funds.
- (11) The buying broker/custodian makes the delivery of shares to the buyer within one working day after the pay out is received from CC.

- (12) The selling broker/custodian makes the payment of funds to the seller within one working day after the pay out is received from CC.

Settlement Cycle

7.7 The settlement cycle in the Indian stock 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 summarised as under:

Settlement Cycle in case of Cash Segment	
Day	Activity
T	<ul style="list-style-type: none">• Trading on Trading Terminals.• Downloading of statements showing details of transactions and margins at the end of each trading day.• Downloading of provisional securities and funds obligation statements by brokers.
T+1	<ul style="list-style-type: none">• Custodial Confirmation.• Downloading of final securities and funds obligation statements by brokers.
T+2	<ul style="list-style-type: none">• Pay-in of funds and securities.• Pay-out of funds and securities.
T+3	<ul style="list-style-type: none">• Auction on Trading Terminals.
T+4	<ul style="list-style-type: none">• Settlement of Auction Trades.

Technical Guide on Internal Audit of Stock Brokers

Settlement Cycle in case of Derivatives Segment	
Day	Activity
T	<ul style="list-style-type: none">• Trading on Trading Terminals.• Downloading of statements showing details of transactions and margins at the end of each trading day.• Downloading of final funds obligation statements by brokers.
T+1	<ul style="list-style-type: none">• Pay-in of funds.• Pay-out of funds.

Settlement of Funds

8.1 Settlement of funds constitutes Pay-in of funds and Pay-out of funds.

(i) Pay-in of Funds - Pay-in of funds means funds receivable by Clearing Corporation from the broker. Conversely, it can also be said to be the amount of funds payable by the broker to the Clearing Corporation. Funds can be payable on account of purchases, loss on square off transactions, margins payable to the exchange and other charges debited by the stock exchange.

(ii) Pay-out of Funds - Pay-out of funds means funds payable by the Clearing Corporation to the broker. Conversely, it can also be said to be the amount of funds receivable by the broker from the Clearing Corporation. Funds can be receivable on account of sales, profit on square off transactions, margins released by the exchange and other credits given by the stock exchange. The broker is required to issue cheques to its clients and settle their account within one working day.

8.2 Every broker is required to open generally three types of bank accounts - Settlement Account, Client Account and Own Account.

Settlement Account/Clearing Account

8.3 A designated Settlement Account/Clearing Account is required to be opened with any one of the empanelled Clearing Banks. The Settlement Account is to be used exclusively for clearing and settlement operations, i.e., for settling funds and other obligations (e.g., payments of margins, penal charges, etc.) to the CC. Brokers are required to give mandate to the Clearing Bank for debiting and crediting their clearing accounts. The Clearing Bank will debit/credit the clearing account of clearing members as per instructions received from the CC.

Technical Guide on Internal Audit of Stock Brokers

8.4 Select banks have been empanelled by the CC for electronic transfer of funds. The members are required to maintain accounts with any of these banks. The members are informed electronically of their pay-in obligations of funds. The members make available required funds in their accounts with clearing banks by the prescribed pay-in day. The CC forwards funds obligations file to clearing banks which, in turn, debit the accounts of members and credit the account of the CC. In some cases, the CC runs an electronic file to debit members' accounts with clearing banks and credit its own account. On pay-out day, the funds are transferred by the clearing banks from the account of the CC to the accounts of members as per the member's obligations. In cash segment, the pay-in and pay-out of funds as well as securities take place 2 working days after the trade date (i.e., T+2 rolling settlement basis). In case of F&O segment, the settlement takes place on T+1 basis.

Client Bank Account

8.5 The broker is required to have a designated Client bank account in which all the amount receivable from the client will be deposited and all the amount payable to the client will be paid.

Own Bank Account

8.6 The own account is used by the broker for meeting the expenses of the organisation or for making payments for personal liabilities like, purchase of capital assets, giving of loans, or such other transactions of personal nature. The use of own bank account is not permitted for transactions with clients and for settlement purpose. The brokerage accumulated in client bank account should first be transferred to own bank account and then only withdrawn for own purposes.

Segregation of Funds

8.7 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, directed as under:

Settlement of Funds

“1. 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;

Technical Guide on Internal Audit of Stock Brokers

- 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 in 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.”

8.8 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

8.9 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

8.10 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

8.11 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 and Balances

8.12 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.

Settlement of Securities

9.1 This chapter deals with settlement of securities in dematerialised form. Settlement of securities constitutes Pay-in of securities and Pay-out of securities.

Pay-in of Securities - Pay-in of securities means securities receivable by Clearing Corporation from the broker. Conversely, it can also be said to be the securities deliverable by broker to the Clearing Corporation. The delivery of securities is made into the Pool/Principal account of the broker by the client and from there the pay-in is made to Clearing Corporation.

Pay-out of Securities - Pay-out of securities means securities deliverable by Clearing Corporation to the broker. Conversely, it can also be said to be securities receivable by broker from the Clearing Corporation. The delivery of securities is made into the Pool account of the broker/direct pay-out to clients by Clearing Corporation.

9.2 In India, there are two depositories viz., National Securities Depositories Ltd. (NSDL) and Central Depositories Services Ltd. (CDSL) which provide almost instant electronic transfer of securities and more than 99% of turnover is currently settled in the dematerialised form. Every broker is required to open demat accounts with both the depositories and the various types of accounts are:

Type of Account	Depository	Purpose
Pool Account	NSDL	To deliver shares in Pay-in to the CC and to receive shares in Pay-out from the CC.
Pool Account	CDSL	To receive shares in Pay-out from the CC.
Principal Account	CDSL	To deliver shares in Pay-in to the CC.

Technical Guide on Internal Audit of Stock Brokers

Type of Account	Depository	Purpose
CISA Account	CDSL	Shares are automatically transferred from CDSL-Pool Account to CISA Account after one working day from the release of pay-out by CC.
Client Beneficiary Account	NSDL/CDSL	The demat account for holding of client shares or client margin shares can be opened with NSDL or CDSL or with both.
Brokers (Own) Beneficiary Account	NSDL/CDSL	The demat account for holding own shares of the broker can be opened with NSDL or CDSL or with both.

9.3 The provisional statement for securities obligations are sent by CC at the end of the trading day and downloaded by brokers/clearing members/custodians. The final securities obligation statement is received on T+1 day by brokers/clearing members/custodians. The clearing members/custodians are required to make available the required securities in the settlement (Pool for NSDL/Principal for CDSL) account by the prescribed pay-in time for securities. In case of NSDL the members need to give instructions to move the securities to the settlement account of CC, whereas in case of CDSL the members need to ensure that the necessary quantity of securities are available in their principal account. As per the schedule determined by the CC, the securities are transferred on the pay-out day by the depository from the settlement account of the CC to the pool account of clearing members/custodians or directly to the client's demat account (as may be instructed). The pay-in and pay-out of securities is affected on the same day for the same settlements.

Every broker is required to transfer the securities received in the pool account to the account of the client or to their own beneficiary account within one working day. In case of NSDL, if any, securities are lying in the pool account for more than one working day then the broker is penalised by NSDL for the same.

However, in case of CDSL, all the securities lying in pool account for more than one working day are transferred to the CISA account.

Direct Pay-out to Investors

9.4 SEBI vide its circular no.SMDRP/Policy/Cir-05/2001 dated February 1, 2001 had directed stock exchanges to introduce a settlement system for direct delivery of securities to the investors accounts with effect from April 2, 2001. Accordingly, CC has introduced the facility of direct pay-out to clients' account on both the depositories. It ascertains from each broker, the beneficiary account details of their respective clients who are due to receive pay-out of securities. Broker is required to upload the information using the front-end provided by CC. Based on the information received from brokers, the CC sends pay-out instructions to the depositories to deliver securities directly to demat accounts of clients on the pay-out day. The client receives pay-out to the extent of instructions received from the respective brokers. To the extent of instruction not received, the securities are credited to the pool account of the broker.

Client Beneficiary Account

9.5 Every broker is required to open a designated Client Beneficiary account in which the shares of the client will be kept. SEBI has vided Circular no. SMD/SED/Cir/93/23321 dated November 18, 1993 specified that it shall be compulsory for all member brokers to keep separate accounts for client's securities and to keep such books of accounts, as may be necessary, to distinguish such securities from his/their own securities. The broker shall maintain Register of Securities, client-wise and security-wise, which shall *interalia* provide for the following information:

- (i) date of receipt/delivery of security
- (ii) quantity received/delivered
- (iii) party from whom received/to whom delivered
- (iv) purpose of receipt/delivery

Technical Guide on Internal Audit of Stock Brokers

The broker is also required to maintain clear segregation of the client shares and own shares. Every client who wishes to trade on the securities market is required to generally provide details of his demat account to the broker at the time of opening of the account. The broker is also required to properly update the back office software with the demat account information of the client.

9.6 SEBI has also issued circular no. SEBI/MRD/SE/Cir-33/2003/27/08 dated August 27, 2003 laid down that in the case of securities giving/taking delivery of securities in “demat mode” should be directly to/from the “beneficiary account” of the clients except delivery of securities to a recognised entity under the approved scheme of the stock exchange and/or SEBI. Thus, every broker is required to ensure that the demat shares sold by the client are received only from the demat account as informed by the client. Similarly, in case of purchase by client, the demat shares are to be delivered to the demat account as informed by the client. The broker is required to deliver the client’s shares to the client’s demat account within one working day. A broker may keep the shares with himself if instructed in writing by the client. The broker will then maintain all the client shares in the designated client demat account with adequate client-wise details of the shares. Broker has the right to withhold the shares received in pay-out to the extent of amount recoverable from the client.

Shortage

9.7 When shares are received short from the exchange on pay-out towards buy position of the broker or his client then it is called as shortage of shares received from the exchange. In this case, exchange initiates the auction process and short shares are subsequently delivered on auction settlement day. If the shares could not be received in the auction then the transaction is closed out with monetary compensation. When shares are received short from the client towards his pay-in obligation (sell position) then it is called as shortage of shares received from the client. In this case, the exchange processes the auction and auction charges are recovered from the broker. The broker has to recover the same from the client.

Auction

9.8 Auctions are initiated by the CC on behalf of trading members for settlement related reasons. The main reasons are shortages, bad deliveries and objections. The CC purchases the requisite quantity in the Auction Market and gives them to the buying trading member. The shortages are met through auction process and any price difference on account of auction is recoverable from the seller.

Internal Shortage

9.9 Internal Shortage means one client of the broker delivers short quantity of any scrip against his pay-in obligation and where another client of the same broker has buy position in the same scrip in that particular settlement, thus, leading to internal shortage at broker level. It should be ensured that the shares short delivered are received subsequently and in turn delivered to the buyer. Further, in case of internal shortage, BSE has given option to broker to report the shortage by prescribed time limit and in such case the BSE shall conduct the auction and deliver the shares to the buyer.

Close Out

9.10 In case the CC is not in a position to deliver the shares, then it settles the trade by monetary compensation to the buyer which is recoverable from the seller. Such process is called as Close out. Close out of a transaction takes place in the following cases:

- (i) In case of non-delivery of shares of Trade to Trade (T to T) Transactions
- (ii) In case of no bidder being present in the Auction
- (iii) In case of failed delivery by the bidder in case of an Auction.

9.11 With respect to Close out, SEBI has laid down guidelines which stipulate that “the close out price will be the highest price recorded in that scrip on the exchange in the settlement in which the concerned contract was entered into and upto the date of

Technical Guide on Internal Audit of Stock Brokers

auction/close out or 20% above the official closing price on the exchange on the day on which auction offers are called for (and in the event of there being no such closing price on that day, then the official closing price on the immediately preceding trading day on which there was an official closing price), whichever is higher. The auditor should verify the document received from the CC containing the details of the Close out to confirm that the credit/debit has been passed to the correct client and at the correct price.

Square-up/Square-off/Intra-day Transaction

9.12 Long (Purchase)/Short (Sale) position can be nullified by creating the reverse position by the end of the trading session and such a transaction are termed as Square-up/Square-off/Intra-day transactions. However, this is not applicable in case of scrips in Trade to Trade (T to T) group.

Document Register or Inward/Outward Register

9.13 In case of physical delivery of shares, as per Rule 15(1)(g) of Securities Contracts (Regulation) Rules, 1957, every broker is required to maintain a Document register showing full particulars of shares and securities received and delivered. This register contains the particulars of the securities including their distinctive numbers, received from or delivered by a broker from/to clients. This record lists and identifies every security available with the broker at any given time.

Checks and Balances

9.14 The broker is required to prepare demat reconciliation statement on a regular basis. It is advisable that the reconciliation statement should be prepared on a daily/weekly/fortnightly basis, based on the volume and nature of activity of a broker. Auditor should analyse the reason for difference in quantity, if any, between the shares lying in client beneficiary demat account and the shares appearing in the books of the broker. Auditor should also verify the ageing analyses statement of the shares lying in the client beneficiary account to ensure that adequate control is exercised over the shares held for long period. Auditor should also ensure that

there is proper segregation of duty relating to settlement of securities.

9.15 The following documents are required for the verification of the settlement procedure:

- (i) **Exchange Files** - The broker will receive the following files from the exchange:
 - (a) 'Receiving Client-wise Broker-wise Delivery' Report (RCBDL) file in BSE contains the details of shares delivered directly to the client's demat account by the clearing corporation. It gives details of demat account where the pay-out is credited and also details of securities which have been credited to pool account of the broker.
 - (b) 'Auction Receiving Broker-wise Delivery' Report (ARBDL) file in BSE contains the details of shares received in auction from the clearing corporation by the clearing member.
 - (c) 'Client Allocation Details' (CADT) file in NSE contains the details of the pay-out directly credited to the client's demat account by the clearing corporation. It gives details of demat account where the pay-out is credited and also details of securities, which have been credited to pool account of the broker.
- (ii) **Delivery Statement** - Delivery Statement can be generated scrip-wise or client-wise for various groups (e.g., odd lot, normal, etc.) from the back office software. This report is used to ascertain the quantity of shares receivable and/or deliverable from/to the client as well as from/to CC towards settlement obligation.
- (iii) **Close Out file** - In certain instances the settlement procedure cannot be completed due to non receipt/non delivery of shares to/by the exchange. In such a case a close out file is sent by the exchange providing details of the shares that have been closed out and the amount of credit/debit given to the broker by the exchange towards the shares that could not be settled (delivered).

Technical Guide on Internal Audit of Stock Brokers

- (iv) Transaction cum Holding Statement of the Demat Account** - This statement will provide the details of movements of shares in the demat account of the broker. This statement is a third party confirmation and is given by the DP of the broker. The transaction statements of Pool, Principal and Client Beneficiary Account are required to be obtained. This statement will give the details of the demat account from where the shares have been received or the demat account where the share have been delivered and the balance quantity of shares lying with the broker.
- (v) Details of Demat Account of Clients** - This report is generated from the back office software and gives details of various demat accounts of the client informed to the broker.
- (vi) Settlement Calendar** - The exchanges issue the settlement calendar giving details of trade date, settlement number, pay-in and pay-out dates (settlement dates).

Statement of Funds, Securities and Margins

Statement of Accounts for Funds and Securities

10.1 Every broker is required to send a complete 'Statement of Accounts' for both funds and securities in respect of each of its clients in such periodicity not exceeding three months (calendar quarter) within a month of the expiry of the said period. The Statement shall also state that the client shall report errors, if any, in the Statement within 30 days of receipt thereof to the broker. The objective is to reconcile the records of the broker and the clients at regular interval thereby avoiding any disputes between the broker and their clients.

10.2 In case of those brokers who offer trading facility to their clients through internet and provide 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 e-mail to such clients. Broker is required to send Statement of Accounts to institutional clients only in case the broker has received funds/securities from their institutional clients and/or paid funds/delivered securities to such institutional clients directly and not through custodians.

10.3 It is suggested that Statement of Accounts for funds and securities should be sent directly to the client from the main office instead of routing it through branch or other intermediaries. Sending of Statement of Accounts of funds and securities directly to the clients acts as an external evidence (i.e., confirmation received from third party) and is usually more reliable. In case where the Statement of Accounts for the funds and securities are sent by post/courier, adequate despatch records should be maintained and in case of hand delivery acknowledgement of the client along with date of receipt should be obtained.

Client Margin Information

10.4 The broker is required to send Client Margin related information to their clients on daily basis. Such information may include the following details:

- (i) Client code and name, Trade day (T).
- (ii) Total margin deposit placed by the client upto day T-1 (with break-up in terms of cash, FDRs, BGs and securities).
- (iii) Margin utilised upto the end of day T-1.
- (iv) Margin deposit placed by the client on day T (with break-up in terms of cash, FDRs, BGs and securities).
- (v) Margin adjustments for day T.
- (vi) Margin status (balance with the member/due from the client) at the end of day T.

Collateral Utilisation Statement

10.5 The broker is required to send Collateral Utilisation Statement to their clients on daily basis, which shall *interalia* include details of collateral deposited, collateral utilised and collateral status (available balance) with break up in terms of cash, Fixed Deposit Receipts (FDRs), Bank Guarantee and securities. The broker should keep the following records:

- (i) Receipt of collateral from client and acknowledgement issued to client on receipt of collateral.
- (ii) Client authorisation for deposit of collateral with the exchange/clearing corporation/clearing house towards margin.
- (iii) Record of deposit of collateral with exchange/clearing corporation/clearing house.
- (iv) Record of return of collateral to client.
- (v) Credit of corporate action benefits to clients.

The above records should be periodically reconciled with the actual collateral deposited with the broker.

Brokerage and Revenue Leakage

11.1 The broker being agent of the client earns brokerage on the value of transaction at the rates agreed between the client and the broker. The brokerage slabs are defined in the client master at the time of opening of the account. The brokerage is then charged by the software as and when the client transacts through the broker. The brokerage is credited to the brokerage account generally either on the "T-Day" (Trading day) or "Settlement Day" (the date on which the trade is settled) as per the system of accounting regularly followed by the broker. It may be noted that the brokerage accounting is a matter of policy as adopted by the management and it should be ensured that the policy is consistently followed by the organisation.

Brokerage Charged to Clients

11.2 It should be ensured that the client is not charged brokerage at the rate exceeding 2.5%. Adequate access controls should be built into the system so as to avoid unauthorised modification of the brokerage master. There should be adequate audit trail for the modification carried out in the brokerage master in the back office accounting system.

Sharing of Brokerage

11.3 In case a client is introduced by an intermediary (sub broker/remisier/authorised person) then a part of the income shall be shared with such intermediary at the rates agreed between the broker and the intermediary. The brokerage sharing slabs are defined in the client master at the time of opening of the account. Adequate access controls should be built into to the system so as to avoid unauthorised modification of the brokerage sharing master. The brokerage recovered from the client is then credited to the intermediary's account (sub broker/remisier/authorised person) at the agreed rate. The gross figure of brokerage charged from client and brokerage paid to

intermediary should be separately reflected in the Profit & Loss A/c. It should be ensured that brokerage received and paid is not netted-off by the broker in the books of account.

Recoveries from Client

11.4 The broker being agent of the client is entitled to recover the penalties/charges/expenses, etc., incurred on behalf of the client subject to terms and conditions mutually decided. The expenses should be recovered as may be mutually decided and, in any case, not exceeding the actual amount incurred by the broker on behalf of the client. The charges could also be specified in the back office accounting software and then the same shall be charged by the system as and when the client transacts.

Disputed Trades

11.5 There could be trades which are disowned by the client as a result of errors of the dealer or on account of disputes. In the regular course of business practice, such trades are transferred to "Office Vandha A/c" (Dispute/Objection/Error A/c or by whatever name called) and are subsequently squared off at the earliest. It should be ensured that there are legitimate reasons to transfer such trades to "Office Vandha A/c" and such transfers are backed by appropriate sanctions from the designated authorities. In cases where such trades are not squared up immediately and the positions are carried forward in the books of broker, it should be backed by the required sanctions and the motive thereof should be verified. Analysis of such trades should be conducted to get an overall idea as to the nature and quantum of such errors within the organisation. Errors should be analysed with respect to parameters like, terminals from which the erroneous trades are executed, dealers/branch responsible for such errors, scrip in which errors have occurred, etc. Any balance lying in the "Office Vandha A/c" at the year end may be written-off in the Profit & Loss A/c only after obtaining approval from the appropriate authority.

11.6 The internal auditor may also verify whether any insurance claim has been made against such dealing errors or against any other errors specifically covered under the insurance

policy. He may further examine the reasons for weaker controls in those areas.

Corporate Benefits

11.7 In case of corporate benefits (Rights/ Bonus/ Dividend) received for the shares held in client beneficiary account on behalf of the client, it should be ensured that such corporate benefits are promptly passed on to the client. It should also be ensured that the distribution of such corporate benefits is just and fair, i.e., they are paid to the correct person and in proportion to the shares held in the client beneficiary account on the record date/book closure date declared by the concerned company. Dividend received on behalf of the client is a liability and should be shown under the head "Current Liabilities". Similarly, the dividend received on account of own shares held as investment/stock-in-trade should be booked as income and transferred to the Profit & Loss A/C.

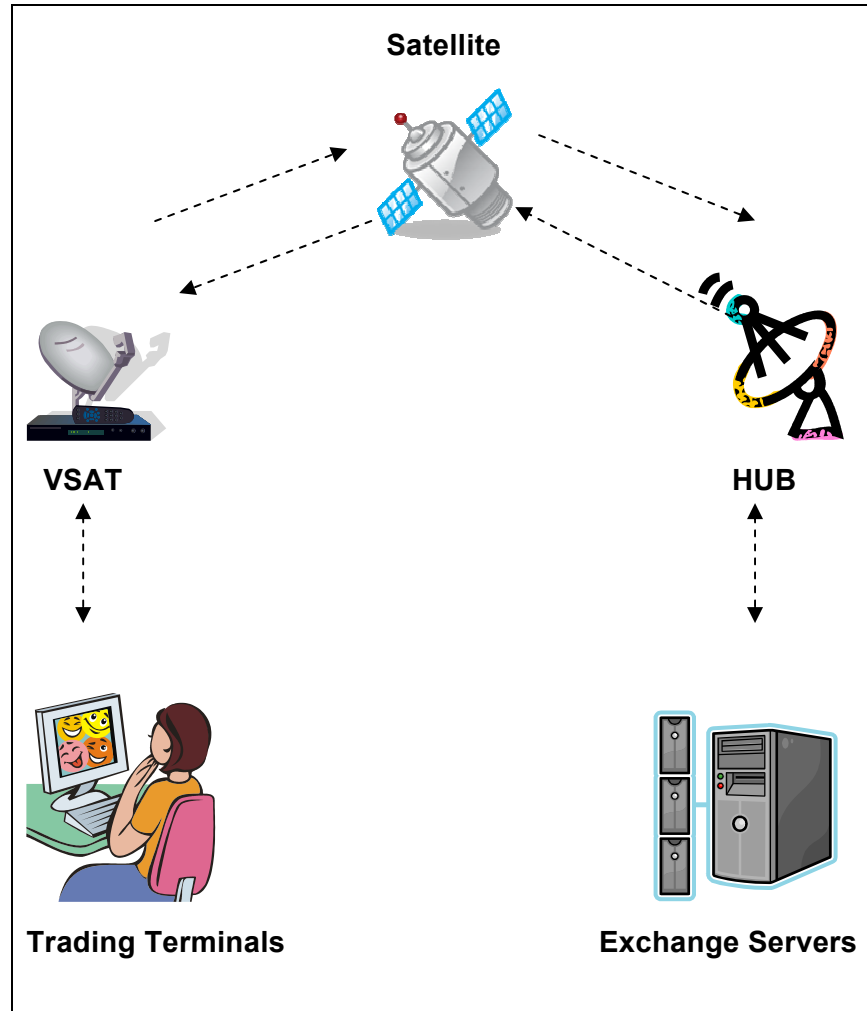
Trading Terminals and Approved Users

12.1 The trading on stock exchanges in India used to take place through open outcry system thereby imposing limits on trading volumes and efficiency. As the system was time consuming, the duration of trading session was restricted to 2 hours a day. Screen based trading system was first introduced in 1994-95 to increase the efficiency, liquidity and transparency in the capital markets. In the screen based online trading system broker can punch into the computer, the quantities of securities and the prices at which he wants to transact and the transaction gets executed as soon as it finds a corresponding sale or buy order from a counter party. The system electronically matches orders on a price/time priority and, hence, cuts down on time, cost and risk of error, as well as on fraud resulting in improved operational efficiency. It improves the depth and liquidity of the market by removing the geographical barriers of the various market participants. It also provides a perfect audit trail, which helps to resolve disputes by logging in the trade execution process in entirety. Currently, almost 100% trading takes place through electronic order matching system. Technology has brought the trading platform from the trading hall of stock exchanges to the premises of brokers, and further to the door steps of investors through internet.

12.2 Brokers have terminals installed at their premises which are connected through VSATs/leased lines/modems to the mainframe computer of the exchange. An investor informs a broker to place an order on his behalf who in turn enters the order through his terminal which sends signal to the Satellite via VSAT/leased line/modem. These signals are then directed to mainframe computer of the exchange. The order confirmation message is immediately displayed on the terminal of the broker along with the exchange generated order number. As and when the order matches, a message is broadcasted to the broker along

Trading Terminals and Approved Users

with the exchange generated trade number. The diagrammatic representation is given hereunder of this process:



Types of Trading Terminals

12.3 Various types of trading terminals are as follows:

- (i) 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

Technical Guide on Internal Audit of Stock Brokers

installed at the desired location by the exchange at the request of the broker.

- (ii) 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.
- (iii) 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.
- (iv) 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.

Internet Trading

12.4 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.

Location of Terminals

12.5 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.

Terminal User

12.6 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.

12.7 The terminal operators are required to obtain certificate as per the specification of the exchange. In case of BSE cash market segment, terminal operators are required to be BCSM (BSE's Certification in Securities Market) certified. In case of NSE capital market segment, the terminal operators are required to be NCFM (NSE's Certification in Financial Market) certified. For every 5 terminal operators (users) or part thereof, 1 user should obtain the certificate provided all the users are at the same location. In case of multiple locations, the condition shall be applicable to each of the locations. Separate certificate shall be required in case of corporate ID of NSE. In case of F&O segment terminal operator can obtain certificate from any of the institutes approved by the SEBI and such certificate could be used for operating trading terminals of either of the exchanges (BSE or NSE).

IML/CTCL Compliances

ID Uploading

12.8 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

Trading Terminals and Approved Users

12.9 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

System Audit Requirement

12.10 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.

12.11 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. Where the scope requires the internal auditor to comment on the non compliances/discrepancies reported by a qualified system auditor then the internal auditor shall give his comments in accordance with Standard on Internal Audit (SIA) 16, "Using the Work of an Expert" issued by the Institute of Chartered Accountants of India.

Sub-Broker/Remisier/Authorised Person

Sub-Broker

13.1 "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.

13.2 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

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

- (i) A sub-broker shall be affiliated only with one broker of an exchange.
- (ii) Director of a corporate broker shall not act as a sub-broker of the same corporate broker.
- (iii) Sub-broker shall not be entitled to commence business unless he has been granted certificate of registration by the SEBI.

Sub-Broker/Remisier/Authorised Person

- (iv) 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.
- (v) A sub-broker shall not issue confirmation memos but the broker shall issue contract note directly to the client introduced by his sub-broker.
- (vi) 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

13.4 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).

Remisier

13.5 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.

13.6 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.

Authorised Person

13.7 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, 1956.

13.8 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.

Chapter I - 14

Advertisement

14.1 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.

14.2 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

14.3 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:

- (i) The broker should designate and authorise a person to ensure the correctness of the information given in any advertisement.

Technical Guide on Internal Audit of Stock Brokers

- (ii) The broker issuing any such advertisement should inform the name of such authorised person to the Exchange.
- (iii) 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.
- (iv) The advertisement should be written in clear language and should not be such which may prejudice interest of the investors in general.
- (v) The advertisement should not contain any confusing, misleading or offensive information.
- (vi) It should be free from inaccuracies.
- (vii) 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.
- (viii) The material should not contain anything which is otherwise prohibited.
- (ix) The advertisement shall contain :-
 - (a) Name and/or his logo, code of NSE membership;
 - (b) Registration Number allotted by the SEBI.
- (x) 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.
- (xi) 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.

Advertisement

- (xii) 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.
- (xiii) 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.
- (xiv) The copy of such advertisement should be retained for a period of three years.
- (xv) 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.
- (xvi) These norms will apply to any other investment/consultancy agencies associated with the broker concerned.
- (xvii) The above norms shall also apply to an advertisement, T.V or Cable T.V. or any other such media of audio/visual nature.
- (xviii) The broker should check with NSE in case of any doubt for advice prior to the issue of any such material or advertisement.
- (xix) 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.
- (xx) In the event of any broker of the exchange having any grievance against any other broker, consequent upon the

Technical Guide on Internal Audit of Stock Brokers

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.

14.4 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:

- (i) 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.
- (ii) 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.
- (iii) 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, authorise 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.
- (iv) 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.
- (v) 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.

Advertisement

- (vi) The advertisement should not contain anything which is otherwise prohibited for publication under the relevant Act, unwarranted, misleading information or make any promises.
- (vii) 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 ii and iii above.
- (viii) 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 (ii) and (iii) above.
- (ix) 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.
- (x) If a broker violates any of the above Regulations for the advertisement, he is liable to be penalised for the same by the exchange authorities and/or the SEBI.
- (xi) 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.

Margin Trading Facility

15.1 SEBI has, vide circular No.SMD/Policy/Cir-6 dated May 7, 1997, clarified, *interalia*, that borrowing and lending of funds by a trading member in connection with or incidental to or consequential upon the securities business would not be disqualified under Rule 8(1)(f) and 8(3)(f) of Securities Contracts (Regulation) Rules, 1957.

15.2 SEBI has, vide its circular No. SEBI/MRD/SE/SU/Cir-15/04 dated March 19, 2004, allowed the brokers to provide margin trading facility to their clients, in the cash segment, subject to certain conditions which are as follows:

- (i) **Securities Eligible** - The securities in Group 1 would be eligible for margin trading facility. SEBI vide its circular dated March 11, 2003 has categorised the securities under 3 groups, namely, Group 1, Group 2 and Group 3. The securities having mean impact cost of less than or equal to 1 and having traded on atleast 80% (+/-5%) of the days for the previous eighteen months, have been categorised as Group 1.
- (ii) **Permission** - The brokers wishing to extend the facility of margin trading to their clients would be required to obtain prior permission from the exchange/s where the margin trading facility is proposed to be provided. The exchange shall have the right to withdraw this permission at a later date, after giving reasons for the same.
- (iii) **Eligibility** - Only corporate brokers with a 'Net worth' of at least Rs. 3 crores would be eligible to offer margin trading facility to their clients. The 'Net worth', for the purpose of margin trading facility, would mean "Capital" (excluding preference share capital) plus free reserves less non-allowable assets, i.e., fixed assets, pledged securities, member's card, non-allowable securities, bad deliveries, doubtful debts and advances (including debts

Margin Trading Facility

and advances overdue for more than 3 months or given to associates), pre paid expenses, intangible assets and 30% of the marketable securities.

- (iv) Agreement** - Stock Broker has to enter into an agreement with each of their clients for margin trading facility before accepting or placing orders on their behalf. SEBI has devised standard format for the Member Client Agreement (model agreement). The broker may modify the agreement only for stipulating any additional or more stringent conditions, provided that no such modification shall have the effect of diluting any of the conditions laid down in the circular No. SEBI/MRD/SE/SU/Cir-15/04 dated March 19, 2004 or in the model agreement.
- (v) Restriction on Client** - A client will be allowed to obtain margin trading facility from one broker per exchange for buying securities in that exchange. To ensure this, it shall be obligatory on the part of every broker to:

 - (a) obtain a declaration from his client whether he has availed of any margin trading facility from any broker in any exchange, or whether his request for margin trading with any broker was rejected, and if so, in both the cases obtain the name of the broker and his registration number; and
 - (b) also verify the details from the concerned broker/s.
- (vi) Due Diligence** - Before providing margin trading facility to a client who has already availed of margin trading facility from another broker in the same exchange, the broker shall ensure that the client has liquidated his outstanding in the margin trading account with the other broker, and obtained a certificate to this effect in writing from that broker.
- (vii) Sources of Funds** - For the purpose of providing the margin trading facility, a broker may use his own funds or borrow from scheduled commercial banks and/or NBFCs regulated by the Reserve Bank of India (RBI). A broker shall not be permitted to borrow funds from any other source.

Technical Guide on Internal Audit of Stock Brokers

- (viii)** The broker shall not use the funds of any client for providing the margin trading facility to another client, even if the same is authorised by the client.
- (ix) Indebtedness** - At any point of time, the total indebtedness of a broker for the purpose of margin trading shall not exceed 5 times of his net worth.
- (x) Exposure** - The “maximum allowable exposure” of the broker towards the margin trading facility shall be within the self imposed prudential limits and shall not, in any case, exceed the borrowed funds and 50% of his ‘net worth’. The term “exposure” will mean the aggregate outstanding margin trading amount in the books of the broker for all his clients.
- (xi) Concentration** - While providing the margin trading facility, the exposure to any single client at any point of time shall not exceed 10% of the broker’s lendable resource (i.e., borrowed funds for the purpose of margin trading + 50% of net worth).
- (xii) Margin** - The initial and maintenance margin for the client shall be a minimum of 50% and 40% respectively, to be paid in cash. The broker may increase the margin percentage. The “initial margin” would mean the minimum amount, calculated as a percentage of the transaction value, to be placed by the client with the broker before the actual purchase. The broker may advance the balance amount to meet full settlement obligations. “Maintenance margin” would mean the minimum amount, calculated as a percentage of the market value of the securities, calculated with respect to the last trading day’s closing price, to be maintained by the client with the broker.
- (xiii) Margin Calls** - When the balance deposit in the client’s margin account falls below the required maintenance margin, the broker shall promptly make margin calls. However, no further exposure can be granted to the client on the basis of any increase in the market value of the securities.

Margin Trading Facility

- (xiv) Liquidation of Securities** - The broker may liquidate the securities if the client fails to meet the margin call made by the broker; or fails to deposit the cheques on the day following the day on which the margin call has been made; or where the cheque deposited by the client has been dishonoured. The broker may also liquidate the securities in case the client's deposit in the margin account (after adjustment for mark-to-market losses) falls to 30% or less of the latest market value of the securities, in the interregnum between making of the margin call and receipt of payment from the client.
- (xv) Demat Account** - The broker shall maintain separate client-wise account of the securities purchased on margin trading with depositories and shall enable the client to observe the movement of securities from his account (through internet). The broker shall also maintain a separate record of details, including the sources of funds, used for the purpose of margin trading.
- (xvi) Books of Accounts** - The books of account, maintained by the broker, with respect to the margin trading facility offered by it, shall be audited on a half-yearly basis. The broker shall submit an auditor's certificate to the exchange/s, within one month from the date of the half year ending 31st March and 30th September of a year certifying, *inter alia*, the extent of compliance with the conditions of margin trading facility. The broker shall also submit to the stock exchange a half-yearly certificate, as on 31st March and 30th September of each year, from an auditor confirming the net worth as specified above. Such a certificate shall be submitted not later than 30th April and 31st October of the year.
- (xvii) Disclosure** - The broker shall disclose to the stock exchange/s details on gross exposure including name of the client, Unique Identification Number (UIN)/client code, name of the scrip, quantity, amount funded, etc. If the broker has borrowed funds for the purpose of providing margin trading facility, name of the lender and amount borrowed, on or before 9.00 pm for the same day of reporting should also be disclosed.

Prevention of Money Laundering

16.1 The Prevention of Money Laundering Act, 2002 (PMLA) has been brought into force with effect from July 1, 2005. As per the provisions of the Act, every banking company, financial institution (which includes chit fund company, a co-operative bank, a housing finance institution and a non-banking financial company) and intermediary (which includes a stock-broker, sub-broker, share transfer agent, banker to an issue, trustee to a trust deed, registrar to an issue, merchant banker, underwriter, portfolio manager, investment adviser and any other intermediary associated with securities market and registered under section 12 of the Securities and Exchange Board of India Act, 1992) shall have to maintain a record of all the transactions; the nature and value of which has been prescribed in the Rules notified under the PMLA. As per Rule 3 of Prevention of Money Laundering Rules, 2005 such transactions include:

- (i) All cash transactions of the value of more than Rs 10 lacs or its equivalent in foreign currency.
- (ii) All series of cash transactions integrally connected to each other which have been valued below Rs 10 lacs or its equivalent in foreign currency, where such series of transactions take place within one calendar month.
- (iii) All cash transactions where forged or counterfeit currency notes or bank notes have been used as genuine, and where any forgery of a valuable security has taken place.
- (iv) All suspicious transactions whether or not made in cash.

16.2 The terms used in the PMLA are defined as under:

- (i) "Intermediary" means a stock-broker, sub-broker, share transfer agent, banker to an issue, trustee to a trust deed, registrar to an issue, merchant banker, underwriter, portfolio manager, investment adviser and any other intermediary associated with securities market and

Prevention of Money Laundering

registered under section 12 of the Securities and Exchange Board of India Act, 1992.

- (ii) “Proceeds of crime” means any property or assets of every description, whether corporeal or incorporeal, movable or immovable, tangible or intangible and includes deeds and instruments evidencing title to, or interest in, such property or assets, wherever located; The term Money Laundering has been defined in Section 3 of the Act as Whosoever directly or indirectly attempts to indulge or knowingly assists or knowingly is a party or is actually involved in any process or activity connected with the proceeds of crime and projecting it as untainted property shall be guilty of offence of money-laundering.

16.3 SEBI has, vide its circular no. ISD/CIR/RR/AML/1/06 dated January 18, 2006, issued the Guidelines to the intermediaries as specified above, in the context of the recommendations made by the Financial Action Task Force (FATF) on anti-money laundering standards. Compliance with these standards by all intermediaries and the country has become imperative for international financial relationships. It may be noted that these Guidelines lay down the minimum requirements/disclosures to be made in respect of clients. The intermediaries may, according to their requirements specify additional disclosures to be made by the clients to address concerns of money laundering and suspicious transactions undertaken by the clients. SEBI has, vide its circular no. ISD/CIR/RR/AML/1/06 dated January 18, 2006, advised all intermediaries to ensure that a proper policy framework as per the Guidelines on anti-money laundering measures is put into place within one month from the date of the circular. The intermediaries are required to designate an officer as ‘Principal Officer’ who would be responsible for ensuring compliance of the provisions of the PMLA.

Guidelines on Anti-Money Laundering Standards

16.4 The Guidelines on Anti-Money Laundering Standards provides a general background on the subject of money laundering and terrorist financing. It summarises the main

Technical Guide on Internal Audit of Stock Brokers

provisions of the applicable anti-money laundering and anti-terrorist financing legislation in India and provides guidance on the practical implications of the Act. The Guidelines also sets out the steps that a registered intermediary and any of its representatives should implement to discourage and identify any money laundering or terrorist financing activities.

16.5 These Guidelines are intended for use primarily by intermediaries registered under Section 12 of the SEBI Act, 1992. While it is recognised that a “one-size-fits-all” approach may not be appropriate for the securities industry in India, each registered intermediary should consider the specific nature of its business, organisational structure, type of customers and transactions, etc. when implementing the suggested measures and procedures to ensure that they are effectively applied. The overriding principle is that they should be able to satisfy themselves that the measures taken by them are adequate, appropriate and follow the spirit of these measures and the requirements as enshrined in the Prevention of Money Laundering Act, 2002. (PMLA)

16.6 Important points of Guidelines on Anti-Money Laundering Standards are:

- (i) The Anti-Money Laundering program should be approved in writing by the senior management of member and reviewed at frequent intervals.
- (ii) The thrust for the implementation of Anti-Money Laundering Policy is on the following key aspects:
 - (a) Designation of a sufficiently senior person as ‘Principal Officer’ as required under the Prevention of Money Laundering Act, 2002.
 - (b) Customer Due Diligence/KYC Standards
 - (c) Monitoring of transactions for detecting suspicious transactions
 - (d) Reporting of suspicious transactions
 - (e) Ongoing training of employees
 - (f) Audit/Testing of AML Program.

Prevention of Money Laundering

- (iii) Policies and procedures to combat Money Laundering should cover:
 - (a) Communication of group policies relating to prevention of money laundering and terrorist financing to all management and relevant staff that handle account information, securities transactions, money and customer records, etc. whether in branches, departments or subsidiaries;
 - (b) Customer acceptance policy and customer due diligence measures, including requirements for proper identification;
 - (c) Maintenance of records;
 - (d) Compliance with relevant statutory and regulatory requirements;
 - (e) Co-operation with the relevant law enforcement authorities, including the timely disclosure of information; and
 - (f) Role of internal audit or compliance function to ensure compliance with policies, procedures and controls relating to prevention of money laundering and terrorist financing, including the testing of the system for detecting suspected money laundering transactions, evaluating and checking the adequacy of exception reports generated on large and/or irregular transactions, the quality of reporting of suspicious transactions and the level of awareness of front line staff of their responsibilities in this regard.
- (iv) Each registered intermediary should adopt written procedures to implement the anti-money laundering provisions as envisaged under the Anti-Money Laundering Act, 2002. Such procedures should include *inter alia*, the following three specific parameters which are related to the overall 'Client Due Diligence Process':
 - (a) Policy for acceptance of clients;
 - (b) Procedure for identifying the clients; and

Technical Guide on Internal Audit of Stock Brokers

- (c) Transaction monitoring and reporting especially Suspicious Transactions Reporting (STR).
- (v) Classify both the new and existing clients into high, medium or low risk category depending on parameters such as, the customer's background, type of business relationship, transactions, etc. Intermediaries should apply each of the customers due diligence measures on a risk sensitive basis and adopt an enhanced customer due diligence process for high risk categories of customers and *vice-versa*.
- (vi) Registered Intermediaries should ensure that all customer and transaction records and information are available on a timely basis to the competent investigating authorities. Where appropriate, they should consider retaining certain records, e.g. customer identification, account files, and business correspondence, for periods which may exceed that required under the SEBI Act, Rules and Regulations framed under PMLA, 2002, other relevant legislations, Rules and Regulations or Exchange bye-laws or circulars. The records referred in Rule 3 shall be maintained for a period of ten years from the date of cessation of the transactions between the client and the intermediary.
- (vii) Ongoing monitoring of accounts is an essential element of an effective Anti-Money Laundering framework. Such monitoring should result in identification and detection of apparently abnormal transactions, based on laid down parameters. Members should devise and generate necessary reports/alerts based on their clients' profile, nature of business, trading pattern of clients for identifying and detecting such transactions. These reports/alerts should be analysed to establish suspicion or otherwise for the purpose of reporting such transactions.
- (viii) The intermediary should exercise independent judgment to ascertain whether new clients should be classified as Client of Special Category (CSC) or not at the time of acceptance and the category should be reviewed regularly. Client of Special Category include the following:
 - (a) Non resident clients

Prevention of Money Laundering

- (b) High net worth clients
 - (c) Trust, Charities, NGOs and organisations receiving donations
 - (d) Companies having close family shareholdings or beneficial ownership
 - (e) Politically exposed persons (PEP) of foreign origin
 - (f) Current/Former Head of State, Current or Former Senior High profile politicians and connected persons (immediate family, close advisors and companies in which such individuals have interest or significant influence)
 - (g) Companies offering foreign exchange offerings
 - (h) Clients in high risk countries (where existence/effectiveness of money laundering controls is suspect, where there is unusual banking secrecy, countries active in narcotics production, countries where corruption [as per Transparency International Corruption Perception Index] is highly prevalent, countries against which government sanctions are applied, countries reputed to be any of the following – Havens/sponsors of international terrorism, off-shore financial centers, tax havens, countries where fraud is highly prevalent.
 - (i) Non face to face clients
 - (j) Clients with dubious reputation as per public information available, etc.
- (ix) A list of circumstances which may be in the nature of suspicious transactions is given below. This list is only illustrative and whether a particular transaction is suspicious or not will depend upon the background, details of the transactions and other facts and circumstances:
- (a) Clients whose identity verification seems difficult or clients appear not to cooperate

Technical Guide on Internal Audit of Stock Brokers

- (b) Substantial increase in activity without any apparent cause
- (c) Large number of accounts having common parameters such as common partners/directors/promoters/address/e-mail address/telephone numbers/introducers or authorised signatories
- (d) Transactions with no apparent economic or business rationale
- (e) Sudden activity in dormant accounts
- (f) Source of funds are doubtful or inconsistency in payment pattern
- (g) Unusual and large cash deposits made by an individual or business
- (h) Transfer of investment proceeds to apparently unrelated third parties
- (i) Multiple transactions of value just below the threshold limit specified in PMLA so as to avoid possible reporting
- (j) Unusual transactions by CSCs and businesses undertaken by shell corporations, off-shore banks/financial services, businesses reported to be in the nature of export-import of small items
- (k) Asset management services for clients where the source of the funds is not clear or not in keeping with the clients apparent standing/business activity
- (l) Clients in high risk jurisdictions or clients introduced by banks or affiliates or other clients based in high risk jurisdictions
- (m) Clients transferring large sums of money to or from overseas locations with instructions for payment in cash

Prevention of Money Laundering

- (n) Purchases made on own account transferred to a third party through off-market transactions through DP Accounts
- (o) Suspicious off-market transactions
- (p) Large deals at prices away from the market
- (q) Accounts used as 'pass through'. Where no transfer of ownership of securities or trading is occurring in the account and the account is being used only for funds transfers/layering purposes
- (r) Trading activity in accounts of high risk clients based on their profile, business pattern and industry segment.

PART II

Chapter II - 1

Internal Audit

1.1 With increasing complexities in business, rapid growth and number of regulatory requirements, stock broking activities have undergone a sea change in processes and systems. Effective internal audit provides a tool to ease out all complexities and acts as a fuel to wholesome improvements in systems and processes and, therefore, in growth and sustainability.

1.2 “Preface to the Standards on Internal Audit”, issued by the Institute of Chartered Accountants of India defines the term “Internal Audit” as:

“Internal Audit is an independent management function, which involves a continuous and critical appraisal of the functioning of an entity with a view to suggest improvements thereto and add value to and strengthen the overall governance mechanism of the entity, including the entity’s strategic risk management and internal control system. Internal audit, therefore, provides assurance that there is transparency in reporting, as a part of good governance”

Internal auditing is a valuable resource to executive management and the board of directors (BoD) in accomplishing overall organisational goals and objectives, and simultaneously strengthening internal control and overall governance.

1.3 Internal audit activity evaluates risk exposures relating to the organisation's governance, operations and information systems, in relation to:

- Effectiveness and efficiency of operations.
- Reliability and integrity of financial and operational information.
- Safeguarding of assets.

Technical Guide on Internal Audit of Stock Brokers

- Compliance with laws, regulations, and contracts as well as policies laid down by the management.
- Accomplishment of objectives and goals of the organisation through ethical and effective governance.

Standards on Internal Audit

1.4 Internal Audit Standards Board of the Institute of Chartered Accountants of India has, till date, issued sixteen Standards on Internal Audit (SIAs) which are as follows:

- SIA 1, Planning an Internal Audit
- SIA 2, Basic Principles Governing Internal Audit
- SIA 3, Documentation
- SIA 4, Reporting
- SIA 5, Sampling
- SIA 6, Analytical Procedures
- SIA 7, Quality Assurance in Internal Audit
- SIA 8, Terms of Internal Audit Engagement
- SIA 9, Communication with Management
- SIA 10, Internal Audit Evidence
- SIA 11, Consideration of Fraud in an Internal Audit
- SIA 12, Internal Control Evaluation
- SIA 13, Enterprise Risk Management
- SIA 14, Internal Audit in an Information Technology Environment
- SIA 15, Knowledge of the Entity and its Environment
- SIA 16, Using the Work of an Expert

These Standards codify the best practices in the field of internal audit. “Framework for Standards on Internal Audit” provides a

frame of reference for the internal audit standards being issued by the Institute.

Basic Principles Governing an Internal Audit

1.5 Standard on Internal Audit (SIA) 2, “Basic Principles Governing an Internal Audit” establishes standards and provides guidance on the general principles governing an internal audit. This Standard explains the principles, namely, integrity, objectivity and independence, confidentiality, due professional care, skills and competence, work performed by others, documentation, planning, evidence and reporting which governs the internal auditor’s professional responsibilities.

Terms of Internal Audit Engagement

1.6 The Terms of engagement defines the scope, authority, responsibilities, confidentiality, limitation and compensation of the internal auditors. Terms of Internal Audit Engagement lay down clarity between the internal auditors and the users of their services for inculcating professionalism and avoiding misunderstandings as to any aspect of the engagement. Standard on Internal Audit (SIA) 8 “Terms of Internal Audit Engagement” provides guidance in respect of terms of engagement of the internal audit activity whether carried out in house or by an external agency. This SIA describes the elements of the terms of engagement, viz., scope, responsibility, authority, confidentiality, limitations, reporting, compensation and compliance with Standards.

1.7 SIA 8 requires that the terms of engagement should indicate areas where internal auditors are expected to make their recommendations and value added comments. It should also clearly mention the responsibility of the auditee vis-à-vis the internal auditor. Further, the management of the auditee is responsible for providing timely and accurate data, information, records, personnel, etc., and for extending co-operation to the audit team.

1.8 In cases, where the internal auditor is appointed based on the requirement of the regulator (SEBI/ Exchanges), then the bases of his appointment should be clearly brought out in the engagement letter. The scope of -internal audit as stipulated by

the regulator has to be understood and reference of the same also needs to be incorporated in the engagement letter. Limitations on scope, coverage and reporting requirement, if any, in carrying out the internal audit assignment should be also brought into the letter. The engagement letter should also clearly lay down the requirements as to the manner and frequency of reporting and the list of intended recipients of the internal audit report. A sample copy of the engagement letter for an internal audit of a stock broker is given in **Appendix I**.

Knowledge of the Entity and its Environment

1.9 Standard on Internal Audit (SIA) 15 ‘Knowledge of the Entity and Its Environment’ lays down that in performing an internal audit engagement, the internal auditor should obtain knowledge of the economy, the entity’s business and its operating environment, including its regulatory environment and the industry in which it operates, sufficient to be able to review the key risks and entity-wide processes, systems, procedures and controls. The internal auditor should identify sufficient, appropriate, reliable and useful information to achieve the objectives of the engagement. Such knowledge is used by the internal auditor in reviewing the key operational, strategic and control risks and in determining the nature, timing and extent of internal audit procedures.

1.10 Knowledge of the entity’s business is a frame of reference within which the internal auditor exercises professional judgment and using this information appropriately assists the internal auditor in:

- Assessing the risk & identifying the problems
- Planning & performing the internal audit effectively & efficiently
- Evaluating audit evidence
- Providing better service to the client

1.11 The internal auditor should prepare the flow of events, transactions and processes in the entity on the basis of discussion with key management persons, internal

documentation produced by the entity, management policy manual, procedure manuals of accounting and internal control systems, etc. An illustrative flowchart of the business process in a stock broking entity is given as **Appendix II**.

1.12 A number of legislative and regulatory provisions are applicable to a stock broker. Non-compliances with laws and regulations could result in financial consequences for the entity such as, fines, litigation, etc. The internal auditor should obtain sufficient appropriate audit evidence regarding compliance with the provisions of various laws and regulations applicable to the stock broking entity. For the purpose of identifying instances of non-compliance with laws and regulations, the internal auditor should inquire management and, where appropriate, those charged with governance, as to whether the entity is in compliance with such laws and regulations; and also inspect correspondence, if any, with the relevant regulatory authorities. He should also respond appropriately to non-compliance or suspected non-compliance with laws and regulations identified during the audit.

Audit Planning

1.13 After acquiring the knowledge of the business and various laws and regulations applicable to the stock broking industry, in general and to the client in specific, the internal auditor should plan out the internal audit activity. An internal audit plan is a document defining the scope, coverage and resources, including time required for an internal audit over a defined period. Standard on Internal Audit (SIA) 1, "Planning an Internal Audit" requires that the internal audit plan should be based on the knowledge of the entity's business. While developing the internal audit plan, the internal auditor should have regard to the objectives of the internal audit engagement as well as the time and resources required for conducting the engagement. Further, the internal audit plan should be comprehensive enough to ensure that it helps in achieving of the above overall objectives of an internal audit.

Technical Guide on Internal Audit of Stock Brokers

1.14 SIA 1, "Planning an Internal Audit" specifies that the 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.

Sampling

1.15 The internal auditor should design and select an audit sample to perform audit procedures and evaluate sample. Standard on Internal Audit (SIA) 5, "Sampling" lays down that when using either statistical or non-statistical sampling methods, the internal auditor should design and select an audit sample, perform audit procedures thereon, and evaluate sample results so as to provide sufficient appropriate audit evidence to meet the objectives of the internal audit engagement unless otherwise specified by the client. Key steps in the construction and selection of a sample include:

- (i) Determine the objectives of the internal audit
- (ii) Define the population to be sampled
- (iii) Determine the sampling methods
- (iv) Calculate the sample size
- (v) Select the sample.

Documentation

1.16 Standard on Internal Audit (SIA) 3, “Documentation” lays down that internal audit documentation:

- Aid in planning and performing the internal audit.
- Aid in supervision and review of the internal audit work.
- Provide evidence of the internal audit work performed to support the internal auditor’s findings and opinion.
- Aid in third party reviews, where so done.
- Provide evidence of the fact that the internal audit was performed in accordance with the scope of work as mentioned in the engagement letter, SIAs and other relevant pronouncements issued by the Institute of Chartered Accountants of India.

1.17 Internal audit documentation should record the internal audit charter, the internal audit plan, the nature, timing and extent of audit procedures performed, and the conclusions drawn from the evidence obtained. 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.

Reporting

1.18 The internal auditor’s report should contain a clear written expression of significant observations, suggestions/ recommendations based on the policies, processes, risks, controls and transaction processing taken as a whole and managements’ responses.

1.19 Standard on Internal Audit (SIA) 4 “Reporting” lays down the following basic elements of the Internal Audit Report:

- (i) Title;
- (ii) Addressee;
- (iii) Report Distribution List;
- (iv) Period of coverage of the Report;

Technical Guide on Internal Audit of Stock Brokers

- (v) Opening or introductory paragraph;
 - (a) identification of the processes/functions and items of financial statements audited; and
 - (b) a statement of the responsibility of the entity's management and the responsibility of the internal auditor;
- (vi) Objectives paragraph - statement of the objectives and scope of the internal audit engagement;
- (vii) Scope paragraph (describing the nature of an internal audit):
 - (a) a reference to the generally accepted audit procedures in India, as applicable;
 - (b) a description of the engagement background and the methodology of the internal audit together with procedures performed by the internal auditor; and
 - (c) a description of the population and the sampling technique used.
- (viii) Executive Summary, highlighting the key material issues, observations, control weaknesses and exceptions;
- (ix) Observations, findings and recommendations made by the internal auditor;
- (x) Comments from the local management;
- (xi) Action Taken Report – Action taken/ not taken pursuant to the observations made in the previous internal audit reports;
- (xii) Date of the report;
- (xiii) Place of signature; and
- (xiv) Internal auditor's signature with Membership Number.

Internal Control Evaluation and Risk Management

Internal Control Evaluation

2.1 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 organisation working together to provide reasonable assurance that the organisation 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.

2.2 Standard on Internal Audit (SIA) 12, “Internal Control Evaluation” lays down that the internal auditor should examine the continued effectiveness of the internal control system through evaluation and make recommendations, if any, for improving its effectiveness. The internal auditor should focus towards improving the internal control structure and promoting better corporate governance. 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.

2.3 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 pay-outs, or other reconciliations, etc. may depict good accounting controls but not sound internal controls. The internal auditor

Technical Guide on Internal Audit of Stock Brokers

should gather fair understanding of control environments such as,

- (i) Management's philosophy and operating style
- (ii) Integrity and ethical values
- (iii) Entity's organisational structure and methods of assigning and reviewing authorities
- (iv) Organisational 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.
- (v) There is a regular system of reviewing and updating the policies and procedures.

2.4 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.

2.5 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.

Internal Control Evaluation and Risk Management

The internal auditor should communicate significant deficiencies and material weaknesses to management and those charged with governance.

Risk Management

2.6 Risk is an event which can prevent, hinder or fail to further or otherwise obstruct the enterprise in achieving its objective. Risk can cause financial disadvantage, for example, additional cost or loss of funds or assets. It can result in damage, loss of value and/or loss of an opportunity to enhance the entrepreneurial opportunities or activities. It is the probability of occurrence of an event and the financial impact of such occurrence to an enterprise.

2.7 As robust, flawless and seamless manufacturing activities are of paramount importance to the survival of any manufacturing organisation, so is the 'Risk Management' to stock brokers. There may be different types of risks; some of them are as follows:

- (i) Strategic Risk: Risk associated with primary long term objectives and direction for business, revenue models, etc.
- (ii) Credit/Financial Risks:
 - (a) Relating to clients : Clients' exposure policies and credit policies
 - (b) Relating to enterprises: Process, techniques, instruments, etc used to manage the finance of an enterprise.
- (iii) Process/Operation risk: Risk associated with on going day-to-day operations of an enterprise
- (iv) Information technology risk : Risk associated with weak Information technology environment and weak controls in IT
- (v) Regulations Risk: Risk associated with non-compliances of directions, rules and regulations of SEBI, and exchanges.

2.8 Standard on Internal Audit (SIA) 13, "Enterprise Risk Management" specifies that the role of the internal auditor in

Technical Guide on Internal Audit of Stock Brokers

relation to Enterprise Risk Management is to provide assurance to management on the effectiveness of risk management. Due consideration should be given to ensure that the internal auditor protects his independence and objectivity of the assurance provided. The role of the internal auditor is to ascertain that risks are appropriately defined and managed.

2.9 The scope of the internal auditor's work in assessing the effectiveness of the enterprise risk management would, normally, include:

- (i) assessing the risk maturity level both at the entity level as well as the auditable unit level;
- (ii) assessing the adequacy of and compliance with the risk management policy and framework; and
- (iii) for the risks covered by the internal audit plan:
 - (a) Assessing the efficiency and effectiveness of the risk response; and
 - (b) Assessing whether the score of the residual risk is within the risk appetite.

Auditing in an Information Technology Environment

3.1 Modern day stock broking activities have totally moved to an Information Technology Environment. Trading, operations, settlements and accounting all have become technology based. From computerised accounting the industry has moved far away to computerised procedures, operations, documentations, risk management and controls. The overall objective and scope of an internal audit does not change in an Information Technology environment. However, the use of computer changes the processing, storage, retrieval and communication of financial information and the interplay of processes, system and control procedures. This may affect the internal control systems employed by the entity.

3.2 Standard on Internal Audit (SIA) 14 "Internal Audit in an Information Technology Environment" lays down that the internal auditor should consider the effect of an IT environment on the internal audit engagement, inter alia:

- a) The extent to which IT environment is used to record, compile, process and analyse information; and
- b) The system of internal control in existence in the entity with regard to:
 - The flow of authorised, correct and complete data to processing centre
 - The processing, analysis and reporting tasks undertaken in the installations and
 - The impact of computer based accounting system on the audit trail which would otherwise be expected to exist in an entirely manual system.

3.3 The internal auditor should have sufficient knowledge of the IT system to plan, direct, supervise, control and review the

Technical Guide on Internal Audit of Stock Brokers

work performed. If specialised skills are needed, the assistance of technical expert can also be sought, who may either be the internal auditor's staff or an outside professional. The internal auditor should consider the IT environment in designing audit procedures to review the systems, processes, controls and risk management framework of the entity.

3.4 The internal auditor should review the robustness of the IT environment and consider any weakness or deficiency in the design and operation of any IT control within the entity, by reviewing:

- a) System Audit reports of the entity, conducted by independent Information System auditors;
- b) Reports of system breaches, unsuccessful login attempts, passwords compromised and other exception reports;
- c) Reports of network failures, virus attacks and threats to perimeter security, if any;
- d) General controls like segregation of duties, physical access records, logical access controls;
- e) Application controls like input, output, processing and run-to-run controls; and
- f) Excerpts from the IT policy of the entity relating to business continuity planning, crisis management and disaster recovery procedures.

3.5 A stock broker uses different applications for different processes, sometimes they are integrated and sometimes they are not. The internal auditor should gather information about various applications, its vendor and the process where it is used. There may be various names of application packages but there are basically three main types of files.

- Master files
- Parameters files
- Transaction files

Auditing in an Information Technology Environment

Normally, master files and parameters files are under the direct supervision and control of senior personnel, whereas, the transactions files are with operational staff. The internal auditor should inquire about supervisory controls on each such files.

3.6 At times, exchanges also direct the stock brokers to get the system audit/connectivity audits conducted by the experts possessing those skills. The internal auditor should in such cases review the findings of the System/IT auditor. At times, the stock broker appoints an outsourced agency to control and process the information in IT environment. The internal auditor should review the extent to which the entity's controls provide reasonable assurance regarding the completeness, validity, reliability and availability of the data and the information processed by such outsourced agency.

3.7 The internal auditor should check whether an adequate IT policy is in place and what is the degree of adherence to such policy. He can use checklist format for various IT controls such as, environment control, backups, virus protection controls, access controls, securities levels, etc. He should gather knowledge of access logs, network accounts, remote access, no. of trading terminals, no. of servers, connectivity, etc. If required the internal auditor should perform the system walk-through and compare the results outside the system with independent workings.

3.8 An illustrative checklist of IT controls to be reviewed by the internal auditor is as follows:

Sr. No.	CONTROL PARAMETERS
IT Access Control	
1	There is a structured IT Policy and facility personnel are aware of the applicable policies.
IT Back-up & Recovery	
2	The network has adequately documented backup and recovery procedures/plans/schedules for critical sites.

Technical Guide on Internal Audit of Stock Brokers

Sr. No.	CONTROL PARAMETERS
3	LAN is supported by an uninterruptible power supply (UPS).
4	UPS tested in the last year (to test the batteries)?
5	For disaster-recovery purposes, LAN applications have been prioritized and scheduled for recovery based on importance to the operation.
IT Environmental Controls	
6	Smoke detection and automatic fire-extinguishing equipments installed for adequate functioning and protection against fire hazards
IT Inventory	
7	There is a complete inventory of the following: Hardware: Computers, File Servers, Printers, Modems, Switches, Routers, Hubs, etc. Software: all software for each Computer is logged with licenses and serial numbers.
8	There are written procedures for keeping LAN inventory. And they identify who (title) is responsible for maintaining the inventory report
9	Unused equipment is properly and securely stored
IT Operations	
10	LAN administrator has a backup person
11	LAN administrator monitors the LAN response time, disk storage space, and LAN utilization
12	LAN administrator is experienced and familiar with operation of the LAN facility
IT Physical Security	
13	Alarms installed at all potential entry and exist points of sensitive areas

Auditing in an Information Technology Environment

Sr. No.	CONTROL PARAMETERS
IT Service Agreements	
14	Vendor reliability considered before purchasing LAN hardware and software
15	Service log maintained to document vendor support servicing
16	LAN hardware and software purchase contracts include statements regarding vendor support and licensing
IT Virus Protection Policy	
17	The level of virus protection established on servers and workstations is determined and the monitoring of infection are being done by IT administration. Virus Application should be updated on a monthly basis. Laptops if issued should be ensured to have secured internet access.

3.9 The internal auditor should document the internal audit plan, nature and extent of audit procedures performed and the conclusion drawn from the evidence obtained. In an internal audit in IT environment, some or all of the audit evidence may be in the electronic form. He should also satisfy himself that such evidence is adequately and safely stored and is retrievable in its entirety as and when required.

Internal Audit Checklist

4.1 This chapter contains detailed internal audit checklist on various aspects of stock-broking business.

Books of Accounts, Records and Documents

4.2 The internal auditor should:

- (i) Verify that the books of accounts are maintained exchange-wise separately.
- (ii) Verify that the books of accounts, records and documents as specified in Regulation 17 of SEBI (Stock Brokers and Sub-Brokers) Regulation, 1992 are maintained for a minimum period of 5 years.
- (iii) Verify that all the documents are updated and properly maintained.
- (iv) Verify that the place of maintenance of documents has been intimated to the SEBI.
- (v) Verify that after the closing of any client account all records which relate to the terms and conditions, with respect to the opening and maintenance of such account, are being maintained for a period of 7 years.
- (vi) Verify that where copies of the records/documents have been collected by enforcement agencies during the course of their investigation, the originals of such documents are preserved till the time trial is completed.
- (vii) Verify that the records referred to in Rule 3 of Prevention of Money Laundering Rules are maintained for a period of 10 years from the date of cessation of the transactions between the client and the intermediary.

Client Registration

4.3 The internal auditor should:

- (i) Verify that broker has, when establishing relationship with a new client, taken reasonable steps to assess the background, genuineness, financial soundness and investment objectives of such client. Check whether broker has obtained Member Client Agreement (MCA), Client Registration Form (CRF) and Risk Disclosure Document (RDD) duly signed by the client in the prescribed form at before accepting or placing orders on their behalf.
- (ii) Verify that separate MCA has been executed with the client for trading on different exchanges.
- (iii) Check whether a separate exchange wise Tri-partite Agreement (applicable only in cash segment) is entered between broker, sub-broker and the client.
- (iv) Verify that MCA is executed and adequate amount of stamp duty is paid thereon separately for each exchange.
- (v) Verify that agreement is entered within six months from the date of stamping/franking.
- (vi) Verify that franking is not done after the date of agreement.
- (vii) Verify that broker has obtained CRF, MCA and RDD complete in all respects with all supporting documents.
- (viii) Verify that photograph of client is affixed in 'Individual' CRF and it has been signed by the client. Also, check that photograph affixed is matching with the photograph on proof of identity.
- (ix) Verify whether all supporting documents are obtained from the client like proof of identity, proof of address, bank account(s) proof, demat account(s) proof, financial information proof (if any), PAN card copy, etc.
- (x) Check that all supporting documents are verified with original and stamp of verification is put (recommended)

Technical Guide on Internal Audit of Stock Brokers

on all supporting documents and signed by authorised person.

- (xi) Verify whether board resolution has been obtained from all corporate clients permitting trading in equity/derivatives/debt and also for authorised signatories.
- (xii) Verify whether upon registration copy of KYC and other documents are delivered to the clients and proof of such delivery/communication is maintained.
- (xiii) Verify whether in person verification has been conducted by the broker's own staff and has affixed the date of verification, name and signature of the official conducting in-person verification, stamp of the broker in the client registration form while registering clients.
- (xiv) Verify that remisier has signed as an introducer in KYC form for the client introduced by him on BSE.
- (xv) Verify that additional clauses/documents are marked as voluntary (optional) documents in bold.
- (xvi) Verify that at the time of registering a client, the client is informed in writing that only the documents stated as per SEBI model formats are mandatory, and any additional clause or documentation shall be voluntary and at the discretion of the trading member and the client.
- (xvii) Verify that separate docket is prepared for mandatory and voluntary documents.
- (xviii) Verify that additional clauses incorporated in MCA, if any, are not in conflict with any of the clauses in the model document, as also the Rules, Regulations, Articles, Bye-laws, Circulars, etc.
- (xix) Verify that PAN of the client is cross verified with Income Tax Website and it is recommended that proof of the same is maintained for each client.
- (xx) Verify whether disclosure of proprietary trading by the broker have been given to each of the client (in case of broker having proprietary trading).

Internal Audit Checklist

- (xxi) Verify that e-mail id of client and consent letter is obtained in case client has opted for receiving contract notes and other documents through ECN or electronic form.
- (xxii) Verify that every year Annual Accounts and shareholding pattern have been obtained from Non-Individual clients.
- (xxiii) Verify that trade has been done after completion of all formalities related to client registration.
- (xxiv) Verify that financial information provided by the client has been monitored with trading activities of the client.
- (xxv) Verify that client's information has been reviewed periodically and in view of the current trading activity of the client, updation of the client's information is done on an ongoing basis. (Refer Circular No. NSE/INVG/2006/7236 dated March 3, 2006 and BSE Notice No. 20060704-5 dated July 4, 2006)
- (xxvi) Evaluate inventory controls relating to blank KYC documents given to branches/sub-brokers/clients and lying at Head Office of the broker.
- (xxvii) Verify whether control serial number is printed on each KYC docket for better internal controls.
- (xxviii) Verify that internal control procedures are in place for authorisation, verification and acceptance of documents.
- (xxix) Verify that master records in back office software are updated correctly and no discrepancy has been noticed with the details provided in KYC documents.
- (xxx) Verify storage facility of registered KYC documents of clients and ensure that documents are stored in such a way that retrieval of documents is easy and fast.

Unique Client Code (UCC)

- 4.4 The internal auditor should:
- (i) Verify that Unique Client Code (UCC) has been allotted to all the clients including clients of sub-brokers.

Technical Guide on Internal Audit of Stock Brokers

- (ii) Verify that PAN and names of clients as they appear on the PAN card are correctly uploaded on the exchange in respect of all clients.
- (iii) Verify that details of Unique Client Code have been uploaded after completion of all formalities related to Client Registration.
- (iv) Verify that the broker is having a system of mapping of client codes with clients respective PAN and/or Passport No./Driving License No./Voter Card No. in their back offices.
- (v) Verify that the details of Unique Client Code are obtained upfront before entering any order.
- (vi) In case broker has opened different party ledger accounts by allotting various back office client codes, verify that only one Unique Client Code is used for all such accounts or back office client codes. PAN can be the sole identification number for tracking the client opening multiple client codes.

Margins

4.5 The internal auditor should:

For Cash Segment Margins

- (i) Verify whether broker has adopted Risk Management Policy by passing the requisite resolution.
- (ii) Verify whether broker has a prudent system of Risk Management to protect themselves from client default.
- (iii) Verify whether broker has well documented policy of Risk Management and Margin Collection from the client.
- (iv) Verify that broker has collected margins as specified in risk management policy and no deviation is noticed.
- (v) Verify that in case of deficiency in collection and maintenance of margins as per policy, the same have been reported to the management.

Internal Audit Checklist

- (vi) Verify whether the required synchronisation exists between margin collection department and risk management department for the purpose of giving exposure to the client.

For Derivative Segment Margins

- (i) Verify that in case of derivatives market, client margin reporting is done on daily basis.
- (ii) Verify whether client margin reporting is done within the time line prescribed by the exchange.
- (iii) Verify whether broker has reported correctly the margin collected from the client in case of derivatives segment.
- (iv) Verify that valuation of collaterals is done correctly. Ensure that unpaid securities are not considered as margin collected.
- (v) Analyse the penalties charged by the exchange to fix up the responsibility of the concerned department.
- (vi) Verify whether penalties charged by the exchange on account of short collection of margins from clients have been recovered from the respective client as per the terms of agreement.
- (vii) Verify that no wrong reporting is done by the broker for client margin reporting in case of derivatives segment.

Register of Transaction (Sauda Book)

- 4.6 The internal auditor should:
- (i) Verify the process of generating the sauda book including internal controls thereof.
 - (ii) Verify that sauda book reflects all information as per the requirement of the respective exchanges.
 - (iii) Compare sauda book and trade files to verify that there are no client code modifications.

Technical Guide on Internal Audit of Stock Brokers

- (iv) Compare sauda book and trade files to verify that there are no modification to the market rate.
- (v) Verify that client code modification, if any is done only for genuine reasons and after obtaining necessary internal sanctions and the same have also been intimated to the stock exchange.
- (vi) Verify that there are no cross deals entered into by the broker.
- (vii) Verify that there are no fictitious trades executed by the broker.
- (viii) Verify that there are no cases of front running by the dealer (terminal operator) or the broker.
- (ix) Verify that Principal to Principal trades are executed only after obtaining necessary approvals from the exchange (BSE) and after complying with the exchange directives.
- (x) Verify that no off market trades are executed by the broker.

Contract Note

- 4.7 The internal auditor should:
- (i) Verify the process of generating the contract notes including internal controls thereof.
 - (ii) Verify contract notes have been issued to all the clients.
 - (iii) Verify whether correct brokerage is charged to the client.
 - (iv) Verify that brokerage is charged to all the clients.
 - (v) Verify that the format of contract note is as prescribed by the respective exchange.
 - (vi) Verify that contract notes have been issued to client for shares offered in auction settlement by the clients.
 - (vii) Verify whether client code, name and address of the client are mentioned on the contract note.

Internal Audit Checklist

- (viii) Verify whether contract notes are issued within twenty-four hours of trade.
- (ix) Verify whether PAN of client is printed on contract note where the value of the contract note exceeds Rs. 1 lakh.
- (x) Verify whether contract notes have pre-printed/computerised running serial number initialised on a financial year basis.
- (xi) Verify whether the contract note number, amount, rate etc., on the duplicate contract note matches with details in back office software.
- (xii) Verify that dealing office address is mentioned on the contract notes for trades executed on NSE.
- (xiii) Compare contract notes issued by the broker with trade files to ensure that contract notes are issued to all the clients and no off-market trades are executed by the broker.
- (xiv) Verify whether the brokerage charged to client does not exceeds the maximum limit of 2.5% of the contract price or Rs. 0.25/- per share.
- (xv) Verify whether brokerage charged to client on option contract does not exceed the maximum limit of 2.5% on the premium or Rs. 100/-, whichever is higher.
- (xvi) Verify that brokerage is charged on option contract on the premium amount only and not on the premium plus strike price.
- (xvii) Verify whether contract note is signed by Director/ Authorised signatory and the name of such Directors/ Authorised signatory is printed on the contract note.
- (xviii) Verify that the board resolution/ power exchange of attorney, as the case may be, to sign the contract notes is submitted to the exchange.
- (xix) Verify whether the duplicate copies of contract notes are preserved as per the exchange guidelines.

Technical Guide on Internal Audit of Stock Brokers

- (xx) Verify whether contract notes are acknowledged by clients (date and signature of client should be obtained) in case of hand delivery, and dispatch records are maintained in case where the contract notes are sent by post/ courier.
- (xxi) In case where summary contract notes are issued to clients, verify that details of trades are attached as annexure thereto.
- (xxii) Verify statement of STT is issued to the client on annual (financial year) basis or at such periodicity as required by the client.

Electronic Contract Note (ECN)

- 4.8 The internal auditor should*:
- (i) Verify the process of generating and uploading the ECN including internal controls thereof.
 - (ii) Verify ECN is digitally signed, encrypted and is in non-tamperable form.
 - (iii) Ensure the validity of digital signature.
 - (iv) Verify that the format of contract note is as prescribed by the respective exchange.
 - (v) Verify consent letter of the client/clauses in the MCA to receive ECN specifying the e-mail address.
 - (vi) Verify acknowledgement of the e-mail has been retained in a soft and non-tamperable form.
 - (vii) Verify log report generated by the system at the time of sending the ECN have been maintained for the specified period.
 - (viii) Verify the agreement contains clause that informs the client that non-receipt of bounced mail notification by the

* These check points are in addition to the points specified under the head "Contract Notes".

Internal Audit Checklist

broker shall amount to delivery of the ECN at the e-mail ID of the client.

- (ix) Verify whether the log report provides the details of the ECN that are not delivered to the client/e-mails rejected or bounced back.
- (x) Verify that physical contract notes are issued to clients with twenty-four hours, 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.
- (xi) Verify that ECNs are simultaneously published on the designated web-site of broker in a secured way by issue of username and password, and also enables relevant access to the clients including the option to print the same.

Straight Through Processing (STP)

4.9 The internal auditor should:

- (i) Verify that all the institutional trades executed on the stock exchanges have been processed through the STP.
- (ii) Verify that contract notes have been signed using digital signatures.
- (iii) Verify that STP for electronic trade are processed with a common messaging standard ISO 15022.
- (iv) Verify that log reports have been preserved properly.

Settlement of Funds

4.10 The internal auditor should:

- (i) Verify that proper bank accounts, as required, have been opened and the same are used only for the specified purpose.
- (ii) Verify that separate designated 'Client' bank account is maintained for clients' money.

Technical Guide on Internal Audit of Stock Brokers

- (iii) Verify that a clear segregation is maintained for clients' money and the broker's own money.
- (iv) Verify that dishonoured cheques of clients have been properly accounted for and are not pending in Bank Reconciliation Statement.
- (v) Verify that the bank reconciliation are carried out on regular basis and all unreconciled/pending entries are thoroughly scrutinised, especially entries that are pending for unreasonably long period.
- (vi) Verify that the settlement account is properly tallied and all entries, as appearing in the settlement bank statement, are properly accounted in the back office records.
- (vii) Analyse the reason for dishonoured/bounced cheques that have been issued by the broker.
- (viii) Verify that there are no cash dealings made by the broker with the clients except under exceptional circumstances as permitted by the SEBI.
- (ix) Verify that pay-in of funds due from clients is received from the respective clients account only, i.e., it has not been received from third party.
- (x) Verify that pay-out of funds due to clients is made to the respective clients only, i.e., it has not been paid to third party.
- (xi) Verify that client funds are not used for own purposes.
- (xii) Verify that there are no unauthorised transfer of funds from one client account to another client account, in cases where separate client-wise accounts are maintained by the broker.
- (xiii) Evaluate the alerts generated from the bank reconciliation statement that may lead to frauds like, teaming and lading, etc.
- (xiv) Verify that the credits due to clients are paid to them within one working day after the pay-out has been received from the clearing corporation.

Internal Audit Checklist

- (xv) Verify that in cases where the pay-out of funds has not been made within the time limit prescribed by the exchange, the instruction from the client to withhold the funds has been received.
- (xvi) Verify that the broker is not involved in fund based activities.
- (xvii) Verify that there is no misutilisation of the client money by the broker.

Settlement of Securities

4.11 The internal auditor should -

- (i) Verify the process of pay-in and pay-out prevailing in the organisation and internal controls thereof.
- (ii) Verify that separate designated 'Client' beneficiary account has been maintained for the purpose of holding client shares.
- (iii) Verify that a clear segregation is maintained of the client shares and own shares.
- (iv) Verify that in case of dematerialised securities, register of securities client-wise and security-wise has been maintained.
- (v) Verify that in case of securities in physical form, Document register or Inward/Outward register has been maintained.
- (vi) Verify that delivery/receipt of shares purchased/sold by the client is to/from their respective accounts, i.e., no third party shares are received or delivered.
- (vii) Verify that no shares lie in the Pool account of the broker for more than one working day. (This can be cross checked from the transaction statement of CISA Account with the CDSL and from penalty levied by the NSDL.)
- (viii) Verify that the pay-out of shares to the client has been made within one working day of the receipt of pay-out from the exchange.

Technical Guide on Internal Audit of Stock Brokers

- (ix) Verify that in cases where the pay-out of securities has not been made within the time limit prescribed by the exchange, the instruction from the client to withhold the securities has been obtained.
- (x) Verify that the client shares have not been used for own purposes.
- (xi) Verify that the shares of one client have not been used for another client.
- (xii) Verify that in case of short delivery of shares by the client, the broker has debited the defaulting client by the auction charges recovered by the exchange for such short delivery of shares.
- (xiii) Verify that close out credit have been properly received and accounted.
- (xiv) Verify that the shares lying in the client beneficiary demat account is regularly reconciled with the client shares as appearing in the records maintained by the broker.
- (xv) Verify that in case of internal shortages, shares are subsequently delivered to the buyer.
- (xvi) Verify that 'Power of Attorney' has been duly executed in case of demat account of clients operated by the broker to honour the pay-in obligation of the client.
- (xvii) Verify that there is proper segregation of duty relating to settlement of securities and maker checker concept has been implemented.
- (xviii) Analyse the reasons for shares of the clients lying with the broker for a long period.

Statement of Accounts for Funds and Securities

4.12 The internal auditor should:

- (i) Verify that the broker has sent 'Statement of Accounts' for both funds and securities to his clients as well as to the clients of the sub-broker, for every quarter in case of NSE

Internal Audit Checklist

and once at least in 6 months for BSE, within a month of the expiry of the said period.

- (ii) Verify that the error reporting clause has been incorporated in the Statement of Accounts.
- (iii) Verify that the Statement of Accounts returned undelivered are scrutinised to ensure the genuineness of the account.
- (iv) Verify that the Statement of Accounts for funds and securities are sent directly to the client, from the main office instead of routing it through branch or other intermediaries.
- (v) Verify that written consent of the client is obtained in case where the Statement of Accounts has been sent by e-mail.
- (vi) Verify that in case of those brokers who offer trading facility to their clients through internet and provide an access to an on-line accounting, viewing and print-out facility, it would be treated as sufficient compliance, if they send the 'Statements of Accounts' by e-mail to such clients.
- (vii) Verify that the errors reported by the clients are scrutinised to ensure the genuineness of the transaction and appropriate action is taken by the broker.
- (viii) Verify that in respect of institutional clients, the said requirement is applicable in case the broker pay/receive funds and receive/deliver securities from or to the institutional clients directly and not through custodians.
- (ix) Verify that where the statement of accounts for the funds and securities are sent by post/courier, adequate dispatch records have been maintained and in case of hand delivery, acknowledgement of the client along with date of receipt has been obtained.

Brokerage and Revenue Leakage

4.13 The internal auditor should:

- (i) Verify that revenue is recognised in accordance with Accounting Standard (AS) 9 “Revenue Recognition” issued by the Institute of Chartered Accountants of India. The brokerage can be booked either on completed settlement basis or on financial year basis in accordance with the policy of the broking house.
- (ii) Verify the process of charging of brokerage including internal controls thereof.
- (iii) Verify the process of sharing of brokerage with intermediaries including internal controls thereof.
- (iv) Verify that brokerage earned from clients and shared with intermediaries is not netted-off in the “Brokerage Account”.
- (v) Verify that corporate benefits have been promptly passed on to the client.
- (vi) Verify that dividend payable to client is shown under the head Current Liabilities and Dividend on own investment should be shown in Profit and Loss Account.
- (vii) Verify that brokerage slabs are correctly defined in the brokerage masters of the back office accounting software.
- (viii) Verify adequacy of access controls in the accounting software to avoid unauthorised modification of brokerage in the accounting software.
- (ix) Verify adequacy of audit trails for modification of brokerage in the accounting software.
- (x) Verify the correctness of brokerage shared with the intermediary and also ensure that brokerage is shared only for the clients introduced by the said intermediary.
- (xi) Verify adequacy of access controls to avoid unauthorised modification of sharing of brokerage with intermediaries in the accounting software.

Internal Audit Checklist

- (xii) Verify adequacy of audit trails for modification in sharing of brokerage with intermediaries in the accounting software.
- (xiii) Verify that expenses/fines/penalties, etc., incurred on behalf of clients are recovered subject to the provisions of agreement entered between the broker and the client (e.g., stamp paper charges, franking charges, transaction charges levied by the exchange, etc.).
- (xiv) Verify authorisation of losses incurred for trades transferred to “Own A/c” or “Office Vandha A/c” on account of dispute with the client.
- (xv) Verify that trades transferred to “Office Vandha A/c” is squared up as per the organisation’s policies and in case where the trades have not been squared up verify the sanctions thereof to carry forward such trades in the books of accounts.
- (xvi) Analysis of trades transferred to “Office Vandha A/c” is conducted to get an overall idea as to the nature, quantum of such errors and internal controls prevailing in the organisation.
- (xvii) Verify that balance lying in the “Office Vandha A/c” is written-off in the Profit and Loss A/c at the year end.
- (xviii) Verify whether insurance claim has been made against dealing errors.
- (xix) Verify that corporate benefits are passed on to correct client and in proportion to the shares held in the client beneficiary account on the record date.

Trading Terminals

4.14 The internal auditor should:

BSE Terminals

- (i) Verify that trading terminals are installed only at the member-broker’s office, branch offices, sub-brokers’

Technical Guide on Internal Audit of Stock Brokers

offices. (An office is considered as branch office only if it is owned, leased or rented by the broker.)

- (ii) Verify terminals are operated by brokers/employees of broker/sub-broker/employees of sub-broker.
- (iii) Verify that remisier is operating terminal from brokers' office only.
- (iv) Verify that 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, have been uploaded to the exchange.
- (v) Verify that all the IML user ids created in the IML server of the trading member has been mapped to 16 digits Location ID on one-to-one basis and a record of the same is maintained.
- (vi) Verify that all the terminal users are BCSM certified as per the requirement of exchange.
- (vii) Verify that all the terminal users have obtained the required certificate from any of the SEBI approved institutes.
- (viii) Verify that System audit is conducted as per the exchange requirement and the audit report has been submitted by due date.

NSE Terminals

- (i) Verify that trading terminals are located only in the main/branch offices of the broker or in the office of the sub-broker or in the office of authorised person for F&O segment.
- (ii) Verify that trading terminals are managed either by an authorised employee or by a registered sub-broker and in case of terminals located at branches, branch office is managed and supervised by the trading member's own employee or by a registered sub-broker.

Internal Audit Checklist

- (iii) Verify that the required details of all the CTCL 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, have been uploaded as per the requirement of the Exchange.
- (iv) Verify that all the CTCL user ids created in the CTCL server of the trading member have been mapped to 12 digit codes on a one-to-one basis and a record of the same has been maintained.
- (v) Verify that all the terminal users are NCFM certified as per the requirement of exchange.
- (vi) Verify that all the terminal users have obtained the required certificate from any of the SEBI approved institutes.
- (vii) Verify that the required certificate is obtained by the person operating the Corporate ID.
- (viii) Verify that System audit is conducted, as per the exchange requirement, and the audit report has been submitted by due date.
- (ix) Verify that no former trading member or a user of such trading member have been appointed as user by the broker without the approval of the exchange.

Sub-Broker

4.15 The internal Auditor should:

- (i) Verify sub-broker's certificate of registration from SEBI (Stock Broker and Sub-broker) Regulation, 1992.
- (ii) Verify brokerage is shared with the sub-broker only after the date of the registration.
- (iii) Verify that in case of BSE 20% of the sub-brokers have been inspected every year and in case of NSE 10% of the active sub-brokers have been inspected every year.

Technical Guide on Internal Audit of Stock Brokers

- (iv) Verify that no Director of a corporate broking house is acting as sub-broker of the same broking house.
- (v) Verify tripartite agreement is executed between broker, sub-broker and client in case of clients introduced by sub-broker.
- (vi) Verify that contract note is issued only by the broker and no sub-broker is issuing confirmation memos to its clients.
- (vii) Verify that delivery of securities and the payment of funds relating to the client's transaction are made directly between a broker and the client introduced by sub-broker.

Remisier

4.16 The internal auditor should:

- (i) Verify that the business with remisier is commenced only after registering the remisier with the BSE.
- (ii) Verify that no brokerage is shared with remisier for his personal business.
- (iii) Verify that remisier is not an employee of any other broker.
- (iv) Verify that remisier is not a sub-broker with any other broker of any exchange.
- (v) Verify that contract note is issued only by the broker and no remisier is issuing confirmation memos to its clients.
- (vi) Verify that remisier has not been allotted the terminals at places other than head office or branch office of the broker.
- (vii) Verify that the remisier has not refunded the brokerage, directly or indirectly, to the clients introduced by him or to any other person or agent.
- (viii) Verify that the remisier has not issued contract notes, confirmation memo and/or bills to the clients in their name.

- (ix) Verify that the clients introduced by the remisier have delivered securities and made payments directly to the broker and *vice-versa*.

Authorised Person

4.17 The internal auditor should:

- (i) Verify that the business with authorised person is commenced only after registering the authorised person with the NSE.
- (ii) Verify that authorised person is not an employee of any other broker.
- (iii) Verify that contract note is issued only by the broker and no authorised person is issuing confirmation memos to its clients.
- (iv) In case where the application of authorised person, is subsequently rejected by the SEBI verify that no further dealings are carried on with the authorised person.
- (v) Verify that the authorised person has not issued contract notes, confirmation memo and/or bills to the clients in their name.
- (vi) Verify that the clients introduced by the authorised person have delivered securities and made payments directly to the broker and *vice-versa*.

Advertisement

4.18 The internal auditor should:

- (i) Verify that the advertisement is issued in accordance with the Regulation 17 and Bye-Law 358 of BSE Rules, Bye-Laws and Regulations, 1957 and/or in accordance with the Code of Advertisement specified by NSE.
- (ii) Verify that the broker has not issued an advertisement unless it has been permitted by the stock exchange.
- (iii) Verify that the advertisement does not contain any recommendation regarding purchase or sale of any

Technical Guide on Internal Audit of Stock Brokers

particular share or security of any company and/ or any recommendation regarding any company.

- (iv) Verify that the advertisement specifies the name/title as recorded for the membership of the Exchange along with the registration number allotted by SEBI.
- (v) Verify that all information given in the advertisement is correct and accurate.
- (vi) Verify that the advertisement does not include publicity for any party other than the broker himself and it does not contain any reference to any person, firm or institution.
- (vii) Verify that the broker has submitted a copy of the advertisement to the Membership Department of the Exchange authorities as soon as it is published in case of advertisement published by a BSE broker.

Margin Trading Facility

4.19 The internal auditor should:

- (i) Verify whether prior permission of the exchange has been obtained for the purpose of providing Margin Trading Facilities to the clients and letter from exchange has been received allowing broker to provide margin trading facilities to their clients.
- (ii) Verify whether broker has taken adequate care and exercised due diligence before providing margin trading facility to any client.
- (iii) Verify that broker has allotted Unique Client Code to the client by obtaining necessary supporting documents.
- (iv) Verify that broker has obtained a declaration from the client stating whether he has availed of any margin trading facility from any broker in any exchange, or whether his request for margin trading with any broker was rejected and, if so, verify that, in both the cases, the name of the broker and his registration number details has been obtained.

Internal Audit Checklist

- (v) In case client has availed margin trading facility from any other broker in any exchange then check that whether broker has verified the details from the concerned broker/s.
- (vi) Verify that before providing margin trading facility to a client who has already availed of margin trading facility from another broker in the same exchange, the broker has ensured that the client has liquidated his outstanding in the margin trading account with the other broker, and obtained a certificate to this effect in writing from that broker.
- (vii) Verify that broker has provided margin trading facility to clients only in cash segment.
- (viii) Verify that broker has provided margin trading facility to clients only in 'Group 1' Securities.
- (ix) Verify that broker has entered into an agreement with his client for providing the margin trading facility on the lines of the model agreement prescribed by the SEBI (Ref. SEBI circular No. SEBI/MRD/SE/SU/Cir-15/04 dated March 19, 2004).
- (x) Verify whether broker has modified the agreement for stipulating additional or more stringent conditions. In this case, verify whether any additional clause or conditions has the effect of diluting any of the conditions laid down in the model agreement.
- (xi) Verify that broker has used his own funds or borrowed funds from scheduled commercial banks and/or NBFCs regulated by RBI for the purpose of providing margin trading facility, and broker has not used borrowed funds from any other source for the purpose of providing margin trading facility.
- (xii) Verify that at any point of time, the total indebtedness of the broker for the purpose of margin trading has not exceeded five times of his net worth.
- (xiii) Verify that the "maximum allowable exposure" of the broker towards the margin trading facility is within the self

Technical Guide on Internal Audit of Stock Brokers

imposed prudential limits and has not, in any case, exceeded the borrowed funds and 50% of his “net worth”.

- (xiv) Verify that broker has no concentration on any single client. In any case, the exposure to any single client at any point of time has not exceeded 10% of the broker’s lendable resource (i.e., borrowed funds for the purpose of margin trading + 50% of net worth).
- (xv) Verify that broker has adhered to the requirements relating to initial margin and maintenance margin.
- (xvi) Verify that broker has promptly made margin calls to his clients, in case balance deposit in the client’s margin account falls below the required maintenance margin, and no further exposure is granted to such client on the basis of any increase in the market value of the securities.
- (xvii) Verify that broker has liquidated securities of the client in the following conditions only:
 - (a) if the client fails to meet the margin call made by the broker; or
 - (b) fails to deposit the cheques on the day following the day on which the margin call has been made; or
 - (c) where the cheque deposited by the client has been dishonored; or
 - (d) in case the client’s deposit in the margin account (after adjustment for mark-to-market losses) falls to 30% or less of the latest market value of the securities.
- (xviii) Verify that broker has maintained separate client-wise accounts of the securities purchased on margin trading with depositories and enabled the client to observe the movement of securities from his account (through internet).

Internal Audit Checklist

- (xix) Verify that the broker has also maintained a separate record of details (including the sources) of funds used for the purpose of margin trading.
- (xx) Verify that the books of accounts, maintained by the broker, with respect to the margin trading facility offered by it have been audited on a half-yearly basis.
- (xxi) Verify that the broker has submitted an auditor's certificate to the exchange/s, within one month from the date of the half year ending 31st March and 30th September of the year certifying, *inter alia*, the extent of compliance with the conditions of margin trading facility.
- (xxii) Verify that the broker has submitted to the stock exchange a half-yearly certificate, as on 31st March and 30th September of each year, from an auditor confirming the net worth, within one month from the date of the half year ending 31st March and 30th September of the year.
- (xxiii) Verify that the broker has disclosed to the stock exchange/s details on gross exposure including name of the client, Unique Identification Number (UIN)/client code, name of the scrip, quantity, amount funded, etc. (as per the format prescribed by SEBI vide its Circular No. SEBI/MRD/SE/SU/Cir-15/04 dated March 19, 2004) and if the broker has borrowed funds for the purpose of providing margin trading facility, name of the lender and amount borrowed, on or before 9.00 pm for the same day of reporting.

Prevention of Money Laundering

4.20 The internal auditor should:

- (i) Verify whether proper policy framework as per the Guidelines on anti-money laundering measures is put into place.
- (ii) Verify whether the above referred policy is approved by Board of Directors.
- (iii) Verify whether an officer has been appointed as 'Principal Officer'.

Technical Guide on Internal Audit of Stock Brokers

- (iv) Verify whether such appointment of 'Principal Officer' is intimated to the Office of the Director-FIU, New Delhi.

One Time / Periodical Compliances

- (i) Verify whether proper record of transactions prescribed under Rule 3 are maintained.
- (ii) Verify whether the following information in respect of transactions referred to in Rule 3 are maintained and preserved:
 - (a) nature of the transactions;
 - (b) amount of the transaction and the currency in which it was denominated;
 - (c) date on which the transaction was conducted; and
 - (d) parties to the transaction.
- (iii) Verify whether an internal mechanism has been evolved for proper maintenance and preservation of such records and information in a manner that allows easy and quick retrieval of data as and when requested by the competent authorities.
- (iv) Verify whether such records as are sufficient to permit reconstruction of individual transactions (including the amounts and types of currencies involved, if any) have been maintained so as to provide, if necessary, evidence for prosecution of criminal behaviour.
- (v) Verify whether the policies and procedures on prevention of money laundering and terrorist financing are regularly reviewed to ensure their effectiveness.
- (vi) Verify whether review is done by the person who is different from the person who has framed such policies and procedures.

Ongoing / Continuous Compliance

- (i) Verify whether the following information has been maintained for the purpose of satisfactory audit trail:
 - (a) beneficial owner of the account;
 - (b) volume of the funds flowing through the account for selected transactions;
 - (c) origin of the funds;
 - (d) form in which the funds were offered or withdrawn, e.g., cash, cheques, etc.;
- (ii) identity of the person undertaking the transaction;
- (iii) destination of the funds; and
- (iv) form of instruction and authority.

Customer Due Diligence

- (i) Verify whether Customer Due Diligence Process has been conducted.
- (ii) Verify whether records of the identity of clients have been maintained.
- (iii) Verify whether sufficient information in order to identify persons who beneficially own or control securities account has been obtained.
- (iv) Verify whether beneficial ownership and control has been identified, i.e., which individual(s) ultimately own(s) or control(s) the customer and/or the person on whose behalf a transaction is being conducted.
- (v) Verify whether customer's identity has been verified using reliable, independent source documents, data or information.
- (vi) Verify whether ongoing due diligence and scrutiny has been conducted.

Policy for Acceptance of Clients

- (i) Verify whether customer acceptance policy has been defined.
- (ii) Verify whether safeguard has been taken while accepting the clients that no account is opened in a fictitious or benami name or on an anonymous basis.
- (iii) Verify whether documentation requirement and other information in respect of different classes of clients depending on perceived risk and having regard to the requirement of the Prevention of Money Laundering Act, 2002, Guidelines issued by RBI and SEBI from time to time have been collected.
- (iv) Verify whether identity of the client is verified for known criminal records or is not banned in any other manner, whether in terms of criminal or civil proceedings by any enforcement agency worldwide.
- (v) Verify whether failure by prospective client to provide satisfactory evidence of identity have been noted and reported to the higher authority.

Client Identification Procedure

- (i) Verify whether the client identification procedure has been formulated on lines of the applicable legal framework.
- (ii) Verify whether client identification procedure is implemented properly.
- (iii) Verify whether Customer Due Diligence has been conducted on a risk sensitive basis depending on the type of customer business relationship.
- (iv) Verify whether customers are identified as per risk sensitive basis.

Monitoring of Transactions

- (i) Verify whether regular monitoring of transactions is done for ensuring effectiveness of the Anti-Money Laundering procedures.

Internal Audit Checklist

- (ii) Verify whether special attention has been given to all complex, unusually large transactions/patterns which appear to have no economic purpose.
- (iii) Verify whether compliance cell or department has randomly examined a selection of transaction undertaken by clients to comment on their nature, i.e., whether they are in the suspicious transactions or not.

Suspicious Transaction Monitoring and Reporting

- (i) Verify whether transaction of suspicious nature or any other transaction notified is reported to the appropriate law authority.
- (ii) Verify whether suspicious transactions are also regularly reported to the higher authorities/head of the department.
- (iii) Verify whether the cash transaction report (CTR) (wherever applicable) for each month is submitted to FIU-IND by 15th of the succeeding month.
- (iv) Verify whether the Suspicious Transaction Report (STR) is submitted within 7 days of arriving at a conclusion that any transaction, whether cash or non-cash, or a series of transactions integrally connected are of suspicious nature.
- (v) Verify whether the Principal Officer has recorded his reasons for treating any transaction or a series of transactions as suspicious. Verify whether there is any undue delay in arriving at such a conclusion.

Training to Staff and Hiring Policies

- (i) Verify whether the content of PML Guidelines is understood by all staff members' Verify whether appropriate training has been provided to staff.
- (ii) Verify whether staff members' awareness and vigilance to guard against money laundering and terrorist financing has been developed.

Technical Guide on Internal Audit of Stock Brokers

- (iii) Verify whether adequate screening procedures are in place to ensure high standards when hiring employees.

Audit/Testing of Anti-Money Laundering Program

- (i) Verify whether the audit is conducted periodically to test Anti-Money Laundering Program adequacy to meet the compliance requirements.
- (ii) Verify whether the audit/testing is conducted by member's own personnel not involved in framing or implementing the AML program or it is done by a qualified third party.
- (iii) Verify whether the report of such an audit/testing is placed before the senior management for making suitable modifications/improvements in the AML program.

Procedural Compliances

- (i) Verify whether KYC is complete in all respects before opening any client account.
- (ii) Verify whether Branch/Relationship Managers are instructed to verify all original documents with copies of the same which form part of supporting to KYC.
- (iii) Verify whether any account is opened without Introducer details and signature. If yes, whether any employee of the organisation has taken interview of the client.
- (iv) Verify whether any guidelines has been given to branches for the following:
 - (a) No Cash transactions
 - (b) No Third Party Cheque or Securities to be accepted
 - (c) Number of Demand Draft to be accepted
 - (d) POA with Photo Identity and address proof
 - (e) Income Proof of HNI Clients
- (v) Verify whether KYC Profile for risk sensitive clients including HNI is updated on periodical basis.

Internal Audit Checklist

- (vi) Verify whether following transactions are monitored and reported to Principal Officer:
 - (a) Client whose identity verifications seems difficult or client appears not to co-operate in providing details.
 - (b) Clients in high risk jurisdictions
 - (c) Substantial increase in volume without apparent cause
 - (d) Large number of accounts having common parameters such as, common partners/directors/promoters/address/e-mail address/telephone numbers/introducers or authorised signatories.
 - (e) Unusually large cash deposits made by an individual or business
 - (f) Client is willing to accept uneconomic terms without apparent reason
 - (g) Transaction inconsistent with legitimate business activity
 - (h) Transaction inconsistent with the normal pattern of client's investment activity
 - (i) Client is financially capable of transactions he has asked for
 - (j) Activity of the client is resumed after being in-operative for more than 3 months
 - (k) High value payments made from bank accounts not notified in KYC form
 - (l) Transfer of large number of securities from demat accounts not notified in KYC form or not pertaining to client
 - (m) Multiple transactions of value just below the threshold limit specified in PMLA so as to avoid possible reporting

Technical Guide on Internal Audit of Stock Brokers

- (n) Purchases made on own account transferred to a third party through off-market transactions through DP Accounts.

Others

4.21 The internal auditor should:

Notice Board and SEBI Registration Certificate

- (i) Verify that Notice Board in the format prescribed by NSE and BSE is displayed in Main Office and branch office (or any other offices where the trading terminals are located) and the registered Sub-broker's office.
- (ii) Verify that Notice Board is displayed at prominently visible locations and in a permanent manner.
- (iii) In case of BSE Broker, verify that a list of general Do's and Don'ts for the investors to follow while investing/trading in the stock markets is prominently displayed.
- (iv) Verify that a copy of SEBI Registration Certificate is prominently displayed in all offices of the member.
- (v) Verify that SEBI Registration Certificate issued to the sub-broker is prominently displayed at all sub-broker's offices.

Trading Through Other Stock Broker

4.22 The internal auditor should -

- (i) Verify that stock broker has dealt with broker/sub-brokers of the same exchange either for proprietary trading or for trading on behalf of clients. If yes, verify that whether prior permission of the exchange has been obtained in this regard.
- (ii) Verify that stock broker has dealt with broker/sub-brokers of the other exchange for proprietary trading. If yes, verify whether prior intimation has been given to parent stock exchange of the stock broker about name of such other stock broker or sub broker.

- (iii) In case stock broker has dealt with broker/sub-brokers of the other exchange for executing trades on behalf of clients, then verify it has been done after obtaining necessary registration with SEBI as sub-broker of such other broker in the other stock exchange.

Block Deal

4.23 The internal audit should:

- (i) Verify that details of block deal are executed perfectly and within the time lines prescribed by the exchange.
- (ii) Verify that stock broker has verified indicative report of block deals and reported mismatch, if any, to the exchange within half an hour of receiving the return file.

Bulk Deal

4.24 The internal auditor should -

- (i) Verify the process of tracking of bulk deal(s) in respect of all transactions in scrip where total quantity of shares bought/sold by a single client in a day is more than 0.5% of the number of equity shares of the company listed on Exchange.
- (ii) Verify that stock broker has disclosed to exchange in respect to all transactions in scrip where total quantity of shares bought/sold by a single client in a day is more than 0.5% of the number of equity shares of the company listed on Exchange.
- (iii) Verify that proper disclosure as per the format of the Exchange has been made.
- (iv) Ensure that disclosure has been made within the time lines prescribed by the exchange.

Proprietary Account Trading

4.25 The internal auditor should -

- (i) Verify that stock broker has intimated the place or location alongwith terminal details to the exchange in case stock

Technical Guide on Internal Audit of Stock Brokers

broker wants to avail of the facility of placing orders on 'Pro-Account' from his default location.

- (ii) Verify that stock broker has taken permission of the exchange for the facility of 'Pro-Account' trading from location other than default location or on CTCL Terminals.
- (iii) Ensure that the undertaking has been submitted to the exchange in the prescribed format for availing the facility of proprietary trading from location other than default location and it is taken on the adequate amount of stamp paper.
- (iv) Verify that no client trade has been executed by the stock broker from 'Pro-Account' enabled trading terminals (including CTCL Terminals) located at other than default location.

Disclosure of Proprietary Trading to Clients

4.26 The internal auditor should:

- (i) In case broker does proprietary trading, verify that broker has disclosed to his clients about proprietary trading upfront to his clients at the time of entering into the member client agreement.
- (ii) In case of broker commencing trade on proprietary account, verify that broker has informed to all his clients about proprietary trading before carrying out any trading on pro account.

Compliance Officer

4.27 The internal auditor should:

- (i) Verify that the appointment of compliance officer has been intimated to the stock exchange.
- (ii) Verify that any change in the compliance officer has been intimated to the stock exchange.
- (iii) Verify whether the roles and responsibilities of the compliance officer have been defined by the management and the same have been adhered to.

Investor Greivance

4.28 The internal auditor should -

- (i) Verify that an exclusive e-mail id for registering complaints of clients is designated.
- (ii) Verify that all complaints received from investors are recorded in complaints register with adequate details.

APPENDICES

Appendix - I

Illustrative Internal Audit Engagement Letter for a Stock Broking Entity

It is an illustrative internal audit engagement letter for a stock broking entity drafted on the basis of SIA 8, "*Terms of Internal Audit Engagement*" issued by the Institute of Chartered Accountants of India. It may vary according to individual requirements and circumstances relevant to the engagement.

<on the letter head>

Date:

Place:

To,

<Board of Directors> or

Mr./Mrs.<Name of appropriate representative of Board of Directors>

<Designation>

Dear Sir/Madam,

Sub: Internal Audit Engagement Letter

This is with reference to your letter dated _____ appointing us to conduct internal audit of M/s ABC as per the scope agreed. (If the appointment is in accordance with the circular no. MIRSD/ DPSIII/ Cir-26/08 dated August 22, 2008 issued by the Securities and Exchange Board of India, the same is to be mentioned)

Technical Guide on Internal Audit of Stock Brokers

This letter is to confirm our understanding of the terms and objectives of the engagement and the nature and limitations of the services, we will provide.

Scope and Objectives

Normally the scope and objective of an internal audit differs from broker to broker based on their individual requirements. At the same time the place from which audit needs to be conducted (head office / branches, etc) also may be specified at the time of internal audit. In such cases the scope is required to be drafted keeping in the mind the requirements of an internal audit assignment. At times, such internal audit assignments have been mandated due to requirement of the regulators (SEBI), then the scope as given in the relevant circular / notification of the regulator should be covered hereunder.

Period:

The audit assignment will be for the period covering from _____ to _____ and shall be deemed to have been renewed for such subsequent periods unless terminated

Responsibility:

The management would be responsible for regular compliance of circulars and guidelines issued by the SEBI and the respective stock exchanges.

As part of our normal procedures, we may request you to provide timely and accurate data, information, records, personnel, etc., and to cooperate with the audit teams. The internal audit will be conducted on test basis and on the basis of the information and explanation provided by you. However, having regard to the test nature of an audit, persuasive rather than conclusive nature of audit evidence together with inherent limitations of any accounting and internal control system, there is an unavoidable risk that even some material misstatements, resulting from fraud, and to a lesser extent error, if either exists, may remain undetected.

Report:

Our Audit Report shall contain the following information:

- Executive Summary.
- Detailed Audit Observations, covering our Observations, Recommendations and Annexures of Evidences.
- Presentation to Management and Audit Committee.

(In case if the audit report format has been agreed between the auditor and the auditee or if it is prescribed by any regulator/s, the same needs to be covered.)

Fees:

The fees for the assignment for the above period is estimated as Rs. _____ excluding statutory levies and other out of pocket expenses.

Resources Required:

- Access to all the data, record, employees required for the effective performance of internal audit.
- Computers with access to company ERP, E-mail and other systems with printing facility with adequate stationary.
- As part of our normal procedures, we may request you to provide written confirmations of any information or explanations given to us orally during the course of our work.

Confidentiality Clause:

We shall maintain confidential all the information collected as part of the engagement and shall not disclose them unless until necessary as per the regulations of the land of assignment. In case of need to disclose the information, we shall take the permission of the client coordinator before disclosing.

Technical Guide on Internal Audit of Stock Brokers

Termination Clause:

The assignment can be terminated by either parties by giving a notice in advance of at least 1 month. Thereafter the information/ documentation collected shall be returned back to the client.

Please sign and return the attached copy of this letter to indicate that it is in accordance with your understanding of the arrangements for the assignment.

XYZ and Co.
Chartered Accountants

Signature
(Name of the Member)
Designation
Membership No.

Address :

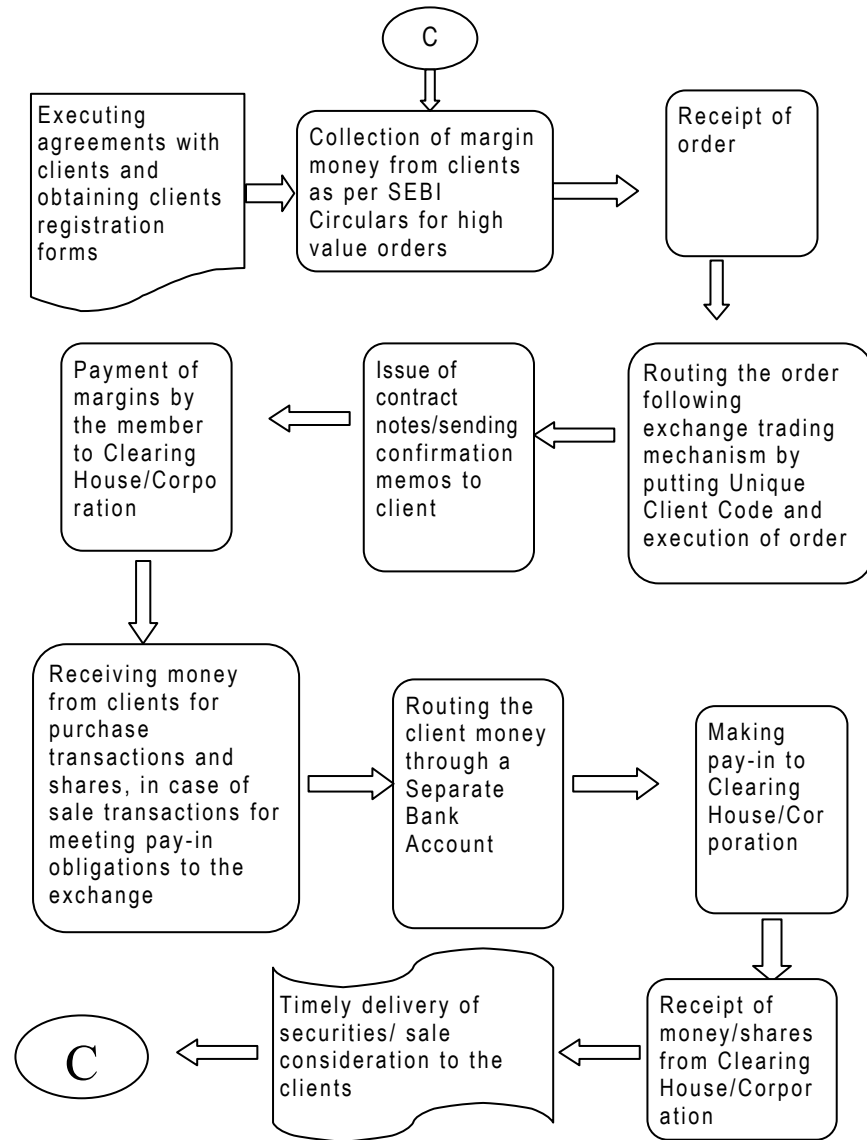
Date:

Acknowledged on behalf of _____ (name of the Organisation)

Signature
Name and Designation
Date:
Address:

Appendix - II

Illustrative Flowchart of the Business Process of a Stock Broking Entity



Appendix - III

Indicative Compliance Due Dates for Stock Brokers

(The compliance due dates given below are only an indicative list and is subject to changes made by Exchange / SEBI from time to time.)

Sr. No.	Particulars	Periodicity	Submission to	Due Date
1.	Annual Returns	Yearly	BSE	On or before 31 st October
2.	Annual Returns	Yearly	NSE	For the member having financial year ending 31st March: On or before 31 st October For the member having financial year ending other than 31st March: Within a period of 6 months from the end of their respective financial year.
3.	Net worth Certificate	Half Yearly	NSE and BSE	Within 3 months of the end of half year
4.	Annual Compliance Report	Yearly	NSE	Within 3 months from the end of accounting year
5.	Temporary Client Funding Report	Monthly	NSE	Within 7 days from the end of the month

Appendix - III

Sr. No.	Particulars	Periodicity	Submission to	Due Date
6.	Temporary Client Funding Report	Monthly	BSE	Within 7 days from the end of the month or as the date prescribed by BSE from time to time
7.	Intimation of Change in Compliance Officer	On Change	NSE and BSE	Immediately
8.	Intimation of Change in Principal Officer (PMLA)	On Change	FIU – India	Immediately
9.	Proof of Insurance cover	Yearly	NSE and BSE	On or before 31 st July
10.	Statement of Accounts for Funds and Securities	Quarterly	Clients of NSE	Within a month of the expiry of the period not exceeding three months
11.	Statement of Accounts for Funds and Securities	Half Yearly	Clients of BSE	Within 30 days from the end of the half year
12.	Submission of SSL certificate for IBT services	Yearly	NSE and BSE	On or before 31 st July
13.	System Audit Report	Yearly	NSE and BSE	On or before 31 st July

Technical Guide on Internal Audit of Stock Brokers

Sr. No.	Particulars	Periodicity	Submission to	Due Date
14.	Net worth Certificate for MTF (Margin Trading Facility)	Half Yearly	NSE and BSE	Within one month from the date of half year ending i.e. 31 st March and 30 th September
15.	Compliance Certificate in case of MTF	Half Yearly	NSE and BSE	Within one month from the date of half year ending i.e. 31 st March and 30 th September
16.	Unique Client Code details	Daily	NSE and BSE	Prior to commencement of trading on the exchange
17.	F&O Client Margin Reporting	Daily	NSE and BSE	Within two working days from the trade date
18.	Issue of Contract Notes	Daily	Clients	Within 24 hours from the trade
19.	Payout of Funds to clients	Daily	Clients	On T+2 day by 9:30 A.M.
20.	Payout of Securities to clients	Daily	Clients	On T+2 day by 9:30 A.M.
21.	Trading Terminal Details	--	NSE and BSE	Prior to activation of trading terminal

Appendix - IV

Indicative Fines and Penalties – BSE

[List of indicative penalty in respect of violations observed during inspections or otherwise in Cash segment, Derivative and Debt segment as prescribed by BSE (vide BSE Notice no. 20080307 - 8 dated March 07, 2008)]

No.	Details of contravention	Penalty (Fine in Rupees)
I - Dealings with Clients		
1	Client Registration:	
	(a) Documents not executed	Rs.10,000/- per client
	(b) Inclusion of contravening clauses / omission of material details	Rs.10,000/-
	(c) otherwise not in the prescribed format	Advice
2	Non-maintenance of Books of Accounts, Records and Documents including non maintenance of Client-wise Accounts for Funds / Securities Mis-utilisation of clients' funds or securities	Rs.50,000/-
3	Bank and Demat Account Operations:	
	(a) Separate Clients Bank or Demat Account not maintained for clients' transactions	Rs.10,000/-

Technical Guide on Internal Audit of Stock Brokers

No.	Details of contravention	Penalty (Fine in Rupees)
	(b) Pay-in / Pay-out not received from / delivered to respective clients' accounts	In excess of 2% of number of instances, fine of Rs.10,000/- Otherwise, Advice
	(c) Non-segregation of Own and Clients' Funds or Securities	In excess of 2% of number of instances, fine of Rs.10,000/- Otherwise, Advice
	(d) Delay in release of payout of Funds / Securities to clients	In excess of 2% of number of instances, fine of Rs.10,000/- Otherwise, Advice
	(e) Delayed / Non payment of Dividend (Delay in Excess of 90 days)	0.5 % of the amount (Rs.10,000/- if amount is not known)
4	Excess Brokerage Charged	TM to be advised to refund the excess brokerage charged to the constituents and fine of Rs.50,00/- or Excess Brokerage whichever is higher. If not charged at all – Advice
5	Use of Multiple Codes for Client or Own Trades	Advice
6	Contract Note related contraventions:	
	(a) Non issue / delay in issue/ issued with material discrepancies or contract notes not signed by Authorised	Rs.10,000/-

Appendix - IV

No.	Details of contravention	Penalty (Fine in Rupees)
	Signatory or Duplicates or Copies / Proof of dispatch of contract notes not maintained Non-compliances related to Spot Transaction	
	(b) Otherwise not as prescribed Non-compliances related to STP system	Advice
7	Quarterly Statement of Accounts for funds or securities not sent	In excess of 2% of number of clients, fine of Rs10,000/- Other discrepancies - Advice
8	Cash dealings with clients	Fine of 0.1% of the value in excess of Rs 10 lakhs. Otherwise - Advice
9	Non-disclosure of trading on own account to clients Exclusive Email-ID for investors' complaints not created or not displayed	Advice
10	Transfer of Trades / Errors at the time of order entry	In excess of 2% of number of orders executed, fine of 0.1% of the value of trades transferred
11	Margin Trading related contraventions:	
	(a) Agreement not executed with clients	Rs.5,000/- per client
	(b) Margin Trading facility in scrips other than permitted	Rs.10,000/-

Technical Guide on Internal Audit of Stock Brokers

No.	Details of contravention	Penalty (Fine in Rupees)
	(c) Short collection of margin in excess of 20%	Rs.10,000/-
	(d) Other procedural contraventions	Rs.10,000/-
II - Dealings with Intermediaries		
1	Dealing with Unregistered Intermediaries	Rs.1,00,000/- per Unregistered Intermediary. Further, member is to be advised to ensure that the entities stop dealing as unregistered intermediaries and be directed to withdraw the terminal(s), if any, allotted to such entities, immediately. In addition to monetary fine, suspension of the trading membership may also be considered depending upon the gravity of the violation, in cases where instances of dealings with more than 5 Unregistered Intermediaries are observed.
2	Doing business for / through other TMs or sub-brokers of other TMs without prior approval of the Exchange	Rs.10,000/- for dealing with member of same Exchange. With brokers / sub-brokers of other Exchanges - Advice

Appendix - IV

No.	Details of contravention	Penalty (Fine in Rupees)
3	Inspection of active Sub-Brokers / Branches not done Sharing of Brokerage / Commission, except as permitted under the Bye-Laws of the Exchange. Non-compliances by Subsidiaries of Regional Exchanges.	Advice
III - Trading System and Office Management		
1	Operation of Trading Terminals by persons other than an Approved User / Person	Advice
2	Allowing Trading Terminals to be operated by persons without BCFM Certification	Advice
3	(a) Unauthorised extension of BOLT or IML Terminal / Commencement of Internet trading without prior approval	Rs.50,000 per terminal. If trading terminals are observed to be used for carrying out illegal trading activity, suspension of the trading membership may also be considered depending upon the gravity of the violation.
	(b) Errors in upload of Terminal details to the Exchange	In excess of 5 terminals, fine of Rs 5,000/- per terminal
4	Non-display of Notice Board or SEBI Registration Certificate	Rs.10,000/-

Technical Guide on Internal Audit of Stock Brokers

No.	Details of contravention	Penalty (Fine in Rupees)
5	Non-appointment of Compliance Officer	Rs.10,000/-
6	Execution of trades on own account from locations other than those permitted	Rs.10,000/-
7	Evasion of margin by entering wrong client code	0.3% of the value of trades or Rs.25,000/- whichever is higher.
8	Not following the Advertisement Code of the Exchange	Rs.5,000/-
9	Non-compliance with PMLA Requirements	Rs.10,000/-
10	Books of Accounts, Registers, Records and Documents not in prescribed format / not maintained properly or not submitted for inspection	Advice
11	Post Compliance Inspection:	
	(a) Submitting wrong Compliance Certificate	Rs.15,000/-
	(b) Repeated violations observed in both, last normal inspection and post compliance inspection and where member was warned.	Fines prescribed for violations observed in routine inspection.
	(c) Repeated violations observed in both, last routine inspection and post compliance inspection and where penalty was levied	Twice the amount of penalty levied in routine inspection.

No.	Details of contravention	Penalty (Fine in Rupees)
IV - Margin reporting requirement (Derivative segment)		
1	'% of factual wrong reporting of margin collection from constituents to total margin reported as collected.	
	Upto 5%	Warning
	> 5% and upto 10%	0.5% of wrongly reported amount
	> 10% and upto 25%	2% of the wrongly reported amount
	> 25% and upto 50%	2% of the wrongly reported amount and suspension from trading for 1 day
	> 50%	2% of the wrongly reported amount and suspension from trading for 5 days
2	'% of (margin available but not properly accounted for / received from third parties) to total margin reported as collected.	
	Upto 5%	Advice
	> 5% and upto 10%	0.5% of the wrongly reported amount, subject to maximum of Rs 25,000/-
	> 10% and upto 25%	0.75% of the wrongly reported amount, subject to maximum of Rs 50,000
	> 25% and upto 50%	1% of the wrongly reported amount, subject to maximum of Rs 75,000/-

Technical Guide on Internal Audit of Stock Brokers

No.	Details of contravention	Penalty (Fine in Rupees)
	> 50%	1.25% of the wrongly reported amount, subject to maximum of Rs 1,00,000/-

Note:- All the requisite records, if available/maintained by the trading members in electronic form, shall be considered as compliance.

Appendix – V

Indicative Fines and Penalties – NSE

[List of indicative penalty in respect of violations observed during inspections or otherwise in Capital Market, F&O and Wholesale Debt Market segments as prescribed by NSE vide Circular No. NSE/INSP/2007/9971 dated December 27, 2007)]*

No	Details of Contravention	Penalty (Fine in Rupees)
I – Dealings with Clients		
1	Client registration documents:	
	(a) not executed	10000/- per client
	(b) inclusion of contravening clauses / omission of material details	10000/-
	(c) otherwise not in the prescribed format	Advice
2	Client-wise accounts for funds / securities not maintained	50000/-
3	Bank and demat account operations:	
	(a) Separate clients bank or demat account not maintained	10000/-
	(b) Pay-in / Pay-out not received from / delivered to respective clients	In excess of 2% of number of instances, fine of Rs. 10000/- Otherwise, advice

* Please refer also to Circular no. NSE/INSP/2008/72 dated September 18, 2008, *Consolidated Circular – Inspection Department* issued by the National Stock Exchange of India Limited.

Technical Guide on Internal Audit of Stock Brokers

No	Details of Contravention	Penalty (Fine in Rupees)
	(c) Non-segregation of own and clients' funds or securities	In excess of 2% of number of instances, fine of Rs. 10000/- Otherwise, advice
	(d) Delay in release of payout of funds / securities	In excess of 2% of number of instances, fine of Rs. 10000/- Otherwise, advice
	(e) Delayed / non-payment of dividend (delay in excess of 90 days)	0.5 % of the amount (Rs. 10000/- if amount not known)
4	Excess brokerage charged	TM to be advised to refund the excess brokerage charged to the constituents and fine of the excess brokerage or Rs. 5000/- whichever is higher
5	Use of multiple codes for a client or own trades	Advice
6	Contract notes related contraventions:	
	(a) Issued with material discrepancies / Duplicates or copies or proof of dispatch of contract notes not maintained	10000/-
	(b) otherwise not as prescribed	Advice
7	Quarterly statement of accounts for funds or securities not sent	In excess of 2% of number of clients, fine of Rs.10000/- Other discrepancies - Advice

Appendix - V

No	Details of Contravention	Penalty (Fine in Rupees)
8	Cash dealings with clients	0.1% of the value in excess of Rs. 10 lakhs Otherwise - Advice
9	Non-disclosure of trading on own account to clients / Exclusive E-mail ID for investors' complaints not created or not displayed	Advice
10	Transfer of trades / errors at the time of order entry	In excess of 2% of number of orders executed, fine of 0.1% of value of trades transferred
11	Margin trading related contraventions:	
	(a) Agreement not executed with clients	5000/- per client
	(b) Margin trading facility in scrips other than permitted	10000/-
	(c) Short collection of margin in excess of 20%	10000/-
	(d) Other procedural contraventions	10000/-
II - Dealings with Intermediaries		
1	Dealing with unregistered intermediaries in CM segment / intermediaries in F&O segment	100000/- per unregistered intermediary TM to be advised to ensure that the entities stopped dealing as unregistered intermediaries and directed to withdraw the terminal(s), if any, allotted to such entities immediately

Technical Guide on Internal Audit of Stock Brokers

No	Details of Contravention	Penalty (Fine in Rupees)
		In addition to monetary fine, suspension of the trading membership may also be considered depending upon the gravity of the violation, in cases where dealings with more than 5 unregistered intermediaries (in the CM segment) and / or intermediaries (in the F&O segment) are observed
2	Doing business for / through other TMs or sub-brokers of other TMs without prior approval of the Exchange	10000/- With brokers / sub-brokers of other exchanges - Advice
3	Inspection of active sub-brokers / branches not done	Advice
III - Trading system and office management		
1	Operation of terminals by persons other than an approved user / person	Advice
2	Allowing trading terminals to be operated by persons without NCFM certification	CM - Advice F&O - Rs 1000/- per terminal
3	(a) Unauthorised extension of NEAT terminal / Non-upload of CTCL details to the Exchange / Upload of CTCL details with incorrect terminal location	50000/- per terminal In cases where non-upload of details of more than five CTCL terminals are observed and such CTCL terminals are also observed to be operated by entities acting as unregistered intermediaries in the CM

Appendix - V

No	Details of Contravention	Penalty (Fine in Rupees)
		segment or as intermediaries in the F&O segment and / or such terminals are observed to be used for carrying out illegal trading activity, suspension of the trading membership may also be considered depending upon the gravity of the violation
	(b) Errors in upload of CTCL details	In excess of 5 terminals, Rs 5000/- per terminal
4	Non-display of notice board or SEBI registration certificate	10000/-
5	Non-appointment of compliance officer	10000/-
6	Execution of trades on own account from locations other than those permitted by the Exchange	10000/-
7	Evasion of margin	0.3% of the value of trades s.t. a minimum of Rs 25000/-
8	Not following the advertisement code of the Exchange	5000/-
9	Non-compliance with PMLA requirements	10000/-
10	Books of accounts, registers, records and documents not in prescribed format / not maintained properly	Advice

Technical Guide on Internal Audit of Stock Brokers

No	Details of Contravention	Penalty (Fine in Rupees)
IV - Margin reporting requirement (F&O segment)		
(a) % of factual wrong reporting of margin collection from constituents to total margin reported as collected is :		
	Upto 5%	Warning
	> 5% and upto 10%	0.5% of wrongly reported amount
	> 10% and upto 25%	2% of the wrongly reported amount
	> 25% and upto 50%	2% of the wrongly reported amount and suspension from trading for 1 day
	> 50%	2% of the wrongly reported amount and suspension from trading for 5 days
(b) % of (margin available but not properly accounted for / received from third parties) to total margin reported as collected is :		
	Upto 5%	Advice
	> 5% and upto 10%	0.5% of the wrongly reported amount, (Subject to a maximum of Rs 25,000/-)
	> 10% and upto 25%	0.75% of the wrongly reported amount, (Subject to a maximum of Rs 50,000)
	> 25% and upto 50%	1% of the wrongly reported amount, (Subject to a maximum of Rs 75,000/-)
	> 50%	1.25% of the wrongly reported amount, (Subject to a maximum of Rs 1,00,000/-)

Note: Above penalties are subject to changes made by Exchange / SEBI from time to time.

Appendix – VI

Commonly Observed Irregularities/Violations/ Deficiencies

The following are the commonly observed irregularities/violations / deficiencies relating to various areas:

Books of Accounts, Records and Documents

- (a) The documents are not kept at location as intimated to the Securities Exchange Board of India.

Client Registration

- (a) Execution of Member Client Agreement otherwise than in the prescribed format or execution of common Member Client Agreement for more than one Exchange.
- (b) Non-execution of Member Client Agreements/Tripartite Agreements prior to execution of trades for the clients.
- (c) Not updation of the client's registration forms including the financial details of the clients on a periodic basis.
- (d) Non-segregation of mandatory and non-mandatory (voluntary/optional) documents for registration of clients.
- (e) Wrong category of Client Registration Form is used for registering a client, e.g., Individual client category of form is used for registering Non-individual category of client.
- (f) In- person verification has not been carried out and/or stamp of the members who has done in-person verification has not been affixed.
- (g) All supporting documents are not verified with original and/or stamp of verification on all supporting documents is not affixed along with the signature of an authorised person.

Technical Guide on Internal Audit of Stock Brokers

- (h) PAN of the client is not cross verified with Income Tax Website or proof of the same is not maintained.
- (i) Board resolution has not been obtained while opening of corporate clients and/or board resolution authorizing trading in derivatives segment has not been obtained.

Unique Client Code

- (a) Allotting multiple client codes to clients.
- (b) Not uploading the correct and complete details of the clients including the PAN details in the UCC database of the Exchange.
- (c) Execution of trades before uploading the unique client code to the exchange.

Margins

- (a) Wrong margin has been reported to exchange in case of derivatives segment.
- (b) In case of derivatives segment, unspecified scripts have been considered as margin shares while reporting to the exchange and proper hair cuts as applicable have not been levied while valuing the shares held as margins.

Register of Transactions (Sauda Book) and Contract Note

- (a) Not having pre-printed/computerized running serial number on a financial year basis.
- (b) Not issuing contract note in the prescribed format.
- (c) Contract notes have been issued for trades which have not been executed on the platform of the stock exchange/contract notes have been issued for fictitious trades not executed at the exchange.
- (d) The dealing office address is not printed on the contract notes for trades executed on the NSE.

Appendix - VI

- (e) Contract notes have been signed by unauthorised signatories.
- (f) Client codes have been modified/contract notes have been issued in name of clients other than those as registered with the exchange.
- (g) Not issuing/dispatching the contract notes within 24 hours of execution of trades.
- (h) Brokerage has been charged to the clients in excess of the limit as specified by the exchange.
- (i) Details of the trades are not attached in case of trades for which summary contract notes have been issued.
- (j) Non-issuance of statement of STT on an annual basis at the end of the financial year.
- (k) Physical contract notes have not been issued to clients within 24 hours where the ECNs have not been delivered or has been rejected (bouncing of mails) by the E-mail ID of the client.
- (l) In case where ECNs are issued, the contract note has not been simultaneously published on the designated web-site of broker.
- (m) In case of Option, brokerage charged to clients exceeding 2.5% of premium or Rs. 100/- per lot.

Settlement of Fund

- (a) Not maintaining a separate Client Bank Account for client's funds.
- (b) Client Bank Account is not designated as a Client Account by including words "Client" in the title of the Client Bank Account.
- (c) Using Client Bank Account for meeting expenses or for non-specified purposes/own purpose.
- (d) Not routing client's funds through the Client Bank Account.

Technical Guide on Internal Audit of Stock Brokers

- (e) The funds are received from/paid to the clients other than from/to the account as informed by them to the broker as their own account.
- (f) Accepting cash from clients whether against obligations or as margins for purchase of securities and/or give cash against sale of securities to clients.

Settlement of Securities

- (a) Not maintaining a separate beneficiary account for securities of clients retained by the broker.
- (b) Not maintaining client wise segregation of securities retained in the client beneficiary account.
- (c) Receipt and delivery of securities from a demat account other than the demat account of the client in whose account transaction has been executed and contract issued.

Statements of Account for Funds and Securities

- (a) Not sending Statement of Account for funds and securities to the clients at least once in every quarter within a month of the expiry of the said period.
- (b) Delay in sending the statement of account of funds and securities.
- (c) Issuing statement of account of funds and securities without error reporting clause requiring the client to report errors within 30 days of receipt thereof to the Trading Member.
- (d) Not maintaining records of dispatch/confirmation of the clients.

Brokerage and Revenue Leakage

- (a) Non-payment/delay in payment of dividend received on account of securities of clients lying with the broker are not transferred to the respective clients.
- (b) The corporate benefits are not passed to correct client.

Trading Terminals

- (a) Trading terminals allotted at locations other than the registered office/branch office of the Trading Member or the offices of the sub-brokers.
- (b) Location and user details of trading terminals are not correctly uploaded to the Exchange.
- (c) Indicating offices as Branch Offices that are neither leased/licensed/rented nor owned by the Trading Member.
- (d) Location of pro-account trading terminals is not informed to the exchange or pro-transactions are entered through unauthorised pro-trading terminals.
- (e) The CTCL/IML terminals are not mapped to their 12/16 digits location Id respectively.
- (f) Executing pro-account trades from multiple locations without prior approval of the exchange.
- (g) Executing trades for another member of the Exchange without prior approval of the exchange.

Sub-broker/Remisier/Authorised Person

- (a) Brokerage is shared with un-registered sub-broker/remiser.
- (b) Brokerage is shared prior to the registration of the person as a sub-broker/remiser.
- (c) Inspection of the sub-brokers has not been carried out by the broker.

Advertisement

- (a) The advertisement has been issued for business promotion without the permission of the stock exchange.

Margin Trading Facility

- (a) Prior permission of the exchange has not been obtained before providing margin trading facilities to the clients.

Technical Guide on Internal Audit of Stock Brokers

- (b) The broker has used borrowed funds from unauthorised sources for the purpose of providing margin trading facility.

Prevention of Money Laundering

- (a) The broker has not complied with the requirements of appointing a principal officer and intimating the same to Financial Intelligence Unit (FIU).
- (b) The broker has not adopted a framework for implementation of Anti Money Laundering Policies.
- (c) The broker does not have a proper reporting of the cash and suspicious transactions to the Financial Intelligence Unit (FIU).

Notice Board and SEBI Registration Certificate

- (a) Non-display of notice board and SEBI registration certificates at all offices of the broker/office of the sub-broker.
- (b) The notice board is not made in the format as prescribed by the exchange or does not have all the information as required to be specified on the notice board.

Other Observations

- (a) Dealing with more than one member of another Exchange for proprietary trading.
- (b) The information regarding block/bulk deals have not been provided to the exchange.
- (c) Not having a prudent system of risk management which is well documented and made accessible to the clients and the exchanges as and when required.
- (d) Not maintaining Investors Grievance Register.
- (e) Not designating an E-mail ID exclusively for the purpose of registering complaints by investors and display such E-mail IDs and other relevant details prominently on their websites and in the various materials/pamphlets/

Appendix - VI

advertisement campaigns initiated by them for creating investor awareness.

- (f) Change in shareholding pattern without prior approval of the exchange.
- (g) Change in Directors without prior approval of the exchange.

Appendix - VII

List of Important BSE/SEBI Rules, Bye-Laws, Regulations and Circulars

Sr. No.	Particulars	Reference
Books of Accounts, Records and Documents		
1	Books of accounts to be maintained.	<ul style="list-style-type: none">• Reg. 17(1) if the SEBI (Stock Brokers and Sub Brokers) Rules, 1992 and• Rule 15 of SC (R) Rules, 1957
2	Maintenance of books of accounts, records and documents	<ul style="list-style-type: none">• Exchange Notice No.20050805-20 dated August 5, 2005 and• Exchange Notice No. 20051227-18 dated December 27, 2005.
Client Registration		
3	Client Registration Forms and Client database (Uniform Documentary Requirements for trading) Member Client Agreement Format Uniform Risk Disclosure Document Model Tripartite Agreement Broker – sub-broker Agreement	<ul style="list-style-type: none">• Exchange Notice No. 20040827-11 dated August 27, 2004

Appendix - VII

Sr. No.	Particulars	Reference
4	Disclosure of Proprietary Trading	<ul style="list-style-type: none"> • Exchange Notice No. 20031125-7 dated November 25, 2003
5	The client information is periodically reviewed and updated on an ongoing basis in view of the current trading activity of the client.	<ul style="list-style-type: none"> • Exchange Notice No. 20060303-20 dated March 3, 2006, • Exchange Notice No. 20060704-5 dated July 04, 2006 and • Exchange Notice No. 20061120-9 dated November 20, 2006.
6	Segregation of mandatory and voluntary documents/ clauses in the client registration docket	<ul style="list-style-type: none"> • Exchange Notice No. 20060704-6 dated July 04, 2006.
7	Dispatch of copy of Client Registration documents along with UCC and Email ID of the client.	<ul style="list-style-type: none"> • Exchange Notice No. 20080624-8 dated June 24, 2008.
8	In-person' verification of Clients by Stock Brokers	<ul style="list-style-type: none"> • Exchange Notice No. 20080707-3 dated July 07, 2008.
9	Remisier to sign as an Introducer in KYC Form	<ul style="list-style-type: none"> • Exchange Notice No. 20080801-2 dated August 01, 2008.
Unique Client Code		
10	Entering correct\ unique client codes while placing the orders in the system and mapping the client code with PAN\ Passport etc. in the back office and entering the client details on BOLT	<ul style="list-style-type: none"> • Exchange Notice Nos. 93424/2001 dated July 23, 2001 and • Exchange Notice No. 20040128-3 dated January 28, 2004.

Technical Guide on Internal Audit of Stock Brokers

Sr. No.	Particulars	Reference
11	Transfer of trades executed for one client to another client or own account to client account or <i>vice-versa</i>	<ul style="list-style-type: none"> • Exchange Notice No. 101502/2001 dated October 12, 2001.
Trading Terminals		
12	Installation of BOLT Terminals other than at members' registered offices, branch offices and registered sub-brokers office.	<ul style="list-style-type: none"> • Exchange Notice No. 104616/2001 dated November 12, 2001.
13	"Pro-account" trading terminal	<ul style="list-style-type: none"> • Exchange Notice No. 20030909-1 dated September 9, 2003.
14	BOLT Terminal operation by Remisier	<ul style="list-style-type: none"> • Exchange Notice No. 20040205-13 dated February 5, 2004.
15	Registering/Uploading of IML/TWS location information	<ul style="list-style-type: none"> • Exchange Notice No.20050808-26 dated August 8, 2005, • Exchange Notice No. 20050930-13 dated September 30, 2005 and • Exchange Notice No. 20051004-13 dated October 04, 2005.
16	Uploading of Location information for Internet Trading ID	<ul style="list-style-type: none"> • Exchange Notice No.20070531-8 dated May 31, 2007.
17	TWWS/IML Registration on BOLT and FAQ's on the same	<ul style="list-style-type: none"> • Exchange Notice No. 20050823-20 dated August 23, 2005.

Sr. No.	Particulars	Reference
18	BSE's Certification on Securities Market (BCSM) for users of BOLT TWS / IML Terminals	<ul style="list-style-type: none"> • Exchange Notice No. 20070522-25 dated May 22, 2007.
19	Direct Market Access Facility	<ul style="list-style-type: none"> • Exchange Notice No. 20080417-24 dated April 17, 2008.
Margin and Risk Management		
20	Comprehensive Risk Management Framework for the Cash Market.	<ul style="list-style-type: none"> • Exchange Notice No. 20050304-9 dated March 04, 2005.
Contract Note		
21	Issue of contract notes.	<ul style="list-style-type: none"> • Bye-law – 219 and • Exchange Notice No. 5116/93 dated November 11, 1993.
22	Contract Note format prescribed by the Exchange.	<ul style="list-style-type: none"> • Appendix B to Regulation 14, • Exchange Notice No. 20060627-18 dated June 27, 2006 and • Exchange Notice No. 20021109-9 dated November 9, 2002.
23	Electronic Contract Notes – Additional Conditions	<ul style="list-style-type: none"> • Exchange Notice No. 20050909-13 dated September 9, 2005.
24	Signature on Contract Notes and numbering of Contract Notes	<ul style="list-style-type: none"> • Exchange Notice No. 4914/96 dated August 13, 1996 and • Exchange Notice No.5419/96 dated September 14, 1996.

Technical Guide on Internal Audit of Stock Brokers

Sr. No.	Particulars	Reference
25	Board Resolution / Power of Attorney for signing of Contract Notes to be submitted to the Exchange	• Exchange Notice No.1024/98 dated March 20, 1998.
26	Issue of contract notes within 24 hours.	• Bye-law – 247A
27	Acknowledge on contract notes. Proof of delivery in case of dispatch through courier or post	• Exchange Notice No. 4914/96 dated August 13, 1996.
28	Duplicates of the contract notes issued to be maintained. Counter foils to be maintained with adequate details.	• Exchange Notice No. 4850/97 dated December 10, 1997.
29	Details of the trade to be attached in case of issue of consolidated contract notes	• Exchange Notice No. 4646/97 dated November 29, 1997
30	Provision for printing of PAN of the member and / or PAN of the constituents, wherever the value of contract exceeds Rs. 1 lakh.	• Exchange Notice No. 20020931-4 dated September 30, 2002.
31	Compulsory PAN in Derivatives	• Exchange Notice No.20050926-11 dated September 26, 2005.
32	Compulsory PAN in Cash Markets	• Exchange Notice No. 20061215-19 dated December 15, 2006.

Appendix - VII

Sr. No.	Particulars	Reference
33	Permanent Account Number (PAN) to be the sole identification number for all transactions in the securities market	<ul style="list-style-type: none"> • Exchange Notice No. 20070626-28 dated June 26, 2007.
34	Brokerage to be charged	<ul style="list-style-type: none"> • Regulation 14
35	Commission terms for remisiers and sharing of Brokerage	<ul style="list-style-type: none"> • Exchange Notice No. 20051207-10 dated December 07, 2005.
Straight Through Processing (STP)		
36	Mandatory use of STP system for all Institutional trades executed on the Stock exchanges	<ul style="list-style-type: none"> • Exchange Notice No. 20040420-12 dated April 20, 2004.
37	STP and use of exchange allotted Unique Client Codes	<ul style="list-style-type: none"> • Exchange Notice No. 20040705-10 dated July 5, 2004.
Off Market Transactions		
38	Contract notes to be issued for trades not executed through the BOLT	<ul style="list-style-type: none"> • Exchange Notice No. 24512/99 dated September 2, 1999.
39	Issue of contract note for transactions in securities not listed / permitted on the Exchange	<ul style="list-style-type: none"> • Bye-law – 26.
40	Written consent to be taken from the client for entering into a principal to principal transaction	<ul style="list-style-type: none"> • Bye-law - 199 and • Exchange Notice No. 4914/96 dated August 13, 1996.

Technical Guide on Internal Audit of Stock Brokers

Sr. No.	Particulars	Reference
41	Contract notes to be issued in Form B for entering into principal to principal transactions	<ul style="list-style-type: none"> Exchange Notice No. 4914/96 dated August 13, 1996.
42	Transactions done on a spot basis to be reported to the Exchange	<ul style="list-style-type: none"> SEBI Circular No. SMD/RCG/CIR/(BRG)/293/95 Dated March 14, 1995.
43	Transactions done on a spot basis is to be reported to the Exchange within the prescribed time limit	<ul style="list-style-type: none"> SEBI Circular No. SMD/RCG/CIR/(BRG)/293/95 Dated March 14, 1995.
44	Transaction done on a spot basis to be settled within the prescribed time limit	<ul style="list-style-type: none"> Section 2(i) of the SCRA, 1956
Client Monies		
45	Client's funds to be routed through designated 'Client Account'	<ul style="list-style-type: none"> Bye-law – 247A
46	Segregation of own and client transactions in separate bank accounts	<ul style="list-style-type: none"> Exchange Notice No. 7031/94 dated December 6, 1994
47	Clients Account not to be used for non-specified purposes	<ul style="list-style-type: none"> Exchange Notice No.4850/97 dated December 10, 1997
48	Client account not to be used for own / misuse of funds / unauthorized transfer of funds from one client's account to another client's account.	<ul style="list-style-type: none"> Exchange Notice No. 20020917-2 dated September 17, 2002.

Sr. No.	Particulars	Reference
	Payments of funds to clients Payment of dividend / reconciliation of dividend account	
49	Transaction with Clients in Cash (Mode of Payment)	<ul style="list-style-type: none"> • Exchange Notice No. 20020917-2 dated September 17, 2002, • Exchange Notice No. 20030903-5 dated September 3, 2003 and • Exchange Notice No. 20050324-21 dated March 24, 2005.
Clients' Securities		
50	Securities due to the clients transferred to the members' beneficiary account.	<ul style="list-style-type: none"> • Bye-law – 247A
51	Securities due to one client transferred to another client OR Securities due to the clients used for meeting the pay-in- obligation of the member/other client	<ul style="list-style-type: none"> • Exchange Notice Nos. 7031/94 dated December 6, 1994
52	Delay in delivery of securities to clients	<ul style="list-style-type: none"> • Exchange Notice No.4850/97 dated December 10, 1997 and • Exchange Notice No. 20020917-2 dated September 17, 2002.

Technical Guide on Internal Audit of Stock Brokers

Sr. No.	Particulars	Reference
53	Deliver / Receive securities other than from respective Clients Beneficiary Account or under approved scheme	<ul style="list-style-type: none"> • Exchange Notice No. 20030903-5 dated September 3, 2003.
54	Statement of accounts for funds/ securities to be sent to the clients	<ul style="list-style-type: none"> • Exchange Notice No. 20020906-3 dated September 6, 2002, • Exchange Notice No. 20030114-9 dated January 14, 2003 and • Exchange Notice No. 20080527-6 dated May 27, 2008.
55	Client Margin Information to clients on daily basis	<ul style="list-style-type: none"> • Exchange Notice No. 20080211-19 dated February 11, 2008.
56	Statement of Collateral Utilisation to clients on daily basis	<ul style="list-style-type: none"> • Exchange Notice No. 20080421-32 dated April 21, 2008.
Dealing with Intermediaries		
57	Registration of Remisiers	<ul style="list-style-type: none"> • Exchange Notice No. 2628/97 dated June 9, 1997
58	Sharing Commission \ brokerage only after registering such persons as remisiers with the Exchange	<ul style="list-style-type: none"> • Bye-law – 218(a), • Rule 216 – Rule 235, • Exchange Notice No. 2628/97 dated June 9, 1997 and • Exchange Notice No. 20031006-21 dated October 6, 2003.

Appendix - VII

Sr. No.	Particulars	Reference
59	Registration of sub-brokers	<ul style="list-style-type: none">• Exchange Notice No. 62311/2000 dated September 14, 2000.
60	Members of other Exchanges routing orders of their clients through BOLT, to be registered as Sub-brokers with SEBI	<ul style="list-style-type: none">• Exchange Notice No. 54809/2000 dated July 1, 2000.
61	Affiliation of sub-brokers with members	<ul style="list-style-type: none">• Exchange Notice No. 200300288-3 dated February 28, 2003.
Bulk Deals		
62	Bulk Deals Disclosures	<ul style="list-style-type: none">• Exchange Notice No. 20040216-10 dated February 16, 2004 and• Exchange Notice No. 20040311-7 dated March 11, 2004.
63	Bulk Deals reporting through DUS software	<ul style="list-style-type: none">• Exchange Notice No. 20040722-11 dated July 22, 2004.
Block Deals		
64	Modalities for Block Deal	<ul style="list-style-type: none">• Exchange Notice No. 20051108-28 dated November 8, 2005.
65	Disclosure of Trade details of Block Deals	<ul style="list-style-type: none">• Exchange Notice No. 20051108-29 dated November 8, 2005.
Client Funding		
66	Information regarding Client Funding by Members	<ul style="list-style-type: none">• Exchange Notice No. 20041029-13 dated October 29, 2004,

Technical Guide on Internal Audit of Stock Brokers

Sr. No.	Particulars	Reference
		<ul style="list-style-type: none"> • Exchange Notice No. 20050824-16 dated August 24, 2005 and • Exchange Notice No. 20051216-8 dated December 16, 2005.
67	Penalty Norms for not uploading client funding details	<ul style="list-style-type: none"> • Exchange Notice No.20060221-11 dated February 21, 2006.
Prevention of Money Laundering		
68	Provisions relating to Prevention of Money Laundering and Appointment of Principal Officer	<ul style="list-style-type: none"> • Exchange Notice No. 20060120-6 dated January 20, 2006, • Exchange Notice No. 20060321-15 dated March 20, 2006, • Exchange Notice No. 20070330-27 dated March 30, 2007, • Exchange Notice No. 20070831-28 dated August 31, 2007 and • Exchange Notice No. 20081222-21 dated December 22, 2008.
Margin Trading		
69	Margin Trading	<ul style="list-style-type: none"> • Exchange Notice No. 20040402-31 dated April 2, 2004 and • SEBI Circular No. SEBI/MRD/SE/SU/Cir-16/04 dated March 31, 2004.

Sr. No.	Particulars	Reference
70	Penalty norms for not uploading client funding details	<ul style="list-style-type: none"> • Exchange Notice No. 20070919-1 dated September 19, 2007.
Securities Transaction Tax (STT)		
71	Securities Transaction Tax (STT)	<ul style="list-style-type: none"> • Exchange Notice No.20060929-22 dated September 29, 2006, • Exchange Notice No. 20040927-13 dated September 27, 2004, • Exchange Notice No. 20041005-7 dated October 5, 2004 and • Exchange Notice No.20050520-14 dated May 20, 2005.
Submission of Audit Report, Audited Accounts and Net worth Certificate		
72	Maintenance of minimum Net worth requirements	<ul style="list-style-type: none"> • Exchange Notice No. 20030905-1 dated September 5, 2003
73	Submission of Audit Report, Annual Accounts and Net worth Certificate	<ul style="list-style-type: none"> • Exchange Notice No. 20040524-10 dated May 24, 2004.
Others		
74	Done business on behalf of suspended / defaulter / expelled members without obtaining prior permission of the Exchange	<ul style="list-style-type: none"> • Bye-Law 358 (vi)

Technical Guide on Internal Audit of Stock Brokers

Sr. No.	Particulars	Reference
75	Incomplete / Non-maintenance of registers (Register of Securities/ Register of Transactions / Register of Complaints / Dividend ledger / Margin Deposit Book)	<ul style="list-style-type: none"> • Exchange Notice No. 4850/97 dated December 10, 1997.
76	Involved in Fund-based activities	<ul style="list-style-type: none"> • Rule 8(1)(f) and 8(3)(f) of SC(R) Rules, 1957 and • SEBI Circular No. SMD/POLICY/CIR-6/97 dated May 7, 1997.
77	Member / Partners / Designated Directors involved in business other than securities business	<ul style="list-style-type: none"> • Rule 8(1)(f) of the SC (R) Rules, 1957.
78	Appointment of Compliance Officer	<ul style="list-style-type: none"> • Exchange Notice No. 20021001-5 dated October 1, 2002.
79	Advertisement Code	<ul style="list-style-type: none"> • Regulation 17, • Bye-law 358 (xi) and • Exchange Notice No. 104615/ 2001 dated November 12, 2001.
80	Review of norms relating to trading by members/ sub-brokers	<ul style="list-style-type: none"> • Exchange Notice No. 20040117-8 dated January 17, 2004.
81	Display of Notice – Board (Compliance Requirements for Trading Members)	<ul style="list-style-type: none"> • Exchange Notice No. 20050902-21 dated September 2, 2005.

Appendix - VII

Sr. No.	Particulars	Reference
82	System Audit Requirements and Submission of System Audit Report, Network Diagram and SSL Certificate	<ul style="list-style-type: none"> • Exchange Notice No. 20070517-26 dated May 17, 2007.
83	Manipulation of Order Book	<ul style="list-style-type: none"> • Exchange Notice No. 20070323-26 dated March 23, 2007.
84	Tagging of Demat Accounts of Trading Members	<ul style="list-style-type: none"> • Exchange Notice No. 20070628-19 dated June 28, 2007.
85	Common irregularities / deficiencies observed by the Exchange during the course of Inspection of Trading Members	<ul style="list-style-type: none"> • Exchange Notice No. 20070906-10 dated September 06, 2007.
86	Submission / Compliance Requirements	<ul style="list-style-type: none"> • Exchange Notice No. 20070906-13 dated September 06, 2007.
87	Provisions relating to Internet Trading Facilities	<ul style="list-style-type: none"> • SEBI Circular No. SMDRP/Policy/Cir-6/00 dated January 31, 2000
88	Exclusive email ID for investors to register their complaints	<ul style="list-style-type: none"> • Exchange Notice No. 20070131-11 dated January 31, 2007.
Penalty Norms		
89	Penalty Norms – Cash Segment	<ul style="list-style-type: none"> • Exchange Notice No. 20060602-7 dated June 2, 2006.

Technical Guide on Internal Audit of Stock Brokers

Sr. No.	Particulars	Reference
90	Penalty Norms for Non-registration of Client codes / Execution of trades without uploading PAN details of clients in Cash segment.	<ul style="list-style-type: none"> • Exchange Notice No. 20061229-26 dated December 29, 2006.
91	Penalty scheme for not uploading IML/BOLT TWS location details to the exchange	<ul style="list-style-type: none"> • Exchange Notice No. 20070517-22 dated May 17, 2007.
92	Penalty Norms of Department of Investor Services	<ul style="list-style-type: none"> • Exchange Notice No. 20071217-2 dated December 17, 2007.
93	Penalty Norms for Mandatory Insurance Cover	<ul style="list-style-type: none"> • Exchange Notice No. 20071206-9 dated December 6, 2007.
94	Revision of penalty structure for non-registration of client codes along with PAN details in the UCC database of the exchange	<ul style="list-style-type: none"> • Exchange Notice No. 20080307-7 dated March 07, 2008.
95	List of indicative penalty in respect of violations observed during inspections or otherwise in Cash segment, Derivative and Debt segment	<ul style="list-style-type: none"> • Exchange Notice No. 20080307-8 dated March 07, 2008.
Internal Audit		
96	Internal Audit for Stock Brokers / Clearing Members	<ul style="list-style-type: none"> • Exchange Notice No. 20080825-2 dated August 25 2008 and • Exchange Notice No. 20081022-30 dated October 22, 2008.

Appendix - VIII

List of Important NSE Rules, Bye-Laws, Regulations and Circulars

Sr. No.	Particulars	For Capital Market of NSE	For Future and Option Segment of NSE
Books of Accounts, Records and Documents			
1	Maintenance of Books of Accounts, Records and Documents	<ul style="list-style-type: none">Regulation 6 of NSE Trading Regulations	<ul style="list-style-type: none">Regulation 6 of NSE Trading Regulations
2	Maintenance of Register of Securities - client wise and security wise	<ul style="list-style-type: none">Regulation 6.1.3A (e) of the NSE Trading RegulationsCircular No. NSE/INSP/4986 dated April 16, 2004	<ul style="list-style-type: none">Regulation 17(1) of SEBI (Stock brokers and sub-brokers) Regulations, 1992Circular No. NSE/INSP/4986 dated April 16, 2004
Client Registration			
3	Execution of Member Client Agreements	<ul style="list-style-type: none">Regulation 4.3.1 of NSE Trading Regulations	<ul style="list-style-type: none">Regulation 4.3.1 of NSE Trading Regulations

Technical Guide on Internal Audit of Stock Brokers

Sr. No.	Particulars	For Capital Market of NSE	For Future and Option Segment of NSE
		<ul style="list-style-type: none"> • Circular No. SEBI/MIRSD /DPS – 1/Cir – 31/2004 dated August 26, 2004, • Circular No. NSE/INSP/5387 dated August 27, 2004, • Circular No. NSE/INSP/7657 dated July 5, 2008, and • Circular No. NSE/INSP/10872 dated June 23, 2008 	<ul style="list-style-type: none"> • Circular No. SEBI/MIRSD/ DPS – 1/Cir – 31/2004 dated August 26, 2004, • Circular no. NSE/INSP/5387 dated August 27, 2004, • Circular No. NSE/INSP/7657 dated July 5, 2008,, and • Circular no. NSE/INSP/10872 dated June 23, 2008
4	Client registration forms (KYC)	<ul style="list-style-type: none"> • Circular No. CNSE/MEMB /0245 dated May 2, 1997, • Circular No. NSE/MEMB/0280 dated June 24, 1997 and • Circular No. NSE/INSP/5387 dated August 27, 2004 	<ul style="list-style-type: none"> • Regulation 4.3.2 of NSE Trading Regulations

Appendix - VIII

Sr. No.	Particulars	For Capital Market of NSE	For Future and Option Segment of NSE
5	Risk Disclosure Document (RDD)	<ul style="list-style-type: none"> • Circular No. NSE/CMTR/4468 dated October 8, 2003 and • Circular No. NSE/INSP/5387 dated August 27, 2004 	<ul style="list-style-type: none"> • Regulation 4.3.3 of NSE Trading Regulations
6	Segregation of Mandatory and voluntary documents/ clauses in the client registration docket	<ul style="list-style-type: none"> • Circular No. NSE/INSP/7657 dated July 5, 2006 	<ul style="list-style-type: none"> • NSE/INSP/7657 dated July 5, 2006
7	Execution of Internet Trading Agreements with clients	<ul style="list-style-type: none"> • Circular No. NSE/CMT/1532 dated March 16, 2000 	<ul style="list-style-type: none"> • Circular No. NSE/ F&O / 1877 dated August 24, 2000
8	The client information is periodically reviewed and updated on an ongoing basis in view of the current trading activity of the client.	<ul style="list-style-type: none"> • Circular No. NSE/INVG/2006/7236 dated March 3, 2006 	<ul style="list-style-type: none"> • Circular No. NSE/INVG/2006/ 7236 dated March 3, 2006

Technical Guide on Internal Audit of Stock Brokers

Sr. No.	Particulars	For Capital Market of NSE	For Future and Option Segment of NSE
9	Dispatch of copy of Client Registration documents along with UCC and email id of the client.	<ul style="list-style-type: none"> • Circular No. NSE/INSP/ 10872 dated June 23,' 2008 	<ul style="list-style-type: none"> • Circular No. NSE/INSP/ 10872 dated June 23,' 2008
10	In-person' verification of Clients by Stock Brokers	<ul style="list-style-type: none"> • Circular No. NSE/INSP/ 10938 dated July 04,' 2008 	<ul style="list-style-type: none"> • Circular No. NSE/INSP/ 10938 dated July 04, 2008
Unique Client Code			
11	Allotment of UCC	<ul style="list-style-type: none"> • Circular No. NSE/INVG/ 2002/3690 dated October 18, 2002 	<ul style="list-style-type: none"> • Circular No. NSE/INVG/ 2002/3690 dated October 18, 2002
12	Mapping of the client codes with UCC	<ul style="list-style-type: none"> • Regulation 6.1.4 of NSE Trading Regulations 	<ul style="list-style-type: none"> • Regulation 6.1.5 of NSE Trading Regulations
13	UCC and PAN details of clients	<ul style="list-style-type: none"> • Regulation 3.14 of Capital Market Trading Regulations, • Circular No. NSE/INVG/ 2006/7673 dated July 13, 2006, 	<ul style="list-style-type: none"> • Circular No. NSE/INVG/ 2005/6690 dated September 23, 2005

Appendix - VIII

Sr. No.	Particulars	For Capital Market of NSE	For Future and Option Segment of NSE
		<ul style="list-style-type: none"> • Circular No. NSE/INVG/ 2006/7944 dated September 28, 2006 and • Circular No. NSE/INVG/ 2006/8056 dated October 27, 2006 	
14	Allotment of Trading Client Code	<ul style="list-style-type: none"> • Circular No. NSE/INSP/ 2007/9859 dated December 4, 2007 and • Circular No. NSE/INVG/ 2004/5487 dated September 30, 2004 	<ul style="list-style-type: none"> • Circular No. NSE/INSP/ 2007/9859 dated December 4, 2007 and • Circular No. NSE/INVG/ 2004/5487 dated September 30, 2004
15	Unique Client Code – Non Submission Charges	<ul style="list-style-type: none"> • Circular No. NSE/INVG/ 2006/8152 dated November 30, 2006, • Circular No. NSE/INVG/ 2006/7117 dated January 31, 2006 and 	<ul style="list-style-type: none"> • Circular No. NSE/INVG/ 2006/8152 dated November 30, 2006, • Circular No. NSE/INVG/ 2006/7117 dated January 31, 2006 and

Technical Guide on Internal Audit of Stock Brokers

Sr. No.	Particulars	For Capital Market of NSE	For Future and Option Segment of NSE
		<ul style="list-style-type: none"> • Circular No. NSE/INVG/2006/8310 dated December 29, 2006 	<ul style="list-style-type: none"> • Circular No. NSE/INVG/2006/8310 dated December 29, 2006
Trading Terminals			
16	Trading terminals are operated by the respective approved users / approved persons only.	<ul style="list-style-type: none"> • Circular No. NSE/ MEMB/1591 dated April 20, 2000 	<ul style="list-style-type: none"> • Circular No. NSE/ MEMB/ 1591 dated April 20, 2000
17	Neat terminals have been extended / CTCL terminals have been installed with the approval of the Exchange and required information in respect of all the CTCL terminals (including view only / admin / test / etc) have been uploaded to the Exchange	<ul style="list-style-type: none"> • Circular No. NSE/ MEMB/1591 dated April 20, 2000; • Circular No. NSE/MEMB/ 3574 dated August 29, 2002; • Circular No. NSE/MEMB/ 3635 dated September 25, 2002; • Circular No. NSE/MEMB/ 5664 dated 15th December 2004 and all related 	<ul style="list-style-type: none"> • Circular No. NSE/ MEMB/1591 dated April 20, 2000; • Circular No. NSE/MEMB/ 3574 dated August 29, 2002; • Circular No. NSE/MEMB/ 3635 dated September 25,2002; • Circular No. NSE/MEMB/5 664 dated 15th December 2004 and all related

Appendix - VIII

Sr. No.	Particulars	For Capital Market of NSE	For Future and Option Segment of NSE
		circulars issued w.r.t. the same	circulars issued w.r.t. the same
18	Own trading is carried out at permitted locations only. Trades on own account have been executed under PRO code only and client trades have not been executed through terminal earmarked for executing PRO trades	<ul style="list-style-type: none"> • Circular No NSE/CMTR/4460 dated October 3, 2003 	<ul style="list-style-type: none"> • Circular No NSE/F&O/4464 dated October 3, 2003
19	Disclosure of OWN trading	<ul style="list-style-type: none"> • Circular No NSE/INVG/2003/4590 dated November 25, 2003 	<ul style="list-style-type: none"> • Circular No NSE/INVG/2003/4590 dated November 25, 2003
20	NEAT/ CTCL users are NCFM certified	<ul style="list-style-type: none"> • Circular No NSE/MEMB/3740 dated. November 13, 2002 and • Circular No NSE/MEMB/7992 dated October 10, 2006 	<ul style="list-style-type: none"> • Regulation 2.2.10 (e) of NSE Trading Regulations

Technical Guide on Internal Audit of Stock Brokers

Sr. No.	Particulars	For Capital Market of NSE	For Future and Option Segment of NSE
21	Direct Market Access Facility	<ul style="list-style-type: none"> • Circular No NSE/CMTR/10537 dated April 3, 2008 and • Circular No NSE/CMTR/10548 dated April 4, 2008 	<ul style="list-style-type: none"> • Circular No NSE/FAOP/10538 dated April 3, 2008 and • Circular No NSE/CMTR/10548 dated April 4, 2008
Margins and Risk Management System			
22	Margins and Risk management Systems	<ul style="list-style-type: none"> • Circular No NSE/CMPT/5868 dated February 24, 2005 	<ul style="list-style-type: none"> • NSCCL Circular No NSCC/F &O/C&S/97 dated February 1, 2002
23	Margin Collection from Clients	--	<ul style="list-style-type: none"> • Circular No NSE/INSP/10367 dated February 28, 2008
Contract Notes			
24	Issue of Contract notes	<ul style="list-style-type: none"> • Regulation 3.5.1, 3.5.2 and 3.5.3 of NSE Trading Regulations • Circular No NSE/CMT/001 dated October 28, 1994; 	<ul style="list-style-type: none"> • Regulation 3.6 of NSE Trading Regulations • Circular No NSEIL/LEGAL/7037 dated January 5, 2006 and

Appendix - VIII

Sr. No.	Particulars	For Capital Market of NSE	For Future and Option Segment of NSE
		<ul style="list-style-type: none"> • Circular No NSE/CMT/005 dated December 12, 1994, • Circular No NSEIL /LEGAL/7036 dated January 5, 2006 and • Circular No NSE/INSP/7330 dated March 30, 2006 	<ul style="list-style-type: none"> • Circular No NSE/INSP/73 March 29 and 30, 2006
25	Maintenance of copies/ duplicates of Contract Notes	<ul style="list-style-type: none"> • Regulation 6.1.17 of NSE Trading Regulations 	<ul style="list-style-type: none"> • Regulation 6.1.18 of NSE Trading Regulations
26	Issue of Electronic Contract Notes (ECN)	<ul style="list-style-type: none"> • Circular No NSE/CMT/2279 dated January 30, 2001 and • Circular No NSE/INSP/6623 dated September 9, 2005 	<ul style="list-style-type: none"> • NSE/CMT/2279 dated January 30, 2001 and • Circular No NSE/INSP/6623 dated September 9, 2005
27	Transfer of trades from one client to another	<ul style="list-style-type: none"> • NSCCL Circular No NSCC/CM/C&S/207 dated August 31, 2001 	<ul style="list-style-type: none"> • Regulation 3.6.1 of NSE Trading Regulations

Technical Guide on Internal Audit of Stock Brokers

Sr. No.	Particulars	For Capital Market of NSE	For Future and Option Segment of NSE
28	Transfer of trades from own account to another client and vice versa	<ul style="list-style-type: none"> • NSCCL Circular No. NSCC/CM/C&S/207 dated August 31, 2001 	<ul style="list-style-type: none"> • Regulation 3.6.1 of NSE Trading Regulations
Straight Through Processing (STP)			
29	Mandatory use of STP system for all institutional trades	<ul style="list-style-type: none"> • Circular No NSE/INVG/ 2004/ 5216 dated June 30, 2004 	<ul style="list-style-type: none"> • Circular No NSE/INVG/ 2004/ 5216 dated June 30, 2004
Off Market Transactions			
30	No off market deals have been executed	<ul style="list-style-type: none"> • Circular No NSE/CMT/ 1230 dated October 8, 1999 	<ul style="list-style-type: none"> • Regulation 3.6.1 of NSE Trading Regulations
Banking Operations			
31	Segregation of client funds and own funds	<ul style="list-style-type: none"> • Regulation 6.1.5 (a) of NSE Trading Regulations 	<ul style="list-style-type: none"> • Regulation 6.1.6.1 of NSE Trading Regulations
32	Separate client bank account and it's operations	<ul style="list-style-type: none"> • Regulation 6.1.5 (b) of NSE Trading Regulations 	<ul style="list-style-type: none"> • Regulation 6.1.6.1 of NSE Trading Regulations
33	No transfer / withdrawal from clients' account	<ul style="list-style-type: none"> • Regulation 6.1.5 (c) of NSE Trading Regulations 	<ul style="list-style-type: none"> • Regulation 6.1.6.2 of NSE Trading Regulations

Appendix - VIII

Sr. No.	Particulars	For Capital Market of NSE	For Future and Option Segment of NSE
Dealings With Clients			
34	Funds/ securities of clients have not been improperly used	<ul style="list-style-type: none"> • Regulation 4.5.3 (e) of NSE Trading Regulations 	<ul style="list-style-type: none"> • Regulation 4.5.3 (e) of NSE Trading Regulations
35	Brokerage has been charged separately and indicated separately, in the contract note.	<ul style="list-style-type: none"> • Regulation 3.6.3 of NSE Trading Regulations 	<ul style="list-style-type: none"> • Regulation 3.6.1 of NSE Trading Regulations
36	Rate of Brokerage	<ul style="list-style-type: none"> • Regulation 3.6.2 of NSE Trading Regulations and • Circular No NSE/CMT/ 001 dated October 28, 1994. 	<ul style="list-style-type: none"> • Circular No NSE/F&O/ 1688 dated 08/06/2000; • Circular No NSE/F&O/ 2596 dated 05/06/2001; • Circular No NSE/FAOP/ 5978 dated March 30, 2005 and • Circular No NSE/INSP/ 8338 dated January 5, 2007
37	Payout of funds / securities	<ul style="list-style-type: none"> • Regulation 4.4.15 of NSE Trading Regulations 	<ul style="list-style-type: none"> • Regulation 4.4.15 of NSE Trading Regulations

Technical Guide on Internal Audit of Stock Brokers

Sr. No.	Particulars	For Capital Market of NSE	For Future and Option Segment of NSE
38	Early Pay-in of Funds	<ul style="list-style-type: none"> • Circular No NSE/CMPT/10603 dated April 17, 2008 	
39	Dispatch of statement of accounts for funds / securities (with error reporting clause)	<ul style="list-style-type: none"> • Regulation 6.1.5 (d) of NSE Trading Regulations and • Circular No NSEIL/LEGAL/6806 dated October 24, 2005 	<ul style="list-style-type: none"> • Circular No NSCC/F&O/C&S/132 dated October 8, 2002 and • Circular No NSEIL/LEGAL/7410 dated April 21, 2006
40	No cash dealings are undertaken	<ul style="list-style-type: none"> • Circular No NSE/INSP/4377 dated September 1, 2003 	<ul style="list-style-type: none"> • Circular No NSE/INSP/4377 dated September 1, 2003
41	Pay-in of funds and securities due from clients are received from the respective clients only	<ul style="list-style-type: none"> • Circular No NSE/INSP/4377 dated September 1, 2003 	<ul style="list-style-type: none"> • Circular No NSE/INSP/4377 dated September 1, 2003
42	Payout of funds and securities due to the clients are made to the respective clients only	<ul style="list-style-type: none"> • Circular No NSE/INSP/4377 dated September 1, 2003 	<ul style="list-style-type: none"> • Circular No NSE/INSP/4377 dated September 1, 2003

Appendix - VIII

Sr. No.	Particulars	For Capital Market of NSE	For Future and Option Segment of NSE
43	Separate client beneficiary account and its operations	<ul style="list-style-type: none"> • Regulation 6.1.5 (f) of NSE Trading Regulations 	<ul style="list-style-type: none"> • Regulation 6.1.6.2 (v) of NSE Trading Regulations
44	Client Margin Information to clients on daily basis	<ul style="list-style-type: none"> • Circular No. NSE/INSP/ 10239 dated February 11, 2008 	<ul style="list-style-type: none"> • Circular No. NSE/INSP/ 10239 dated February 11, 2008
45	Statement of Collateral Utilisation to clients on daily basis	<ul style="list-style-type: none"> • Circular No NSE/INSP/ 10605 dated April 21, 2008 	<ul style="list-style-type: none"> • Circular No NSE/INSP/ 10605 dated April 21, 2008
Dealings with Intermediaries			
46	No dealings are done through un-registered intermediaries	<ul style="list-style-type: none"> • Circular No NSE/MEMB/ 0275 dated June 12, 1997 and • Circular No NSE/MEMB/ 2284 dated January 31, 2001 	<ul style="list-style-type: none"> • Clause 12 (1) of SEBI Act, 1992
47	Sharing of brokerage with another Trading Member of the Exchange or an employee of another Trading	<ul style="list-style-type: none"> • Clause 33 (a) of Chapter IX of Byelaws of the Exchange 	<ul style="list-style-type: none"> • Bye Law 33(a) of Chapter IX of the Bye laws of the Exchange and

Technical Guide on Internal Audit of Stock Brokers

Sr. No.	Particulars	For Capital Market of NSE	For Future and Option Segment of NSE
	Member or a person with whom Trading Members are forbidden to do business		<ul style="list-style-type: none"> • Circular No NSE/MEMB/4082 dated April 10, 2002 and • Circular No NSE/MEMB/6378 dated July 14, 2005
48	Sharing of brokerage/ transacted business with suspended or expelled or defaulting Trading Members	<ul style="list-style-type: none"> • Rule 5 of Chapter IV of Rules of the Exchange 	<ul style="list-style-type: none"> • Rule 5 of Chapter IV of Rules of the Exchange
49	Inspection of Sub brokers/ Branches	<ul style="list-style-type: none"> • Circular No NSE/MEMB/275 dated 12/06/1997 and • Circular No NSEIL/INSP/3685 dated 17/10/2002 	<ul style="list-style-type: none"> • Circular No NSE/MEMB/275 dated 12/06/1997 and • Circular No NSEIL/INSP/3685 dated 17/10/2002
50	Registration of Authorised Person in F&O Segment	--	<ul style="list-style-type: none"> • Circular No NSE/MEMB/6882 dated 21/11/2005,

Appendix - VIII

Sr. No.	Particulars	For Capital Market of NSE	For Future and Option Segment of NSE
			<ul style="list-style-type: none"> • Circular No NSE/MEMB/ 6769 dated October 14, 2005 and • Circular No NSE/MEMB/ 9655 dated 22/10/2007
Bulk Deals			
51	Bulk Deal Reporting	<ul style="list-style-type: none"> • Circular No NSE/CMTR/ 4808 dated February 16, 2004 and • Circular No NSE/CMTR/ 7864 dated September 13, 2006 	--
Block Deals			
52	Block Deal Execution	<ul style="list-style-type: none"> • Circular No NSE/CMTR/ 6846 dated November 8, 2005 and • Circular No NSE/CMTR/ 7864 dated September 13, 2006 	--

Technical Guide on Internal Audit of Stock Brokers

Sr. No.	Particulars	For Capital Market of NSE	For Future and Option Segment of NSE
Client Funding			
53	Client Funding Reporting	<ul style="list-style-type: none"> • Circular No NSE/CMTR/ 6963 dated December 19, 2005, • Circular No NSE/CMTR/ 6962 dated December 19, 2005, • Circular No NSE/CMTR/ 6373 dated July 13, 2005 and • Circular No NSE/CMTR/ 8454 dated January 31, 2007 	--
Prevention of Money Laundering			
54	Adopted written procedures to implement the anti money laundering provisions and Appointment of Principal Officer	<ul style="list-style-type: none"> • Circular No NSE/INVG/ 2006/ 7102 dated January 25, 2006 and • Circular No NSE/INVG/ 2006/33 dated March 24, 2006 	<ul style="list-style-type: none"> • Circular No NSE/INVG/ 2006/ 7102 dated January 25, 2006 and • Circular No NSE/INVG/ 2006/33 dated March 24, 2006

Appendix - VIII

Sr. No.	Particulars	For Capital Market of NSE	For Future and Option Segment of NSE
55	Master Circular on PMLA	<ul style="list-style-type: none"> • Circular No NSE/INVG/2009/11798 dated December 22, 2008 	<ul style="list-style-type: none"> • NSE/INVG/2009/11798 dated December 22, 2008
Margin Trading			
56	Provisions relating to Margin Trading Facility	<ul style="list-style-type: none"> • Circular No NSE/MEMB/4972 dated April 7, 2004; • Circular No NSE/CMTR/5420 dated September 9, 2004; • Circular No NSE/MEMB/5917 dated March 11, 2005; • Circular No NSE/MEMB/4973 dated April 7, 2004 and • Circular No NSE/CMTR/5914 dated March 10, 2005 	<ul style="list-style-type: none"> • -N.A.-

Technical Guide on Internal Audit of Stock Brokers

Sr. No.	Particulars	For Capital Market of NSE	For Future and Option Segment of NSE
Securities Transaction Tax (STT)			
57	Securities Transaction Tax (STT)	<ul style="list-style-type: none"> • Circular No NSE/INSP/ 8108 dated November 16, 2006, • Circular No NSCCL/LEG AL/5482 dated September 30, 2004 and • Circular No NSE/F&A/ 5757 dated January 13, 2005 	<ul style="list-style-type: none"> • Circular No NSE/INSP/ 8108 dated November 16, 2006, • Circular No NSCCL/LEG AL/5945 dated March 17, 2005 and • Circular No NSE/FandA/5 757 dated January 13, 2005
Submission of Annual Returns and Net worth Certificate			
58	Submission of Annual Returns	<ul style="list-style-type: none"> • Circular No NSE/COMP/ 9307 dated August 10, 2007 	<ul style="list-style-type: none"> • Circular No NSE/COMP/ 9307 dated August 10, 2007
59	Submission of Half Yearly Networth Certificate	<ul style="list-style-type: none"> • Circular No NSE/COMP/ 9788 dated November 20, 2007 and • Circular No NSE/MEMB/ 6928 dated December 06, 2005 	<ul style="list-style-type: none"> • Circular No NSE/COMP/9 788 dated November 20, 2007 and • Circular No NSE/MEMB/ 6928 dated December 06, 2005

Appendix - VIII

Sr. No.	Particulars	For Capital Market of NSE	For Future and Option Segment of NSE
Others			
60	Involved in fund based activities/ financing clients	<ul style="list-style-type: none"> • Circular No NSE/ MEMB/261 dated May 27, 1997 and • Circular No NSE/INSP/ 6938 dated December 9 2005 	<ul style="list-style-type: none"> • Circular No NSE/MEMB/ 261 dated May 27, 1997
61	Change in share holding / profit sharing pattern of the corporate / firm only with prior approval of the Exchange.	<ul style="list-style-type: none"> • Circular No NSE/MEMB/ 00310 dated July 23, 1997 and the Membership Undertaking 	<ul style="list-style-type: none"> • Circular No NSE/MEMB/ 00310 dated July 23, 1997 and the Membership Undertaking
62	Change in directors / partners of the corporate / firm only with prior approval of the Exchange.	<ul style="list-style-type: none"> • Circular No NSE/MEMB/ 4299 dated July 25, 2003 	<ul style="list-style-type: none"> • Circular No NSE/MEMB/ 4299 dated July 25, 2003
63	Advertisements	<ul style="list-style-type: none"> • Rule (5)(h) of Chapter IV of the Rules of the Exchange 	<ul style="list-style-type: none"> • Rule (5)(h) of Chapter IV of the Rules of the Exchange

Technical Guide on Internal Audit of Stock Brokers

Sr. No.	Particulars	For Capital Market of NSE	For Future and Option Segment of NSE
64	Dealing through or on behalf of another trading member/sub-broker of the same exchange with prior approval of the Exchange in writing	<ul style="list-style-type: none"> • Bye Law 7 of Chapter VII of the Bye laws and • Regulation 2.1.11 of NSE Trading Regulations 	<ul style="list-style-type: none"> • Bye Law 7 of Chapter VII of the Bye laws and • Regulation 2.1.16 of NSE Trading Regulations
65	Dealing through or on behalf of another trading member/sub-broker of the another exchange after intimating the name of such broker / sub-broker to the Exchange	<ul style="list-style-type: none"> • Regulation 2.1.12 of NSE Trading Regulations 	<ul style="list-style-type: none"> • Regulation 2.1.16 of NSE Trading Regulations
66	Dealings on behalf of client with a broker of another Exchange after registration as a sub-broker	<ul style="list-style-type: none"> • Regulation 2.1.12 of NSE Trading Regulations 	<ul style="list-style-type: none"> • Regulation 2.1.16 of NSE Trading Regulations
67	Display of Notice Board	<ul style="list-style-type: none"> • Circular No NSE/MEMB/ 1591 dated April 20, 2000 and 	<ul style="list-style-type: none"> • Circular No NSE/MEMB/ 1591 dated April 20, 2000 and

Appendix - VIII

Sr. No.	Particulars	For Capital Market of NSE	For Future and Option Segment of NSE
		<ul style="list-style-type: none"> • Circular No NSE/MEM/6706 dated September 28, 2005 	<ul style="list-style-type: none"> • Circular No NSE/MEM/6706 dated September 28, 2005
68	Display of SEBI registration certificate	<ul style="list-style-type: none"> • Circular No NSE/ MEMB/1591 dt. April 20, 2000 	<ul style="list-style-type: none"> • Circular No NSE/ MEMB/1591 dt. April 20, 2000
69	Intimation of Branch office	<ul style="list-style-type: none"> • Regulation 4.1.1 of NSE Trading Regulations 	<ul style="list-style-type: none"> • Regulation 4.1.1 of NSE Trading Regulations
70	Compliances with respect to dealings by branches, intermediaries, etc.	<ul style="list-style-type: none"> • Circular No NSE/INSP/6334 dated July 6, 2005 	<ul style="list-style-type: none"> • Circular No NSE/INSP/6334 dated July 6, 2005
71	Appointment of Compliance officer	<ul style="list-style-type: none"> • Circular No NSE/ MEMB/3441 dated June 14, 2002 	<ul style="list-style-type: none"> • Circular No NSE/ MEMB/3441 dated June 14, 2002
72	Record of all written complaints of constituents have been maintained	<ul style="list-style-type: none"> • Regulation 6.1.15 of NSE Trading Regulations 	<ul style="list-style-type: none"> • Regulation 6.1.16 of NSE Trading Regulations

Technical Guide on Internal Audit of Stock Brokers

Sr. No.	Particulars	For Capital Market of NSE	For Future and Option Segment of NSE
73	Provisions relating to Internet trading facility	<ul style="list-style-type: none"> • Circular No NSE/CMT/ 1424 dated January 31, 2000 	<ul style="list-style-type: none"> • Circular No NSE/F&O/ 1877 dated August 24, 2000
74	Exclusive e-mail ID for investors to register their complaints	<ul style="list-style-type: none"> • Circular No NSE/MEMB/ 8352 dated January 09, 2007 	<ul style="list-style-type: none"> • Circular No NSE/MEMB/8 352 dated January 09, 2007
75	Tagging of demat accounts of trading / clearing members	<ul style="list-style-type: none"> • Circular No NSE/INSP/ 9090 dated June 28, 2007 	<ul style="list-style-type: none"> • Circular No NSE/INSP/ 9090 dated June 28, 2007
76	Placement of orders at prices significantly away from market price	<ul style="list-style-type: none"> • Circular No NSE/INVG/ 2007/8719 dated March 23, 2007 	--
77	Consolidated Circular - Inspection Department	<ul style="list-style-type: none"> • Circular No NSE/INSP/ 11324 dated September 18, 2008 	<ul style="list-style-type: none"> • Circular No NSE/INSP/ 11324 dated September 18, 2008
78	Compliance Hand Book	<ul style="list-style-type: none"> • Circular No NSE/INSP/ 11532 dated October 23, 2008 	<ul style="list-style-type: none"> • Circular No NSE/INSP/ 11532 dated October 23, 2008

Appendix - VIII

Sr. No.	Particulars	For Capital Market of NSE	For Future and Option Segment of NSE
Penalty norms			
79	Penalty Norms - CM and F&O	<ul style="list-style-type: none"> • Circular No NSE/INSP/2007/9971 dated December 27 2007 	<ul style="list-style-type: none"> • Circular No NSE/INSP/2007/9971 dated December 27, 2007
80	Penalty for Mandatory Insurance Cover	<ul style="list-style-type: none"> • Circular No NSE/COMP/9109 dated July 03, 2007 	--
Internal Audit			
81	Internal Audit for Stock Brokers / Clearing Members	<ul style="list-style-type: none"> • Circular No NSE/INSP/11172 dated August 22, 2008 and • Circular No NSE/INSP/11537 dated October 23, 2008 	<ul style="list-style-type: none"> • Circular No NSE/INSP/11172 dated August 22, 2008 and • Circular No NSE/INSP/11537 dated October 23, 2008

Reference

As the new circulars and notifications are frequently issued by the Regulators, it is necessary that an internal auditor should possess an updated knowledge on the compliances and other regulations relating to the stock brokers. Circulars issued by Regulatory Authorities are hosted on their websites. These websites may be visited for availing the advantage of updating on various issues on capital market.

- Securities and Exchange Board of India - www.sebi.gov.in.
- National Securities Exchange of India Limited - www.nseindia.com.
- Bombay Stock Exchange of India Limited - www.bseindia.com.

Stop Press

I. Circular on Internal Audit of Stock Brokers/Trading Members/Clearing Members issued by NSE

NATIONAL STOCK EXCHANGE OF INDIA LIMITED INSPECTION DEPARTMENT CIRCULAR

DOWNLOAD REF.NO: NSE/INSP/12174

Circular No. NSE/INSP/2009/76 Dated: 25th March 2009

To,

All Trading Members and Clearing Members

Sub: Internal Audit of stock brokers / trading members / clearing members

This is further to our circular NSE/INSP/2008/70 (download reference no. NSE/INSP/11172) dated August 22, 2008 and NSE/INSP/2008/74 (download reference no. NSE/INSP/11537) 23rd October, 2008 wherein all trading members / clearing members were directed to carry out complete internal audit on a half yearly basis by independent qualified Chartered Accountants or Company Secretaries or Cost and Management Accountants. It was also informed that the first internal audit period would be from October 1, 2008 to March 31, 2009.

Further based on SEBI's letter no. MIRSD/DPS-I/PG/158174/09 dated March 23, 2009, the applicability, scope / guidelines of audit, format of audit report and the time limit for submission of audit report have been finalized and enclosed herewith as Annexure I, II and III.

In view of the above all trading members / clearing members are required to ensure to 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

Technical Guide on Internal Audit of Stock Brokers

have any conflict of interest.

All members are requested to ensure compliance with the above.

For any clarifications, members may contact any of the following officials:

Name	Board Lines 2659 8100 – 8114	Direct No
Mr. Hansen Cardoza	Extn. : 5123	26598196
Mr. Parameshwaran	Extn. : 5124	
Ms. Sania Surve	Extn. : 5128	

For **National Stock Exchange of India Ltd.**

C N Upadhyay

Asst. Vice-President- Inspection Dept

Encl: As above

Annexure I

Internal Audit for Stock Brokers

I. Applicability

Trading members (Stock brokers) and Clearing members are required to appoint an internal auditor for carrying out internal audit of their operations in all segments of the Exchange in which they are enabled for trading /clearing (wherein atleast a one/single trade have been executed or cleared by them) and submit exchange wise report on half yearly basis. The first half year period would start from October 01, 2008.

II. Who Can Conduct Internal Audit

Internal audit is required to be carried out by any Chartered Accountant, Company Secretary or Cost and Management Accountant who is in practice and who do not have any conflict of interest.

III. Scope/Purpose of Audit

The purpose of audit should be:

- (a) to ensure that the books of account, records and documents are being maintained in the manner required under Securities Exchange Board of India Act, 1992, Securities Contracts (Regulation) Act, 1956, SEBI (Stock brokers and Sub-brokers) Regulations, 1992, Securities Contracts (Regulation) Rules, 1957, circulars issued by SEBI, agreements, Bye laws of the Exchanges, data security and insurance in respect of operations of trading member/clearing members.
- (b) to ascertain whether adequate internal control systems, procedures and safeguards have been established and are being followed by the intermediary to fulfill its obligations under Securities and Exchange Board of India Act, 1992, Securities Contracts (Regulation) Act, 1956, SEBI (Stock brokers and Sub-brokers) Regulations, 1992, Securities Contracts (Regulation) Rules, 1957, circulars

Technical Guide on Internal Audit of Stock Brokers

issued by SEBI, agreements, Bye laws of the Exchanges, data security and insurance in respect of operations of trading member/clearing members.

- (c) to ascertain whether any circumstances exist which would render the intermediary unfit or ineligible for dealing in securities market.
- (d) to ascertain whether the provisions of the securities laws and the directions and/or circulars issued there under by SEBI/Exchanges are being complied with.
- (e) to ascertain, whether the provision of stock exchange, Bye-laws, notices, circulars, instructions or orders issued by stock exchanges are being complied with.
- (f) to inquire suo motu into such matters as may be deemed fit by the auditor in the interest of investors or the securities market.

IV. Submission of Internal Audit Report

Internal auditor would submit the audit report to the Proprietor/Partners/Board of respective trading/clearing member who would place the report before its Board of Directors/proprietor/partners and shall forward the same along with para-wise comments to respective stock exchange within 3 months of the end of half year period. The audit report may be combined across segments and activity (trading/clearing) for respective Exchange.

V. Non-Compliance Relating to Internal Audit by The Members

Non-submission of internal audit report as per the aforesaid guidelines shall be treated as non-compliance and appropriate action may be initiated against the concerned members. Where, in the opinion of the Exchange, the quality of the reporting is not satisfactory or the audit is not carried out in accordance with the aforesaid guidelines, the Exchange reserves the right to advise the concerned members to change the auditors and/or submit revised reports.

Annexure II

Areas to be Covered in Internal Audit and Areas on which Comments Needs to be Incorporated in the Report are given below

1. Client Registration and Documentation	
Execution of Know Your Client(KYC), Member Constituent Agreement(MCA)/Tripartite Agreement(TPA) and Risk Disclosure Document (RDD) – checks and balances in place	Whether KYC, MCA/TPA, RDD are executed in the prescribed formats and the same is executed before execution of trades <i>for the client</i> ?
Verification of formats of KYC, MCA/TPA and RDD and attachments including proof of identity and address, as prescribed by NSE/ SEBI	Whether UCC is allotted to the client & the same is uploaded to the Exchange <i>with PAN</i> ?
Verification that Contradictory clauses are not mentioned in KYC, MCA,TPA and RDD	Whether all fields in KYC including client's financial details are filled in properly?
Systems and procedures put in place by member for verification of PAN before opening account	Whether proper proof of identity, PAN and proof of address are taken with KYC form?
Procedure followed by the member for informing UCC to the clients & uploading to the Exchange	Whether any contravening clauses are included in MCA/TPA?
Mechanism to ensure financial details of clients	
Procedure adopted for in person verification of clients	Whether in person verification of clients is done by the employees of the
Procedure adopted by	

Technical Guide on Internal Audit of Stock Brokers

relationship managers, if any, for procuring new clients	trading member only?
Delivery of copies of client registration documents to the clients	Whether date of verification, name and signature of the official who has done in-person verification and the member's stamp incorporated in the client registration form? Whether copies of all the documents executed by client are given to the respective clients? 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?
Storage of client registration documents and retrieval mechanism	
Procedure adopted for obtaining clients' consent for electronic contract notes	
Periodic review of client related information and updation of the same in system	
Verification of RDD/KYC/MCA/TPA of different types of clients	
Acquaintance procedure for new clients	
<p><i>Exchange regulatory references Circulars- Download no. NSE/INSP/11324 dated 18-Sep-08, Download no. NSE/INVG/7236 dated 3-Mar-06</i></p> <p><i>SEBI references</i></p> <ul style="list-style-type: none"> • <i>SEBI/MIRSD/DPS-1/Cir-31/2004, dated August 26, 2004 & Regulation 7 D</i> • <i>MIRSD/DPS III / 130466 / 2008 dated July 02, 2008</i> • <i>MRD/DoP/Cir- 05/2007 dated April 27, 2007</i> • <i>SMDRP/Policy/Cir-39/2001 dated July 18, 2001.</i> • <i>MRD/DoP/SE/Cir- 35/2004 dated October 26, 2004</i> 	

2. Order Management and Risk Management Systems	
Procedure adopted for receipt of orders from clients	<p>Whether checks are in place to ensure that no unauthorized orders are executed from any of the terminals?</p> <p>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?</p> <p>In case of dormant accounts, are there any checks in place to ensure that incase the account is reactivated whether it is operated by the respective client only?</p> <p>Whether initial and other margins are collected from respective clients in the prescribed form of funds, fixed deposit receipts, bank guarantees and approved securities with appropriate haircut ?</p> <p>Whether the member has a proper system for reporting the correct client margin collection to NSCCL, in</p>
Mechanism for order management and execution	
Procedure adopted for setting Limits at client level / Terminal level/Dealer level	
Policy on Margin collection mechanism and the modes of margin money	
Procedure adopted for reporting of client margin collection to clearing corporation	
Review of process adopted for monitoring/recovery of long outstanding debit balances	
Procedure adopted for calculation and reporting client funding	
Procedure for monitoring institutional trades not routed through custodians	
Procedure adopted for providing Direct Market Access (DMA) facility	

	<p>Derivatives segment?</p> <p>Verify whether the margin reported by the member to the Exchange in Derivates segment is actually collected and available in the books of accounts of the member. In case of any irregularity observed, mention the instances wherein wrong reporting of margin collected from clients/trading members was observed.</p> <p>Whether Risk Management System (RMS) includes policy on margin collection from clients/trading member and the RMS is documented?</p> <p>Whether proper systems are in place to ensure timely collection for pay-in from the respective client as per settlement schedule?</p> <p>Whether proper monitoring mechanism is in place to review long outstanding debit balances in clients' account and recovery of the same?</p> <p>Whether member has reported details of client funding, if any, to the</p>
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	<p>exchange within prescribed time limit?</p> <p>What are the sources of funds in case client funding is observed?</p> <p>Whether all institutional trades are routed through custodians by following Straight Through Processing?</p> <p>What are the reasons for institutional trades not being routed through custodians? Whether any specific pattern is observed for the same?</p> <p>Whether member has obtained prior approval from the exchange before providing terminal to the clients under DMA facility?</p> <p>Whether member has complied with regulatory requirements related to DMA?</p>
<p><i>Exchange's regulatory references Circulars- Download no. NSE/INVG/7236 dated 3-Mar-06, Download no. NSE/MEMB/261 dated 27-May-97, Download no. NSE/INSP/11324 dated 18-Sep-08, Download no. NSE/CMPT/6610 dated 06-Sep-05, NSE/CMPT/6653 dated 16-Sep-05, Download NSE/CMTR/10537 dated 3-Apr-08, Download no. NSE/CMTR/6732 dated 04-Oct-05, Download no. NSE/CMTR/6963 dated 19-Dec-05, Download no.</i></p>	

<p>NSE/CMPT/11276 dated 10-Sep-08</p> <p>SEBI references</p> <ul style="list-style-type: none"> • MRD/DoP/SE/Cir-07/2005 dated February 23, 2005 • MRD/DoP/SE/Cir- 17/2005 dated September 02, 2005 	
<p>3. Contract Notes, Client Margin details and Statement of Accounts</p>	
<p>Procedure adopted for issuance of contract notes</p>	<p>Whether contract note are sent within 24 hours of execution of trades and margin details are sent daily to respective clients and proof of delivery / dispatch is maintained?</p> <p>Whether all prescribed details including name and signature of authorised signatory, dealing office details and brokerage are contained in contract note?</p> <p>In case contract notes and margin details are sent in electronic form, whether log is maintained? Whether trail of bounced mails is maintained and physical delivery is ensured in case of bounce mails?</p> <p>Whether member has complied with regulatory requirements related to. Electronic contract notes (ECN)?</p>
<p>Verification of format of contract notes issued</p>	
<p>Verification of copy of contract note with Proof of dispatch/register of despatch/logs maintained</p>	
<p>Adherence to electronic contract note norms, if applicable</p>	
<p>Procedure adopted for sending statement of accounts</p>	
<p>Contents & periodicity of statement of accounts of funds and securities</p>	
<p>Procedure adopted for sending margin details to clients</p>	
<p>Procedure for maintaining acknowledgement/proof of delivery of contract notes/statement of accounts/margin details to the clients</p>	

	<p>Whether complete statement of accounts for funds and securities are issued on a quarterly basis to clients, with error reporting clause? Whether proof of sending the same is maintained?</p>
<p><i>Exchange's regulatory references Circular Download no. NSE/INSP/11324 dated 18-Sep-08</i></p> <p><i>SEBI references</i></p> <ul style="list-style-type: none"> • <i>Clause B(2) of Code of conduct for Stock Brokers specified under Regulation 7</i> • <i>SMD-1/23341 dated November 18, 1993</i> • <i>SMD (B)/104/22775/93 dated October 29, 1993</i> • <i>SMD/MDP/CIR/043/96 dated August 5, 1996</i> • <i>MRD/DoP/SE/Cir-20/2005 dated September 08, 2005</i> • <i>SEBI/DNPD/143542 /Cir-43/08 dated November 06, 2008</i> 	
<p>4. Dealing with Clients' Funds and Securities</p>	
<p>Verification of details of cash receipts from/payments to clients, if any, observed during the audit period are to be given (mentioning any specific branch involved).</p>	<p>Whether cash dealings with clients are done by branches/sub brokers?</p>
<p>Verification of internal controls adopted by the member while accepting banker's cheque/demand draft from clients</p>	<p>Whether banker's cheque/demand draft are accompanied with written request from the respective client?</p>
<p>Procedure for ensuring that receipts and payment of funds/securities are from/to respective client only</p>	<p>Whether pay-in or pay-out is received from or delivered to respective clients only?</p>

Technical Guide on Internal Audit of Stock Brokers

<p>Periodic Reconciliation of books of accounts</p>	<p>Whether client's funds/ securities are transferred to respective clients within one working day of payout from Exchange?</p>
<p>Verification of following books of accounts/records</p> <ul style="list-style-type: none"> - Register of Securities - Bank Statements - Depository accounts maintained by member - Client ledgers - Cash Book - Bank Book - Details of records of client securities pledged, if any. - Underlying for any overdraft/loan account. 	<p>Whether any instance of misutilisation of clients' funds or securities is observed? If yes, give complete details of such instances</p> <p>Whether any instances were observed wherein pay-in/ pay out was received from/ made to account other than the respective client account? Whether there are any systems in place to ensure compliance in this regard by the member?</p> <p>Whether collaterals of clients were pledged with banks/ other entities for raising funds? If yes, details of such instances observed are to be given.</p> <p>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?</p> <p>Whether bank book and</p>

	<p>register of securities are in alignment with bank statements and transaction statements provided by banks and depositories?</p> <p>Whether dividend and other corporate benefits received on behalf of clients is paid/credited/passed on to the respective clients account?</p>
<p><i>Exchange's regulatory Circular Download no. NSE/INSP/11324 dated 18-Sep-08 and CM and F&O Regulations.</i></p> <p><i>SEBI references</i></p> <ul style="list-style-type: none"> • <i>SEBI Circular No. SEBI/MRD/SE/Cir- 33/2003/27/08 dated August 27, 2003</i> • <i>SMD/POLICY/Cir -06 /03 dated February 12, 2003</i> • <i>Code of conduct for Stock Brokers specified under Regulation 7 of SEBI (Stock Brokers and Sub brokers) Regulations, 1992.</i> • <i>MRD/DoP/SE/Cir- 11/2008 dated April 17, 2008</i> 	
<p>5. Banking and Demat Account Operations</p>	
<p>Procedure for segregation of own and clients' funds and securities (in separate accounts)</p>	<p>Whether member maintains separate bank account for client funds and own funds. 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>Internal controls for use of client bank and client beneficiary accounts only for authorized purposes.</p>	
<p>Verification of client's bank account and constituent beneficiary accounts</p>	

Technical Guide on Internal Audit of Stock Brokers

	<p>Are there any instances of use of constituent beneficiary account or client bank account for other than authorized purposes? In case of any irregularity observed, mention the instances in detail.</p>
<p><i>Exchange's regulatory references Circular Download no. NSE/INSP/11324 dated 18-Sep-08 and CM and F&O Regulations.</i></p> <p><i>SEBI reference</i></p> <ul style="list-style-type: none"> • <i>SEBI Circular No. SMD-1/23341 dated November 18, 1993.</i> 	
<p>6. Terminal Operations and Systems</p>	
<p>Procedure and policy adopted by member before allotment of trading terminals</p>	<p>Whether terminals are provided by the member in its head office, branch office or the office of sub broker?</p>
<p>Verification of terminals and its users, at the audit place.</p>	<p>Whether any unauthorized terminal is observed to be allotted? If yes, give complete details.</p>
<p>Verification of certification of the approved users.</p>	<p>Whether periodic audit of systems and software is conducted by certified system auditor?</p>
<p>Due diligence adopted for password security</p>	<p>Whether terminals are operated by approved persons/approved users with valid NCFM certification?</p>
<p>Procedure in place for audit of systems and software</p>	
<p>Periodic updating of version and back up mechanism</p>	
<p>System adopted for data storage, security and access</p>	

Verification of logs from server	<p>Whether correct User name, login id, terminal location are reported to the Exchange?</p> <p>Whether internal controls are in place to ensure that the certification of approved users has not expired?</p> <p>Whether prior permission is obtained by member for providing CTCL? Whether member has complied with applicable provision of CTCL?</p> <p>Whether updated version of software is used?</p> <p>Whether back up facilities are in place and followed?</p> <p>Whether broker has got his system audit done & submitted the system audit report to the Exchange within prescribed time limit?</p> <p>Whether sufficient system for data security is in place?</p>
<p><i>Exchange's regulatory references –Download no.</i> <i>NSE/CMTR/6552 dated 24-Aug-05, download no.</i> <i>NSE/FAOP/6553 dated 24-Aug-05, download no.</i> <i>NSE/MEMB/3574 dated 29-Aug-02, NSE/MEMB/3635 dated 25-Sep-02, download no</i> <i>NSE/MEM/3740 dated 13-Nov-02 and</i> <i>NSE/MEM/7992 dated 10-Oct-06, download no.</i> <i>NSE/CMTR/7634 dated 28-Jun-06, download no.</i></p>	

<p>NSE/CMTR/6128 dated 10-May-05, download no. NSE/CMTR/8089 dated 10-Nov—06</p> <p>SEBI references</p> <ul style="list-style-type: none"> • SMDRP/Policy/Cir-49/2001 dated October 22, 2001 • SEBI/MRD/SE/15958/2003 August 22, 2003 	
<p>7. Management of Branches / Sub Brokers and Internal Control</p>	
System and Policy followed for opening / closing of branch	<p>Whether survey is conducted by the member for opening / closing of branches?</p> <p>In case of closure, whether advance notice of the same is sent to clients? Proof of the same.</p> <p>Whether there is monitoring mechanism to identify sudden increase / decrease in client level turnover from any specific branch?</p> <p>Whether periodic inspection of branch / sub broker is conducted and reports are maintained? What is the follow-up mechanism?</p> <p>Whether unregistered intermediation is observed?</p> <p>Whether the member has shared commission/ brokerage with entities with whom trading members are forbidden to do business/</p>
Procedure adopted to inform the same to clients	
Periodicity and procedure adopted for inspection of branches / sub brokers	
Reporting mechanism and mode of informing the inspection observations to branches / sub brokers	
Follow up action plan	
Policy of fixing of roles and responsibilities of officials in head office, branches and sub-brokers office	
Process laid out so as to prevent unregistered intermediation	
Documentation of Internal controls and Comments on Internal controls in place	
Verification of Stock broker indemnity insurance policy	

Sharing of commission/brokerage	another trading member/employee in the employment of another trading member?
	Whether internal controls exists and are sufficient to cover the risks at the members end?
<p><i>Exchange's regulatory references – Circular no. NSE/INSP/11324 dated 18-Sep-08 and CM and FO Rules and Byelaws of the Exchange</i></p> <p><i>SEBI references</i></p> <ul style="list-style-type: none"> • <i>Section 12 of SEBI Act</i> • <i>SEBI Circular No. SMD/Policy/CIR-3/98 dated January 16, 1998</i> • <i>Circular No. Sub-Brok/Cir/02/2001 dated January 15, 2001</i> • <i>Regulation 18 B of SEBI (Stock Brokers and Sub-Brokers) Rules, 1992</i> • <i>SMD/POLICY/CIRCULAR/3- 97 dated March 31, 1997.</i> 	Whether Stock broker indemnity policy with standard cover/clauses has been taken?
8. Investor Grievance Handling	
Mechanism to monitor complaints lodged with branches/Sub brokers	What is the system to report complaints received by branches / sub brokers to the head office?
Maintenance of complaints register	Whether complaints are received from specific branch/sub broker?
Redressal mechanism for complaints registered against the member	

Technical Guide on Internal Audit of Stock Brokers

<p>Comment on complaints pending for long period</p>	
<p>Verification of investor grievance register and email id</p>	<p>Whether complaints register includes complete details of investor complaints?</p>
<p>Internal control for verification of complaints received through the designated email –id</p>	<p>What is the procedure adopted to resolve complaints?</p> <p>Whether specific action plan is framed by the member in respect of long pending complaints?</p> <p>Whether designated email id for investor grievance is created and informed to the investors?</p> <p>What is the periodicity of monitoring investor complaints?</p> <p>Whether complaints of substantial amount is escalated to the top management?</p>
<p><i>Exchange's regulatory references - Circular NSE/MEMB/8352 dated 9-Jan-07, Circular no. NSE/INSP/5387 dated 30-Aug-04</i></p> <p><i>SEBI references</i></p> <ul style="list-style-type: none"> • <i>Clause 1(d) of Regulation 12A</i> • <i>MRD/DoP/Dep/SE/Cir-22/06 dated December 18, 2006</i> 	

9. Maintenance of Books of Accounts	
Prescribed books of accounts, registers and records are maintained Exchange wise, with the required details and for the stipulated period as per regulatory requirement	<p>Whether prescribed books of accounts, registers and records are maintained Exchange wise, with the required details and for the stipulated period as per regulatory requirement?</p> <p>Whether register of securities is maintained client wise-scrip wise?</p> <p>Whether exchange wise separate books of accounts are maintained?</p> <p>Whether member has dealt with suspended/ defaulter/ expelled members and entities prohibited from accessing market?</p>
Verification of books of accounts and other records	
Ledger Scrutiny	
Internal controls on the process for taking approval of the Exchange	Whether prior approval has been obtained by member for change in shareholding/directors/constitution?
Analysis of financial reports	<p>Whether prior approval has been obtained in case the member has dealt with another member of the Exchange?</p> <p>Whether member has intimated the Exchange in case of they have dealt with</p>

Technical Guide on Internal Audit of Stock Brokers

	<p>member of another stock exchange?</p> <p>Whether advertisements are issued after prior permission of the Exchange?</p> <p>Whether member maintains and update client master in its back office?</p> <p>Whether financial reports of the member has been analysed? Comments on the same.</p>
<p><i>Exchange's regulatory references download circular no. NSE/INSP/11324 dated 18-Sep-08 and CM and F&O Regulations.</i></p> <p><i>SEBI references</i></p> <ul style="list-style-type: none">• <i>Rule 15 of Securities Contract Regulation (Rule)1957</i>• <i>Regulation 17(1) of SEBI (Stock Brokers and Sub brokers) Regulations, 1992</i>• <i>SEBI/MRD/SE/Cir-15/2005 dated August 4, 2005</i>• <i>SEBI/MIRSD/Cir-06/2004 dated January 13, 2004</i>• <i>Rule 4 (c) of SEBI (Stock Brokers and Sub Brokers) Rules, 1992</i>• <i>MIRSD-DR 1/SRP/Cir- 43/28408 /04 dated December 15, 2004</i>• <i>MIRSD/MSS/Cir- 30/ 13289/03 dated July 09, 2003</i>• <i>Clause C(4) & C (5) of Regulation 7</i>• <i>Circular No. SMDRP/Policy/Cir-49/2001 dated October 22, 2001</i>	

10. Systems & Procedures pertaining to Prevention of Money Laundering Act, PMLA, 2002	
Customer acceptance policy and customer due diligence measures	What is the process adopted by member to verify the identity the customer and/or the person on whose behalf a transaction is being conducted ?
Walk through of the process	
Process of generation and monitoring alerts	
System in place that allows continuous monitoring of transactions	Whether any account was opened in fictitious name/benami account?
Process for identifying STR (Suspicious Transaction Report) and reporting the same to FIU-India	What checks and balances are in place to ensure that the identity of the client does not match with any person having criminal background or is not banned in any other manner?
Processes for verification of alerts with KYC details	<p>What are the factors of Risk perception having regards to client's location, address, nature of business activity, trading turnover and the manner of making payments so that the clients can be classified in to "High Risk", "Medium Risk"," Low Risk" category?</p> <p>Whether details of appointment of Principal Officer and change in Principal officer, if any, is</p>

Technical Guide on Internal Audit of Stock Brokers

	<p>intimated to FIU-India?</p> <p>Whether member has adopted and implemented written guidelines prescribed under PMLA, 2002 ?</p> <p>Whether member has adequate system to generate alerts for suspicious transactions?</p> <p>As per provisions of Prevention of Money Laundering Act, 2002 whether record of transactions, it's nature and it's value are maintained?</p>
<p><i>Exchange's regulatory references Circular download no. NSE/INVG/7102 dated 25-Jan-06 and NSE/INVG/7307 dated 24-Mar-06 and NSE/INVG/11798 dated 22-Dec-08 and NSE/INVG/11928 dated 22-Jan-09)</i></p> <p><i>SEBI references</i></p> <ul style="list-style-type: none"> • <i>ISD/AML/CIR-1/2008 dated December 19, 2008</i> 	
<p>11. Transfer of trades</p>	
<p>Procedure and system adopted for Transfer of Trades in the back office</p>	<p>Whether any trades were transferred from one client code to another client code or from client code to pro or vice-versa in the back office of the member?</p>
<p>Verification of trade files downloaded by the Exchange</p>	<p>Whether any pattern was observed in case transfer of</p>

with sauda register/back-office file of member (based on which contract notes are generated)	trades carried out at member's back office?
Internal controls for transfer of trades	
<p><i>Exchange's regulatory references – CM and F&O regulations</i></p> <p><i>SEBI references</i></p> <ul style="list-style-type: none"> • <i>SEBI/MRD/SE/Cir- 32/2003/27/08 dated August 27, 2003</i> 	
12. Margin Trading	
Verification of agreements	<p>Whether member has obtained specific approval from the exchange, in case he is providing margin trading facility to his clients?</p> <p>Whether member has complied with regulatory requirements related to margin trading?</p>
Records of funding	
<p><i>Exchange's regulatory references</i> <i>Circular download</i></p> <p><i>NSE/MEM/4972 Dated 7-Apr-04</i></p> <p><i>SEBI references</i></p> <ul style="list-style-type: none"> • <i>SEBI/MRD/SE/SU/Cir-15/04 dated March 19, 2004</i> 	
13. Proprietary Trading	
Verification of ids enabled for pro	<p>If member is doing pro trading, whether member has disclosed this information to his clients?</p> <p>If member is doing pro trading from multiple locations, whether member has obtained prior approval</p>

Technical Guide on Internal Audit of Stock Brokers

	from the Exchange in this regard?
Process for approval of Exchange	
<p><i>Exchange's regulatory references - Circular NSE/CMTR/4540 Dated 6-Nov-03 and Exchange Circular NSE/CMTR/4460 Dated 3-Oct-03</i></p> <p><i>SEBI references</i></p> <ul style="list-style-type: none"> • <i>SEBI/MRD/SE/Cir- 32/2003/27/08 dated August 27, 2003</i> • <i>SEBI/MRD/SE/Cir- 42 /2003 dated November 19, 2003</i> 	
14. Internet Trading	
Process of approval from Exchange	Whether member has obtained specific approval from the exchange, in case he is providing internet trading facility to his clients?
Verification of internet agreements	
Procedure followed for user id and password	Whether member has complied with regulatory requirements related to internet trading?
Internal controls for internet trading	Whether broker has got his system audit done & submitted the system audit report to the Exchange within prescribed time limit?
<p><i>Exchange's regulatory references Circular download no. NSE/CMTR/1532 dated 16-Mar-00</i></p> <p><i>SEBI references</i></p> <ul style="list-style-type: none"> • <i>SMDRP/POLICY/Cir-06/2000 dated January 31, 2000</i> 	

15. Operations of Professional Clearing member/ Members clearing trades of other trading members	
Verification of execution of trading -clearing member (TM-CM) agreements/Custodial Participant agreements	Whether TM-CM agreements are executed in prescribed formats with trading member?
Verification of issuance of statement of accounts to trading members/custodial participants	Whether Clearing member custodial participant agreements are executed in prescribed formats?
	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?
	Whether interest is charged to the trading member? If yes, what is the basis of interest with complete details like percentage of interest, periodicity of interest charged
<i>Exchange's regulatory references - Circular no. NSE/CMPT/11276 dated 10-Sep-08</i>	

16. Securities Lending & Borrowing Scheme	
Process of approval from Exchange	Whether member has obtained specific approval from the exchange?
Verification of SLBS agreement	Whether member has complied with regulatory requirements related to SLBS ?
<p><i>Exchange's regulatory references - Circular no NSE/CMPT/10146 dated 28-Jan-08, NSE/CMPT/10593 dated 17-Apr-08 and NSE/CMPT/11757 dated 12-Dec-08, NSE/CMPT/10146 dated 30-Jan-08</i></p> <p><i>SEBI references</i></p> <ul style="list-style-type: none"> • <i>MRD/DoP/SE/Cir- 31 /2008 dated October 31, 2008</i> 	

Points to be noted:

The guidelines prescribed hereunder do not limit the scope of the internal audit. The points mentioned are only indicative in nature and not exhaustive. It however, does not limit the scope of the internal audit. This has been prepared based on the regulatory requirement (as per relevant acts, rules, regulations and circulars) which keep on developing from time to time. The auditors should peruse them and update the scope of the audit.

The report shall also include the following:

1. If any major significant deviations and deviations of recurring nature are observed, the same should be reported separately in the covering page of the audit report. If auditors observations are in the nature of a deviation or a recommendation, the member's response should be sought and recorded in the report.
2. Comments by auditor on the status of compliance in respect of deviations reported in the last audit report,
3. Improvements brought about in the operations between the last audit and the current audit.

4. In case the member has been inspected in the relevant half year by the Exchange / SEBI, comments by the auditor on whether the member has complied with the observations made in Exchange / SEBI inspection report are to be included in the audit report.
5. A statement by the auditor that the provisions of SCRA 1956, SEBI Act 1992, SEBI (Stock Brokers and Sub-brokers) Regulations 1992, SCRR 1957, Rules, Bye laws, Regulations, circulars of SEBI, agreements, Bye laws of Exchange/Clearing Corporation, date security and insurance have been covered in the audit.
6. Auditor shall specifically declare about direct / indirect interest in or relationship with the member or its share holders / directors / partners / proprietors / management if any and also confirm that they do not perceive any conflict of interest in such relationship / interest while conducting internal audit of the said member.
7. Membership number allotted by the affiliated professional body should be quoted at the bottom of the report as provided in the format.
8. Observations in the report should be quantified giving instance wise details, details of segment and activity (trading or clearing) for which such violations are observed.

Annexure III

Certificate for Internal Audit

We have examined the relevant books of accounts, records and documents maintained by M/s. _____, (name of the trading/clearing member) bearing SEBI registration number _____) a member of the National Stock Exchange of India Limited / Bombay Stock Exchange Ltd / MCX-Stock Exchange /other Stock Exchange, for the following segments to fulfill the internal audit requirement as prescribed by SEBI vide Circulars dated 22 August 2008 & 21 October 2008, for the half year ended _____.

Segment (Cash Segment/ Derivatives Segment/ Debt Segment /Currency Derivatives/Securities Lending & Borrowing segment)	Activity (Trading/Clearing/Trading and Clearing)	SEBI registration number

The purpose of this Audit is to examine that the processes, procedures followed and the operations carried out by the Trading Member/Clearing Member are as per the applicable Acts, Rules, Regulations, Bye-laws and Circulars prescribed by SEBI and the stock exchange(s).

We have obtained all the information and explanations, which to the best of our knowledge and belief were necessary for the purpose of this Internal Audit. In our opinion proper books of accounts, records and documents, as per the regulatory requirement have been maintained by the member, so far as it appears from examination of the books.

We have conducted the audit within the framework provided by SEBI/Stock Exchange for the purpose of this Internal Audit.

To the best of our knowledge and belief and according to the information and explanations given to us, no material fraud / non-compliance /violation by the Member is observed during the course of this Audit.

Based on the scrutiny of relevant books of accounts, records and documents , we certify that the Member has complied with the relevant provisions of SEBI Act, 1992, Securities Contracts (Regulation) Act 1956, Securities Contracts (Regulation) Rules 1957, SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992 and various circulars of SEBI. The Member has complied with the Rules, Bye laws, Regulations of NSE / BSE / MCX-SE and various circulars issued by the Stock Exchange and Clearing Corporation/Clearing House.

We declare that we do not have any direct / indirect interest in or relationship with the member or its share holders / directors / partners / proprietors / management and also confirm that we do not perceive any conflict of interest in such relationship / interest while conducting internal audit of the said member.

In our opinion and to the best of our information and according to the explanations given to us by the proprietor/partner (s)/director (s)/ compliance officer, the Report provided by us as per the Annexure and subject to our observations, which covers the entire scope of the Audit, is true and correct.

Company Secretary / Cost and Management Accountant /
Chartered Accountant

(Seal & Signature)

(Name of the Proprietor / Partner)

Membership no. / CP. No.

Place:-

Date:-

II. Circular on Internal Audit of Stock Brokers/Trading Members/Clearing Members issued by BSE

Notice no : 20090325-22
Notice date : Wednesday, March 25, 2009
Subject : Internal Audit of stock brokers/ trading members/clearing members
Segment Name: General

Contents :

To,

The Members

This is further to Exchange Notice no. 20080825-2 dated August 25, 2008 and Notice no. 20081022-30 dated October 22, 2008 wherein all the stock brokers/trading members/clearing members were directed 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. It was also informed that, the first internal audit period would be from October 1, 2008 to March 31, 2009.

Further, on the basis of SEBI letter no. MIRSD/DPS-I/PG/158174/09 dated March 23, 2009, the applicability, scope/guidelines of audit, format of audit report, audit certificate and the time limit for submission of audit report are finalised and given as Annexure 1, 2 and 3.

All stock brokers/trading members/clearing members are advised to ensure compliance with the above requirements.

Members are advised to submit the Audit Reports to Dept. of Surveillance & Supervision (Inspection Cell) on 24th floor of the Exchange.

In case of any queries / clarification, the members may contact the under mentioned officials on Tel:022-22721233/34

Name of the Officials	Intercom No.
Ms. Neha Malviya	8898
Ms. Anita Gorhe	8095
Ms. Parul Kothari	8196
Mr. Mitesh Thakkar	8880

P. K. Ramesh
General Manager
Surveillance & Supervision

Yogesh Bambardekar
Asst. Gen. Manager
Surveillance & Supervision

Annexure - 1

Internal Audit for Stock Brokers/ Trading Members/Clearing Members

Applicability

Trading Members (Stock Brokers) and Clearing members are required to appoint an internal auditor for carrying out complete internal audit in all segments of the Exchange in which they are enabled for trading/clearing (wherein atleast a one/single trade have been executed or cleared by them) and submit a report to the Exchange on half yearly basis. The first half year period would start from October 01, 2008.

Who can Conduct Internal Audit

Internal audit is required to be carried out by any Chartered Accountant, Company Secretary or Cost and Management Accountant who is in practice and who does not have any conflict of interest.

Scope/Purpose of Audit

The purpose of audit should be :

- (a) to ensure that the books of account, records and documents have been maintained in the manner required under Securities Exchange Board of India Act, 1992, Securities Contracts (Regulation) Act, 1956, SEBI (Stock brokers and Sub-brokers) Regulations, 1992, Securities Contracts (Regulation) Rules, 1957, circulars issued by SEBI & Exchange, Bye laws of the Exchange including agreements, data security and insurance in respect of operations of trading member/clearing member.
- (b) to ascertain whether adequate internal control systems, procedures and safeguards have been established and are being followed by the intermediary to fulfill its obligations under Securities and Exchange Board of India Act, 1992, Securities Contracts (Regulation) Act, 1956, SEBI (Stock brokers and Sub-brokers) Regulations, 1992, Securities Contracts (Regulation) Rules, 1957, circulars

issued by SEBI & Exchange, Bye laws of the Exchanges and with respect to data security and insurance in respect of operations of trading member/clearing member.

- (c) to ascertain whether any circumstances exist which would render the intermediary unfit or ineligible for dealing in securities market.
- (d) to ascertain whether the provisions of the securities laws and the directions and/or circulars issued there under by SEBI/Exchange have been complied with
- (e) to ascertain, whether the provision of Bye-laws, notices, circulars, instructions or orders issued by stock exchanges have been complied with
- (f) to inquire suo motu into such matters as may be deemed fit by the auditor in the interest of investors or the securities market

Submission of internal audit report

Internal auditor would submit the audit report to the Proprietor/Partners/Board of respective trading/clearing member who would place the report before its Board of Directors/proprietor/partners and shall forward the same along with para-wise/point wise comments to respective stock exchanges within 3 months from the end of the relevant half year audit period. The audit report may be combined across segments and activity (trading/clearing) for respective Exchanges.

Non-compliance relating to Internal Audit by the Members

Non-submission of internal audit report as per the aforesaid guidelines shall be treated as non-compliance and suitable disciplinary action may be initiated against the concerned member/s. Where, in the opinion of the Exchange, the quality of the reporting is not satisfactory or the audit is not carried out in accordance with the aforesaid guidelines, the Exchange reserves the right to advise the concerned member/s to change the auditors and/or submit revised reports.

Annexure - 2

Areas to be Covered in Internal Audit and Areas on which Comments Needs to be Incorporated in the Report are given below

1. Client Registration and Documentation	
Execution of KYC, MCA/TPA, and RDD – checks and balances in place	Whether KYC, MCA/TPA, RDD are executed in the prescribed formats & the same is executed before execution of trades for the client?
Verification of formats of KYC, MCA/TPA and RDD and attachments including proof of identity and address, as prescribed by SEBI/BSE	Whether UCC is allotted to the client & the same is uploaded to the Exchange with PAN
Verification that Contradictory clauses are not mentioned in KYC, MCA/TPA and RDD	Whether all fields in KYC including client's financial details are filled in properly?
Systems and procedures put in place by member for verification of PAN before opening account	Whether proper proof of identity, PAN and proof of address are taken with KYC form?
Procedure followed by the member for informing UCC to the clients & uploading to the Exchange	Whether any contravening clauses are included in MCA/TPA?
Mechanism to ensure financial details of clients	Whether in person verification of clients is done by the employees of

Procedure adopted for in person verification of clients	the trading member only?
Procedure adopted by relationship managers, if any, for procuring new clients	Whether date of verification, name and signature of the official who has done in-person verification and the member's stamp incorporated in the client registration form?
Delivery of copies of client registration documents to the clients	Whether copies of all the documents executed by client are given to the respective clients?
Storage of client registration documents and retrieval mechanism	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?
Procedure adopted for obtaining clients' consent for electronic contract notes	Whether client details including financial details are reviewed periodically and updated?
Periodic review of client related information and updation of the same in system	
Verification of RDD/KYC/MCA/TPA of different types of clients	
Acquaintance procedure for new clients	
<p>SEBI circular no. SMDRP/Policy/Cir-39/2001 dated July 18, 2001</p> <p>SEBI circular no. SEBI/MIRSD/DPS-1/Cir-31/2004, dated August 26, 2004 & Regulation-7 D</p> <p>SEBI circular no. MRD/DoP/SE/Cir- 35/2004 dated October 26, 2004</p> <p>SEBI circular no. MRD/DoP/Cir- 05/2007 dated April 27, 2007</p> <p>MIRSD/DPS-III / 130466 / 2008 dated July 02, 2008</p>	

Technical Guide on Internal Audit of Stock Brokers

<p>Exchange Notice No.20040827-11 dated August 27, 2004 Exchange Notice No. 20060704-6 dated July 04, 2006 Exchange Notice No. 20080624-8 dated June 24, 2008 Exchange Notice no.20080707-3 dated July 07, 2008 Exchange Notice no.20080801-2 dated August 01, 2008</p>	
<p>2. Order Management and Risk Management Systems</p>	
<p>Procedure adopted for receipt of orders from clients</p>	<p>Whether checks are in place to ensure that no unauthorized orders are executed from any of the terminals?</p> <p>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?</p> <p>In case of dormant accounts, are there any checks in place to ensure that in case the account is reactivated whether it is operated by the respective client only?</p> <p>Whether initial and other margins are collected from respective clients in the prescribed form of funds, fixed deposit receipts, bank guarantees and approved securities with appropriate haircut?</p> <p>Whether the member has a proper system for reporting the correct client margin collection, in Derivatives segment?</p> <p>Verify whether the margin reported by the member to the Exchange in Derivatives segment is actually</p>
<p>Mechanism for order management and execution</p>	
<p>Procedure adopted for setting Limits at client level / Terminal level/Dealer level</p>	
<p>Policy on Margin collection mechanism and the modes of margin money</p>	
<p>Procedure adopted for reporting of client margin collection to Clearing House</p>	
<p>Review of process adopted for monitoring / recovery of long outstanding debit balances</p>	
<p>Procedure adopted for calculation & reporting client funding</p>	
<p>Procedure for monitoring institutional trades not routed through custodians</p>	

<p>Procedure adopted for providing Direct Market Access (DMA) facility</p>	<p>collected and available in the books of accounts of the member. In case of any irregularity observed, mention the instances wherein wrong reporting of margin collected from clients/trading members was observed.</p> <p>Whether Risk Management System (RMS) includes policy on margin collection from clients/trading member and the RMS is documented?</p> <p>Whether proper systems are in place to ensure timely collection for pay-in from the respective client as per settlement schedule?</p> <p>Whether proper monitoring mechanism is in place to review long outstanding debit balances in clients' accounts and recovery of the same?</p> <p>Whether member has reported details of client funding, if any, to the exchange within prescribed time limit?</p> <p>What are the sources of funds in case client funding is observed?</p> <p>Whether all the institutional trades are routed through custodians by following Straight Through Processing (STP) ?</p> <p>What are the reasons for institutional trades not being routed through custodians? Whether any specific pattern is observed for the same?</p>
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Technical Guide on Internal Audit of Stock Brokers

	<p>Whether member has obtained prior approval from the exchange before providing terminal to the clients under DMA facility?</p> <p>Whether member has complied with regulatory requirements related to DMA?</p>
<p>SEBI circular no. MRD/DoP/SE/Cir-07/2005 dated February 23, 2005</p> <p>SEBI circular no. MRD/DoP/SE/Cir- 17/2005 dated September 02, 2005</p> <p>Exchange Notice no. 20040420-12 dated April 20, 2004.</p> <p>Exchange notice no. 20080417-24 dated April 17, 2008.</p> <p>Exchange Notice No. 20051216-8 dated December 16, 2005</p>	
<p>3. Contract Notes, Client Margin details and Statement of Accounts</p>	
<p>Procedure adopted for issuance of contract notes</p>	<p>Whether contract notes are sent within 24 hours of execution of trades and margin details are sent daily to respective clients and proof of delivery / dispatch is maintained?</p> <p>Whether all prescribed details including name and signature of authorised signatory, dealing office details and brokerage are contained in contract note?</p> <p>In case contract notes and margin details are sent in electronic form, whether log is maintained? Whether trail of bounced mails is maintained</p>
<p>Verification of format of contract notes issued</p>	
<p>Verification of copy of contract note with Proof of dispatch/register of dispatch/logs maintained</p>	
<p>Adherence to electronic contract note norms, if applicable</p>	
<p>Procedure adopted for sending statement of accounts</p>	
<p>Contents & periodicity of statement of accounts of</p>	

funds and securities	and physical delivery is ensured in case of bounce mails?
Procedure adopted for sending margin details to clients	Whether member has complied with regulatory requirements related to Electronic Contract Notes(ECN)?
Procedure for maintaining acknowledgement / proof of delivery of contract notes/statement of accounts/margin details to the clients	Whether complete statement of accounts for funds and securities are issued on a quarterly basis to clients, with error reporting clause? Whether proof of sending the same is maintained?
<p>Clause B(2) of Code of conduct for Stock Brokers specified under Regulation 7</p> <p>SMD-1/23341 dated November 18, 1993</p> <p>SMD (B)/104/22775/93 dated October 29, 1993</p> <p>SMD/MDP/CIR/043/96 dated August 5, 1996</p> <p>MRD/DoP/SE/Cir-20/2005 dated September 08, 2005</p> <p>SEBI/DNPD/143542 /Cir-43/08 dated November 06, 2008</p> <p>Exchange Notice No.20080527-6 dated May 27, 2008</p> <p>Bye-Law 247A of the Rules, Bye-laws & Regulations of the Exchange</p> <p>Exchange Notice No. 20060627-18 dated June 27, 2006</p> <p>Exchange Notice No. 20050909-13 dated September 09, 2005</p> <p>Exchange Notice No. 20080211- 19 dated February 11, 2008</p>	
<p>4. Dealing with Clients' Funds and Securities</p>	
Verification of details of cash receipts from / payments to clients, if any, observed during the audit period are to be given (mentioning any specific	<p>Whether cash dealings with clients are done by branches / sub brokers?</p> <p>Whether banker's cheque / demand</p>

Technical Guide on Internal Audit of Stock Brokers

branch involved).	draft are accompanied with written request from the respective client?
Verification of internal controls adopted by the member while accepting banker's cheque / demand draft from clients	Whether pay-in or pay-out is received from or delivered to respective clients only?
Procedure for ensuring that receipts and payment of funds/securities are from/to respective client only	Whether any instances were observed wherein pay-in / pay out was received from / made to account other than the respective client account? Whether systems are in place to ensure compliance in this regard by the member?
Periodic Reconciliation of books of accounts	
<p>Verification of following books of accounts/records</p> <ul style="list-style-type: none"> - Register of Securities - Bank Statements - Depository accounts maintained by member - Client ledgers - Cash Book - Bank Book - Details of records of client securities pledged, if any. - Underlying for any overdraft/loan account. 	<p>Whether collaterals of clients were pledged with banks / other entities for raising funds? If yes, details of such instances observed are to be given.</p> <p>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?</p> <p>Whether client's funds / securities are transferred to respective clients accounts within one working day of after the pay-out of the settlement?</p> <p>Whether any instance of misutilisation of clients' funds or</p>

	<p>securities is observed? If yes, give complete details of such instances</p> <p>Whether bank book and register of securities are in alignment with bank statements and transaction statements provided by banks and depositories?</p> <p>Whether dividend and other corporate benefits received on behalf of clients is paid/credited/passed on to the respective clients account?</p>
<p>SEBI circular no. SEBI/MRD/SE/Cir- 33/2003/27/08 dated August 27, 2003</p> <p>Code of conduct for Stock Brokers specified under Regulation 7 of SEBI (Stock Brokers and Sub brokers) Regulations, 1992.</p> <p>SEBI circular no. MRD/DoP/SE/Cir-11/2008 dated April 17, 2008</p> <p>Exchange Notice No.20030903-5 dated September 03, 2003</p>	
<p>5. Banking and Demat Account Operations</p>	
<p>Procedure for segregation of own and clients' funds and securities (in separate accounts)</p>	<p>Whether member maintains separate bank accounts for clients funds & own funds. Also, whether maintains separate beneficiary accounts for clients' securities & own securities?</p>
<p>Internal controls for use of client bank and client beneficiary accounts only for authorized purposes.</p>	<p>Whether clients funds and securities are segregated from own funds and securities?</p>
	<p>Are there any instances of use of client beneficiary account or client bank account for unauthorised</p>

Technical Guide on Internal Audit of Stock Brokers

	purposes? In case of any irregularity observed, mention the instances in detail.
SEBI circular no. SMD/SED/CIR/93/23321 dated November 18, 1993.	
Bye-Law 247A of the Rules, Bye-laws & Regulations of the Exchange	
6. Terminal Operations and Systems	
Procedure and policy adopted by member before allotment of trading terminals	Whether terminals are provided by the member in his head office, branch office or the office of sub broker?
Verification of terminals and its users, at the audit place.	Whether any unauthorized terminal is observed to be allotted? If yes, give complete details.
Verification of certification of the approved users.	
Due diligence adopted for password security	Whether periodic audit of systems and software is conducted by certified systems auditor?
Procedure in place for audit of systems and software	Whether terminals are operated by approved persons/approved users with valid BCSM certification?
Periodic updating of version and back up mechanism	
System adopted for data storage, security and access	Whether correct User name, login id, terminal location are reported to the Exchange?
Verification of logs from server	

	<p>Whether internal controls are in place to ensure that the certification of approved users has not expired?</p> <p>Whether prior permission is obtained by member for providing IML? Whether member has complied with applicable provision of IML?</p> <p>Whether updated version of software is used?</p> <p>Whether back up facilities are in place and followed?</p> <p>Whether broker has got his system audit done & submitted the system audit report to the Exchange within prescribed time limit?</p>
<p>SEBI circular no. SMDRP/Policy/Cir-49/2001 dated October 22, 2001</p> <p>SEBI/MRD/SE/15958/2003 August 22, 2003</p> <p>Exchange Notice No.20070517-26 dated May 17, 2007</p>	
<p>7. Management of Branches / Sub Brokers and Internal Control</p>	
<p>System and Policy followed for opening / closing of branch</p>	<p>Whether survey is conducted by the member for opening / closing of branches?</p>
<p>Procedure adopted to inform the same to clients</p>	

Technical Guide on Internal Audit of Stock Brokers

Periodicity and procedure adopted for inspection of branches/ sub brokers	In case of closure, whether advance notice of the same is sent to clients? Proof of the same.
Reporting mechanism and mode of informing the inspection observations to branches / sub brokers	Whether there is monitoring mechanism to identify sudden increase / decrease in client level turnover from any specific branch?
Follow up action plan	
Policy of fixing of roles and responsibilities of officials in head office, branches and sub-brokers office	Whether periodic inspection of branch / sub broker is conducted and reports are maintained? What is the follow-up mechanism?
Process laid out so as to prevent unregistered intermediation	Whether unregistered intermediation is observed?
Documentation of Internal controls and Comments on Internal controls in place	Whether the member has 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?
Verification of Stock broker indemnity insurance policy	
Sharing of commission/ brokerage	Whether internal controls exists and are sufficient to cover the risks at the members end? Whether Stock broker indemnity policy with standard cover/clauses has been taken?
Section 12 of SEBI Act	

<p>SEBI circular no. SMD/SED/RCG/270/96 dated January 19, 1996 SEBI circular no. SMD/Policy/CIR-3/98 dated January 16, 1998 SEBI circular no. Sub-Brok/Cir/02/2001 dated January 15, 2001 Regulation 18B of SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992 SEBI circular no. SMD/POLICY/CIRCULAR/3- 97 dated March 31, 1997. Exchange Notice No.20080612-3 dated June 12, 2008 Exchange Notice No.20080716 – 10 dated July 16, 2008.</p>	
<p>8. Investor Grievance Handling</p>	
<p>Mechanism to monitor complaints lodged with branches/sub-brokers</p>	<p>What is the system to report complaints received by branches / sub brokers to the head office?</p>
<p>Maintenance of complaints register</p>	<p>Whether complaints are received from specific branch/sub-broker?</p>
<p>Redressal mechanism for complaints registered against the member</p>	<p>Whether complaints register includes complete details of investor complaints?</p>
<p>Comment on complaints pending for long period</p>	<p>What is the procedure adopted to resolve complaints?</p>
<p>Verification of investor grievance register and email id</p>	<p>Whether specific action plan is framed by the member in respect of long pending complaints?</p> <p>Whether designated email id for investor grievances is created and informed to the investors ?</p>
<p>Internal control for verification of complaints received through the designated email –id</p>	

Technical Guide on Internal Audit of Stock Brokers

	<p>What is the periodicity of monitoring investor complaints?</p> <p>Whether complaints of substantial amount is escalated to the top management ?</p>
<p>SEBI circular no. MRD/DoP/Dep/SE/Cir-22/06 dated December 18, 2006</p> <p>Clause 1(d) of Regulation 12A</p> <p>Exchange Notice No.20070131-11 dated January 31, 2007</p>	
<p>9. Maintenance of Books of Accounts</p>	
<p>Prescribed books of accounts, registers and records are maintained Exchange wise, with the required details and for the stipulated period as per regulatory requirement</p>	<p>Whether prescribed books of accounts, registers and records are maintained Exchange wise, with the required details and for the stipulated period as per regulatory requirement?</p> <p>Whether exchange wise separate books of accounts are maintained?</p> <p>Whether member has dealt with any suspended /defaulter /expelled member and/or prohibited entity?</p>
<p>Verification of books of accounts and other records</p>	<p>Whether prior approval has been obtained by member for change in shareholding/directors/constitution?</p>
<p>Internal controls on the process for taking approval of the Exchange</p> <p>Analysis of Financial Reports</p>	<p>Whether prior approval has been obtained in case the member has dealt with another member of the Exchange?</p> <p>Whether member has intimated the Exchange in case of they have</p>

	<p>dealt with member of another stock exchange?</p> <p>Whether advertisements are issued after prior permission of the Exchange?</p> <p>Whether member maintains and updates client master in its back office?</p> <p>Whether financial reports of the member has been analysed? Comments on the same.</p>
<p>Rule 15 of Securities Contract Regulation Rules 1957 Regulation 17(1) & 18 of SEBI (Stock Broker Sub-broker) Regulation 1992 Rule 4 (c) of SEBI (Stock Brokers and Sub Brokers) Rules, 1992 Clause C(4) & C (5) of Regulation 7 SEBI Circular No. SMDRP/Policy/Cir-49/2001 dated October 22, 2001 SEBI circular no. MIRSD/MSS/Cir- 30/ 13289/03 dated July 09, 2003 SEBI circular no. SEBI/MIRSD/Cir-06/2004 dated January 13, 2004 SEBI circular no. MIRSD-DR 1/SRP/Cir- 43/28408/04 dated December 15, 2004 SEBI circular no. SEBI/MRD/SE/Cir-15/2005 dated August 4, 2005 Exchange Notice No. 20040117-8 dated January 17, 2004</p>	
<p>10. Systems and Procedures pertaining to Prevention of Money Laundering Act (PMLA), 2002</p>	
<p>Customer acceptance policy and customer due diligence measures</p>	<p>What is the process adopted by member to verify the identity of the customer and/or the person on</p>

Technical Guide on Internal Audit of Stock Brokers

Walk through of the process	whose behalf a transaction is being conducted ?
Process of generation and monitoring alerts	Whether any account was opened in fictitious name/benami account ?
System in place that allows continuous monitoring of transactions	What checks and balances are in place to ensure that the identity of the client does not match with any person having criminal background or is not banned in any other manner?
Process for identifying STR (Suspicious Transaction Report) and reporting the same to FIU-India filed	What are the factors of Risk perception having regard to client's location, address, nature of business activity, trading turnover and the manner of making payments so that the clients can be classified in to "High Risk", " Medium Risk"," Low Risk" category?
Processes for verification of alerts with KYC details	<p>Whether details of appointment of Principal Officer and change in Principal officer, if any is intimated to FIU-India?</p> <p>Whether member has adopted and implemented written guidelines prescribed under PMLA, 2002?</p> <p>Whether member has adequate system to generate alerts for suspicious transactions?</p> <p>As per provisions of Prevention of Money Laundering Act, 2002 whether record of transactions, its nature and its value are maintained?</p>

<p>SEBI circular no. ISD/CIR/RR/AML/1/06 dated January 18, 2006 SEBI circular no. ISD/CIR/RR/AML/2/06 dated March 20, 2006 SEBI circular no. ISD/AML/CIR-1/2008 dated December 19, 2008 SEBI letter no. ISD/SR/AK/AML/150847/2009 dated January 15, 2009 Exchange Notice no.20060321-15 dated March 21, 2006 Exchange Notice No.20081222-21 dated December 22, 2008 Exchange Notice No.20090122-9 dated January 22, 2009</p>	
<p>11. Transfer of Trades</p>	
<p>Transfer of trades in the back office</p>	<p>Whether any trades were transferred from one client code to another client code or from client code to pro or vice-versa in the back office of the member?</p> <p>Whether any pattern was observed in case, transfer trades carried out at member's back office</p>
<p>Verification of trade files downloaded by the Exchange with sauda register/back-office file of member (based on which contract notes are generated)</p>	
<p>Internal controls for transfer of trades</p>	
<p>SEBI circular no. SEBI/MRD/SE/Cir- 32/2003/27/08 dated August 27, 2003 Exchange Notice No.20030329-1 dated March 29, 2003</p>	
<p>12. Margin Trading</p>	
<p>Verification of agreements</p>	<p>Whether member has obtained specific approval from the exchange, in case he is providing margin trading facility to his clients?</p>
<p>Records of funding</p>	

Technical Guide on Internal Audit of Stock Brokers

	Whether member has complied with regulatory requirements related to margin trading?
SEBI circular no. SEBI/MRD/SE/SU/Cir-15/04 dated March 19, 2004 Exchange Notice No.20040402-31 dated April 02, 2004	
13. Proprietary Trading	
Verification of ids enabled for pro	If member is doing pro trading, whether member has disclosed this information to his clients?
Process for approval of Exchange	If member is doing pro trading from multiple locations, whether member has obtained prior approval from the Exchange in this regard?
SEBI circular no. SEBI/MRD/SE/Cir-32/2003/27/08 dated August 27, 2003 SEBI letter no. SEBI/MRD/SE/Cir-42/2003 dated November 19, 2003 Exchange Notice No. 20031125-7 dated November 25, 2003 Exchange Notice No. 20030909-1 dated September 09, 2003	
14. Internet Trading	
Process of approval from Exchange	Whether member has obtained specific approval from the exchange, in case he is providing internet trading facility to his clients?
Verification of internet agreements	
Procedure followed for user id and password	Whether member has complied with regulatory requirements related to

	internet trading?
Internal controls for internet trading	Whether broker has got his system audit done & submitted the system audit report to the Exchange within prescribed time limit?
SEBI Circular no. SMDRP/POLICY/CIR-06/2000 dated January 31, 2000	
Exchange Notice No. 47315 /2000 dated April 17, 2000	
15. Operations of Professional Clearing Member/ Members Clearing Trades of other Trading Members	
Verification of execution of trading -clearing member (TM-CM) agreements/Custodial Participant agreements	Whether TM-CM agreements are executed in prescribed formats with trading member? Whether Clearing member custodial participant agreements are executed in prescribed formats ?
Verification of issuance of statement of accounts to trading members/custodial participants	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?

	Whether interest is charged to the trading member? If yes, what is the basis of interest with complete details like percentage of interest, periodicity of interest charged
16. Securities Lending and Borrowing Scheme	
Process of approval from Exchange	Whether member has obtained specific approval from the exchange?
Verification of SLBS agreement	Whether member has complied with regulatory requirements related to SLBS ?
<p>SEBI circular no. MRD/DoP/SE/Dep/Cir- 14 /2007 dated the December 20, 2007</p> <p>SEBI circular no. MRD/DoP/SE/Cir- 31 /2008 dated October 31, 2008</p> <p>Exchange notice no. 20071224-10 dated December 24, 2007</p> <p>Exchange notice no. 20080128-3 January 28, 2008</p> <p>Exchange notice no. 20080130-38 dated January 30, 2008</p> <p>Exchange notice no. 20080417-23 dated April 17, 2008</p> <p>Exchange notice no. 20081223-15 dated December 23, 2008</p>	

Points to be noted:

The guidelines prescribed hereunder do not limit the scope of the internal audit. The points mentioned are only indicative in nature and not exhaustive. This has been prepared based on the regulatory requirement (as per relevant acts, rules, regulations and circulars) which keep on developing from time to time. The auditors should peruse them and update the scope of the audit.

The report shall also include the following:

1. If any major significant deviations and deviations of recurring nature are observed, the same should be reported separately in the covering page of the audit

report. If auditors observations are in the nature of a deviation or a recommendation, the member's response should be sought and recorded in the report.

2. Comments by auditor on the status of compliance in respect of deviations reported in the last audit report,
3. Improvements brought about in the operations between the last audit and the current audit.
4. In case the member has been inspected in the relevant half year by the Exchange / SEBI, comments by the auditor on whether the member has complied with the observations made in the Exchange/SEBI inspection report are to be included in the audit report.
5. A statement by the auditor that the provisions of SCRA 1956, SEBI Act 1992, SEBI (Stock Brokers and Sub-brokers) Regulations 1992, Rules, Bye laws, Regulations and circulars of SEBI, agreements, Bye laws of Exchange, circulars of Clearing House, data security and insurance have been covered in the audit.
6. Auditor shall specifically declare about direct / indirect interest in or relationship with the member or its share holders / directors / partners / proprietors / management, if any and also confirm that they do not perceive any conflict of interest in such relationship / interest while conducting internal audit of the said member.
7. Membership number allotted by the affiliated professional body should be quoted at the bottom of the report as provided in the format.
8. Observations in the report should be quantified giving instance wise details, details of segment and activity (trading or clearing) for which such violations are observed.

Annexure - 3

Certificate for Internal Audit

We have examined the relevant books of accounts, records and documents maintained by M/s. _____, (name of the trading/clearing member) bearing SEBI registration number _____) a member of the National Stock Exchange of India Limited / Bombay Stock Exchange Ltd. / MCX-Stock Exchange /other Stock Exchange, for the following segments to fulfill the internal audit requirement as prescribed by SEBI vide circulars dated August 22, 2008 & October 21, 2008, for the half year ended_____.

Segments (Cash Segment/ Derivatives Segment / Debt Segment /Currency Derivatives/Securities Lending & Borrowing segment)	Activity (Trading/Clearing /Trading and Clearing)	SEBI registration number

The purpose of this audit is to examine that the processes, procedures followed and the operations carried out by the Trading Member/Clearing Member are as per the applicable Acts, Rules, Regulations, Bye-laws and Circulars prescribed by SEBI and the Stock Exchange.

We have obtained all the information and explanations, which to the best of our knowledge and belief were necessary for the purpose of this internal audit. In our opinion proper books of accounts, records & documents, as per the regulatory requirement have been maintained by the member, so far as it appears from examination of the books.

We have conducted the audit within the framework provided by SEBI/Stock Exchange for the purpose of this internal audit.

To the best of our knowledge and belief and according to the information and explanations given to us, no material fraud / non-compliance /violation by the member is observed during the course of this audit.

Based on the scrutiny of relevant books of accounts, records and documents, we certify that the member has complied with the relevant provisions of SEBI Act, 1992, Securities Contracts (Regulation) Act 1956, Securities Contracts (Regulation) Rules 1957, SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992 and various circulars of SEBI. The member has complied with the Rules, Bye-laws, Regulations of BSE / NSE / MCX-SE and various circulars issued by the Stock Exchange and Clearing Corporation/Clearing House.

We declare that we do not have any direct / indirect interest in or relationship with the member or its directors/ partners/proprietors/ management and also confirm that we do not perceive any conflict of interest in such relationship / interest while conducting internal audit of the member.

In our opinion and to the best of our information and according to the explanations given to us by the proprietor/ partner(s)/director(s)/compliance officer, the Report provided by us as per the Annexure and subject to our observations, which covers the entire scope of the audit, is true and correct.

Company Secretary / Cost and Management Accountant /
Chartered Accountant

(Seal & Signature)

(Name of the Proprietor / Partner)

Membership no. / CP. No.

Place:-

Date:-

