



All India Conference on Internal Audit

Jointly Organised By :

**Internal Audit Standards Board, ICAI
and
The Northern India Regional Council of ICAI**

**Internal Audit of Stock Brokers
the New SEBI Mandate**

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What is Internal Audit ?



Preface to the Standards on Internal Audit, issued by the Institute of Chartered Accountants of India defines internal audit as follows:

“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 risk management and internal control system.”



Role of Internal Audit



- Obtain knowledge of Rules and Regulations governing the entity
 - Obtain understanding of the risk management and internal control framework of the entity
 - Effectiveness of the existing Internal Control Procedures
 - Identifying the activities warranting special focus
 - Identifying and allocation of staff to different activities
 - Setting the time budget for each activity
 - Identifying the reporting responsibility
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Circular by SEBI



The Security Exchange Board of India, through there Circular No. MIRSD/ DPSIII/ Cir-26/ 08 dated August 22, 2008 decided that Stock Brokers / Trading Members / Clearing Members shall carry out complete internal audit on a half yearly basis.



Who is a Stock Broker



The Securities Exchange Act, 1934 defines the term “Broker” as:

“Anyone, other than a bank, engaged in the business of effecting securities transactions for the account of other”

In other words, Broker is an intermediary who is associated with securities market and is registered under Section 12 of the SEBI Act, 1992.



Business Process of Stock Broking Entity



- Agreement with Client
 - Obtain Client Registration Form (applicability of KYC Norms)
 - Collection of Margin Money from the Client as per SEBI Circulars for high value order
 - Receipt of Order
 - Route the order through exchange trading mechanism by putting Unique Client Code
 - Issue of confirmation memos to Client
 - Margin money paid to Clearing House
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Business Process of Stock Broking Entity



- Received Money from the Client for purchase transaction
 - Received Shares from the Client for sales transaction
 - Route the Client money through a Separate Bank Account
 - Making pay – in to Clearing House
 - Receipt of Money/ Shares from Clearing House
 - Timely delivery of securities / sale consideration to the client
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Code of Conduct for Stock Broker



The Schedule III of the Securities and Exchange Board of India (Stock Brokers and Sub – Brokers) Regulations, 1992 prescribes the Code of Conduct :

General

1. Integrity
 2. Exercise of due skill and care
 3. Manipulation
 4. Malpractices
 5. Compliance with Statutory Requirements
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Code of Conduct for Stock Broker



Duty to the Investor

1. Execution of Orders
 2. Issue of Contract Note
 3. Breach of Trust
 4. Business and Commission
 5. Business of Defaulting Clients
 6. Fairness to Clients
 7. Investment Advice
 8. Investment Advice in Publicly Accessible Media
 9. Competence of Stock Broker
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Code of Conduct for Stock Broker



Duty to Other Stock Brokers

1. Conduct of Dealings
 2. Protection of Clients Interest
 3. Transactions with Stock Brokers
 4. Advertisement and Publicity
 5. Inducement of Clients
 6. False or Misleading Returns
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Bye Laws of the Stock Exchange



The Securities Contract (Regulation) Act, 1956 empowers the Stock Exchanges to issue Bye – Laws, subjecting to the approval of the Central Government, described as :

1. *Maintenance of a clearing house for all business transacted at the stock exchange.*
 2. *Regulation, limitations or abolition of blank transfer and carry over facilities.*
 3. *Determination and declaration of market rate.*
 4. *Regulation of the “taravni” business.*
 5. *Limitation on business done by individual members.*
 6. *Fixation of the scale of brokerage, fine, fees and the margin requirements.*
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KYC Requirement



KYC Framework is have two fold objectives :

- *To ensure client identification and verifying his identity and residential address and*
- *To monitor transactions of a suspicious nature*

NSE, *vide* Circular No NSE/INVG/2006/7236 dated 3rd March, 2006 and BSE, *vide* Notice No – 20060704 – 6 dated 4th July, 2006, made the KYC Norms enforceable.



Requirement of Internal Audit



The Scope of the Internal Audit shall cover, inter alia:



1. *The Existence, Scope and Efficiency of the Internal Control System*
2. *Compliance with*
 - *Provisions of the SEBI Act, 1992*
 - *Provisions of the Securities Contracts (Regulation) Act, 1956*
 - *Bye Laws of the Exchange*
 - *Data Security*
3. *Insurance in respect of the operations of Stock Brokers / Clearing Members.*
4. *Circulars issued by SEBI*
5. *KYC Requirements*

Thank
You



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