

COST AUDIT

FOR WHAT PURPOSES THE COST AUDITOR REFERS TO FINANCIAL RECORDS WHILE CONDUCTING COST AUDIT OF AN ENTITY?

- A cost auditor expresses an opinion as to whether the company has maintained proper cost accounting records so as to give a true and fair view of cost of production, etc.
- He is required to ascertain the cost of raw materials consumed, cost of power, cost of stock, employer costs, provision for depreciation, fuel etc.
- Annexure to the cost audit reports require detailed information in respect of financial position including capital employed, net worth, profit, net rates, operating profit, total wages and salaries, etc.
- Thus, cost audit cannot be done without reference to financial books.
- Moreover, there is a statutory requirement to have a statement of reconciliation with financial accounts as part of cost audit report.
- Further the cost statements also contain a summary of all expenditure incurred by the company.
- Naturally this can be done only with reference to financial ledger.
- Material discrepancy between financial records and cost records will be highlighted in the reconciliation statement requiring the cost auditor to examine deviation before reporting on the same.
- Thus it is clear that the cost auditor needs to refer to financial records for conducting the cost audit.



AUDIT OF STOCK EXCHANGE

CIRCUIT FILTERS /CIRCUIT BREAKERS

- (a) This is the price band that set the upper and lower limit within which a stock can fluctuate on any particular day.
- (b) A price band for a day is a function of the previous days closing price.
- (c) According to SEBI directions circuit filter is applied on scrips traded in rolling settlement, if their price fluctuate more than 10% of the closing price of scrip on the previous day.
- (d) Thus circuit filters restrict extreme price movement and resist price manipulation.
- (e) This also protects investor from extreme fluctuations.

PURPOSES OF APPOINTING INSPECTING OFFICER OF A DEPOSITORY

SEBI appoints inspecting officers to investigate or inspect the affairs of a depository for any of the following purposes:

- (1) To ensure that the books of accounts are maintained in the names specified in the regulations.
- (2) To look into the complaints received from depositor's participant, beneficial owners or other persons.



- (3) To ascertain whether the provisions of the Act, bye-laws agreements and these regulations are being complied.
- (4) To ascertain whether the systems, procedures and safeguards are being followed in the interests and to secure the market.
- (5) To ensure that the affairs are being conducted in the interest of the Investors/Securities markets.

CONTRACT NOTES IN CASE OF AUDIT OF MEMBER OF STOCK EXCHANGE

Contract note is a document through which a contractual obligation is established between a member and a client. Every member of the stock-exchange has to issue contract notes to his clients for the trades executed on their behalf. The contract notes should be issued to the client within 24 hours of execution of the trades. Members are also required to preserve counter-toils or duplicates of the copies of contract notes issued to clients. The member is also required to maintain written consent of clients for the contracts entered into as Principal. Contract notes should show the brokerage separately. The total brokerage charged by the member should not exceed the specified value of the-trade.



STOCK EXCHANGE

It may be noted that the brokerage percentage is prescribed from time to time.

The Contract Notes should be signed by the member or his constituted attorney. When a sole proprietor or partnership firm wishes to authorise another person to sign the contract notes, then the member is required to submit a power of attorney to the Exchange. In case of corporate membership, a board resolution is required to authorize a person including Directors to sign the contract notes.

The member thereafter prepares a Contract Note in the prescribed form after adding the brokerage and sends the original Contract Note to the client. The auditor should evaluate the internal control procedures instituted by the stock broker for proper maintenance and issuance of contract notes. He should verify that the transactions done by a member are recorded in the sauda book. It should also be examined that contract notes are issued for all the business conduct on behalf of the clients. The auditor should verify the trades executed with the bills raised.

"MARGINS" OR DEPOSITS WITH STOCK EXCHANGES

The exchanges witness wide fluctuations in prices of securities over a period of time. in order to restrict excessive speculations and safeguard the interest of the investors, members are- required to maintain certain deposits with the exchange. The members are required to collect margins from their clients and deposit it with clearing house.

There are three types of margins:

- (i) **Mark to market margin:** The objective of this margin is to cover a loss that a member may incur in case the transaction is closed out at the closing price of the trading day, which is different from the price at which the transaction has been entered into.
- (ii) **Volatility Margin:** The volatility margin is imposed to curb excessive volatility in the market and to prevent building up of excessive outstanding positions.
- (iii) **Gross Exposure Margin:** Gross exposure margin is the percentage of net cumulative outstanding positions (purchases or sales) in each security that the member should keep with the exchange.

ROLLING SETTLEMENTS

A rolling settlement is one in which trades outstanding at the end of the day have to be settled (payments made for purchases or deliveries in the case of sale of securities)

Rolling settlement was first introduced at the over the counter exchange of India (OTCEI) on a T+3 basis. The specified business days are expressed as T+No. of days from the transaction date (T= Transaction date) for example, under "T+2" Rolling settlement, a transaction entered into a Monday should be settled on immediate Wednesday, when the pay-in or payout takes place.

Trades on each single day are settled separately from the trades done earlier or subsequent trade days. The netting of trades is done only for the day and not for multiple days. Under this scheme the pay-in and pay-out of funds are effected on same day.

For rolling settlement to be successful three essential prerequisites are:

1. Electronic trading of shares.
2. Equity derivatives.
3. Stock lending and borrowing schemes.

While rolling settlement is technically possible with physical certificates the infrastructure required is not forthcoming. At the stock exchange level, rolling settlement with physical certificates would involve daily pay-in, pay-out, withdrawal, daily auction and deposits of scrips. The introduction of rolling settlement would most, probably result in the demise of the badla system.

In case, a member fails to deliver the shares sold in rolling settlement, the stock exchange conducts an auction session on T+6, to meet the short fall created by non-delivery of shares. In this auction session, offers are invited from other members to deliver the shares sold by originally selling member since delivery has to be made to the buying member. In case no shares are received in auction, the sale transaction is closed-out at a close-out price, determined by higher of the following:

- Higher price recorded in the scrip from the settlement in which the transaction took place upto a day prior to the auction, or
- 20% above the closing price on a day prior to the auction.

In this case, the auction price/close-out and difference between sale price, if positive is payable by the seller. Who failed to deliver the scrips, in case, auction/close out price is less than sale price, the difference is not given to seller but is credited to investor protection fund.

HIT OR TAKE ORDERS

Hit or take orders occur in screen-based trading in stock exchange, this is a variation of market orders. It allows for faster order execution without cluttering up the limit order book. This method converts the key strokes or mouse clicks of the broker into a limit order at the touch line price for particular scrip, without his having to place a limit order. Further all unexecuted orders of this type are automatically killed and are therefore not stored in the order book.

A broker interested in particular scrip would ask the system to display the touch line of that scrip. He would then operate certain predefined keys or mouse clicks which would be different for buy and sell orders. The system would ask the broker to identify the client and to quantify the order. The system would then convert his buy or sell order for the quantity specified into a limit order and attach the touch line offer price for a buy order or a touch line bid price for a sell order. This order will be matched against jobber quotes and the order book for the quantity can be executed. The unexecuted quantity if any will be killed and removed from the system.

TYPES OF MARKET UNDER NEAT (NATIONAL EXCHANGE AUTOMATED TRADING)

Broadly, there are four types of market under national exchange automated trading.

1. **Normal Market:** All orders which are of the regular lot size or multiples thereof are traded in Normal Market.
2. **Odd Lot Market:** An order is called, an odd lot order if the order size is less than the regular lot size, such orders have different settlement periods vis-a-vis normal orders.
3. **Spot Market:** In all respects spot orders are similar to the normal market orders except that spot orders have different settlement periods vis-a-vis normal orders.

4. **Auction Market:** Stock exchanges on behalf of their members initiate auctions to purchase from the market, the number of shares short deposited by the members. In this way, they complete the settlement process.

ENERGY AUDITOR

INTRODUCTION

Energy auditing is as an activity that serves the purpose of assessing energy use pattern of a factory or energy consuming equipment and “identifying energy saving opportunities. In that context, energy management involves the basis approaches reducing avoidable losses, improving the effectiveness of energy use, and increasing energy use efficiency. The function of an energy auditor can be compared with that of a financial auditor. The energy auditor is usually expected to give recommendations on efficiency improvements leading to monetary benefits and also advise on energy management issues. Generally, energy auditor for the industry is an external party.

FUNCTIONS OF ENERGY AUDITOR

The following are some of the key functions of the energy auditor.

- (i) Quantity energy costs and quantities
- (ii) Correlate trends of production or activity to energy costs
- (iii) Devise energy database formats to ensure they depict the correct picture— by product, department, consumer, etc.
- (iv) Advise and check the compliance of the organisation for policy and regulation aspects.
- (v) Highlight areas that need attention for detailed investigations
- (vi) Conduct preliminary and detailed energy audits which should include the following:
 - (a) Data collection and analysis.
 - (b) Measurements, mass and energy balances.
 - (c) Reviewing energy procurement practices
 - (d) Identification of energy efficiency projects and techno-economic evaluation
 - (e) Establishing action plan including energy saving targets, staffing requirements, implementation time requirements, procurement issues, details and cost estimates.
 - (f) Recommendations on goal setting for energy saving, record keeping, reporting and energy accounting, organisation requirements, communications and public relations.

ENVIRONMENTAL AUDIT

Environmental Audit is an Assessment of the Nature and extent of any harm or detriment or any possible harm or detriment, which may be inflicted on any aspect of the environment by any activity process development programme, or any product chemical, or waste substance.

Audits may be designed to:

- 1. Verity or other wise comply with environmental requirements
- 2. evaluate the effectiveness of existing environmental management systems.
- 3. assess risks generally; or
- 4. assist in planning for future improvements in environment protection and pollution control.



MAIN AREAS TO BE COVERED IN ENVIRONMENT AUDIT OF INDUSTRIAL UNIT

Key Code: **ENVIRONMENT**

1. **Emergency safety Arrangement:** Safety arrangements should remain alert all the time. Staff equipped with requisite awareness and alertness should be engaged to meet contingency.
2. **No Wastage of Resource:** Resources include air, water, land, energy, raw materials and human resources etc. Use of all are interlinked and the best- use in a harmonized manner results in, the best output and minimum waste.
3. **Very Hygienic i.e. Industrial Hygiene:** A proper system should be established to eliminate industrial unhygienic state.
4. **Information Assimilation and Reporting System:** information System should be strengthened to generate and its reporting system should be proper. A report of compliance of all statutory environmental law should be put to Board at regular intervals.
5. **Regulatory Mechanism:** Persons who are directly working with the system are generally unaware of the latest developments and requirements for the compliance of stipulations and standards prescribed by the various regulatory authorities.
6. **Occupational Health:** Safeguards against occupational Health hazards should be made available for all the workers.
7. **No damage to the Society:** This aspect should be considered to make a balance between its own development and the society concern
8. **Medical & Healthcare:** Adequate medical facilities should be maintained.
9. **Environmental Impact Assessment:** The system should be designed to accommodate deviations in predictions from the actual happening.
10. **No Pollution i.e Pollution Control System:** An effective system of pollution control should be in existence. The efficacy of the pollution control measure system should be ascertained.
11. **Total Layout and Design:** The layout should be designed to allow adequate provisions for installing pollution control devices. it should also accommodate up gradation of pollution control measures

CONTENTS OF AUDIT REPORT OF MUTUAL FUND

The auditor's report shall comprise the following:

1. Whether he has obtained all information explanations which, to the best of his knowledge and belief, were necessary for the purpose of the audit.
2. Whether the balance sheet and revenue account give a fair and true view of the scheme, state of affairs and surplus or deficit in the fund for the accounting period to which the Balance sheet or, as the case may be the Revenue account relates.
3. Whether the statement of account has been prepared in accordance with accounting policies and the standards as specified in Ninth Schedule.



Q1) What are the key functions of an Energy Auditor?

Answer:

Energy auditing is as an activity that serves the purpose of assessing energy use pattern of a factory or energy consuming equipment and “identifying energy saving opportunities. In that context, energy management involves the basis approaches reducing avoidable losses, improving the effectiveness of energy use, and increasing energy use

efficiency. The function of an energy auditor can be compared with that of a financial auditor. The energy auditor is usually expected to give recommendations on efficiency improvements leading to monetary benefits and also advise on energy management issues. Generally, energy auditor for the industry is an external party. The following are some of the key functions of the energy auditor.

- (i) Quantity energy costs and quantities
- (ii) Correlate trends of production or activity to energy costs
- (iii) Devise energy database formats to ensure they depict the correct picture— by product, department, consumer, etc.
- (iv) Advise and check the compliance of the organisation for policy and regulation aspects.
- (v) Highlight areas that need attention for detailed investigations
- (vi) Conduct preliminary and detailed energy audits which should include the following:
 - (a) Data collection and analysis.
 - (b) Measurements, mass and energy balances.
 - (c) Reviewing energy procurement practices
 - (d) Identification of energy efficiency projects and techno-economic evaluation
 - (e) Establishing action plan including energy saving targets, staffing requirements, implementation time requirements, procurement issues, details and cost estimates.
 - (f) Recommendations on goal setting for energy saving, record keeping, reporting and energy accounting, organisation requirements, communications and public relations.

Q2) Enumerate the main areas to be covered by the auditor in the case of environment audit of an industrial unit.

Answer:

Main Areas To Be Covered In Environment Audit Of Industrial Unit

- 1. Layout and Design:** The layout should be designed to allow adequate provisions for installing pollution control devices. It should also accommodate up gradation of pollution control measures.
- 2. Resource Management:** Resources include air, water, land, energy, raw materials and human resources etc. Use of all are interlinked and the best- use in a harmonized manner results in, the best output and minimum waste.
- 3. Pollution Control System:** An effective system of pollution control should be in existence. The efficacy of the pollution control measure system should be ascertained.
- 4. Emergency safety Arrangement:** Safety arrangements should remain ale|1 all the time. Staff equipped with requisite awareness and alertness should be engaged to meet contingency.
- 5. Medical & Healthcare & Industrial Hygiene:** Adequate medical facilities should be maintained. A proper system should be established to eliminate industrial unhygienic state.
- 6. Information Assimilation and Reporting System:** information System should be strengthened to generate and its reporting system should be proper. A report of compliance of all statutory environmental law should be put to Board at regular intervals. .
- 7. Regulatory Mechanism:** Persons who are directly working with the system are generally unaware of the latest developments and requirements for the compliance of stipulations and standards prescribed by the various regulatory authorities.
- 8. Environmental Impact Assessment:** The system should be designed to accommodate deviations in predictions from the actual happening.
- 9. Concern for the Society:** This aspect should be considered to make a balance between its own development and the society concern
- 10. Occupational Health:** Safeguards against occupational Health hazards should be made available for all the workers.

Q3) Write a short note on Rolling Settlements.

Answer:

A rolling settlement is one in which trades outstanding at the end of the day have to be settled (payments made for purchases or deliveries in the case of sale of securities)

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- 20% above the closing price on a day prior to the auction.

In this case, the auction price/close-out and difference between sale price, if positive is payable by the seller. Who failed to deliver the scrips, in case, auction/ close out price is less than sale price, the difference is not given to seller but is credited to investor protection fund.

Q4) State the items contained in SEBI’s checklist for auditors in respect of contract notes issued by a Stock Broker.

Answer:

Contract note is a document through which a contractual obligation is established between a member and a client. Every member of the stock-exchange has to issue contract notes to his clients for the trades executed on their behalf. The contract notes should be issued to the client within 24 hours of execution of the trades. Members are also required to preserve counter-toils or duplicates of the copies of contract notes issued to clients. The member is also required to maintain written consent of clients for the contracts entered into as Principal. Contract notes should show the brokerage separately. The total brokerage charged by the member should not exceed the specified value of the-trade.

It may be noted that the brokerage percentage is prescribed from time to time. The Contract Notes should be signed by the member or his constituted attorney. When a sole proprietor or partnership firm wishes to authorise another

person to sign the contract notes, then the member is required to submit a power of attorney to the Exchange. In case of corporate membership, a board resolution is required to authorize a person including Directors to sign the contract notes.

The member thereafter prepares a Contract Note in the prescribed form after adding the brokerage and sends the original Contract Note to the client. The auditor should evaluate the internal control procedures instituted by the stock broker for proper maintenance and issuance of contract notes. He should verify that the transactions done by a member are recorded in the sauda book. It should also be examined that contract notes are issued for all the business conduct on behalf of the clients. The auditor should verify the trades executed with the bills raised.

Q5) Write a short note on:

- a) **Contract Notes**
- b) **Sauda Book**

Answer:

(a) Contract Notes: Contract note is a document through which a contractual obligation is established between a member and a client. Every member of the stock-exchange has to issue contract notes to his clients for the trades executed on their behalf. The contract notes are required to be issued to the Client within 24 hours of execution of the trades. Members are also required to preserve counter-foils or duplicates of the copies of contract notes issued to clients. The member is also required to maintain written consent of clients for the contracts entered into as Principal. Contract notes issued to clients should show the brokerage separately. The total brokerage charged by the member should not exceed the specified value of the trade. It may be noted that the brokerage percentage is prescribed from time to time. The Contract Notes are required to be signed either by the member himself or his constituted attorney. In case of a sole proprietor / partnership firm wishes to authorise another person to sign the contract notes, then the member is required to submit a power of attorney to the Exchange. In case of corporate membership, a board resolution is required to authorise a person including Directors to sign the contract notes.

The member then prepares a Contract Note in the prescribed form after adding the brokerage and sends the original Contract Note to the client. The auditor should evaluate the internal control procedures instituted by the stock broker for proper maintenance and issuance of contract notes. The auditor should verify that the transactions done by a member are recorded in the sauda book. It should also be examined that contract notes are issued for all the business conducted on behalf of the clients. The auditor should verify the list of trades executed with the bills raised. The auditor should apply appropriate audit procedures to satisfy himself that –

- (i) Contract notes have been serially numbered.
- (ii) No serial number has been left blank.
- (iii) Format of the Contract Note is as prescribed by the Regulations of the Exchange.
- (iv) Duplicate copies / counterfoils of contract notes are maintained.
- (v) Brokerage charged in contract notes is within the permissible limits and is indicated separately including service tax.
- (vi) Contract notes have been signed by an authorised person.
- (vii) Contract notes have been issued in respect of all transactions.
- (viii) Transaction Identification, Trade Identification and Trade Execution time has been printed on the contract note issued.
- (ix) SEBI Registration number, Settlement number, Settlement dates have been mentioned.
- (x) PAN number of the member and client has been mentioned on Contract Note where if required.
- (xi) All clauses specified by the Exchange have been printed on the reverse of the contract notes.

(b) Sauda Book: All members are required to maintain a 'Sauda Book', which contains details of all deals transacted by them on a day to day basis. This is a basic record, which each member is required to maintain regularly on day-to-

day basis. It contains the details regarding the name of the code of the client on whose behalf the deals have been done, rate and quantity of bought or sold. These details are maintained date wise. This register contains all the transactions, which may be of any of the kind mentioned below:

- (i) member's own business on the Exchange;
- (ii) member's business on the Exchange on behalf of clients;
- (iii) member's business with the clients on principal-to-principal basis;
- (iv) member's business with the members of other Stock Exchanges;
- (v) member's business on behalf of his clients with the members of other Stock Exchanges;
- (vi) Spot transactions, etc.

Q6) Write a note on the following:

- a) **Margins (Under Stock Exchange Trading Regulations)**
- b) **Types of market under NEAT (National Exchange Automated Trading)**

Answer:

(a) Margins: The exchanges witness wide fluctuations in prices of securities over a period of time. In order to restrict excessive speculations and safeguard the interest of the investors, members are required to maintain certain deposits with the exchange. The members are required to collect margins from their clients and deposit it with clearing house. There are three types of margins:

- (i) **Mark to market margin:** The objective of this margin is to cover a loss that a member may incur in case the transaction is closed out at the closing price of the trading day, which is different from the price at which the transaction has been entered into.
- (ii) **Volatility Margin:** The volatility margin is imposed to curb excessive volatility in the market and to prevent building up of excessive outstanding positions.
- (iii) **Gross Exposure Margin:** Gross exposure margin is the percentage of net cumulative outstanding positions (purchases or sales) in each security that the member should keep with the exchange.

(b) Types of market under NEAT: Broadly, there are four types of market under national exchange automated trading.

- 1. **Normal Market:** All orders which are of the regular lot size or multiples thereof are traded in Normal Market.
- 2. **Odd Lot Market:** An order is called, an odd lot order if the order size is less than the regular lot size, such orders have different settlement periods vis-a-vis normal orders.
- 3. **Spot Market:** In all respects spot orders are similar to the normal market orders except that spot orders have different settlement periods vis-a-vis normal orders.
- 4. **Auction Market:** Stock exchanges on behalf of their members initiate auctions to purchase from the market, the number of shares short deposited by the members. In this way, they complete the settlement process.

Q7) Write a short note on - Circuit Filters/Circuit Breakers (as specified by SEBI).

Answer:

- (i) This is the price band that sets the upper and lower limit within which a stock can fluctuate on any particular day.
- (ii) A price band for a day is a function of the previous day's closing price.
- (iii) According to SEBI directions, circuit filter is applied on scrips traded in rolling settlement, if their price fluctuates more than 10% of the closing price of scrip on the previous day.
- (iv) Thus circuit filters restrict extreme price movement and resist price manipulation.
- (v) This also protects investor from extreme fluctuations.

Q8) Write a note on the following:

- a) Environmental Audit
- b) Probable Format of Environmental Statement

Answer:

a) Environmental Audit is an Assessment of the Nature and extent of any harm or detriment or any possible harm or detriment, which may be inflicted on any aspect of the environment by any activity process development programme, or any product chemical, or waste substance.

Audits may be designed to:

1. Verify or otherwise comply with environmental requirements
2. evaluate the effectiveness of existing environmental management systems.
3. assess risks generally; or
4. assist in planning for future improvements in environment protection and pollution control.

The aspects to be considered while conducting an environmental audit are:

1. Layout and design.
2. Management of Resources.
3. Pollution control systems.
4. Emergent Safety system.
5. Medical and Health care facilities.
6. industrial hygiene.
7. Occupational health.
8. Information Assimilation and reporting system
9. Compliance to the Regulatory mechanism.
10. Concern for the Society.

b) Probable format of “Environmental Statement”: The following are the main aspects which may be covered in the probable format of “Environmental Statement” -

- (i) Name and address of the owner/occupier of the industry, operation or process.
- (ii) Date of last environmental audit report submitted.
- (iii) Consumption of water and other raw materials as input during current and previous year.
- (iv) Pollution generated in air and water along with the output and the types of pollutants and the deviation from standard.
- (v) Generation of hazardous waste (in line with the Hazardous Waste Management and Handling Rules, 1989) in current year and previous year from processes or from pollution control facility.
- (vi) Quantity of solid waste generated during current year and previous year from processes from pollution control facility and from recycling or reutilisation of waste, etc.
- (vii) The disposal practice for different type of waste.
- (viii) The practice sorted for conservation of natural resources.
- (ix) The additional investment proposal for environmental protection including abatement of pollution.

Q9) Write a short note on Contents of Audit report of Mutual Fund.

Answer:

The auditor's report shall comprise the following:

1. Whether he has obtained all information explanations which, to the best of his knowledge and belief, were necessary for the purpose of the audit.
2. Whether the balance sheet and revenue account give a fair and true view of the scheme, state of affairs and surplus or deficit in the fund for the accounting period to which the Balance sheet or, as the case may be the Revenue account relates.
3. Whether the statement of account has been prepared in accordance with accounting policies and the standards as specified in Ninth Schedule.

Q10) Write a short note on the purpose of appointing Inspecting officer of a Depository

Answer:

SEBI appoints inspecting officers to investigate or inspect the affairs of a depository for any of the following purposes:

- (1) To ensure that the books of accounts are maintained in the names specified in the regulations.
- (2) To look into the complaints received from depositor's participant, beneficial owners or other persons.
- (3) To ascertain whether the provisions of the Act, bye-laws agreements and these regulations are being complied.
- (4) To ascertain whether the systems, procedures and safeguards are being followed in the interests and to secure the market.
- (5) To ensure that the affairs are being conducted in the interest of the Investors/Securities markets.