UNIT 7 : AUDIT OF DEPOSITORIES

1. REGULATORY FRAMEWORK

The SEBI (Depositories and Participants) Regulations, 1996 empower SEBI to conduct inspection and audit. The regulation requires that depositories shall have adequate mechanisms for the purposes of reviewing monitoring and evaluating the depository’s controls systems, procedures and safeguards.

The legal framework for a depository system has been laid down by the Depositories Act, 1996 and is regulated by SEBI. The depositories are regulated by –

- The Depositories Act, 1996
- The SEBI (Depositories and Participants) Regulations, 1996
- Bye-laws of Depository

Apart from the above, Depositories are also governed by certain provisions of the Companies Act, the Indian Stamp Act, Securities and Exchange Board of India Act, Securities Contracts (Regulation) Act, Benami Transaction (Prohibition) Act, Income Tax Act, 1961 and Prevention of Money Laundering Act etc.

Depositories are required to maintain the following records and documents, namely:

(a) records of securities dematerialised and rematerialised;
(b) the names of the transferor, transferee, and the dates of transfer of securities;
(c) a register and an index of beneficial owners;
(d) details of the holding of the securities of beneficial owners as at end of each year.
(e) records of instructions received from and sent to participants, issuers, issuers’ agents and beneficial owners;
(f) records of approval, notice, entry and cancellation or pledge or hypothecation, as the case may be;
(g) details of participants;
(h) details of securities declared to be eligible for dematerialisation in the depository; and
(i) such other records as may be specified by the Board for carrying on the activities as a depository.

* Source : CS Mukesh H Shah
Every depository shall intimate the Board the place where the records and documents are maintained. Subject to the provisions of any other law the depository shall preserve records and documents for a minimum period of five years.

Where records are kept electronically by the depository, it shall ensure that the integrity of the automatic data processing systems is maintained at all times and take all precautions necessary to ensure that the records are not lost, destroyed or tampered with and in the event of loss or destruction, ensure that sufficient back up of records is available at all times at a different place.

Some of the regulations of the SEBI (Depositories and Participants) Regulations, 1996 relating to inspection or investigation are discussed below:

2. BOARD'S RIGHT TO INSPECT (REGULATION 59)

The SEBI has also the power to appoint one or more persons as inspecting officer to undertake inspection of the books of account, records, documents and infrastructure, systems and procedures, or to investigate the affairs of a depository, a participant, a beneficial owner an issuer or its agent for any of the following purposes, namely:

(a) to ensure that the books of account are being maintained by the depository, participant, issuer or its agent in the manner specified in these regulations;

(b) to look into the complaints received from the depositaries, participants, issuers, issuers’ agents, beneficial owners or any other person;

(c) to ascertain whether the provisions of the Act, the Depositories, the bye-laws, agreements and these regulations are being complied with by the depository, participant, beneficial owners, issuer or its agent;

(d) to ascertain whether the systems, procedures and safeguards being followed by a depository, participant, beneficial owners, issuer or its agent are adequate;

(e) to suo motu ensure that the affairs of a depository, participant, beneficial owner, issuer or its agent, are being conducted in a manner which are in the interest of the investors or the securities market.

3. NOTICE BEFORE INSPECTION AND INVESTIGATION (REGULATION 60)

(1) Before ordering an inspection or investigation under regulation 59, the Board shall give not less than 10 days notice to the depository, participant, beneficial owner, issuer or its agent, as the case may be.
(2) Notwithstanding anything contained in sub-regulation (1), where the Board is satisfied that in the interest of the investors no such notice should be given, it may, by an order in writing direct that such inspection be taken up without such notice.

(3) During the course of an inspection or investigation, the depository, a participant, a beneficial owner, an issuer or its agent against whom the inspection or investigation is being carried out shall be bound to discharge his obligation as provided in regulation 61.

4. OBLIGATIONS ON INSPECTION BY THE BOARD (REGULATION 61)

(1) It shall be the duty of the depository, a participant, a beneficial owner, an issuer or its agent whose affairs are being inspected or investigated, and of every director, officer and employee thereof, to produce to the inspecting officer such books, securities, accounts, records and other documents in its custody or control and furnish him with such statements and information relating to his activities as a depository, a participant, a beneficial owner, an issuer or its agent, as the inspecting officer may require, within such reasonable period as the inspecting officer may specify.

(2) The depository, a participant, a beneficial owner, an issuer or its agent shall allow the inspecting officer to have reasonable access to the premises occupied by him or by any other person on his behalf and also extend reasonable facility for examining any books, records, documents and computer data in the possession of the depository, a participant, a beneficial owner, an issuer or its agent or such other person and also provide copies of documents or other materials which, in the opinion of the inspecting officer are relevant for the purposes of the inspection.

(3) The inspecting officer, in the course of inspection of investigation, shall be entitled to examine or to record the statements of any director, officer or employee of the depository, a participant, a beneficial owner, an issuer or its agent.

(4) It shall be the duty of every director, officer or employee of the depository, a participant, a beneficial owner, an issuer or its agent to give to the inspecting officer all assistance in connection with the inspection, which the inspecting officer may reasonably require.

The inspecting officer shall, as soon as possible, on completion of the inspection or investigation submit a report to the Board. He may also be required to submit an interim report if directed by the Board.

5. AUDITOR AND ITS POWERS

The SEBI has power to appoint an auditor to inspect or investigate, into the books of account, records, documents, infrastructures, systems and procedures or affairs of a depository, a participant,
a beneficial owner, an issuer or its agent:

It is also provided that the auditor so appointed shall have the same powers of the inspecting or investigating officer as stated in regulations 59 and 60, and the obligation of the depository, participant, beneficial owner, issuer or its agent and their respective directors, officers and employees, as the case may be, as stated in regulation 61, shall be applicable to the inspection or investigation under this regulation.

6. RETURN OF DEPOSITS TO BE FILED WITH THE REGISTRAR

Rule 16 of the Companies (Acceptance of Deposits) Rules, 2014 requires, every company to which these rules apply shall, on or before the 30th day of June of every year, file with the Registrar, a return in the prescribed Form along with the specified fee and furnishing the information contained therein as on 31st day of March of that year, duly audited by the auditor of the company.

7. INSPECTION REPORT

The Inspection Report should be drafted in a manner that it provides sufficient insight into the operations. As suggested in the Contents and Format of Inspection Report, Inspection report should be divided in 4 parts.

1. Executive Summary
2. Observations
3. Checklist
4. Annexure