

## Special Audit Assignments

### Question 1

*Write a short note on Market Wide Circuit Breaker (MWCB). (4 Marks, November, 2014)*

### Answer

**Market Wide Circuit Breakers (MWCB):** Market wide circuit breakers do the same job for the entire market what circuit filters do for individual scrips. MWCB has been introduced to control excessive market movements in BSE sensex and Nifty. SEBI has introduced MWCB at 10-15-20% of the movements in these indices. The stock exchange on a daily basis shall translate the 10%, 15% and 20% circuit breaker limits of market-wide index variation based on the previous day's closing level of the index. These breakers provide the time to participants to react to the movement by way of the trading halt. Additionally, a 15 minutes pre-opening session post each trading halt has been introduced vide SEBI Circular No.CIR/MRD/DP/25/2013 dated September 3, 2013.

The trigger limits and the respective halt duration is given below:

Trigger Limit	Trigger Time	Trading halt duration	Pre-opening session duration post each halt
10%	Before 1 P.M.	45 Minutes	15 Minutes
	On or After 1 P.M. to 2.30 P.M.	15 Minutes	15 Minutes
	On or after 2.30 P.M.	No Trading Halt	-
5%	Before 1 P.M.	1 Hour 45 minutes	15 Minutes
	On or after 1 P.M. before 2 P.M.	45 Minutes	15 Minutes
	On or after 2 P.M.	Trading halt for the remaining period of the day.	-
20%	Any time of the day	Trading halt for the remaining period of the day.	-

**Basis for calculating percentages for MWCB:** These percentages are not calculated on a day-to-day basis rather they are fixed for a quarter. These are fixed in absolute points of index variation on the basis of the closing of index on the last trading day of previous quarter and are reported in advance to the market participants at the beginning of the relevant quarter.

Question 2

*Good Bank Ltd. intends to advance to a customer, based on the stocks and receivables. It appoints you to conduct a periodical review of status of stocks and receivables of that borrower. Please draft a suitable program of verification. (5 Marks, May, 2014)*

Answer

Program of Verification for Status of Stock and Receivables: As an auditor for conducting the periodical review of stock and receivables, suitable program of verification will include-

(A) Verification Program for Stock:

- (i) Observe Physical Inventory- Inspect the premises to ensure the arrangement of inventory is such that an accurate count is possible.
- (ii) Determine whether scrap, obsolete, damaged goods and sold inventory are adequately identified and segregated.
- (iii) Examine issues transactions and supporting documentation for a period before the balance sheet date and determine that goods issued before the balance sheet date have been excluded from raw materials inventory.
- (iv) Test the costing of the detailed priced inventory listings to obtain a moderate to low level of assurance that accuracy is achieved by tracing unit costs of inventory items to and from suppliers' invoices.
- (v) Inspect the authentication of all the documents related to the insurance coverage of the inventory.

(B) Verification Program for Receivables:

- (i) Trace totals to the comparative summary of accounts receivable balances.
- (ii) Assess the adequacy of allowance for doubtful accounts by reviewing and testing the process used by management to develop their estimate of collectability. Consider the reasonableness of bad debt expense compared with prior years.
- (iii) Select sales and credit memoranda to obtain a moderate to low level of assurance that cutoff is achieved by reviewing the cutoff at the time of inventory taking and at year-end.
- (iv) By doing aging analysis of receivables.
- (v) Ensure if any litigations or dispute is going on in respect of receivables.

Question 3

*Write a short note on Environment Impact Assessment. (4 Marks, November, 2013)*

Answer

Environment Impact Assessment: The Environmental Impact Assessment (EIA) is usually pre-requisites to start an industry. This is done considering the known spheres of activities on the existing environmental conditions. But the predictions necessarily deviate from the actual

happenings when the industry starts working. To accommodate the deviation in the system is also to be incorporated in the EIA report, if it is noticed that the degradation to the environment caused on the establishment and running of the industry is much higher than what was predicted, the mitigatory measures suggested must also be furthered.

#### Question 4

Write a short note on Volatility Margin, its computation and its application. (4 Marks, May, 2013)

#### Answer

**Volatility Margin:** Volatility margin is imposed to curb excessive volatility in the market and to act as a deterrent to building up of excessive outstanding positions.

**Computation:** Price variations on account of calls, bonuses, rights, mergers, amalgamations and schemes of arrangements are adjusted for determining volatile securities and adjustments in prices is made for the purpose of computation of volatility, when securities are traded ex-benefits.

**Application:** Securities that attract volatility margin and the applicable margin rates are announced on the last day of the trading cycle and are applicable from the first day of the succeeding trading cycle. The volatility margin is levied on the net outstanding positions of the member, in each security, based on the respective margin rates.

#### Question 5

Write short notes on the following:

- (a) *Circuit filters/Circuit breakers.* (4 Marks, November, 2012) (5 Marks, November, 2010)  
(4 Marks, November, 2008) (4 Marks, November, 2007)
- (b) *Environmental Audit.* (4 Marks, November, 2012)

#### Answer

##### (a) Circuit Filters/Circuit Breakers:

- (i) This is the price band that set 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 fluctuate more than 20% of the closing price of scrip on the previous day in any direction.
- (iv) However, feeling the threat of high settlement default in scrips forming part of sensex or in which derivatives and futures are available, because of these filters, SEBI has restricted the fluctuation to 10% instead of 20%.
- (v) Thus circuit filters restrict extreme price movement and resist price manipulation.
- (vi) This also protects investor from extreme fluctuations.

- (b) **Environmental Audit:** To understand environmental audit, firstly environmental reporting need to be understood. Environmental reporting deals with the disclosure by an entity of environmentally related data, regarding environmental risks, environmental impacts, policies, strategies, targets, costs, liabilities or environmental performance to those who have an interest in such information as an aid to enabling/enriching their relationship with the reporting entity via either the annual report; a stand-alone corporate environmental performance report; or some other medium (e.g. staff newsletter, video, CD ROM, internet site). The reports that are generated after such audits can be either compliance-based reporting or impact-based performance reporting.

Environmental audit deals with verification of information contained in such reports with a view to expressing an opinion thereon. Environmental audit can be performed by external agencies or internal experts (including internal auditors). In practice, environmental audit is not done by a single agency but by various agencies who are experts in the field. Since the subject matter of environmental audit involves multi-disciplinary knowledge and skill, it is preferable to form a team of persons drawn from different disciplines who may assist the chartered accountant in performing the task in an effective manner, generally environmental audits are not required by any statute but are sometimes done at the request of the management to address issues like compliance with environmental laws and regulations, etc.

#### Question 6

*Write short notes on the following:*

- (a) *Mark to Market Margin.* (4 Marks, May, 2012) (4 Marks, May, 2010)
- (b) *Matter to be reported in respect of inventory in the case of a special audit of a non-corporate borrower of a Bank.* (4 Marks, May, 2012)

#### Answer

- (a) **Mark to Market Margin (MTM):** MTM margin is the notional loss, which a stock member or his client would incur, if the net cumulative outstanding positions in all securities were closed out at the closing price of the relevant trading day, which is different from the price at which the transaction had been entered into. For each security, this is worked out by multiplying the difference between the closing price and the price at which the trade was executed by the cumulative buy and sell open position (for buy position the close price being lower than actual trade price and for sell position the close price being higher than actual trade price). The aggregate amount computed across all securities is MTM margin payable by a member. The mark-to-market margin is payable with reference to net position at client's level.
- (b) **Matter to be Reported in Respect of Inventory in the case of a Special Audit of a Non-Corporate Borrower of a Bank:** A lending bank may, in special cases, require the non-corporate entity to obtain a special report from the auditor. Such a report can be called by a lending bank if it finds that it is necessary to have more information about the working of the entity. In such a case the report will have to be given by the auditor on a

quarterly basis. The special audit report which is to be given on a quarterly basis in the specified form is in addition to the normal audit report which is to be given by the auditor on a yearly basis.

- (i) In the quarterly special audit report, the auditor will have to give information relating to the operating data for each quarter. This information will have to be classified in the actual production; actual production as a percentage of rated capacity, sales, cost of goods sold/cost of production, gross margin, interest on bank borrowing etc. Further, the age-wise classification of raw materials and finished goods is to be given.
- (ii) For this purpose, age-wise classification is to be made in the following manner in respect of raw materials and finished goods separately:
  - (a) Inventory for more than 1 year
  - (b) Between 6 months and 1 year
  - (c) Between 3 months and 6 months
  - (d) Below 3 months.

Similar information about the work-in-progress (i.e. the number of days of production which remains in progress) should also be given.

The basis of the valuation of raw material and finished goods should be given. For this purpose, the following information is to be given:

- (a) The manner of determination of cost (i.e. components of cost).
- (b) The method of valuing stock i.e. FIFO, weighted average cost.

#### Question 7

*State the functions of Energy Auditor.*

*(5 Marks, November, 2011)*

*Or*

*Enumerate some of the key functions of the Energy Auditor.*

*(8 Marks, May, 2007)*

*Or*

*What are the key functions of an Energy Auditor?*

*(8 Marks, May, 2004)*

#### Answer

**Functions of Energy Auditor:** Energy auditing is defined as an activity that serves the purposes 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 could be compared with that of a financial auditor. The energy auditor is normally 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) Quantify 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.

**Question 8**

*Write a short note on Contract notes in case of audit of member of Stock Exchange.*

*(4 Marks, November, 2011)*

**Or**

*Write a short note on Contract Notes (Under Stock Exchange Trading Regulations).*

*(4 Marks, November, 2005)*

**Answer**

**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 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.

#### Question 9

*Write a short note on Volatility margin.*

*(4 Marks, May, 2011)*

#### Answer

**Volatility Margin:** Volatility margin is imposed to curb excessive volatility in the market and to act as a deterrent to building up of excessive outstanding positions. Price variations on account of calls, bonuses, rights, mergers, amalgamations and schemes of arrangements are adjusted for determining volatile securities and adjustments in prices is made for the purpose of computation of volatility, when securities are traded ex-benefits. Securities that attract volatility margin and the applicable margin rates are announced on the last day of the trading cycle and are applicable from the first day of the succeeding trading cycle. The volatility margin is levied on the net outstanding positions of the member, in each security, based on the respective margin rates.

Question 10

*Write a short note on Probable format of Environmental Statement. (4 Marks, June, 2009)*

Answer

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 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 with output and types of pollutants and deviation from standard.
- (v) Generation of hazardous waste in current year and previous year from processes or from pollution control facility.
- (vi) Quantity of sold waste generated during current year and previous year from process/es from pollution control facility and from recycling or reutilization of waste, etc.
- (vii) The disposal practice for different type waste.
- (viii) The practice of conservation of natural resources.
- (ix) The additional investment proposal for environmental protection including abatement of pollution.

Question 11

*Write a short note on Purpose of appointing Inspecting officer of a Depository.*

*(4 Marks, November, 2008)*

Answer

Purpose of Appointing Inspecting Officer of a Depository: The SEBI may appoint one or more persons as inspecting officer to undertake the inspection of the books of account, records, documents and infrastructure, systems and procedures or to investigate the affairs of a mutual fund, the trustees and asset Management Company for any of the following purposes, namely-

- (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 depositors' 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.

Question 12

*In the context of Audit of members of Stock Exchanges, explain what is Rolling Settlement?*

*(5 Marks, May, 2008)*

*Or*

*Write short explanatory notes on Rolling Settlement.*

*(4 Marks, May, 2004)*

Answer

Rolling settlement: 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) within 'X' business days from the transaction date.

In the rolling settlement, 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.

SEBI has gradually mandated most of the scrips to be settled exclusively on Rolling Settlement basis [t +2]. Thus, in a T+2 rolling settlement, a transaction entered into on Monday, for instance, will be settled on Wednesday when the pay-in or pay-out takes place. The transaction in the Compulsory Rolling Settlement (CRS) are settled on T+2 basis i.e. both pay in and pay out of monies and securities for transactions in scrips on transaction day (T-Day) would take place on the day after immediately following day.

However, transactions in 'Z' group securities are settled only on trade to trade basis on T+2, i.e. the facility of netting up of buy and sell transactions of the same day, as available in other securities, is not available with securities falling under 'Z' group. In other words, if the investor buys and sells X number of shares on the same day, then he shall first have to actually deliver and then receive the securities on the settlement day.

Value at Risk (VaR) based margining approach has been adopted for transactions done in CRS scrips w.e.f. July 2, 2001. In the VaR system of margining, historical volatilities of scrips and overall market volatility is considered to arrive at a VaR margin percentage for a scrip. Further the mark-to-market difference are collected on a daily basis and the broker members are required to maintain a capital level, as prescribed by the exchange, adequate to support their exposure at all times.

In case, a member fails to deliver the shares sold in rolling settlement, the exchange conducts an auction session on T+2, to meet the shortfall created by non-delivery of shares. In this auction session, offers are invited from the 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:

- Highest 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 the seller, but is credited to investor protection fund.

### Question 13

*Write short notes on the following:*

(a) *Securities Transaction Tax.*

(b) *Price/Earnings (P/E) ratio.*

*(4 Marks each, May, 2008)*

### Answer

- (a) **Security Transaction Tax (STT):** In the union budget for 2004-05, Government has introduced Security Transaction Tax to be levied on all transactions done on stock exchanges. As per the provisions of the Finance Bill, the stock exchanges have been entrusted with the responsibility of levy, collection and remittance of the STT on all transactions from the date of notification by the Government of India.

SEBI vide its Circular no. MRD / DOP /Cir – 28 / 2004 dated August 23, 2004 directed that no stock exchange shall permit trading activities unless it implements necessary software and procedures for the levy, collection and remittance of STT.

- (b) **Price/Earning Ratio:** The pre-issue price/earning ratio should be calculated by using the following formula-

$$\frac{\text{Issue price per share}}{\text{Earning per share}} \times 100$$

The issue price per share which is to be used for computing this ratio (and not the market price per share which is normally used for computation of the price/earning ratio).

Accordingly, for this purpose issue price per share is required to be used. However, P/E ratio of the company based on issue price is to be compared with the industry P/E ratio, based on market price. For the purpose of the industry P/E ratio, the auditor should check that the market price should be the market price for the industry prevailing within one month prior to the date of auditor's report or as close thereto as possible.

### Question 14

*State the items contained in the SEBI's check list for auditors in respect of contract notes issued by a Stock Broker.*

*(8 Marks, May, 2007)*

Answer

SEBI's Check List for Auditors in Respect of Contract Notes issued by a Stock Broker:

- (i) Members should issue Contract Notes to his clients for all trades executed by him on their behalf.
- (ii) The member should stamp his order sheets/records and the order time should be reflected in the Contract Note along with the time of execution of order.
- (iii) The Contract Notes should bear SEBI Registration number of the member. It should be pre-printed with serial numbers and issued within 24 hours of trade execution. Appropriate stamps should be affixed on the contract Note. Duplicate copies of the contract note should be maintained.
- (iv) The Contract Note should be signed by the member or his constituted attorney.
- (v) Contract note issued to the clients should show the brokerage separately.
- (vi) In case the broker acts as a principal, the Contract Note should be in Form B.
- (vii) Consent of the client should be taken for any trade done by the broker while acting as a principal.
- (viii) Brokerage should be within the limits prescribed by the exchange.

Question 15

*Write a short note on Contents of Audit report of Mutual Fund. (4 Marks, May, 2007)*

Answer

Audit Report of Mutual Fund: It comprises the following-

- (i) The auditor has obtained all information and explanations which, to the best of his knowledge and belief, were necessary for the purpose of the audit.
- (ii) The balance sheet and the revenue account give a fair and true view of the scheme, state of affairs and surplus or deficit in the fund for accounting period to which the balance sheet or, as the case may be, the revenue account relates.
- (iii) The statement of account has been prepared in accordance with accounting policies and standards as specified in the ninth schedule.

Question 16

*Enumerate the main areas to be covered by the auditor in the case of environment audit of an industrial unit. (8 Marks, November, 2006)*

Answer

Main Areas to be Covered in the case of Environment Audit of an Industrial Unit:

- (i) Layout and Design – The layout to be sketched in the style which will allow adequate provisions for installing pollution control devices, as well as provision for up gradation of pollution control measures and the meeting of the requirements of the regulations framed

by the Government. In the course of the audit, the area which requires attention but not attended to by the industry to be pinpointed as well as the future requirements of the environmental measures required in commensuration with the proposed future course of working plan are to be identified.

- (ii) **Management of Resources** – Management resources includes air, water, land, energy, raw materials and human resources besides others. The use of all resources is interlinked and the best uses in a synchronised manner results the best output and minimum waste. The waste of resources to the minimum possible extent is good for the health of the industry as well as the environment.
- (iii) **Pollution Control System** – An effective system of pollution control should be in existence. One aspect should be whether all required pollution control measures are in vogue or not next aspect should be whether the same is effective or not, further it is to investigate, whether more measures are required, keeping in view the type of industry and its nature of working with respect to its grade of polluting the environment.
- (iv) **Emergent Safety Arrangement** – The chemical, gas, etc., industries which are prone to sudden requirement of safety arrangements, must remain alert all the while. The emergency plans are to be reviewed periodically; sufficient staff along with other required safety amenities should be kept ready. The staff, remained so engaged, must possess the required awareness and alertness to meet the contingency. The degree of awareness, however, can be upgraded with proper training provisions.
- (v) **Medical & Healthcare Facilities** – The medical services should be maintained. The health of the workers should be a big consideration for the management.
- (vi) **Industrial Hygiene** – Proper system should be in vogue to eliminate industrial unhygienic state.
- (vii) **Occupational Health** – The requirement for safeguarding against occupational health hazards should be available for all the workers. As the occupational health hazards varies from industry to industry due to the difference in the nature of working atmosphere and the pollutants present in it, the concerned industry must pay proper weightage to those diseases which are prone to that particular type of industry.
- (viii) **Information Assimilation and Reporting System** – The information system should be strengthened to generate and its reporting system should be proper, keeping in view, the authorities, responsibilities and subsequent delegations. A report of compliance of all statutory environmental laws along with other preventive and precautionary measures should be put to Board at regular intervals.
- (ix) **EIA Methodology** – The Environmental Impact Assessment (EIA) is usually a pre-requisite to start an industry. This is done considering the known spheres of activities on the existing environmental conditions. But the predictions necessarily deviate from the actual happenings when the industry starts working. To accommodate the deviation in the system is also to be incorporated in the EIA report, if it is noticed that the degradation to the environment caused on the establishment and running of the industry is much

higher than what was predicted, the mitigatory measures suggested must also be furthered.

- (x) **Compliance to the Regulatory Mechanism** – As the persons who are directly working with the system, may be unaware of the latest developments and requirements for the compliance of stipulations and standards prescribed by the various regulatory authorities, they should be trained and instructed on regular basis, to avoid making the Board/owner vulnerable to prosecution and penalty.
- (xi) **Concern for the Society** – The industry very often transforms the agrarian environment into an industrial environment. The people so displaced by industrialisation feel alienated and develop a feeling of facing the gaseous, dusty, clumsy state of surroundings. The audit should look into this aspect how the industry is making a balance between its own development and the society's concern.

#### Question 17

*Write a short note on Types of market under NEAT (National Exchange Automated Trading).*

*(4 Marks, November, 2006)*

#### Answer

##### Type of Markets under NEAT (National Exchange Automated Trading)-

- (i) **Normal Market:** All orders of regular lot size or multiples thereof are traded in the normal market. Normal market consists of various book types wherein orders are segregated as regular lot orders, special term orders, negotiated trade order and stop loss order depending on their order tributes.
- (ii) **Odd Lot Market:** An order is called an odd lot order if the order size is less than the regular lot size; such orders are traded in the odd lot market. In an odd lot market both the price and quantity of both the orders (buy and sell) should exactly match for the trade to take place.
- (iii) **Spot Market:** Spot orders are similar to normal market orders except that spot orders have different settlement periods vis-a-vis normal market.
- (iv) **Auction Market:** In the auction market, auctions are initiated by the exchange on behalf of trading members, for completing the settlement process.

#### Question 18

*Write a short note on Disclosure under "Basis of Issue Price" in prospectus. (4 Marks, May, 2006)*

#### Answer

**Disclosures under 'Basis of Issue Price':** Under this heading, the following information is to be disclosed-

- (i) Earnings Per Share and Diluted Earnings Per Share pre-issue for the last three years (as adjusted for changes in capital).
- (ii) P/E pre-issue.

- (iii) Average return on net worth in the last three years.
- (iv) Minimum return on the increased net worth required to maintain pre-issue EPS.
- (v) Net Asset Value per share based on last balance sheet.
- (vi) Net Asset Value per share after issue and comparison thereof with the issue price.
- (vii) Comparison of all the accounting ratios of the issuer company as mentioned above with the industry average and with the accounting ratios of the peer group (i.e., companies of comparable size in the same industry (indicate the source from which industry average and accounting ratios of the peer group has been taken).
- (viii) The face value of shares (including the statement about the issue price/ floor price/ price band being "X" times of the face value).

Provided that the projected earnings shall not be used as a justification for the issue price in the prospectus.

Provided further that the accounting ratios disclosed in the prospectus in support of basis of the issue price shall be calculated after giving effect to the consequent increase in capital on account of compulsory conversions outstanding, as well as on the assumption that the options outstanding, if any, to subscribe for additional capital will be exercised.

#### Question 19

*Write short notes on the following:*

- (a) *Vostro and Nostro Accounts.*
- (b) *Margins (Under Stock Exchange Trading Regulations). (4 Marks each, May, 2005)*

#### Answer

- (a) **Vostro and Nostro Accounts:** Bank's maintain stocks of foreign currencies in the form of Bank Accounts with their overseas branches/correspondents. Such foreign currency accounts maintained by Indian banks at other overseas centres is designated by it as "Nostro Account". For example all banks in India would be maintaining a US Dollar Account with their New York office/branch/correspondents, such account would be designated by the Indian office as Nostro Account. "Vostro Account" is the opposite of Nostro accounts. Here a foreign bank in another country maintains stocks of Indian rupees with their Indian branch/correspondent/local bank. Such Indian Rupee Accounts are designated as a Vostro Account. For example a German Bank might maintain a Vostro Account in rupees in terms with Indian Bank. While examining the transaction in foreign exchange, the auditor should also pay attention to reconciliation of Nostro Accounts with the respective minor account. The amount in the Nostro account is stock of foreign currency in the form of bank accounts with the overseas branches and correspondents. Unreconciled Nostro Accounts, on an examination, may reveal unauthorized payments from the foreign currency account, unauthorized withdrawals, and unauthorized debit to minor account. The auditor should also evaluate the internal control with regard to inward/ outward messages. The inward/ outward messages should be properly authenticated and discrepancies noticed, should be properly dealt with, in the

books of accounts.

The auditor should also verify whether prescribed procedure in relation to interbank confirmation in the Vostro account is followed or not. In case balance confirmation certificate have been received but the same have not been reconciled, or where confirmation has not been received the same should be reported, in respect of each Vostro Account.

- (b) **Margins:** Margin refers to deposit made by members with the stock exchange authorities. There can be wide fluctuations at the time of settlement in the prices of securities since the closing rate of the earlier settlement. In order to restrict excessive speculation and also to safeguard the interest of the investors, members are required to keep certain deposits with the stock exchange. The members are required to collect the margin from their clients and deposit the same with clearing house. Margin is intended to protect the members by providing them with funds to cover anticipated fluctuations in prices of securities, particularly, if the client delays or is unable to meet his commitments. It also helps prevent excessive speculation, as clients would be required to invest some funds and not indulge in speculations without adequate resource. Different type of margins which a member is normally required to deposit are: Gross exposure margin, Mark to market margin, Volatility margin, Additional Volatility margin, Special margin and Ad-hoc margin. These margins are required to be paid on due dates at stipulated time as decided by the exchange or clearing house of the exchange. The members are required to compute margin payable for all the securities traded by them.

#### Question 20

*Write a short note on Sauda Book.*

*(4 Marks, November, 2004)*

#### Answer

**Sauda Book:** All members of a stock exchange 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.

#### Question 21

*Write short explanatory notes on Human Resource Accounting.*

*(4 Marks, May, 2004)*

Answer

**Human Resource Accounting:** Human resource is perhaps the most valuable asset in an undertaking. Flamholtz defines human resource as "accounting for people as an organizational resource. It involves measuring the costs incurred by business firm and other organizations to recruit, select, hire, train and develop human assets. It also includes measuring the economic value of people to organisations". This definition gives two methods of valuing human resources, i.e., cost and the economic value. A company may value its human resources on the cost basis, i.e., at the costs incurred by it in procuring and developing these assets. Another method is to work out the replacement values of persons, representing the economic value. According to Flamholtz, an individual possesses value for an organisation because he is capable of rendering future services. Theoretically, therefore, his value to an organisation is equal to the present worth of his expected future services. Thus, an individual's value to an organisation can be defined as the present worth of the set of future services that the person is expected to provide during the period he is anticipated to remain in the organisation. In this connection, putting a monetary value on human resources presents a lot of practical problems particularly from the auditor's view point because of element of subjectivity is inherent in the process of such valuation.