

A practical insight into Credit Audit and Audit of Inventories/ Receivables / Securities

(In the context of bank borrowers)

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1.0 Introduction

The most essential components, which form a significant portion of the total assets of an entity in general and current assets in particular are Inventories and Debtors. They are considered as the lifeblood of every business activity since they are the indicators of good health of the company. The basic objective of verification of the assets is to indicate their physical existence and safety aspects.

In view of the magnitude of loans entities obtain from banks in the form of Cash credit against hypothecation of Inventories and debtors, the importance of the physical verification of Inventories, their valuation and security aspects is not overemphasized, but rightly stated. The banks would like to get an assurance that the loans that have been made are backed by security that have a proper repaying capacity. Audit in banks is useful not only from the point of view of the management, who is the appointing authority but also from the point of other parties, who are interested for their different objectives viz, the Government, public, RBI, Investors, Depositors and Analysts

In order to get an assurance that the norms stated in the loan sanction form have not been disregarded, the bank appoints an external auditor, who is an independent person. The auditor undertaking such responsibility should take care that the requirements of the banks are met with and an early detection of the lapses and inconsistencies is done.

The main purpose of conducting the Inventories audit in banks is to get an assurance that the security against which the loan is sanctioned represents the quality and quantity it claims to possess. With this assurance, the purpose of the Inventories audit as required by the bank is served. The examination of the securities against which the loan has been sanctioned consists of not only physical verification of the securities but also includes verification of aspects such as ownership, valuation and proper storage. The Auditor's role assumes great significance in this regard as his report is considered as veritable and neutral. He is therefore expected to be objective and unbiased while undertaking the Inventories audit

2.0 Inventories and receivable audit

2.1 Meaning of Inventories

Inventories denotes tangible property held for sale in the ordinary course of business or in the process of production for such sale or for consumption in the production of goods or services for sale, including maintenance supplies and consumables stores and spare parts meant for replacement in the normal course.

Inventories thus normally comprises of

- a) stores,
- b) spares parts,
- c) loose tools,
- d) Maintenance supplies,
- e) raw materials including components,
- f) work in process,
- g) finished goods including by-products,
- h) Waste or by-products, etc.

2.2 Meaning of Debtors:

A debtor represent the amount due to an entity for goods sold or a service rendered or in respect of other similar contractual obligations but amount includes such amounts which are in the nature of loans and advances. Debtors are represented only by documentary evidence in the form of invoices and they don't have any physical existence.

2.3 Cash-credit facility

A major part of working capital requirement of any unit would consist of maintenance of Inventories of raw materials, semi finished goods, finished goods, stores and spares etc. In trading concern the requirement of funds will be to maintain adequate inventories in trade. Finance against such inventories by banks is generally granted in the shape of cash credit facility where drawings will be permitted against Inventories of goods. It is a running account facility where deposits and withdrawals are permitted.

Cash credit facility is of two types (depending upon the type of charge on goods taken as security by bank.)

(i) **Cash credit - pledge**: When the possession of the goods is with the bank and drawings in the account are linked with actual movement of goods from/to the possession of the bank. The physical control of the goods is exercised by the bank.

(ii) **Cash credit- hypothecation**: when the possession of the goods remains with the borrower and a floating charge over the inventories is created in favour of the bank. The borrower has complete control over the goods and the drawings in the account are permitted on the basis of Inventories statements submitted by the borrower.

2.4 Inventories /receivables audit

The term Inventories Audit in the context of banks refers to verification and valuation of the entire gamut of current assets, current liabilities, loans and advances, diversion of funds, application of funds, accuracy of Inventories statements, arriving at the revised drawing power and any other matter connected with the credit administration by the banks.

The main thrust in Inventories audit therefore, is towards authentication of the quantity, quality, composition and valuation of the Inventories and debtors.

3.0 Credit Audit

Credit Audit examines the compliance of sanctions and post sanction procedures laid down by the bank

Risk is inherent part of Bank's business. Effective Risk Management is critical to any Bank for achieving financial soundness. Credit Audit aims at achieving continuous improvement in the quality of the Commercial Credit portfolio. Duly aligned with Risk Focused Internal Audit, it examines the probability of default, identifies risks and suggests risk mitigation measures

Objectives of Credit Audit

1. Improvement in the Quality of Credit Portfolio
2. Review Sanction process and Compliance status
3. Feedback on regulatory Compliances
4. Credit Risk Assessment
5. Pick up early warning signals and suggest remedial measures

6. Recommend corrective action for improving credit quality, credit administration, skills of staff in credit department

Every advance under audit would have following stages –

- i) Credit Appraisal
- ii) Sanctioning and disbursement,
- iii) Review, Monitoring, Supervision and Inspection,
- iv) Renewal, Enhancement, Rescheduling, Call back,
- v) Classification.

i) Credit Appraisal

The process of granting advances is initiated on receipt of an application from the intending borrower outlining his requirements and detailing his financial strength.

The auditor should check

- a) Whether the application received from the borrower is in the prescribed format furnishing his entire borrowing requirement?
- b) Whether the branch has complied with general guidelines and procedures of the bank for lending, while processing the proposal. These guidelines include assessing the technical feasibility, economic viability and industry performance etc?
- c) Whether both the receipt of application and processing of the same are properly recorded and documented by the branch?
- d) Whether the same has been sent to the controlling/sanctioning authority within the time-frame for sanction?

ii) Sanctioning and disbursement

Every bank has got various layers of sanctioning authorities. Hence the auditor has to test check whether the sanctions have been made by particular sanctioning authorities.

The auditor should verify the following.

1. Sanction letter properly drawn up and communicated to the borrower and acceptance by the borrower is kept on record.
2. Proper documents, correctly stamped, and duly executed are obtained
3. Creation / modification of charges with ROC wherever applicable

4. Inspection of register of charges is made in the ROC office before and after creating Charge
5. Proper valuation of immovable property by Approved Valuer is made and apparently the valuation is not found on higher side.
6. Whether Valuation Report submitted by the Valuer is in Bank's prescribed format.
7. Clear and unambiguous Legal Scrutiny report obtained in Bank's prescribed format from Bank's empanelled Advocate and kept with documents.
8. Proper equitable / legal mortgage as per guidelines is created.
9. Maintaining proper records by way of security register etc. For safekeeping of the security documents is to be ensured.
10. Compliance with the terms and conditions of sanction is to be ensured and to verify whether confirmation thereof is sent to higher authorities.
10. Amount disbursed as per prescribed rules and guidelines in order to ensure proper end use of funds.
11. Whether specific approval of sanctioning authority is obtained for deviations if any.
12. Whether a register for rejected loan proposals is maintained by the Branch and that these are regularly reported to Regional Manager/Head Office through periodical statement as per guidelines laid down by Head Office?

iii) Review, Monitoring, Supervision and Inspection

Monitoring by the branch ensures assess the quality of advances and each bank prescribes various norms for the same. Generally post disbursement monitoring should include the following:

1. Monitoring operations in the accounts like cash withdrawals, kite flying, diversion of funds etc.
2. Conduct of periodical inspections as per terms of sanction and reports in proper format held on record / sent to controlling offices wherever applicable with comments of branch Manager.

3. Obtaining stock statements, MSOD / QIS/ Cash Budget as applicable, analysis thereof and fixation of quarterly operative limits
4. Maintenance of prescribed books and registers like insurance due date register, stock statements register, inspection register, documents due date register etc
5. Compliance of laid down guidelines in respect of consortium accounts, like periodical meetings, joint documentation, creation of charge, exchange of information etc.
6. Application of prescribed rates of interest, incidental & service charges, processing fees etc
7. Timely review/ renewal of credit limits is done and technical review if any made is not more than 3 months old and is not repeated two or more times.
8. Follow up and recovery of devolved LCs & guarantees, Overdue PC, Bills and adhoc limits, recovery of due instalments / interest in time etc
9. classification of the advance under the Credit Rating norms in accordance with the guidelines of the controlling authorities of the Bank
10. Periodical review of credit rating followed by revision of rate of interest.
11. Proper reporting of sanctions, submission of Control Returns and other periodical returns to higher authorities.
12. control returns on advances have to be sent regularly to the R.O/H.O

v) Classification

Advances are classified as Performing and Non Performing Assets. The banks should follow the Reserve Bank of India's guidelines to classify an advance as Non Performing Asset (NPA) and the proper classification of advances is the primary responsibility of the bank's management.

Documents to be examined:

Even though, there is no standardization of the documents taken by various banks from the borrowers, a representative list of documents/papers/reports the scrutiny of which is required to be done by the auditor while checking any file on advances, can be made as follows:-

- a. Application – in prescribed form
- b. Project Report
- c. Credit Appraisal Form
- d. Sanction Letter
- e. Demand Promissory Note (DPN)
- f. General lien and set off letter
- g. Mortgage/Hypothecation Deed
- h. Guarantee Bond
- i. Past three years financial statements
- j. Details of Associates/Sister Concern
- k. Memorandum/Partnership Deed/Trust Deed.
- l. Copy of Resolutions
- m. Identification of Borrower
- n. PAN, Statement of Income, Advance Tax Challan, SSI Registration, pollution Control Board Certificate, Shop & Establishment Certificate, Sales Tax/Profession Tax Registration Certificate, Industrial License.
- o. Ration Card Xerox, Photograph, Driving License Xerox, Passport Xerox, Statement of Income.
- p. Credit Report/Confidential Report on the Borrower.
- q. Affidavit or Caste Proof.
- r. Statement of Wealth.
- s. Income Proof – Borrower and Guarantor
- t. Acknowledgement of debt.
- u. Invoice and receipt
- v. Insurance.

Verification of Documents:

Checking of documentation is one of the key areas in audit of advances. Actual documentation differs from bank to bank but it generally depends on –

- a. Legal Status – Individual, Partnership, Company, Trust
- b. Government Recognised Status – Priority Sector, SSI, Manufacturer

- c. Purpose of Loan – Financing Machinery, Stock, Vehicle.
- d. Security – Primary/Collateral

When auditor is looking at the security, he should specifically ensure the following -

- Whether legally enforceable.
- Whether is in effective control of the bank.
- Whether it is recently inspected.
- Whether valuation is realistic and current.
- Whether it covers value of advance.

In addition, the auditor should check in the following lines.

- a. Whether security ledger is maintained with the name of the borrower, address, nature and amount of limit sanctioned, full details of securities charged and the documents obtained. The entries should be authenticated by the officer in whose presence documents have been executed?
- b. Whether due date diary for the documents is properly maintained and updated. Normally, the due date should be one year earlier than the date of expiry of the documents?
- c. Whether all types of charges are registered with Registrar of companies in case of companies registered under the Companies Act 1956?
- d. Whether the mortgage/equitable mortgage is created wherever necessary?
- e. In cases of old documents, the auditor should mention that the date of the last letter of acknowledgment of debt obtained from the borrowers and also from guarantors/co-obligants in case of each account and/or date of last credit in the loan account, paying-in-slip filled up by the borrower himself or his agent and to comment on enforceability of the documents.
- f. Whether the drawing power is properly calculated & maintained as per the terms of sanction?
- g. Whether all legal documents are duly executed, and securities pledged with Branch are always kept under lock and key with access on actual need basis only? If there is place in strong room, documents should be stored there, if not, in a fire proof cabinet

Fund Based advances

A) Cash Credit Accounts

While scrutinizing the account, the following points should be observed –

- i. Whether turnover in the account is adequate compared to the turnover of the business?
- ii. Whether turnover is inflated by cash withdrawal and cash deposits?
- iii. Whether cash withdrawals are excessive compared to business needs?
- iv. Whether Cash is withdrawn immediately after sanction?
- v. Where cheque payments are not substantial whether stock is fully paid for?
- vi. Whether inter transfer of funds between associate concerns are observed?
- vii. Whether term loans have been given by crediting the same to cash credit account?
- viii. Whether diversion of funds for purchasing fixed assets noted?
- ix. Whether payment for off balance sheet items such as lease is observed?
- x. Whether payment of loan installments to other banks or institutions or private parties observed?
- xi. Whether payments to parties unrelated to business observed?
- xii. Whether frequent bouncing of cheques deposited as well as issued noted?
- xiii. Whether cash deposits sufficient to clear cheques issued noted?
- xiv. Whether irregular or infrequent credits observed?
- xv. Whether overdue bills have been cleared by debit to cash credit account?
- xvi. Whether Inventory // QIS statements are furnished in time?
- xvii. Whether Drawing power is correctly calculated?
- xviii. Whether adequate insurance is available and Policy is with Bank Clause/coverage of all risk?
- xix. Whether Physical verification of assets and inventory is done as per stipulation. Defects pointed out by the Inspectors are rectified?
- xx. Whether Valuation of inventory is proper?

B) Advances against Hypothecation of Book Debts

The auditor shall verify:-

- i. Whether the Branch is obtaining monthly statements of outstanding books debts and such book debts are classified period-wise and that drawings are allowed against book debts outstanding only for a period as stipulated in terms of sanction?
- ii. whether the statement is scrutinized and age of the book debts are analyzed properly according to the terms of sanction and old book debts are weeded out for computation of Drawable limit?
- iii. Whether periodical verification of the statements of book debts received from the borrowers is being done by the Branch with reference to their books?
- iv. Whether In case of limited companies, the bank's charge has been duly registered with the Registrar of Companies?
- v. Whether In the case of parties who are also sanctioned B.D. facility, the auditor shall ensure that bills discounted from time to time are not included in the statement of book debts submitted by them to the Bank and there against drawings have not been allowed?
- vi. Whether the proceeds of book debts are routed through Book Debt account of the borrower?
- vii. whether the statement is scrutinized and age of the book debts are analyzed properly according to the terms of sanction and old book debts are weeded out for computation of Drawable limit?
- viii. In case of the facility extended to a Limited company, the Book debt facility is registered as charge with Registrar of Companies by filing the relevant forms in triplicate and the third copy duly acknowledged by Registrar of Company is on record?
- ix. Whether the statement is scrutinized and age of the book debts are analyzed properly according to the terms of sanction and old book debts are weeded out for computation of Drawable limit?
- x. Whether the book debts are well spread and there is no concentration of book debts involving large amounts amongst the few, or allied/associate/sister concerns unless a specific sanction is accorded? In such case the limit fixed for each concern should be adhered to

C) Advances to Limited Companies

While inspecting accounts in the names of Limited Companies, the auditor shall verify

- i. Whether certified copies of the resolution for borrowing facilities along with the names of directors/other office bearers who are authorized to execute the documents and put the Company's Common Seal are on record?
- ii. Whether The Bank's Charge is registered with the Registrar of Companies and that necessary charge/registration certificate is on record?
- iii. Whether Certified copies of Memorandum and Articles of Association, certificate of incorporation and certificate of commencement of Business (later not applicable in the case of Private Limited Companies) are on record?
- iv. Whether Copies of audited balance sheets/financial statements are obtained regularly?

D) Advances against Govt. Securities, shares etc

- i. Whether these are in order and that the security registers are properly maintained?
- ii. Whether the securities stand in the name of borrowers and are endorsed in favour of the Bank and that interest due thereon has been collected upto date?
- iii. Whether In the case of previous endorsements on securities the same are in order and that the chain of endorsements is unbroken and further that the securities have been examined by the Public Debt Office?
- iv. Whether care is taken that partly paid-up shares have not been accepted as security in any of the accounts?
- v. Whether care is taken that the scripts are not damaged or mutilated and that share certificates do not contain unauthenticated alterations?
- vi. Whether the valuation is being done at current market rates?

E) Advances against Life insurance policies

- i. Whether the Branch is maintaining a register for recording therein life policies against which advances have been made?

- ii. Whether the policies have been properly assigned in favour of the Bank, notice of assignment has been given to the Corporation and the assignments have been duly registered in their books?
- iii. Whether the premium is being regularly paid and that the policies are in full force? The latest receipt has to be verified.
- iv. Whether Mandate to debit borrower's account to pay premium is on record?
- v. Whether the amount of advances does not exceed the surrender value of the policies less prescribed margin, which should have been ascertained by the office before making the advance and that the surrendered value is called from the Corporation periodically and placed on record.
- vi. Whether the policies do not attract provisions of the Married Woman's Property Act and further no advance has been made against policies with a minor as beneficiary or assigned in favour of a minor?

F) Advances against Bank Deposit Receipts (FDR, SDR, R.D and Other Term Deposit Receipts

- i. Whether Bank's lien is noted on the relative receipts and also on the relative ledger folios and that receipt are properly discharged by the depositors and the discharge is verified by an authorized officer of the Branch?
- ii. Whether the deposit receipt is of the Branch itself and stands in the name of the borrower?
- iii. Whether in the case of advances allowed against deposit receipts issued by another office of the Bank, whether the advances has been made only after obtaining confirmation from the issuing office that the discharge on the receipt is in order and that lien has been noted in their books in favour of the lending Branch?
- iv. Whether deposits in the name of minors have not been taken as security in any of the accounts (In case advances has been allowed to the guardian against deposit receipts standing in the name of minor, the auditor has to verify whether the Branch has obtained necessary declaration from the guardian that the amount of advances shall be utilised for the benefit of the minor. In case the date of attainment of majority by the minor does not fall before the date of maturity of the

- receipt because in that case the amount of the receipt in question will be payable to the minor only)?
- v. Whether in the case of advance against deposits standing in joint names, all joint account holders have discharged the receipts and signed the letter of discharge/set-off?
 - vi. Whether in the case of advanced against deposit receipt standing in the name of third party, a letter of request signed by the depositor is held on record authorising the bank to hold the receipt as a security for the advance and to utilise the amount of the deposit on its maturity or earlier towards liquidation of the borrower's dues?
 - vii. In the case of advance against recurring deposit, whether relative pass book duly discharged is obtained and that the signature of the account holder is duly verified?

G) Advances Secured By Mortgage of Immovable Properties

- i. Whether the Branch is in possession of the relative original title-deeds, the Bank's lawyers' non-encumbrance certificate and an independent Bank's approved/ Govt. Recognized valuers' valuation report?
- ii. Whether a search has been got conducted in the office of the Registrar of Assurances which indicate that the property in question is free from any encumbrances?
- iii. Whether the title deed register is properly maintained and all title deeds are entered therein?
- iv. Whether the mortgage deed is in accordance with H.O. instructions?
- v. Whether the Branch has on its record the latest corporate/municipal tax paid receipts of the mortgaged property?
- vi. Whether the properties mortgaged to the bank are adequately insured.
- vii. Whether stamp duty wherever applicable for the creation/extension of Equitable Mortgage is paid or not?

H) Advances against fixed assets (plant & machinery)

- i. Whether the deed of mortgage/hypothecation is obtained according to the terms of the sanction? (in cases where machinery etc. are embedded to the earth, mortgage is obtained and in other cases, hypothecation agreement is taken).

- ii. Whether the properties mortgaged/hypothecated to the Bank are adequately insured?
- iii. Whether the charge is registered with the Registrar of Companies in the case of advances to Limited Companies?
- iv. Whether stipulated installments are regularly paid?
- v. Whether The Bank's name plates are exhibited?

I) Bills Discounted

- i. Whether there are Cases of bills outstanding beyond their due dates?
- ii. Whether an individual liability register is properly maintained and the outstanding are periodically taken down and balanced with the General Ledger balance?

J) Clean Overdrafts

- i. Whether the sanction fall within the manager's discretionary powers or in case where he has exceeded his powers, necessary confirmation has been obtained from the appropriate authorities and placed on record?
- ii. Whether clean overdrafts are utilized properly and for bonafide purposes only and that these are not of permanent nature and also not often granted?
- iii. Whether it is ensured that parties enjoying limits on secured basis are not allowed clean overdrafts which may result in the reduction of prescribed/ stipulated margin in their secured accounts?

Non- fund based advances

A) Guarantees:

- i. Whether the branch is maintaining guarantee issue register?
- ii. Whether the branch holds valid sanctions for guarantees outstanding and issued?
- iii. Whether the purpose for which the guarantee has been issued is in line with the sanction terms and the tenor is within the sanction parameters?
- iv. Whether the guarantee type has been correctly classified, viz, Financial, Performance, Bid, etc?
- v. Whether Margins as stipulated are in place and have been lien marked?
- vi. Whether margin, commission are recovered as per guidelines?
- vii. Whether expired guarantees are reversed as per guidelines within stipulated time?

- viii. Whether guarantee documents are returned back by the beneficiary at the time of canceling/ reversal?
- ix. Whether margin money is returned only after getting back of original guarantee document?
- x. Whether proper documents such as Counter guarantee (in case of not secured by 100% cash margin)?
- xi. Whether the guarantee is covered by other security over and above prescribed minimum cash margin and whether the same is charged to bank by way of EM/ hypothecation as per guidelines?
- xii. Whether branch is undertaking proper monitoring of end use in case advance payment guarantee/ financial guarantee ?

B) Letters Of Credit – General

- i. Whether letters of credit (LCs) have been opened only on behalf of the banks own customers who are known to be participating in the trade?
- ii. Whether the bank had undertaken thorough scrutiny of the proposal and satisfied itself about the genuineness and credit worthiness of the customer before opening the LCs (Availability of proper sanctioned limit?
- iii. Whether the LC contains a provision for indicating the name and address of the bank and the importer in the transport document?
- iv. Whether the bank had obtained a credit report on the beneficiary in case of large imports before opening LCs?
- v. Whether the branch ensures that before establishing letter of credit that the customers are in possession of "Exchange Control purpose" copy of import licence? (Except for imports under OGL)?
- vi. Whether branch verified documentary evidence to show that customers have placed firm order for imports and that the orders have been accepted?
- vii. Where letters of credit have been opened on FOB terms & have adequate amount been earmarked out of the value of Import Licence to cover freight, insurance and commission (if licence is on CIF basis)?

- viii. Has the date of expiry of any letter of credit opened by the branch, have been extended beyond the last date of shipment permitted under the relative import licence, or without revalidation of the expired licence?
- ix. Whether there are indications that importers have entered into contracts with overseas suppliers and have back-dated the contract in order to circumvent the restrictions on or canalization of import of the commodity?
- x. Whether the bank has stipulated a condition that the shipments should be made only by conference vessels which are on the approved list of Lloyds or any certificate to show that the vessel is seaworthy?
- xi. Whether the last date within which shipment should be made in accordance with the extent import licensing regulations been stipulated?
- xii. Whether the bank has been insisting for inspection certificate issued by well-known international inspection agencies?
- xiii. Whether the bank had opened LCs for import through Postal Channel only after satisfying with documentary proof for eligibility of such imports?

Letter Of Credit for Imports from More Than One Country

- xiv. Whether the branch has indicated amount of credit available for each country in the L/C, keeping in view the approved methods of payment?

Revolving Letters Of Credit

- xv. Whether the Branch obtained approval of competent authority before opening revolving Import Letter of Credit?
- xvi. Whether branch opened revolving letter of credit only for the balance available in the import license /OGL?
- xvii. Whether reinstatement clause incorporated?
- xviii. Whether such credit is otherwise in conformity with Exchange Control Regulations?

Reduction & Recovery of N.P.A

An asset becomes non-performing when it ceases to generate income for the bank. With effect from March 31, 2004, a non-performing asset shall be a loan or an advance where:

- i) Interest and/or installment of principal remain overdue for a period of more than 90 days in respect of a Term Loan.
- ii) The account remains '**Out of order**' for a period of more than 90 days, in respect of an Overdraft/ Cash Credit (OD/CC).

Note: “An account should be treated as 'out **of order**' if the outstanding balance remains continuously in excess of the sanctioned limit/drawing power. In cases where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but there are no credits continuously for 90 days or credits are not enough to cover the interest debited during the same period, these accounts should be treated as '**out of order**'”.

- iii) The bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted,
- iv) Any amount to be received remains overdue for a period of more than 90 days in respect of other accounts.

Note: Any amount due to the bank under any credit facility, if not paid by the due date fixed by the bank becomes **overdue**.

Illustrative Warning signals for an advance account:

a.	Frequent request for TOD and persistent out of order.
b.	Frequent return of cheques.
c.	Issuance of cheques in favour of directors/associates
d.	Frequent devolvement of LC
e.	Diversion of funds
f.	Change in management that may affect working of unit.
g.	Adverse market report
h.	Unfavorable external factors
i.	Frequent withdrawals of cash
j.	Non extension of credit by company's suppliers
k.	Any raid by IT or ED on premises of borrowers

1.	Industrial unrest if any.
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Verification of NPA

While verifying NPAs an auditor should look into the following aspects:

- i. Whether proper income recognition and classification of advances is being done as per prudential norms.
- ii. Whether adequate steps have been taken to protect the assets charged to bank, viz. insurance, fresh valuation, inspection etc.
- iii. To find out about the follow up action made by the Branch Manager and Staff in
 - Identifying the borrowers,
 - their assets value,
 - Marketability of the assets charged to the bank,
 - Legal position etc.
 - efforts already made and being made
 - present position of the recovery
 - possibility of compromise
 - if suit filed, its present stage
 - if decreed, whether decree executed etc
- iv. Compromise, write-off, suit filed, decreed accounts' details and the execution of decrees etc and the present position thereof.
- v. Issue of the notice under Securitisation Act and its affect and further follow up.
- vi. Reasons for fresh slippage, Staff Accountability and efforts taken to save the account from turning into NPA.
- vii. Whether sick but viable units are identified and necessary steps are taken for drawing up rehabilitation programme.
- viii. Whether proper liaison is maintained with Advocate for follow-up of suit-filed cases?
- ix. Whether proper sanction obtained and plaint got approved by appropriate authorities / Controlling Office before filing of suit?

- x. Whether application for attachment of securities before judgment made wherever necessary?
- xi. Whether in respect of decreed accounts, the execution process has been initiated without delay?
- xii. Whether steps are being taken for effecting recovery through compromise and the compromise proposals are promptly sanctioned / referred to appropriate authorities?
- xiii. In case of non-compliance with compromise terms, whether appropriate action is taken for immediate recovery of bank's dues?
- xiv. Whether steps taken for follow-up and cash recovery in written-off accounts?
- xv. Whether proper records are maintained in respect of suit filed / decreed and written off accounts and periodically reported to controlling offices?
- xvi. Whether the interest accruals and booking has been stopped and unrealized interest has been reversed properly?

4.0 Different Terms Used In Banking Parlance (in the context of Inventories and receivables audit)

Cash Credit

A credit facility under which a customer draws up to the preset limit, subject to availability of sufficient security with the bank. The difference between an overdraft and cash credit account is that while the former is extended more to individuals, and less for business, the latter is extended only to business bodies. The cash credit facility is unique to India, as in most of the countries it is called overdraft.

Further the cash credit facility is more or less on a permanent basis so long as the business is going on. Internationally at the end of specific period the overdraft facility is withdrawn and the customer is required to pay back the amount lent by the bank. The purpose of cash credit is for working capital. The operations are similar to overdraft.

Cash credit facility is of two types (depending upon the type of charge on goods taken as security by bank.)

- (i) Cash credit - pledge: when the possession of the goods is with the bank and drawings in the account are linked with actual movement of goods from/to the possession of the bank. The physical control of the goods is exercised by the bank.
- (ii) Cash credit- hypothecation: when the possession of the goods remains with the borrower and a floating charge over the stocks is created in favour of the bank. The borrower has complete control over the goods and the drawings in the account are permitted on the basis of stock statements submitted by the borrower.

Charge on assets of a company

A charge means an interest or right which a lender or creditor obtains in the property of the company by way of security that the company will pay back the debt. Charges are of 2 types: -

1. Fixed charge: Such a charge is against a specific clearly identifiable and defined property. The property under charge is identified at the time of creation of charge. The nature and identity of the property does not change during the existence of the charge. The company can transfer the property charged only subject to that charge so that the charge holder or mortgage must be paid first whatever is due to him before disposing off that property.
2. Floating charge: Such a charge is available only to companies as borrower. A Floating charge does not attach to any definite property but covers the property of a circulating and fluctuating nature such as stock-in-trade, debtors, etc. It attaches to the property charged in the varying conditions in which happens to be from time to time. Such a charge remains dormant until the undertaking charge ceases to be a going concern or until the person in whose favor charge created takes steps to crystallize the floating charge. A floating charge on crystallization becomes a fixed charge

Consortium lending

This approach to lending was introduced by the RBI in 1974. Accordingly, more than one bank finances a single borrower requiring large credit limit. It (a) enables banks to spread risk of lending, (b) broke the monopoly of big banks to have large accounts, (c) enables banks to share experience and expertise, (d) introduces uniformity in approaches to lending, (e) enables banks to pool resources, and (f) checks multiple financing of the same account.

Each consortium has a lead bank, which has the largest share in the loan, which processes the loans low rates proposal, which calls the meetings of the consortium for sanction of limits and review of accounts, which obtains RBI permission for credit limits, and which conducts joint inspection of the borrowers activities. The borrower executes a single set of documents with the lead bank. It obtains the letter of authority from member banks and releases the initial requirements of the borrower. Thereafter it obtains reimbursements from the member banks to the extent of their shares in advance. If the member banks delays the reimbursement beyond a week, the lead bank was entitled to charge a penal interest for the period of delay. This arrangement was also called a Single Window Lending.

Creditors

An entity (person or institution) that extends credit by giving another entity permission to borrow money with a stipulation for repayment at a later date

Drawing power

It is the limit up to which the borrower can utilize the cash credit. Drawing power is required to be arrived at based on the stock statement which is current. If the outstanding exceeds the drawing power, it will attract penal interest .The outstanding in the account based on drawing power calculated from stock statements older than three months, would be deemed as irregular. While calculating drawing power based on stock and debtors

statements, care must be taken to exclude old, obsolete and non-moving stock and long outstanding debtors.

Debtors/ Receivables

A person or entity that owes an amount of money or favor to

Inventories

Inventories denotes tangible property held for sale in the ordinary course of business or in the process of production for such sale or for consumption in the production of goods or services for sale, including maintenance supplies and consumables stores and spare parts meant for replacement in the normal course.

Paid Inventories refers to the Inventories which is fully paid i.e. excluding Sundry creditors

Limit sanctioned

This refers to the extent of facility granted to the borrower based on his working capital requirements and securities offered. In the case of cash credit, it is the limit up to which the borrower can withdraw from his borrowal account. The extent to which the borrower draws up to his pre set limit depicts the utilized amount

Margin money

Margin money is like a security deposit retained by the bank till the loan is fully settled. The credit limit is sanctioned by the banks after retaining a margin on the value of the security offered. The percentage of margin requirements varies as per RBI guidelines.

Memorandum of satisfaction

A company must make a report to the Registrar of payment of satisfying in full of any charge registered under this act. The satisfaction of charges must be filed with the Registrar within 30 days from the date of such a payment of charge. On receipt of intimation to the company, the Registrar gives notice to the charge-holder calling upon him to show cause within time not exceeding 14 days as why the payment of satisfaction should not be registered. If no cause is shown within the time stipulated above the Registrar must enter the satisfaction of the payment of charge. If some cause is shown, the Registrar must record note to that effect in the register and inform the company accordingly.

Mortgage

A mortgage is the transfer of an interest in specific immovable property for the purpose of securing the payment of money advanced or to be advanced by way of loan, an existing or future debt, or the performance of an engagement which may give rise to a pecuniary liability. The transferor is called a mortgagor, the transferee a mortgagee; the principal money and interest of which payment is secured for the time being are called the mortgage-money and the instrument (if any) by which the transfer is effected is called a mortgage-deed.

Non-performing assets

An asset, including a leased asset, becomes non-performing when it ceases to generate income for the bank.

With effect from March 31, 2004, a non-performing asset (NPA) shall be a loan or an advance where;

- i. interest and/or installment of principal remain overdue for a period of more than 90 days in respect of a term loan,

- ii. the account remains 'out of order' for a period of more than 90 days, in respect of an Overdraft/Cash Credit (OD/CC),
- iii. the bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted,
- iv. interest and/or installment of principal remains overdue for two harvest seasons but for a period not exceeding two half years in the case of an advance granted for agricultural purposes, and
- v. Any amount to be received remains overdue for a period of more than 90 days in respect of other accounts.

Out of Order / Irregular account

An account should be treated as '**out of order**' if the outstanding balance remains continuously in excess of the sanctioned limit/drawing power. In cases where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but there are no credits continuously for six months as on the date of Balance Sheet or credits are not enough to cover the interest debited during the same period, these accounts should be treated as '**out of order**'.

The outstanding in the account based on drawing power calculated from stock statements older than three months would be deemed as irregular. A working capital borrowal account will become NPA if such irregular drawings are permitted in the account for a continuous period of 90 days (with effect from March 31, 2004).

Overdue account

Any amount due to the bank under any credit facility is 'overdue' if it is not paid on the due date fixed by the bank

Pledge

It is a bailment of property as a security for debt / amount borrowed.

Stock statements

It is a statement (normally in a prescribed format of the lending bank) showing the details of the various items of stock. It should clearly indicate the movement of the stock during the period. Stock which has not been paid for has to be excluded. Stock statements are to be signed by an authorized signatory and submitted to the banks at intervals stipulated in the sanction letter.

Non- submission of stock statements on time will attract penal interest.

Working Capital

There are two measures of working capital: gross working capital and net working capital. Gross working capital is the total of the current assets. Net working capital is the difference between the total of current assets and the total of current liabilities

5.0 Types of Mortgages

Meaning of mortgage

As explained earlier, Mortgage is a transfer of interest in specific immovable property for the purpose securing payment of money advanced, or to be advanced by way of loan, an existing or future debt, or the performance of an engagement, which may give rise to a financial liability.

The transferor is called a Mortgagor and the transferee is a Mortgagee, the principal money and interest of which payment is secured for the time being are called mortgage money, and the instrument, if any, by which the transfer is effected is called a Mortgage Deed.

Sec 58(a) of the Transfer of property act 1882 deals with mortgage. Accordingly, the necessary ingredients of a mortgage are: -

1. Transfer of interest in specific immovable property

2. Transfer is for the purpose of securing the payment of money advanced or to be advanced by way of loan.
3. It may be existing and future debt.
4. It may be also for performance of an engagement, which may lead to financial liability.

Different types of mortgages

There are 6 types of mortgages. They are

1. Simple Mortgage,
2. English Mortgage,
3. Equitable Mortgage or Mortgage by deposit of title deeds,
4. Usufructuary Mortgage,
5. Mortgage by Conditional Sale,
6. Anomalous Mortgage

1. Simple Mortgage

This mortgage is an agreement only whereby the mortgagor personally binds and agrees to repay the money borrowed to the mortgagee and agrees that in the event of failure to do so, the property may be sold and the money realized out of the sale proceeds. However it must be registered. Simple mortgage does not refer to any property transfer at all.

2. English Mortgage

Where the mortgagor binds himself to repay the mortgage-money on a certain date, and transfers the mortgaged property absolutely to the mortgagee, but subject to a proviso that he will re-transfer it to the mortgagor upon payment of the mortgage-money as agreed, the transaction is called an English mortgage

3. Equitable Mortgage

Where a person in any of the following towns, namely, the towns of Calcutta, Madras and Bombay, and in any other town which the State Government concerned may, by notification in the Official Gazette, specify in this behalf, delivers to a creditor or his agent documents of title to immovable property, with intent to create a security thereon, the transaction is called a mortgage by deposit of title-deeds.

4. Mortgage by conditional sale

Where the mortgagor ostensibly sells the mortgaged property
---on condition that on default of payment of the mortgage-money on a certain date the sale shall become absolute, or
---on condition that on such payment being made the sale shall become void, or
---on condition that on such payment being made the buyer shall transfer the property to the seller,

The transaction is called a mortgage by conditional sale and the mortgagee a mortgagee by conditional sale:

Provided that no such transaction shall be deemed to be a mortgage, unless the condition is embodied in the document which effects or purports to effect the sale

5. Usufructuary

Mortgage

Where the mortgagor delivers possession or expressly or by implication binds himself to deliver possession of the mortgaged property to the mortgagee, and authorizes him to retain such possession until payment of the mortgage-money, and to receive the rents and profits accruing from the property or any part of such rents and profits and to appropriate the same in lieu of interest, or in payment of the mortgage-money, or partly in lieu of interest or partly in payment of the mortgage-money, the transaction is called an usufructuary mortgage and the mortgagee an usufructuary mortgagee.

6. Anomalous Mortgage

A mortgage which is not a simple mortgage, a mortgage by conditional sale, a usufructuary mortgage, an English mortgage or a mortgage by deposit of title-deeds within the meaning of this section is called an anomalous mortgage.

Difference between Mortgage and Pledge

- a) Mortgages are dealt as per Transfer of Property Act, 1882 whereas Indian Contract Act, 1872 deals with pledge.
- b) Pledge is the bailment of goods, as security for payment of debt, performance of promise. The creditor holds the possession of goods as security, but has no right of foreclosure; as there is no transfer of ownership. The right of enjoyment of property is not given to the pledge.
- c) While, transfer of possession is very important in case of pledge it is not necessarily so in case of mortgage (depending upon type of mortgage).
- d) In mortgage there is transfer of interest, whereas in case of pledge, the pledgee has only special right of detaining the goods till repayment of loan.
- e) Mortgagor has right of redemption and mortgagee has right of foreclosure, where as the pledgee does not have right of foreclosure.

Charge

The word Charge is not defined in the Companies Act. Section 124 merely states the expression 'charge' includes mortgage. However, Section 100 of the Transfer of Property Act, 1882 defines "mortgage". These two provisions give a fair idea that Charge is nothing but security of its property by the Company in favour of creditor with the intent of securing his debt.

Differences between "Mortgage" and "Charge"

In *Raja Sri Shiva Prasad v. Beni Madhab* AIR 1922 Pat. 529, Das J. stated that the broad distinction between a “mortgage” and “charge” is:

“Whereas a charge only gives a right to payment out of a particular fund or particular property without transferring that fund or property, a mortgage is in essence a transfer of an interest in specific immovable property.”

In other words –

A “mortgage” effectuates transfer of property or an interest therein but there is no such transfer in “charge”. In every “mortgage” there is “charge” but in “charge” there is no “mortgage”.

6.0 Registration of charges

Introduction:

CHARGE as defined in Section 100 of Transfer of Property Act, 1882

Where immovable property of one person is by act of parties or operation of law made security for the payment of money to another, and the transaction does not amount to a mortgage, the latter person is said to have a charge on the property; and all the provisions hereinbefore contained which apply to a simple mortgage shall, so far as may be, apply to such charge.

Nothing in this section applies to the charge of a trustee on the trust-property for expenses properly incurred in the execution of his trust, and, save as otherwise expressly provided by any law for the time being in force, no charge shall be enforced against any property in the hands of a person to whom such property has been transferred for consideration and without notice of the charge.

Important provisions contained in Section 125 of the Companies Act, 1956

(1) Subject to the provisions of this Part, every charge created on or after the 1st day of April, 1914, by a company and being a charge to which this section applies shall, so far as any security on the company’s property or undertaking is conferred thereby, be

void against the liquidator and any creditor of the company, unless the prescribed particulars of the charge, together with the instrument, if any, by which the charge is created or evidenced, or a copy thereof verified in the prescribed manner, are filed with the Registrar for registration in the manner required by this Act within thirty days after the date of its creation :

Provided that the Registrar may allow the particulars and instrument or copy as aforesaid to be filed within thirty days next following the expiry of the said period of thirty days on payment of such additional fee not exceeding ten times the amount of fee specified in Schedule X as the Registrar may determine, if the company satisfies the Registrar that it had sufficient cause for not filing the particulars and instrument or copy within that period.

- (2) Nothing in sub-section (1) shall prejudice any contract or obligation for the repayment of the money secured by the charge.
- (3) When a charge becomes void under this section, the money secured thereby shall immediately become payable.
- (4) This section applies to the following charges:
 - (a) A charge for the purpose of securing any issue of debentures;
 - (b) A charge on uncalled share capital of the company;
 - (c) A charge on any immovable property, wherever situate, or any interest therein;
 - (d) A charge on any book debts of the company;
 - (e) A charge, not being a pledge, on any movable property of the company;
 - (f) A floating charge on the undertaking or any property of the company including Stock-in-trade;
 - (g) A charge on calls made but not paid;
 - (h) A charge on a ship or any share in a ship;
 - (i) A charge on goodwill, on a patent or a license under a patent, on a trade mark, or on a copyright or a license under a copyright.
- (5) In the case of a charge created out of India and comprising solely property situated outside India, thirty days after the date on which the instrument creating or evidencing the charge or a copy thereof could, in due course of post and if dispatched

with due diligence, have been received in India, shall be substituted for thirty days after the date of the creation of the charge, as the time within which the particulars and instrument or copy are to be filed with the Registrar.

- (6) Where a charge is created in India but comprises property outside India, the instrument creating or purporting to create the charge under this section or a copy thereof verified in the prescribed manner, may be filed for registration, notwithstanding that further proceedings may be necessary to make the charge valid or effectual according to the law of the country in which the property is situated
- (7) Where a negotiable instrument has been given to secure the payment of any book debts of a company, the deposit of the instrument for the purpose of securing an advance to the company shall not, for the purposes of this section, be treated as a charge on those book debts.
- (8) The holding of debentures entitling the holder to a charge on immovable property shall not, for the purposes of this section, be deemed to be an interest in immovable property.

Registration of Charges:

A transaction or an arrangement that amounts to a charge, requires registration under the Companies Act only if it satisfies the conditions laid down in Section 125

Such charge should be one among the kinds enumerated in Sub-section (4) of Section 125. Needless to state, a mortgage of every kind is a charge that requires registration.

Object of Registration:

The object of Registration of a charge is to give public notice which can be achieved:

- (1) By requiring the Companies to maintain record of charges and make it available for inspection to the members of the public.
- (2) By requiring the Registrar of Companies to maintain record of the Charges filed by the companies and make it available for public inspection.

The registration of a charge thus is intended to give notice to people who may not otherwise be aware of it, particularly to persons who may advance money to the company, and it may also serve the purpose of preventing a fraudulent and belated claim of a charge in the event of liquidation.

Charges Requiring Registration:

- 1) Section 125 enumerates the kinds of charges which require registration. These are:
 - (a) A charge for the purpose of securing any issue of debentures;
 - (b) A charge on uncalled share capital or the company;
 - (c) A charge on any immovable property, wherever situated, or any interest therein;
 - (d) A charge on any book debts of the company;
 - (e) A charge, not being a pledge, on any movable property of the Company;
 - (f) A floating charge on the undertaking or any property of the company including stock in trade;
 - (g) A charge on calls made but not paid;
 - (h) A charge on a ship or any share in a ship;
 - (i) A charge on goodwill, on a patent or license, on a trade mark, or on a copy right or a license under a copyright.
- 2) A charge created without executing any instrument also requires registration. Execution of an instrument for creating a charge is not a condition precedent for the requirement of registration.
- 3) A resolution of the Board of Directors can be taken to be fact of creation of a Charge.
- 4) A charge created by operation of law or by an order of the court and not by a contract is not a charge created by the company. It therefore does not need registration as Section 125 is applicable only to the charges created by the company itself.
- 5) A charge on any movable property also requires registration (except a charge by way of pledge of movable property) vide clause (e) of sub- section (4). Thus, hypothecation of movable property is a charge that requires registration so long as it is not a pledge.

- 6) A charge on book debts requires registration vide clause (d).
- 7) Pledge of promissory notes by endorsement thereof by a company in favour of its creditor does not require registration. If a transaction satisfies all the requirements of a valid pledge, it would be eligible for exemption from registration under clause (c) of sub-section (4) of section 125; even it is also in the nature of mortgage. The reason for exempting pledge from registration is that in pledge the debtor parts with the possession of the property and passes it on to the creditor which is a sufficient notice of creation of a charge and, therefore, no registration of such a charge is necessary
- 8) A pledge of fixed deposit receipts with a Bank for obtaining a loan does not require registration. The Department of Company Affairs is of the view that registration of pledge, though not mandatory, is permissible at the instance of the company or of any interested person
- 9) A charge on future debts will be void if it is not registered. However, absolute assignment of a future debt is not a charge and a document making such assignment does not require registration.

Consequences of Non-Filing:

- 1) Charge requiring registration is void against the liquidator and any creditor of the Company if prescribed particulars are not filed with the Registrar of Companies (ROC) within thirty days of the date of creation of Charge.
- 2) The words “Filing” and “Registration” are not synonymous and interchangeable Filing is the delivering of particulars of Charges to the ROC. The term Registration denotes the registration of the Charge by the ROC office in its records as per provisions of Companies Act, 1956.
- 3) It is only the omission to file the particulars of a charge within 30 days that renders the Charge void or within next 30 days with the permission of ROC.
- 4) Charge is valid even if ROC does not register it or makes unreasonable delay in registering it, provided the particulars thereof have been filed duly within thirty days.

Filing defective particulars:

Regulation 17 of the Companies Regulations, 1956 provides that:

ROC shall examine, or cause to be examined, every document received in his office

If any such document is found to be defective or incomplete in any respect, the ROC shall direct the company to rectify the defect or complete and no such document shall be registered and recorded until the defect has been so rectified or the document has been completed as the case may be. ROC is thus, under an obligation to inform the Company about the defects. However, the document shall be treated as filed on the date on which it was initially filed and not on the date it was rectified.

Date of creation of Charge:

The date mentioned in the instrument being the date of execution thereof would be taken to be the date of creation of Charge. The period of 30 days would start from such date. In the cases of mortgage of deposit of title deeds, it is the date on which the title deeds are actually deposited and not the date of the Memorandum of the deposit, even if the date of the memorandum is subsequent to the date of deposit of the title deeds.

Procedure for Filing of particulars of creation of Charge:

The Companies (Central Government's) General Rules and Forms, 1956 read with Sections

125, 127, 128, 130, 132, 135 and 138 of the Companies Act, 1956 provides the procedure to file the documents. The Ministry of Company Affairs vide its Notification No.GSR 56 (E) dated 12.2.2006 has issued the Companies (Central Government's) General Rules and Forms (Amendment) Rules, 2006. Accordingly, in place of physical filing of documents, the e-filing has been made mandatory to all incorporated companies whether private or public, listed or unlisted without any sectoral preferences.

- 1) The prescribed particulars together with copy of the instrument creating the charge or

Modification thereof or satisfaction of charge the following Forms shall be filed with the ROC through electronic media or through any other computer readable media:

- Form No. 8: Creation of original Charge and Modification of charges
- Form No.10: Particulars for registration of charges for debentures. (Both creation And modification covered)
- Form No.13: Register of charges [merged with Form No.8 in the new system]
- Form No. 17: Memorandum of complete satisfaction of charge

2) A copy of every instrument evidencing any charge or modification of charge and required to be filed with the Registrar in pursuance of section 125, 127, 128 or 135 shall be verified as follows:

- i. Where the instrument or deed relates solely to property situate outside India, a copy shall be verified by a certificate either under the seal of the company, or under the hand of a responsible officer of the company, or under the hand of some person interested in the mortgage or charge on behalf of any person other than the company, stating that it is a true copy.
- ii. Where the instrument or deed relates, whether wholly or partly, to property situated in India, the copy shall be verified by a certificate of a responsible officer of the company stating that it is true copy or by a certificate of a public officer given under and in accordance with the provisions of section 76 of the Indian Evidence Act, 1872.

3) Form 8 or Form 10 or Form 17 as the case may be, shall be signed on behalf of the company and the charge-holder. The electronic-form shall be authenticated by authorized signatories using digital signatures, as defined in the Information Technology Act, 2000.

Certificate of registration:

As per Section 132 of the Companies Act, 1956 The Registrar shall give a certificate under his hand of the registration of any charge registered in pursuance of this Part,

stating the amounts thereby secured; and the certificate shall be conclusive evidence that the requirements of this Part as to registration have been complied with.

Penalties under Section 142 of Companies Act, 1956:

If default is made in filing with the Registrar for registration the particulars—

- (a) Of any charge created by the company;
- (b) Of the payment or satisfaction of a debt in respect of which a charge has been registered under this Part; or
- (c) Of the issues of debentures of a series;

Requiring registration with the Registrar under the provisions of the Act, then, unless the registration has been effected on the application of some other person, the company, and every officer of the company or other person who is in default, shall be punishable with fine which may extend to five thousand rupees for every day during which the default continues.

Subject as aforesaid, if any company makes default in complying with any of the other requirements of this Act as to the registration with the Registrar of any charge created by the company or of any fact connected therewith, the company, and every officer of the company who is in default, shall, without prejudice to any other liability, be punishable with fine which may extend to ten thousand rupees.

7.0 Need, Scope and Applicability of Inventories audit

7.1 Need for Inventories audit

Like any other audit, the rationale for conducting Inventories Audit also lies in prevention and early detection of frauds and errors. Inventories audit acts as a safeguard against occurrence of both Internal and External frauds.

An Inventories audit is essential for the following purposes:

- 1) To give the bankers an assurance regarding the following:
 - a) That a suitable environment for preservation of Inventories exists
 - b) That a responsible person for safeguarding the Inventories is always present
 - c) That degraded Inventories have been written off
 - d) That adequate safeguards exist against fire and natural calamities
 - e) That physical inventories tally with the Inventories statements submitted to bank
 - f) That the pledged/hypothecated Inventories is realizable
 - g) That Inventories is owned by the borrower
 - h) That all sanction terms have been adhered to
 - i) That inventories are not stagnating and becoming obsolete
- 2) To investigate, wherever the party is not submitting periodic Inventories statements regularly.
- 3) To investigate, where the accounts have been marked as substandard.
- 4) To find out reasons when there are too many qualifying remarks about inventories and receivables in the Auditor's report on the Balance Sheet of the borrower
- 5) To find out suspect dealing in lending procedure
- 6) To make the banks aware of their right of enforcement of the security interest provided in the Securitization and Reconstruction of Financial Assets and enforcement of Security Interest Act, 2002.
- 7) To fulfill Head Office requirement

7.2 Scope of Inventories audit

The scope of the audit covers all the aspects that have a direct impact on the working capital of the unit as well as the aspects relating to Inventories that have a bearing on the bank finance. In other words, it deals with the matters that have an effect on the security and liquidity in view of the banker.

It encompasses the following aspects:

- a) Physical verification of inventories
- b) Verification of condition of storage
- c) Valuation of inventories and pointing out variances
- d) Valuation of obsolete / non-moving Inventories
- e) Age-wise categorization of inventories
- f) Evaluation of the Inventories management by the company
- g) Reconciliation of Inventories statements submitted with the accounting records maintained by borrowers particularly, relating to quantity, rate, value of inventories, age, marketability, etc
- h) Verification and evaluation of sundry creditors indicating separately those relating to Inventories and their relationship with bank finance
- i) commenting upon the sources of the raw materials, i.e., whether any credit is available for the material and which of the items are available against cash payments
- j) Review of the Inventories valuation system
- k) Age-wise and value-wise qualification of debtors
- l) Determination of the drawing power
- m) Determining adequacy of the insurance cover
- n) Verification of documents/ securities
- o) Commenting upon the comparative Profitability and Inventories ratio
- p) Ensuring that the compliance of the terms and conditions of limit sanctioned
- q) Verification of transactions with sister concerns, unsecured Loans to Directors and others
- r) Any other matters of interest to the bank

7.3 Applicability of Inventories audit

Under the following circumstances it is advisable for banks to get annual Inventories audit done by the independent Agencies-

- a) Where there are over dues in term loans or other accounts, where the banks' stake is high.
- b) Where there is evidence of pressure on the borrower from the creditors
- c) Where the inventories are stagnating.
- d) Where party is not submitting period Inventories statements regularly
- e) Where there are grounds to suspect that the position of chargeable current assets indicated may not be correct.
- f) Where there are too many qualifying remarks about inventories and receivables in the auditors report on the balance sheet of a borrower
- g) Where the accounts is marked as sub-standard
- h) Suspect dealings in lending procedure, jeopardizing advances given
- i) An errant borrower, where Inventories audit is needed to supplement actions of the branches for recovery.
- j) Any other valid reason such as mismanagement, heavy losses, lockout, strikes etc
- k) Fulfilling the criteria fixed by the head office to get done Inventories audit.

8.0 Responsibility of the auditor

The responsibility of an auditor lies towards the employing authority and the authority, which regulates the profession. In case of Inventories audit, the bank or the financial institution employs the auditor. They place reliance on the audit report and acts accordingly, due to which the auditors are responsible to them. The reports issued by the auditor also cater to the needs of others including the investors, society, creditors, etc.

The importance of Inventories audit is not limited to only compliance and discharge of responsibility. Inventories Audits also acts as a warning signal to those accounts, which are expected to turn into Non-performing assets (NPA). It may be possible that certain advances are prospective NPAs and their timely detection may prevent them from turning into actual NPAs. The auditor should try to detect such inconsistencies and plug these loopholes so as to prevent the misuse of funds. Thus, the Inventories audit assists the

bank in the process of early detection and prevention of NPAs, so that appropriate action can be taken and such instances avoided. Auditors can perform this function in view of their expertise in this area and help banks form a judgment. The Auditor thus should see to it that the purposes for which the Inventories audit is undertaken are served satisfactorily.

Composition of NPA in Public Sector banks (as on 31st March) (Amount: Rs. In crores)

	Priority sector		Non-Priority sector		Public sector		Total
	Amount	Per cent	Amount	Per cent	Amount	Per cent	
SBI							
2008	8901	58.49	6222	40.88	96.64	0.63	15220
Nationalized Banks							
2008	16385	66.8	7941	32.38	202	0.82	24528
Public sector banks							
2008	25286	63.62	14163	35.63	298	0.75	39748

Source: off –site returns (domestic & Provisional) of banks, Dept of banking supervision, RBI

Special considerations while conducting Stock Audits:

- i. If the stock statement as shown in the hypothecation statement does not tally with the stocks as in the balance sheet , then appropriate action should be taken to find reasons for the differences
- ii. It should be seen that the stocks have been properly valued, after considering the relevant accounting principles, Accounting standards (AS) and Engagement Standards [earlier Known as Auditing and Assurance standards (AAS)]
- iii. It should be seen that Current Assets are not over-stated.

- iv. It should be seen that the Turnover is not over-stated.
- v. It should be seen that the stocks that are genuinely owned by the borrower are shown in the accounts

9.0 Stages in Audit

The five stages in any audit are:

1. Pre-engagement
2. Understanding the business of the entity
3. Audit planning
4. Substantive procedures
5. Reporting

Pre-Engagement

Before commencement of any audit the auditor should

1. Procure Engagement letter from the client.

An engagement letter in case of an audit documents and confirms the auditor's acceptance of appointment, the objective and scope of audit and the extent of the auditor's responsibilities to the client.

SA 210 [earlier AS 26] issued by the Institute of Chartered Accountants of India requires the auditor and the client to agree on the terms of engagement of the audit. The engagement letter should be sent by the auditor, preferably before the engagement to avoid any misunderstandings later. Two copies of the letter should be sent to enable the client to return a duly signed copy to the auditor as an acceptance of the terms stated therein.

On recurring audits, the auditor should consider the necessity for revision or for reminding the client of the terms of engagement.

The scope of an audit shall depend upon the terms of engagement, statutory requirements and the pronouncements issued by the Institute.

The auditor should not agree to a change in the engagement unless there is a reasonable justification for the same. On refusal to accept change, if the auditor is not permitted to continue the original engagement, he should withdraw and consider whether he has any obligation to report withdrawal to other parties.

1. Communicate with the previous auditor

The term “previous auditor” means the immediately preceding auditor who held same or similar assignment comprising same/similar scope of work.

The objective of communication with the previous auditor is not only for professional courtesy but also that the member may have an opportunity to know the reasons for the change in order to be able to safeguard his own interest, the legitimate interest of the public and the independence of the existing accountant.

The requirements of communication with the previous auditor apply to all audit assignments, including internal audits, concurrent audits, tax audits, etc. The object of the communication is to ascertain whether there are any circumstances warranting refusal to accept the audit. There could be a need for a qualified report or something amiss with the administration of the enterprise. The communication could also bring to light the reason for qualified report, if any, and the position of the accounts of the enterprise.

The communication should be in writing to serve as evidence. The view taken by the Council, as confirmed by the Rajasthan High Court is that mere posting of a letter under a certificate of posting is not enough to prove communication. There should be reasonable evidence to prove that the letter has in fact reached the retiring auditor.

The Standards relevant to are:

SA 210 [earlier AAS 26]	Terms of Audit Engagement	The auditor and the client should agree on the terms of engagement
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Understanding the business of the entity

Proper knowledge is a pre-requisite for any kind of planning. Hence, before planning, the auditor should acquire full knowledge of the client’s business and policies, the relevant laws and the requisites of the audit (statutory and otherwise).

This involves understanding /knowing:

1. the nature of business
2. the nature of its products
3. the processes involved in manufacture, production and ascertaining whether any part of the work is to be sent out of the entity for further processing
4. The key personnel involved
5. The business of the entity in order to identify the events and risks that may have an impact on the audit report
6. The transactions of related parties that are material to the financial statements. The auditor should obtain sufficient audit evidence in this regard
7. The accounting and internal control system of the client
8. Effect of a CIS environment on the audit. The auditor should have sufficient knowledge of the CIS to proceed with the audit.

The Standards relevant are:

SA 250 [earlier AAS 21]	Consideration of Laws and Regulations in an audit of financial statement	When the auditor believes that there is a non-compliance, he should document the same and discuss them with the
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		management
SA 315	Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment	<p>The auditor shall obtain an understanding of the following:</p> <p>(a) Relevant industry, regulatory, and other external factors including the applicable financial reporting framework.</p> <p>(b) The nature of the entity,</p> <p>(c) The entity's selection and application of accounting policies,</p> <p>(d) The entity's objectives and strategies, and those related business risks that may result in risks of material misstatement.</p> <p>(e) The measurement and review of the entity's financial performance.</p>

SA 330	The Auditor's Responses to Assessed Risks	The auditor shall design and implement overall responses to address the assessed risks of material misstatement at the financial statement level
SA 550 [earlier AAS 23]	Related parties	The auditor should obtain sufficient audit evidence regarding the transactions of related parties that are material to the financial statements
SA 402 [earlier AAS 24]	Audit considerations relating to entities using service organizations	The auditor should consider how a service organization affects the accounting and internal control system of the borrower

Audit planning

SA 200 [earlier AAS 1] "Basic Principles Governing an Audit" requires an auditor to plan his work to enable him to conduct an effective audit in an efficient and timely manner.

SA 300 [earlier AAS 8] "Audit Planning", requires an auditor to plan on a continuous basis, i.e., it should be revised on a continuous basis during the performance of audit. Audit planning involves,

- Developing an overall plan for the expected scope and conduct of the audit; and

- Developing an audit programme showing the nature, timing and extent of audit procedures.

Audit Plan is prepared prior to commencement of each audit and should-

- Have a flexible process for discussion and resolution of material compliance issues;
- Provide ways of identifying and resolving important issues to reduce audit time;
- Explain the rationale for all audit issues which are not self evident;
- Take into consideration the results of other compliance checks such as internal audit of the client
- Ensure that the Audit team, as a whole, has the appropriate expertise for undertaking the audit;
- Provide a reasonable basis and time frame, to resolve any outstanding issues from previous audits;
- Provide quick access to the Auditor to the relevant books, records, returns, agreements and all other business records (including those maintained in electronic format),
- Establish a process to measure the progress of the audit and adjust the audit plan as mutually agreed to by the parties.
- The audit plan should be signed by the authorised signatory for the auditor.

The Standards relevant while preparing the audit plan are:

SA 300 [earlier AAS 8]	Planning an Audit of Financial Statements	Auditor should plan his work based on the client's business to enable him to conduct an effective audit in an efficient and timely manner
SA 299 [earlier AAS 12]	Responsibility of joint auditors	The division of work should be adequately documented and matters of relevance

		may be communicated to the joint auditors in writing
SA 402 [Earlier AAS 24]	Audit Considerations Relating to Entities Using Service Organizations	While planning the audit, the auditor of the client should determine the significance of the activities of the service organisation to the client and their relevance to the audit
SA 530 earlier [AAS 15]	Audit Sampling	The auditor should design and select an audit sample, perform audit procedures thereon, and evaluate sample results so as to provide sufficient appropriate audit evidence
SA 570 [earlier AAS 16]	Going concern	The auditor should consider the appropriateness of the going concern assumption underlying the preparation of the financial statements
SA 220 [earlier AAS 17]	Quality control for Audit work	The audit firm should implement quality control policies and procedures designed to ensure that all audits are conducted in accordance with Auditing and Assurance standards

. Substantive procedures

An audit programme should lay down the substantive procedures for the purpose of audit. For an audit to be conducted in a systematic and comprehensive manner, the audit programme should be in writing and lay down the procedures to be followed to implement the audit plan in a detailed manner. It should also serve as a set of instructions to the assistants involved in the audit and as a means to control proper execution of the work. It also helps in peer review compliances.

An audit program should be so designed that an auditor is able to perform sufficient checks and sampling for the verification of returns and preparation of the audit report under the Maharashtra Value Added Tax Act, 2002.

The auditor should ensure Compliance with Accounting Standards, Auditing and Assurance Standards, Guidance Notes and Industry Specific Technical Guidelines.

Care should be taken to document working papers as per the Audit Plan.

The Standards relevant for the purpose are:

SA 200 [earlier AAS 1]	Basic Principles Governing an Audit	Auditor should comply with certain basic principles whenever an audit is carried out.
SA 200A [earlier AAS 2]	Objective and Scope of the Audit of Financial Statements	The auditor assesses the reliability and sufficiency of the information contained in

		the underlying accounting records and other source data by making a study and evaluation of accounting systems and internal controls and carrying out such other tests, enquiries and other verification procedures of accounting transactions and account balances as he considers appropriate in the particular circumstances.
SA 230 [earlier AAS 3]	Audit Documentation	Auditor should have proper working papers that will enable him to substantiate his results
SA 240 [earlier AAS 4]	The Auditor's Responsibility relating to Fraud in an Audit of Financial Statements	The auditor should approach the audit with a perspective, which enables him in the process of preventing and in the process, taking corrective measures, for the probable frauds and errors that exist.
SA 500 [earlier AAS 5]	Audit Evidence	The auditor should evaluate whether he has obtained sufficient appropriate evidence before he draws his conclusions
SA 510	Initial Engagements –Opening Balances	The auditor should obtain

[earlier AAS 22]		evidence that the closing balances of the preceding period have been correctly brought forward and the opening balances do not contain misstatements that materially affect the financial statements for the current period.
SA 540 [earlier AAS 18]	Auditing Accounting Estimates, Including Fair Value Accounting Estimates, And Related Disclosures	The auditor has to obtain sufficient appropriate audit evidence whether in the context of the applicable financial reporting framework: (a) accounting estimates, including fair value accounting estimates, in the financial statements, whether recognised or disclosed, are reasonable; and (b) related disclosures in the financial statements are adequate
SA 610 [earlier AAS 7]	Relying upon the work of an Internal Auditor	The auditor should evaluate the internal audit function and accordingly adopt less extensive procedures than otherwise required
SA 620	Using the work of an expert	Auditor should carefully

[earlier AAS 9]		direct, supervise and review work delegated to assistants and should obtain reasonable assurance that work done is adequate for his purpose
SA 600 [earlier AAS 10]	Using the work of another auditor	In the process of giving an assurance that the bank requires, the auditor may have to rely on the work of the other auditors like the Internal auditor, the Inspectors appointed by the RBI, etc. The principal auditor should discuss with the other auditor the audit procedures applied
SA 580 [earlier AAS 11]	Written Representations	The auditor should use his professional judgment in determining matters on which he wishes to obtain Representations by management
SA 320 [earlier AAS 13]	Audit materiality	The auditor should consider materiality and its relationship with audit risk when conducting the audit
SA 520 [earlier AAS 14]	Analytical procedures	The auditor should apply analytical procedures at the planning and overall review

		stages of the audit
SA 560 [earlier AAS 19]	Subsequent events	The auditor should consider the effect of subsequent events on the audit report
SA 505 [earlier AAS 30]	External confirmations	The auditor should determine whether the external confirmations are necessary to support certain assertions in financial statements
SA 501 [earlier AAS 34]	Audit evidence-Additional considerations for specific items	The auditor should perform audit procedures designed to obtain appropriate audit evidence during his presence in physical checking
SA 710 [earlier AAS 25]	Comparatives	The auditor should determine whether the comparatives comply, in all material respects, with the financial reporting framework relevant to the financial statements being audited.

Reporting

1. The report has to be submitted to the authority appointing the auditor.
2. It should be in the prescribed format (Form 704) and should be exhaustive and inclusive of all facts and summaries.

3. It should include the date, time, location of visit and the name of the officials conducting the audit and the official of the entity present at the time of conducting the audit.

The relevant Standards are:

SA 260 [earlier AAS 27]	Communication of Audit matters	The engagement letter should describe the form in which any communication on audit matters of governance interest will be made
SA 700 [earlier AAS 28]	Auditor's report on financial statements	The auditor should review and assess the conclusions drawn from the audit evidence obtained as the basis for the expression of an opinion on the financial statements

10.0 Audit process

Pre-commencement

Before commencement of any audit the auditor should obtain the following documents/ details from the client.

- 1) Engagement letter from the bank.
- 2) All relevant details of the borrower including:
 - a) Name of the unit and of the key persons
 - b) Address of both the registered office and factory of the unit
 - c) Nature of business
 - d) Sanction terms and conditions
 - e) Bank Account No, banking facilities enjoyed by the borrower
 - f) If the advance is a consortium lending, names of lead bank and other banks and their participation
 - g) Last three months bank statements
 - h) Last three months Inventories statements
 - i) Latest inspection report of the account, Annual report or any available audit reports
 - j) Insurance particulars
- 3) An appointment before visiting the borrower's office.
- 4) Wherever applicable, he should communicate with the previous stock auditor

Understanding the entity

This involves understanding /knowing:

1. the nature of business
2. the nature of goods, especially with regard to the storage-
 - i. whether stored at multiple locations,
 - ii. whether they are of deteriorating nature etc
3. the processes involved in manufacture, production and ascertaining whether any part of the work is to be sent out of the entity for further processing
4. The key personnel involved in preparation and submission of Inventories statements and financial statements to the bank
5. The business of the entity in order to identify the events and risks that may have an impact on the audit report
6. The transactions of related parties that are material to the financial statements. The auditor should obtain sufficient audit evidence in this regard
7. Effect of a service organization on the accounting and internal control system of the borrower
8. Effect of a CIS environment on the audit. The auditor should have sufficient knowledge of the CIS to proceed with the audit
9. Accounting software used by the entity

Audit planning

In planning the Inventories and receivables audit, the auditor should consider the following:

1. The nature of the accounting and internal control systems used regarding Inventories.

2. Inherent, control and detection risks, and materiality related to Inventories.
3. Whether adequate procedures are established and proper instructions issued for physical Inventories counting.
4. The timing of the count.
5. The locations at which Inventories is held and its nature.
6. Whether an expert's assistance is needed.

When Inventories is situated in several locations, the auditor would consider at which locations attendance is appropriate, taking into account the materiality of the Inventories and the risk of material misstatement and the assessment of inherent and control risk at different locations.

Inventories are usually located at the following locations:

1. Borrower's premises
2. At the borrower's plant.
3. In transit.
4. On Consignment.
5. In a public warehouse.
6. For processing.

Substantive procedures

The following steps are to be taken for an effective Inventories audit: -

A) Before making visit to party

- 1) Obtain the Name, Address, Telephone No., and Fax No of the party
- 2) Obtain the bank account numbers and full banking details of the party
- 3) List down the various kinds of facilities enjoyed by party and the limits thereof.

- 4) List down the date of sanction, sanction limit, drawing power & current balance in the account. Obtain a copy (Xerox) of the original sanction letter and the latest review note.
- 5) See whether the party is regularly submitting the statement of Inventories & book debts
- 6) See whether the insurance policy has been issued in the favour of bank or not.
- 7) See the amount of insurance policy & date of expiry.
- 8) Go through previous visit record made by branch manager, advance officer or any other officer of the branch.
- 9) Check whether the interest on overdraft or cash credit facility has been regularly paid, same is the case of installment payments of term loan.
- 10) See whether the operation of account is satisfactory or not.
- 11) Get an appointment before visiting the party's office.
- 12) Check the due diligence certificate in the case of Lending under Consortium Arrangement / Multiple Banking Arrangements [Refer RBI/2008-2009/379 DBOD.No. BP.BC.110/08.12.001/2008-09 February 10, 2009]

B) At the borrower's office

- 1) Check whether the party has maintained the Inventories register
- 2) Check whether other books of account have been maintained by the party i.e. cashbook, bank passbook, purchase book, sales book, debtors ledger & creditor ledger etc.
- 3) Check all statutory dues have been paid
- 4) Check whether prescribed particulars of charges as detailed in S 125(4) along with the instrument by which the charge is created has been filed with the Registrar for registration within 30 days after the date of its creation

- 5) Check the sales and purchase invoices
- 6) Bank nameplate stating “Hypothecated to Name of Bank/ Financial Institution” should be affixed on the wall in Inventories premise e.g. “Hypothecated to Corporation Bank”
- 7) If there is damaged Inventories, then it should not be taken into account for calculation of drawing power
- 8) Inventories must be in sufficient quantity to cover the advance given by the bank
- 9) Inventories should be kept in proper condition
- 10) Inventories must be kept in the premises, which should be free from water leakages, fire, & other hazards etc. so that damage to Inventories does not occur
- 11) Fire-fighting equipment must be available in Inventories premises and it should be regularly checked to preserve its utility
- 12) Specify the name of the person who has attended the auditor.

C) Documents to be obtained from the borrower

Copies of following should be obtained from party:

- 1) The auditor should obtain a written representation from management concerning:
 - (a) The completeness of information provided regarding the Inventories; and
 - (b) Assurance with regard to adherence to laid down procedures for physical Inventories count.
 1. Insurance premium receipt with respect to the insurance policy
 2. Bank/ Financial Institutions original sanction letter and the latest review note
 3. Balance Sheet & Profit & Loss Account of the borrower for last 3 years

4. Inventories Statement & Book Debts Statement as on the last day of the quarter and for the year & preceding 3 months before the date of inspection
5. Copy of Memorandum of association, Articles of association along with form No. 32 & 18, partnerships deed, Trust deed & its byelaws as may be applicable
6. Copy of Audited financial statements

D) Procedure for verification of Pledged Inventories

- 1) Ensure that a board is prominently displayed at the entrance and within the godown, clearly stating that the goods are hypothecated or pledged with the respective bank or financial institution.
- 2) Examine the lock to ensure that Bank's / financial institution's name is engraved there on.
- 3) Examine the layout of the godown where inventories are stored
- 4) If the godown is rented, inspect the rent receipt and ensure that it is in the name of the borrower. Also ensure that the rent is not in arrears. If the godown is in ownership, verify the ownership agreement and ensure that it is in the name of the borrower
- 5) Ensure that there is no other gate or entrance to the godown and if it is there, it is properly locked from inside
- 6) Ensure that the godown is located at the address given to the bank and as mentioned in the insurance policy and other documents
- 7) Ensure that the ventilators are covered by grills
- 8) Ensure that no hazardous material is stored nearby the godown. If so, it should be specifically mentioned in the insurance policy

- 9) Ensure that no other Inventories other than those pledged to the bank are stored in the godown without the specific prior authority and if they are stored, then adequate insurance cover is taken
- 10) Ensure that the godown is in a good condition without and leakage or Seepage of water and dampness
- 11) Ensure that the bin cards are signed by the godown keeper and by all inspecting officers
- 12) Ensure that there is proper stacking of goods
- 13) Ensure that the deteriorated goods are not stored in the godown
- 14) Ensure that the goods are not re-pledged

Procedure for verification of Hypothecated Inventories

In the case of hypothecation accounts, there will always be some difference between the inventories shown in the Inventories statements and the actual Inventories on the date of inspection due to the time lag involved. Hence the figures appearing in the Inventories statement and the borrower's books should be reconciled by making necessary adjustments for sales, purchases, production and consumption since the date of Inventories statement. The audit should be designed in such a manner that if the Inventories is large, an extensive check should be made of the material control system.

- i. Verify the actual inventories in the godown physically with that declared in the Inventories statement.
- ii. Verify that the record keeping is proper and that there are no indications of dishonest or inefficient management.
- iii. Verify that there are adequate internal control systems commensurate with the size of the concern
- iv. The auditor should review management's instructions regarding:
 - The application of control procedures, for example, collection of used stock-sheets, accounting for unused stock-sheets, tagging and count and re-count procedures;

- Accurate identification of the stage of completion of work in progress, slow moving, obsolete, damaged or rejected items, Inventories owned by a third party, for example, on consignment and Inventories in transit; and
 - Appropriate arrangements made regarding the movement of Inventories between areas and the shipping and receipt of Inventories before and after the cut-off date.
- v. The auditor should also consider cut-off procedures including details of the movement of Inventories just prior to, during and after the count to ensure that such movements are appropriately included and/or excluded, as applicable from such Inventories. For example,
 - (a) Goods purchased but not received are included in the inventories;
 - (b) Goods sold but not dispatched are excluded from the inventories.
 - vi. Verify whether consistent and accepted accounting principles are adopted for valuation of Inventories
 - vii. Evaluation of the security measures for prevention of theft and pilferage
 - viii. Costing system in operation to ensure the value of the system in use
 - ix. Go through the “Purchase register “, “Sales register “, “Goods received note“, and “Goods returned note” and verify with the invoices. If these registers are not prepared, then examine the books, which serve as a record of the things made as in these registers
 - x. If there is any difference between the physical verification of the inventories and the records, the same should be jotted down
 - xi. In case the inventories are lying with processors, verify whether the branch has obtained a letter of no-lien from the processors
 - xii. Scrutinize at least 20 % of the total raw material and 85 % of the total finished goods and semi-finished goods lying in the godown
 - xiii. Prepare the age-wise list of the inventories in the following manner: -

- more than 12 Months Old
 - more than 6 Months Old and Less than 12 Months Old
 - more than 3 Months Old and Less than 6 Months Old
 - more than 1 Month Old and Less than 3 Months Old
 - less than 1 Month Old
- xiv. Bifurcate the inventories into paid and unpaid and ensure that only paid inventories are taken for the purpose of calculation of drawing power
 - xv. In case of unpaid Inventories, the Bank/Financial Institution should not provide any assistance or credit facility to that extent
 - xvi. Check whether the Insurance policies cover the following risks:
 - a. Fire
 - b. Marine
 - c. Other Natural Calamities
 - xvii. The inventories hypothecated should well within the norms as suggested by the Tandon/ Chore committee. If the borrower is keeping excess Inventories than the prescribed norms, the borrowers should give a time-bound program to reduce the level of Inventories
 - xviii. A written declaration from the borrower about his existing credit facilities with other banks, if any, and an undertaking that the inventories will not be hypothecated to any other banks without the prior consent of the bank is taken on record
 - xix. Also verification of the Production register should be done
 - xx. Details of the Inventories as regards to quantity, quality, life, date of purchase and price must be verified
 - xxi. Check whether goods require any specialized preservation, and if so, then proper arrangement should be made for facilitating such storage
 - xxii. Check the method, which has been employed for ascertaining the final value of closing Inventories
 - xxiii. Check whether borrower follows the method consistently or not
 - xxiv. Verify the movement of Inventories

xxv. Check the work in progress and its basis of valuation and percentage of completion.

Procedure for verification of Hypothecated book debts

The Inventories auditor has to ensure that the book debts charged to the bank have arisen out of genuine trade transactions. Hypothecation of books debts, to be precise, is more like clean advances. Their safety depends upon the quality of checks the branch exercises over the book debts statements, submitted from time to time. Following checks, however, should be done:

1. The debts shown as outstanding should be shown in the respective ledger account in the books of the borrower.
2. Few invoices/ excise gate passes should be checked to ensure actual movement of Inventories.
3. Sundry Debtors may be classified as sound i.e. fully realizable or doubtful.
4. Prepare the age-wise list of the Book debts in the following manner.
 - more than 12 Months Old
 - more than 6 Months Old and Less than 12 Months Old
 - more than 3 Months Old and Less than 6 Months Old
 - more than 1 Month Old and Less than 3 Months Old
 - less than 1 Month Old

The age of the book debts should not be more than stipulated in the sanction. The debts of over a period of 3 months (or as stipulated in sanction) should be excluded while estimating the drawing power

5. The debt should represent sales and service transactions only.
6. Ledger of sundry debtors and sales-register should be pursued
7. Bad or doubtful debts should be excluded while calculating the drawing power
8. The advances have been allowed to reputed corporate borrowers after a careful assessment of the creditworthiness of debtors, besides that of the borrowers.
9. Examine the statement of Debtors to ascertain whether there is undue concentration of Debts involving large amount from a few parties. If so, examine

whether limits for individual debtors have been fixed and whether the limits are adhered to

10. Compare the statement of Book Debts with the Debtors ledger to ascertain the genuineness of the debt, aging of debt, & cases of non-realization of long outstanding debts.

11. All realizations are duly deposited in the account and the borrower furnishes realization statement of book debts.

12. The drawing power is revised from time to time on the basis of statements and the required margin is maintained in the account.

While valuing debtors, it should be seen that the bad and doubtful debts have been written off so as to reflect their correct value.

The following are the indicators that the debts are doubtful and uncollectible:

- 1) Terms of credit have been repeatedly ignored
- 2) Stagnation or lack of healthy turnover
- 3) Payments have been received but balances are increasing continuously
- 4) Cheques are repeatedly dishonored
- 5) Debt under litigation, arbitration or dispute
- 6) Collection becomes time barred
- 7) Debtor is unable to repay the due amount due to insolvency or disowns the debt

Confirmations

Where significant stocks of the entity are held by third parties, the auditor should examine that the third parties are entitled to hold the stocks of the entity. The auditor should also directly obtain from the third parties written confirmation of the stocks held. Arrangements should be made with the entity for sending requests for confirmation to such third parties. In the process of audit, external evidence is considered to be more reliable than internal evidence. Therefore, confirmation of Accounts Receivables, which are hypothecated for the purpose of loans from financial institutions or bank, is a

generally practiced auditing procedure to obtain such evidence. This establishes reliably the existence and the value of the debts as is reflected in the accounts.

The entire process is as follows:

1. Select the parties for obtaining confirmation.
2. Design the confirmation request.
3. Communicate the confirmation request to the third party.
4. Obtain response from the third party.
5. Evaluate the information provided by the third party and scrutinize the same for reliability.

The date of request of confirmation is also very important.

The date may be as follows:

1. Year end date
2. Date prior to year-end.

Generally the confirmation request should be sent approximately a week before the date specified in the request if the debtor is in a foreign country. The auditor should first obtain a schedule of accounts receivable. The auditor should also determine that there are no totaling errors. He should investigate the credit balances and compare all or a selected sample of account balances with the account balances in the ledgers.

The auditor should select the following accounts for the purpose of verification of accounts:

1. All accounts with a balance over a pre-determined amount. The predetermined amount is based on the auditor's assessment of materiality.
2. All accounts having zero balances.
3. Accounts with old unpaid balances especially when subsequent sales have been paid off.
4. Accounts written off during the year under review.
5. Certain accounts that had appeared on the prior year's accounts receivable schedule but not on the current year's schedule.
6. All accounts with credit balances.

Calculation of drawing power

1. Ensure margin requirements as per sanction terms are considered
2. Check for arithmetical accuracy
3. Check that old and obsolete inventories are excluded
4. Check that debtors greater than 90 days are excluded
5. Check that unpaid stock [Sundry Creditors] has been excluded
6. Check that the statement is submitted as per bank's format only
7. Drawing power is required to be arrived at based on the Inventories statement which is current
8. The outstanding in the account based on drawing power calculated from Inventories statements older than three months, would be deemed as irregular
9. The account will become NPA if such irregular drawings are permitted in the account for a continuous period of 90 days even though the unit may be working or the borrower's financial position is satisfactory.

Verification of Insurance coverage

1. Check whether the Inventories hypothecated is adequately insured
2. Check whether the policy is in force

3. Check whether inventories with third parties are also covered
4. Check whether bank clause is included in the policy
5. Check whether the Inventories is covered against all major perils
6. Check whether the collateral security is also insured adequately

Documents to be taken as Working Papers

The auditor should comply with the requirements of the SA 230 [Earlier AAS 3] on documentation and gather the following records as documentary evidence for the purpose of facilitating him in the process of audit

1. Auditor's report on Inventories for the previous three years.
2. Bank statements of the last 3 months.
3. A statement showing previous years Opening Inventories, Purchases, Sales, Work in progress and Finished Goods.
4. Details of Installed capacity, licensed capacity and Actual production with documentary evidence.
5. Copies of sales invoices for last 12 months, taking on an average at least 3 entries per month and checking the process of collection.
6. Copies of purchase invoices for last 12 months, taking on an average at least 3 entries per month and checking the process of collection.
7. A certified copy of the constitution of entity represented by either the Partnership Deed or the Memorandum and Articles of Association or the Trust deed for Trust, etc.
8. In case of a company, the following copies (i) a copy of form No.18 along with filing fees receipt for registered office address (ii) A copy of form no 32 along with filing fees receipt for directors. (iii)A copy of form No. 8 & 13 along with filing fees receipt & charge registration certificate (iv) a copy of Form No.8 & 17 along with filing fees receipt & certificate for registration of charge and balance sheet.
9. The statement of Profit and Loss account for the last 3 years.
10. Month-wise Inventories statement of the last one year.
11. Month-wise book debt statement of the last one year.
12. In case of a manufacturing concern, a brief summary of the manufacturing process

13. A list of books and records maintained for the purpose of Inventories, debtors and security.
14. An organization chart giving an overview of the organizations' hierarchy, along with their respective responsibility.
15. A flowchart depicting the movement of raw materials, work in progress and finished goods.
16. The credit policy as is employed by the company.
17. A detailed statement of debtors showing the date of the bill and age-wise classification of debtors.
18. An Inventories statement as on the date of physical verification along with date of purchase with the detailed breakup of its components.
19. A copy of agreement of ownership / Lease agreement / Rent agreement for office / Factory / Godown.
20. A list of sundry creditors with date of bill for goods purchased on date of physical verification.
21. A certified copy of the Insurance policy in force.
22. A certified copy of loan sanction letter.
23. Comprehensive management representation letter.
24. A certified copy of Excise return (RT-12), Sales tax return and Income tax return of the previous year.
25. Copy of registration certificate under Shops and Establishment Act, Register of Firms, Pollution control Board, Food and Drugs Approval Authority – other laws as applicable.
26. A note specifying the accounting policies that are employed.
27. A detailed note on accounting system for purchases, sales and inventories.

The auditor should verify the documents that are available with the bank branch and satisfy him about the adequacy of such documents. As far as possible the auditor should not, call for these documents if they are insufficient since the borrower may be

hesitant to divulge his trade documents to a third party. Instead the banks should be asked to call for these documents.

Reporting

- 9 The report has to be submitted to the authority appointing the auditor.
- 10 It should be in the prescribed format and should be exhaustive and inclusive of all facts and summaries
- 11 It should include the date, time, location of visit and the name of the officials conducting the audit and the official of the entity present at the entity at the time of conducting the audit
- 12 Copies of confirmations, management representations, etc should be submitted along with the report
- 13 If the auditor is unable to obtain sufficient appropriate audit evidence concerning the existence of Inventories or adequacy of procedures adopted by the management in respect of physical Inventories count, the auditor should make a reference to a scope of limitation in his audit report.
- 14 If the Inventories is not disclosed appropriately in the financial statements, the auditor should issue a qualified opinion.

11.0 Valuation of Inventories

If the inventories are not valued properly then it projects a wrong picture of the financial statements of the company. The valuation of inventories therefore is an important area that needs to be addressed well by the auditors.

There cannot be a universal principle to be applied for the purpose of valuation. Different methods of valuation are adopted, depending upon the type of Inventories, in particular and the type if the business in general. The auditor is therefore required to ascertain the method of valuation that best suits the requirement.

However, it should be borne in mind that he should adopt the principle of conservatism while valuing the Inventories. The Inventories should be valued at cost or market price, whichever is lower. The fundamental concept is that provision for losses should be made and unrealized profits should not be considered. This helps the accounts to project the true value in the real sense.

In the area of valuation, an auditor is therefore expected to do the following:

- I. Find out the cost price of the Inventories
- II. Determine the market value of the Inventories
- III. Since different types of Inventories require different methods of valuation, ascertaining the appropriate method of valuation and valuing it accordingly
- IV. Value the obsolete inventories/non-moving/scrap inventories

I Actual Cost of the Inventories:

Two aspects need to be addressed while arriving at the cost price:

- a) The method of valuation and
- b) Compliance of the section 145A of the Income Tax Act, 1961

Method of Valuation:

The term, cost price is elusive since it is not well defined anywhere. The auditor has to use his discretion to decide which method of ascertaining the cost price best suits his requirement. There are various methods that can be adopted. However, the Institute of Chartered Accountants has prescribed the methods that are mandatory for the valuation of

inventories, by means of the Accounting Standard – 2, which deals with the valuation of inventories.

These methods are Specific Identification method, First-in-First-out method and Weighted Average Method. It is the duty of the auditor to verify that the Inventories has been valued by either of the above methods. The auditor should report any variance from the same.

A brief idea of these methods is given as under:

1. Specific Identification Method: If the materials that have been purchased are utilized for a particular job, the actual purchase price can be charged as the cost of the Inventories. This method is appropriate when there are minimum fluctuations in the prices.
2. First in First out Method (FIFO): This is the most widely used method adopted for valuing the Inventories. Here the Inventories is valued on the basis of the principle that the Inventories is utilized in the order in which it is received. Hence the Inventories remaining is from the latest purchase.
3. Weighted Average Method (WAM): This is a relatively practical method of valuation .As per this method; the Inventories is valued at an average price which is arrived at every time a purchase is made. The simple principle of average should be applied .In other words the total value of the Inventories should be divided by the quantity to arrive at the weighted average price.

Any of the above methods can be employed for the purpose of valuation of Inventories. If any other method is employed the auditor should take note of it and report the discrepancy in the report that is submitted.

Compliance with the sec. 145A

The Income Tax Act, 1961 has inserted Section 145A from Accounting Year 1998-99. This section requires that while valuing Inventories the method employed should be:

- ❖ In accordance with the method regularly employed by the assessee
- ❖ Further adjusted to include the amount of any cess, tax, fee (by whatever name called) actually paid or incurred or fee by the assessee to bring the goods to the place of its location and condition as on the date of valuation.

While valuing the Inventories, it should be ensured that the above requirement of the statute is complied with. The auditor should obtain a satisfaction to the effect that the value of the Inventories is inclusive of any cess, tax or fee that has been either incurred or paid on such Inventories. The auditor should bring any lapse on this account to the notice in the report.

II Net Realizable Value of the Inventories

After having arrived at the cost price of the Inventories, on the basis of the aforementioned parameters, the auditor has to find out the Net Realizable Value of the Inventories. As the Inventories are to be valued at cost or net realizable value whichever is lower, it is an important step in the process of valuation. The net realizable value may seem to be a very simple term, in the sense that it is the price of the Inventories that prevails in the market and can be realized from the sale of inventories in the market. However, in order to arrive at the Net Realizable Value, the purpose for which the Inventories is held is to be found out. If it is held for use then the Net Realizable value is the value arrived at net of selling expenses. Similarly, if the Inventories are required to be replaced, then the cost of replacement as on the date of balance sheet should be taken as the net realizable value.

Thus, after arriving at the net realizable value on the above basis, the auditor can quantify the value of the Inventories.

III Valuation of different types of Inventories:

The Institute of Chartered Accountants of India defines, Inventories to include, stores, spare parts, loose tools, raw materials, materials in process, finished products, waste or by products, etc. Each type of Inventories entails different methods of valuation depending on their unique characteristics. The following points should be kept in mind while arriving at their value:

- i. Stores: Stores have been defined as that component of Inventories that is not held for sale. They are in fact, consumed in the manufacturing process. Examples of stores would include, oil, tallow, grease, dyes, fuel, etc. Since they are not Inventories in the real sense of the term, they should be shown as a separate item in the balance sheet and the amount of stores consumed should be debited to the Manufacturing Account, so as to arrive at the true cost of manufacture. The stores should be shown at cost price only. However, any deterioration in the price should be incorporated to arrive at their true value

- ii. Spare Parts: It refers to the parts that form part of any Plant and Machinery. Spare parts are usually carried as inventory and recognised in profit or loss as and when consumed. However, major spare parts which entity expect to use for more than one accounting period or which can only be used in connection of particular item of plant, property of equipment are capitalized with the cost of the plant, property of equipment with which it can be used. Spare parts should be valued at the cost price only. It is the duty of the auditor to get a list of these spare parts from the Works Manager so that he can verify their existence.

- iii. Raw Materials: It consists of the Inventories that are consumed in the process of manufacture. Raw material is valued at the cost or net realizable value whichever is lower. Cost is generally the invoice price, i.e. the cost price plus a reasonable proportion of freight, duty, etc that has been paid with regard to the Inventories.

Either the actual cost or the average price can be taken as a method of valuation of raw material, depending upon the availability of data. For any diminution in the value of the raw materials, sufficient provision of the fall in the value should be made.

- iv. Materials in process: The goods which are not completed on the date of the balance sheet, some process needs to be carried out thereon, are called materials in process or semi-manufactured goods. These should be valued at cost plus a proportionate amount of wages and other charges, on the basis of percentage of completion. The auditor should verify that the percentage of completion has been worked out properly and hence valuation is in order.

For this purposes, the auditor should or may examine the production / costing records (e.g. cost sheets), hold discussion with the personnel concerned, and obtain expert opinion, where necessary.

In certain cases, due to the nature of the product and the manufacturing process involved, physical verification of work-in-process may be impracticable. In such cases the auditor should lay greater emphasis on ascertaining whether the system from which the W- I- P is ascertained, is reliable.

- v. Finished Goods: The Finished goods are valued at the cost price. The cost price is arrived at after adding all the expenses incurred in the process of manufacture. The auditor should verify that the expenses have been appropriately apportioned.
- vi. Goods on consignment: It may happen sometimes that the goods are sent on a consignment basis and they do not arrive till the date of the balance sheet. In this case, the goods should be valued at the cost price plus proportionate expenses like, freight, dock dues, etc. the auditor should insist on the consignee to verify the quantity of Inventories lying with him. Any expenses incurred during the process of sale, it should be allocated only to the goods sold and not added to the unsold Inventories. Here again the principle of conservatism should be followed,

a price higher than the market price should not be taken, while provision for losses should be done. If the Inventories is valued at selling price, when sent as a consignment, it should be ascertained that the Inventories should be valued after making the adjustments, or else the Inventories will be over-valued.

For computing accumulation of huge inventories the number of days holding of Inventories etc, the following method may be followed:

1) For Raw Material:

$$= \frac{\text{Actual Holding} \times 365}{\text{Annual Raw Material Consumed}}$$

2) For Inventories in Process:

$$= \frac{\text{Actual holding} \times 365}{\text{Annual cost of production}}$$

3) For Finished Goods:

$$= \frac{\text{Actual holding} \times 365}{\text{Annual cost sales}}$$

4) For sundry debtors:

$$= \frac{\text{Actual outstanding debtor's} \times 365}{\text{Annual sales}}$$

5) for sundry creditors

$$= \frac{\text{Actual sundry creditors'} \times 365}{\text{Annual purchases}}$$

IV Valuation of obsolete/ Dormant/Slow-moving/Excess Inventories:

The term obsolete Inventories refers to the Inventories that has become unsaleable due to reasons like

a) Discontinuation of the product in the market b) Physical Deterioration c) Change in the design of the product d) Substitution by a better material in lieu of the existing one. The auditor should make an effort to find out the inventories that have become obsolete due to any of the above reasons. After preparing a list of them, they should be presented to the management who can decide whether they should be disposed off or kept. Obsolete inventories should be valued at net realizable value.

Dormant inventories mean the Inventories whose movement is temporarily hampered due to a variety of reasons, but they are expected to be consumed in the days to come. One such reason for their slow movement is that the Inventories is consumed in the manufacture of goods that are sold seasonally and hence their production is stopped during off-season. Slow moving Inventories means the Inventories with a low turnover rate. In other words, they move at a slow rate.

The dormant and slow moving Inventories should be valued at net realizable value, cost or replacement price, whichever is the lowest. The auditor should make a list of these items also and speed up their disposal, if necessitated by the management.

Excess Inventories, as the name suggests, is the excess of Inventories that has accumulated due to either unwarranted purchase of goods, lapse in the forecast of sales leading to excess Inventories than can be consumed, unhealthy practices in the Inventories management, etc. The question whether any Inventories is in excess is subjective and depends on the discretion of the company. In general any Inventories that is in excess of three years usage will be considered as excess Inventories. The auditor should see to it that the excess Inventories is sold and unless there is any possibility of its usage in the production process.

The auditor should bear in mind the fact that either of the above kind of Inventories necessitates additional blockage of funds, mis-utilisation of space, maintenance cost, Storage cost and fear of pilferage and further deterioration. This has an adverse impact on the bottom line of the company. He should therefore make an effort to see that proper controls are in force so as to ensure that such inventories are kept under check and as far as feasible avoided.

Techniques for the measurement of Cost

For convenience IAS 2 *Inventories* prescribes two techniques for measurement of cost, Standard Costing and Retail method, if it results in approximate cost.

Standard Costing

Standard costs take into account normal levels of materials and supplies, labour, efficiency and capacity utilisation. They are regularly reviewed and, if necessary, revised in the light of current conditions

Retail Method

The retail method is a costing methodology often employed in the retail industry to measure large numbers of rapidly changing items with similar margins for which it is impractical to use other costing methods.

The cost of the inventory is determined by reducing the sales value of the inventory by the appropriate gross margin percentage. The percentage must include inventory that has been marked down below its original selling price. An average percentage per department is often used.

Controls that should be exercised by the auditor:

A) Controls with regard to the scrap, waste and spoilage:

The term scrap refers to that Inventories that arises due to the manufacturing process and has very small value. Waste, on the other hand means goods that have no recovery value. While, spoilage refers to those goods that do not meet the quality standards and hence have to dispose off at less than their actual value.

The auditor should bear the following points in mind while exercising control over the scrap, waste and spoilage.

- a) The management should establish normal rates of scrap at which scrap is generated after having taken into account the past records and experience.
- b) Proper documentation of the scrap records should be done
- c) The actual scrap realized should be compared with the standard set and the variance should be reported
- d) The scrap should be considered as good units for the purpose of valuing the Inventories. Any sale proceeds derived from the sale of such scrap should be deducted from the cost of production.
- e) An important area for the auditor to keep a check is that of sale proceeds of the scrap. He should satisfy himself that the sale proceeds are properly accounted and they have not been misappropriated
- f) The scrap units should be properly stored in the stores department
- g) Top management should be aware of the scrap generated and hence a periodic report should be generated.

B) Controls with regard to stores maintenance:

Raw material forms the most important component in the cost sheet and hence an effort should be made that optimum Inventories is maintained. An auditor should see that the following points have been considered and any deviation from these should be immediately reported:

- a) It should be seen that the Inventories requirement has been properly planned so as to avoid a problem of either excess Inventories or shortage of Inventories. If the Inventories is more than which is required, it will lead to excess blockage of funds, in the other scenario if the Inventories is short, it will hamper the production process.
- b) The Inventories should be properly handled and stored so as to prevent deterioration in value.
- c) The stores department should be well located so as to minimize the transportation cost.
- d) There should be an effective system for recording the movement of Inventories. Any movement should be well documented.
- e) The system of First-in-First-out should be adopted so as to prevent obsolescence of old Inventories
- f) Any non-moving item should be identified and written off, if necessitated.
- g) The principle of re-order point should be followed so as to ensure continuous supply of goods at any point of time.
- h) A system of Continuous Inventories-taking should be in force

Auditor's duty with regard to the valuation of Stock:

The cost of Inventories includes (i) Cost of purchases (ii) Cost of conversion comprising of cost of direct labor and allocated Fixed and variable overheads.

While valuing the Inventories, the auditor has to consider the following:

- a) He should ascertain the accounting policy adopted for valuation of stocks and consider the appropriateness as per AS-2
- b) He should verify that the cost of Inventories does not include:
 - i. Abnormal waste material, labor or other production costs

- ii. Storage cost unless necessary in the production and manufacturing process
 - iii. Administrative overheads not contributing to bringing the Inventories to the present location
 - iv. Selling and distribution expenses
 - v. Interest cost
-
- c) He should check the basis for Net realizable value determination
 - d) He should ascertain that the cost of damaged and obsolete item is written off
 - e) He should check the arithmetic accuracy of stock valuation
 - f) He should check the consistency of the basis of valuation
 - g) He should review Inventories records for identifying slow moving and obsolete items
 - h) He should review the system of overheads allocation

A comparative study between IAS 2 and AS 2 on valuation of Inventories

Definitions: The following terms are used in both the standards with the meanings specified:

1. Inventories are assets:
 - (a) held for sale in the ordinary course of business;
 - (b) In the process of production for such sale; or
 - (c) In the form of materials or supplies to be consumed in the production process or in the rendering of services.
2. Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.
3. Inventories encompass goods purchased and held for resale, for example, merchandise purchased by a retailer and held for resale, computer software held for

resale, or land and other property held for resale. Inventories also encompass finished goods produced, or work in progress being produced, by the enterprise and include materials, maintenance supplies, consumables and loose tools awaiting use in the production process

INDIA AND IFRS

Accounting Standards in India are issued by Accounting Standard Board (ASB) of Institute of Chartered Accountants of India and are largely based on IFRS. ASB formed an IFRS task force in August 2006. Based on the recommendation of this task force, the Council of ICAI, in its 269th meeting decided to fully converge with IFRS from the accounting periods commencing on or after 1st April 2011. At initial stage, this convergence will be mandatory for listed and other public interest entities like banks, insurance companies, NBFCs, and large sized organizations with high turnover or annual income.

12.0 Verification of Securities

What does the term ‘Securities’ denote?

According to Section 2 (h) of Securities Contracts (Regulation) Act, 1956, the term ‘securities’ include-

- i. shares, scrips, inventories, bonds, debentures, debenture Inventories or other marketable securities of a like nature in or of any incorporated company or other body corporate;
- ii. derivatives;
- iii. units or any other instrument issued by any collective investment scheme to the investors in such schemes;
- iv. government securities;
- v. such other instruments as may be declared by the Central Government to be securities; and
- vi. Rights or interests in securities.

The physical as well as demat securities shall be in the form of:

1. Scrips or Certificates.
2. Safe Custody Receipts (SCR).
3. Letter of Allotment.
4. Either Scrips or Allotment Letter.
5. Certificate of holding.

Scope of Audit:

1. To verify physically the certificates of the securities held by the Branch.
2. To see that the registers for the securities held physically are maintained properly.
3. To verify that securities held by the branch are tallying with Security Holding Register.
4. To obtain the statement showing the securities sent for demat and cross tally with the records maintained in the register.
5. To check Vault and other registers with the Inventories Holding Register to see the reconciliation between physically verified scrips and total investments made by the Bank. This scrutiny will reveal major queries relating to demat, redemption, withdrawals, re-deposits, call/put options.
6. To give the report on the following lines.

Reporting should be done on the following:

1. Statement showing primary market holding.
2. Statement showing the securities in the secondary market.
3. Statement showing the securities held in physical form.
4. Statement showing the certificates withdrawn permanently from Vault for redemption or for the purpose of demats.
5. Statement showing the investments neither where allotment letters are received nor the certificates.

6. Statement showing certificates of the investments held by other branches of the bank and for which there is Safe Custody Receipts.
7. The statement showing investments held by the other branches of the bank where the Safe Custody Receipts are not received by the Bank's Investment Section.
8. Statement showing certificates withdrawn from the Vaults for the interest collection.
9. Statement showing the certificates of the investments by the R.B.I.
10. Statements showing demat secondary market holdings.
11. Statement showing half yearly interest bonds.
12. Statement showing details of letters of allotment.
13. Statement showing the investment done in Regional Rural Banks.
14. Statement showing the certificates which are torn or mutilated.
15. Statement showing scrips lodged with branches (e.g. Custody).
16. Statement showing scrips pending for demat.

The auditor has to physically verify securities and check the following points.

(A) WHEN THE ORIGINAL SECURITIES ARE IN CUSTODY OF CLIENT

- (1) Whether the securities are in the name of the client. i.e. Ownership;
- (2) Whether the securities are kept properly and in safe custody. i.e. Custodian;
- (3) Whether the face value of the securities is properly mentioned. i.e. Valuation;
- (4) Whether any security is missing, if so, investigate the reason thereto.

(B) WHEN THE ORIGINAL SECURITIES ARE IN CUSTODY OF ANOTHER PERSON i.e. BANK/ FINANCIAL INSTITUTION

In this case, the auditor will have to obtain a certificate from the holder of the securities that they are holding them on behalf of the client and the same are kept in safe custody.

(C) WHEN THE ORIGINAL SECURITIES ARE SENT BACK TO THE COMPANY FOR SURRENDER/ TRANSFER/ CHANGE IN NAME ETC.

In this case the auditor will have to check up the correspondence with the Company and the acknowledgement of the company that it has received the original security.

13.0 Analytical Review Procedures

In addition to the audit procedures discussed earlier, an auditor has to apply certain analytical procedures to review the financial soundness of the business of the borrower. The auditor should carry on the following procedures:

1. Checking records of opening stock, purchases, production, sales and closing stock
2. Comparison of closing stock with those of previous year quantity
3. Comparison of composition of closing stock with the previous year
4. Compare the current year Gross Profit with that of last year
5. Compare actual stock with budgeted figures
6. Compare Inventories ratios with those of the industry and firms

The most common analytical procedure is **Ratio Analysis**. Ratios are useful tools for review of performance and state of affairs of the organization. Ratios calculated over a period of time can reveal trends based on which meaningful conclusions can be drawn.

At planning stage Ratios give a sense of direction to the Auditor for areas to be covered for audit, during field work they help him draw inferences and identify the main points to be dealt in report while after completion of the audit ratios help the Auditor to re-enforce / establish his inferences and conclusions in his report. Ratios may be classified on the basis of their sources as follows:

1. Balance sheet ratios.
2. Income statement ratios.

3. Mixed ratios-these ratios contain figures from more than one financial statement.

Some of the more common ratios, their classification, method of computation, and the attribute measured are shown in the following list:

<i>Ratios</i>	<i>Formula</i>	<i>Purpose</i>
Liquidity ratios - Measures the entity's ability to meet its short-term obligations, and provide an indication of the Company's solvency.		
Current ratio	$\frac{\text{Current assets}}{\text{Current liabilities}}$	Indicates whether short-term creditors can be met with current assets
Quick ratio or Acid ratio	$\frac{\text{Current assets} - \text{Inventories}}{\text{Current liabilities}}$	Measures the entity's ability to pay off short-term creditors without relying on the sale of inventories

Leverage ratios - Measure the extent to which the entity is financed by debt and provide a measure of the risk of the entity borne by the creditors.

Debt ratio	$\frac{\text{Total debt}}{\text{Total assets}}$	indicates percentage of total funds provided by creditors; high ratios when
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economy is in downturn indicate more risk for creditors.

Times interest Earnings before interest and taxes

Earned Interest charges
earnings

Measures extent to which

can decline and still provide entity with ability to meet annual interest costs; failure to meet this obligation may result in legal action by creditors, possibly resulting in bankruptcy

Long-term debt
proportion of

Long-term debt

indicates the

To equity

Shareholders equity
long-term debt

the entity financed through

Vs. owners' equity.

Active ratios - Measure how effectively an entity employs its resources.

Inventories turnover Cost of goods sold
Average Inventories
sold.

Estimates how many
times a year Inventories is

Age of Inventories 360 days
Average Accounts receivable

Indicates number of
days of Inventories on hand
at year-end,

Accounts receivable $\frac{\text{Net Credit sales}}{\text{Average account receivable}}$ Estimates how many times a year, account receivable are collected

Age of accounts $\frac{360 \text{ days}}{\text{Accounts receivable turnover}}$ Indicates the age of accounts receivable or number of days sales not collected

Total Asset turnover $\frac{\text{Net sales}}{\text{Total assets}}$ Estimates volume of sales based on total assets

Profitability ratios – Measure how effectively the entity is being managed.

Sales to total assets $\frac{\text{Net sales}}{\text{Total assets}}$ Indicates the ability of an Entity to use its assets to generate sales.

Gross margin $\frac{\text{Gross margin}}{\text{Net sales}}$ Provide a percentage relationship based on sales

Profit margin on sales $\frac{\text{Net income}}{\text{Net sales}}$ Indicates the return a Company receives on sales.

Net operating margin $\frac{\text{Operating income}}{\text{Net sales}}$ Indicates management's effectiveness at using Entity's assets to generate Operating income

Return on total assets $\frac{\text{Net income} + \text{Interest income}}{\text{Total assets}}$ Indicates the return a company receives for its assets

Return on common Shareholders equity $\frac{\text{Net income} - \text{Preferred dividends}}{\text{Average stockholders equity}}$ Indicates return on investment to common shareholders

Illustrations:

Facts

A company has cost of sales for the year of Rs.1, 08,000. Its Inventories amounted to Rs.20, 000 at the beginning of the year and Rs.16, 000 at the end of the year. Its Inventories turnover is determined as follows:

1. Average Inventories

Opening stock	Rs.20, 000
Closing Stock	Rs.16, 000

Average Inventories $\frac{20000+16000}{2} = \text{Rs } 18000$

2

NOTE: A better indication of the average Inventories may be obtained by using month-end inventories, if available.

2. Cost of sales

Rs.108,000

3. Inventories Turnover Ratio = Cost of sales/ Average Inventories

$$= \frac{\text{Rs } 108,000}{\text{Rs } 18,000} = 6$$

In the previous year, the Inventories turnover was 6.

Interpretation of the above ratio:

An increase in the Inventories turnover ratio may occur because of improved purchasing, production, and pricing policies. It may also be caused by one of the following:

1. Poor credit rating of client. If the client has a poor credit rating, it may not be getting the entire Inventories it requires. This will cause Inventories levels to decline, and if sales do not decline as rapidly, the Inventories turnover ratio will increase.
2. Unrecorded purchases.
3. Unusual Inventories shrinkage.
4. Extremely conservative Inventories valuation.
5. Error in computing the Inventories.

Audit Procedures:

The following audit procedures may be employed for taking corrective action.

There are no specific auditing procedures when the high turnover is caused by insufficient Inventories because of a poor credit rating. In that situation, however, the

auditor might want to obtain a credit report on the client and should approach the audit with more skepticism than usual.

If the auditor believes that the high turnover of Inventories is caused by other than a poor credit rating, he may take the following additional procedures:

1. Review debit balances in the accounts payable schedule. A debit balance might indicate a payment without the accompanying entry for a purchase.
2. Review Inventories controls to determine the possibility of theft. Also, if the company is a manufacturer, review production records to determine spoilage and waste.
3. Compare Inventories costs with Inventories values.
4. Review Inventories computations.

Illustration 2

Facts

A company had sales (all credit) for the year of Rs.1, 20,000. Its accounts receivable at year-end amounted to Rs.20, 000. Its day's sales in account receivable are computed as follows:

1. Sales	Rs.120,000
2. Accounts receivable	Rs.20,000
3. Average daily sales (Sales Rs.120,000/360 days)	Rs. 333
4. Days sales in accounts receivable	

[Accounts receivable / Average daily sales
(Rs.20, 000 / Rs.333)]

60

In the previous year, the day's sale in account receivable was 45.

Analysis

The company is not collecting its receivables as rapidly as it did in the previous year. This increase in the day's sales accounts receivable indicates a possible problem in the collectibility of the receivables.

Auditing Procedures

The following audit procedures may be employed for taking corrective action.

The auditor may consider doing some or all of the following:

1. Review cash receipts and remittance advices for the subsequent period.
2. Obtain credit reports on significant past due accounts.
3. Analyze year-end sales to determine any unusually large sales. Determine the nature of these and sales and ascertain that they were recorded in the proper accounting period.

Apart from the above ratios, the following ratios may act as a helping tool for the purposes of interpretation of the figures as stated in the books. The illustrative example of these ratios is as below:

Illustration 3

Facts

Following is the trend statement of selected income and expense item

Year	1st	2 nd	3 rd	4 th	5th
Sales	100	116	133	151	168
Selling expenses	100	115	132	150	175

Analysis

Sales have increased at a steady rate over the 5-year period, and selling expenses matched this increase for the first 4 years. In the fifth year, however, the increase in selling expenses was disproportionate to previous years' increases and to the current year's increase in sales.

The increase may have been caused by one of the following:

1. Misclassification of expenses,
2. Classification of prepayments as expenses,
3. Recording of non-business expenses.

Auditing Procedures

The following audit procedures may be employed for taking corrective action.

If a trend statement indicates a disproportionate increase in an expense, the auditor should apply additional substantive tests to this expense. To determine the reason for the disproportionate increase in selling expenses in the preceding examples, the auditor may review invoices for major expense items in order to answer the following:

1. Were administrative or non-selling expenses classified as selling expenses?
2. At year-end, did the Company make advance payments for the subsequent year's selling program and classify these payments as an expense rather than as a prepayment?
3. Are expenses of executives, personal in nature, being charged to the company?

Thus, Ratio Analysis acts as a useful tool for the purposes of interpreting the figures and acts as a guiding light to the auditor for taking the required action.

14.0 Significant observations In Cash-Credit accounts

1. Inventories / Book Debts / QIS statements not furnished in time.
2. Inventories Statement received from Borrower filed in a routine way without scrutiny. Non moving Inventories not identified.
3. Age wise analysis of Debtors not done. Debtors more than 90 days considered for drawing power
4. Drawing power not correctly calculated.
5. Inadequate insurance, insurance not available, Policy without Bank Clause/coverage of all risk.
6. Operations in the accounts not scrutinized with reference to projections, QIS statements, audited accounts etc.
7. In case of consortium advances account is not monitored in close coordination with the member bank

8. Physical verification of assets and Inventories not done as per stipulation. Defects pointed out by the Inspectors are neglected.
9. Valuation of Inventories not verified.
10. Confirmation for Inventories with third party not obtained or physical verification of Inventories not done.
11. Material received from third parties for job work not excluded while calculating drawing power.
12. Diversion of funds and inter account transfers are not properly monitored.
13. Accounts not reviewed/renewed at regular interval.
14. Monitoring of account where sub-limit is transferred to branches.
15. Borrower having operations with other bank.
16. To cover the valuation of security, revaluation of assets done which may not be genuine.

15.0 Inadequacies of Stock Audit

Conducting Stock Audit does not necessarily guarantee absolute veracity of the stock records or even the healthy financial position, for that matter. There are certain inherent deficiencies that are inevitably there. They take place in the following ways:

- i. The auditors appointed for the purpose of Stock Audit cannot be expected to be aware of the industry scenario precisely. If the risk assessment and demand analysis is done without taking into consideration the future industry prospects, then it will undoubtedly reveal a wrong picture and hence a futile report as a result.
- ii. The scope of the auditor's work is limited; in the sense that he is not allowed to delve deep in the technical aspects. Also it is not humanely possible for him to be conversant with the technical details and this prevents him from judging the concept of technological obsolescence, which is a critical aspect as far as stocks are concerned.

- iii. Since the system of allocation of stock audit is not based on a well-worked out methodology, it is sometimes allocated without considering the proper evaluation of the competence, manpower or experience. As a result, it fails to serve the purpose it was meant to serve.
- iv. Several banks resort to window dressing for the purpose of reflecting a healthy financial position than it actually is. This may be in the form of certain liabilities which are not reflected in the books. This is particularly true in cases where the borrower has various group companies.

Remedies:

It is not possible to deal with all the inconsistencies in a fool-proof manner .However the following can be done:

- ✓ The appointment procedure of the Stock auditors can be more scientific and should be based on merit
- ✓ As required by SA 310 [Earlier AAS-20], the auditor should acquaint himself with the Knowledge of the business, before he starts the audit, both technical as well as financial aspects, to give him a better understanding.

Special considerations while conducting Stock Audits:

- ✓ If the stock statement as shown in the hypothecation statement does not tally with the stocks as in the balance sheet , then appropriate action should be taken to find reasons for the differences
- ✓ It should be seen that the stocks have been properly valued, after considering the relevant accounting principles, AS and Engagement standards
- ✓ It should be seen that Current Assets are not over-stated.
- ✓ It should be seen that the Turnover is not over-stated.
- ✓ It should be seen that the accounting policies with regard to stock and debtors is employed

- ✓ It should be seen that the stocks that are genuinely owned by the borrower are shown in the accounts.

16.0 Relevant RBI Notifications

I. DBOD.No.BP.BC. 17 /21.04.048/2009-10 dated July 01, 2009 - Master Circular - Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances

Para 4.2.4 –

The classification of an asset as NPA should be based on the record of recovery. Bank should not classify an advance account as NPA merely due to the existence of some deficiencies which are temporary in nature such as non-availability of adequate drawing power based on the latest available stock statement, balance outstanding exceeding the limit temporarily, non-submission of stock statements and non-renewal of the limits on the due date, etc. In the matter of classification of accounts with such deficiencies banks may follow the following guidelines:

i) Banks should ensure that drawings in the working capital accounts are covered by the adequacy of current assets, since current assets are first appropriated in times of distress. Drawing power is required to be arrived at based on the stock statement which is current. However, considering the difficulties of large borrowers, stock statements relied upon by the banks for determining drawing power should not be older than three months. The outstanding in the account based on drawing power calculated from stock statements older than three months, would be deemed as irregular.

A working capital borrowal account will become NPA if such irregular drawings are permitted in the account for a continuous period of 90 days even though the unit may be working or the borrower's financial position is satisfactory.

Note: **The notification can be viewed at**
http://rbidocs.rbi.org.in/rdocs/notification/PDFs/39MCC010709_FULLL.pdf

II. Lending under Consortium Arrangement / Multiple Banking Arrangements

RBI/2008-2009/379

DBOD.No. BP.BC.110/08.12.001/2008-09

February 10, 2009

The Chairman & Managing Directors /

Chief Executive Officers of

All Scheduled Commercial Banks

(Excluding RRBs and LABs)

Dear Sir,

Lending under Consortium Arrangement / Multiple Banking Arrangements

Please refer to Paragraph 2(iii) of our circular RBI/2008-09/183/DBOD.No.BP.BC.46 /08.12 .001/2008-09 dated September 19, 2008 on the captioned subject.

2. In terms of Paragraph 2(iii) of the above circular, in order to strengthen the information sharing system among banks in respect of the borrowers enjoying credit facilities from multiple banks, the banks are required to obtain regular certification by a

professional, preferably a Company Secretary, regarding compliance of various statutory prescriptions that are in vogue, as per specimen given in Annex III to the above circular.

3. In this context it is clarified that in addition to Company Secretaries, banks can also accept the certification by a Chartered Accountants & Cost Accountants. Further, on the basis of suggestions received from Indian Banks Association, Annex III - Part I & Part II (copy enclosed) has also been modified.

Yours faithfully,

(P. Vijaya Bhaskar)

Chief General Manager.

Encl: As above.

Part: I

DILIGENCE REPORT

To,

The Manager,

_____ (Name of the Bank)

I/We have examined the registers, records, books and papers of _____ Limited having its registered office at..... as required to be maintained under the Companies Act, 1956 (the Act) and the rules made thereunder, the provisions contained in the Memorandum and Articles of Association of the Company, the provisions of various statutes, wherever applicable, as well as the provisions contained in the Listing Agreement/s, if any, entered into by the Company with the recognized stock exchange/s for the half year ended on..... . In my/our opinion and to the best of my/our information and according to the examination carried out by me/us and explanations furnished to me/us by the Company, its officers and agents. I/We report that in respect of the aforesaid period:

1. The management of the Company is carried out by the Board of Directors comprising of as listed in Annexure, and the Board was duly constituted.

During the period under review the following changes that took place in the Board of Directors of the Company are listed in the Annexure, and such changes were carried out in due compliance with the provisions of the Companies Act, 1956.

2. The shareholding pattern of the company as on ----- was as detailed in Annexure

During the period under review the changes that took place in the shareholding pattern of the Company are detailed in Annexure.....:

3. The company has altered the following provisions of

(i) The Memorandum of Association during the period under review and has complied with the provisions of the Companies Act, 1956 for this purpose.

(ii) The Articles of Association during the period under review and has complied with the provisions of the Companies Act, 1956 for this purpose.

4. The company has entered into transactions with business entities in which directors of the company were interested as detailed in Annexure.....

5. The company has advanced loans, given guarantees and provided securities amounting to Rs. _____ to its directors and/or persons or firms or companies in which directors were interested, and has complied with Section – 295 of the Companies Act , 1956.

6. The Company has made loans and investments; or given guarantees or provided securities to other business entities as detailed in Annexureand has complied with the provisions of the Companies Act, 1956.

7. The amount borrowed by the Company from its directors, members, financial institutions, banks and others were within the borrowing limits of the Company. Such borrowings were made by the Company in compliance with applicable laws. The break up of the Company's domestic borrowings were as detailed in Annexure :

8. The Company has not defaulted in the repayment of public deposits, unsecured loans, debentures, facilities granted by banks, financial institutions and non-banking financial companies.

9. The Company has created modified or satisfied charges on the assets of the company as detailed in Annexure.... Investments in wholly owned Subsidiaries and/or Joint Ventures abroad made by the company are as detailed in Annexure

10. Principal value of the forex exposure and Overseas Borrowings of the company as on are as detailed in the Annexure under"

11. The Company has issued and allotted the securities to the persons-entitled thereto and has also issued letters, coupons, warrants and certificates thereof as applicable to the concerned persons and also redeemed its preference shares/debentures and bought back

its shares within the stipulated time in compliance with the provisions of the Companies Act, 1956 and other relevant statutes.

12. The Company has insured all its secured assets.

13. The Company has complied with the terms and conditions, set forth by the lending bank/financial institution at the time of availing any facility and also during the currency of the facility

14. The Company has declared and paid dividends to its shareholders as per the provisions of the Companies Act, 1956.

15. The Company has insured fully all its assets.

16. The name of the Company and or any of its Directors does not appear in the defaulters' list of Reserve Bank of India.

17. The name of the Company and or any of its Directors does not appear in the Specific Approval List of Export Credit Guarantee Corporation.

18. The Company has paid all its statutory dues and satisfactory arrangements had been made for arrears of any such dues.

19. The funds borrowed from banks/financial institutions have been used by the company for the purpose for which they were borrowed.

20. The Company has complied with the provisions stipulated in Section 372 A of the Companies Act in respect of its Inter Corporate loans and investments.

21. It has been observed from the Reports of the Directors and the Auditors that the Company has complied with the applicable Accounting Standards issued by the Institute of Chartered Accountants in India.

22. The Company has credited and paid to the Investor Education and Protection Fund within the stipulated time, all the unpaid dividends and other amounts required to be so credited.

23. Prosecutions initiated against or show cause notices received by the Company for alleged defaults/offences under various statutory provisions and also fines and penalties imposed on the Company and or any other action initiated against the Company and /or its directors in such cases are detailed in Annexure.....

24. The Company has (being a listed entity) complied with the provisions of the Listing Agreement.

25. The Company has deposited within the stipulated time both Employees' and Employer's contribution to Provident Fund with the prescribed authorities.

Note: The qualification, reservation or adverse remarks, if any, are explicitly stated may be stated at the relevant paragraphs above place(s).

Place:

Signature:

Date:

Name of Company Secretary/Firm:

C.P. No.:

Part II

CERTIFICATIONS OF BORROWAL COMPANIES BY CHARTERED ACCOUNTANTS / COMPANY SECRETARIES/ COST ACCOUNTANTS

- i. Terms of reference for stock audit are to be spelt out clearly by the Banks, so that the Chartered Accountants can give focused attention to such areas.
- ii. End-use verification of funds lent, if certified by Statutory Auditors, will be a good comfort to the Banks.
- iii. As Banks quite often deal with unlisted companies, disclosure requirements for such companies above a specific turnover may be made akin to those for listed companies, viz. consolidated balance sheet, segmental reporting etc. Information on large shareholding also will be useful.
- iv. Further, the following additional certification either from Chartered Accountant or Company Secretary or Cost Accountants may also be thought of :-
 - (a) Company Directors not figuring in defaulters list (RBI/ECGC)/willful defaulters list etc.)
 - (b) Details of litigation above a specified cut off limit.
 - (c) A specific certificate, probably from the Company Secretary, regarding compliance with Sec. 372 (a) of the Companies Act.
 - (d) Details of creation/ modification/satisfaction of charges on the assets of the company, position regarding insurance, show cause notices received, finds and penalties awarded.
- v. As regards rotation of Auditors, for the sake of operational convenience, it is suggested they may be changed once every 5 years instead of every 3 years.
- vi. In order to avoid concentration, group companies may have different Statutory/Internal Auditors in case group turnover exceeds Rs.100 crores.

17.0 Specimen Documentation

17.1 Checklist for audit of Inventories and Receivables

Bank:

Branch:

Zone:

Name of the account:

Address:

I) Office:

II) Factory & Go down:

Constitution:

Name of the Partners /directors:

Nature of business:

Latest Sanction:

Authority:

Date

Position of account:

Nature Of Facility	Sanctioned Limit (Rs.)	Drawing Power (Rs.)	Outstanding As On (Rs.)	Overdue Excess, If Any. (Rs.)
Term Loan				

Specify the assets a) Land & Building b) Plant & Machinery c) Others Cash Credit (Inventories & Book- Debts.)				
--	--	--	--	--

Remarks on the payment of interest & installments:

Inspected by:

Date of inspection:

Name and designation of
Attendant:

A) Before going for Physical verification:

Sr No	Particulars	Yes/ No/Not applicable
1	Have you sent an engagement letter?	
2	Have you verified the borrower's file at the branch to ascertain the following details:	
	a) Name of the borrower	
	b) Location of	

	-Office - Godown / Factory													
	c) Constitution (Sole proprietor, Partnership, Pvt. Ltd)													
	d) Managing director / managing partner's details Name, Complete address, Landline number, Mobile number and Email ID													
	e) Nature of Business													
	f) Date of establishment and date of commercial production													
	g) Website Address of the borrower , if any													
	h) Particulars of credit limits <table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="width: 15%;">Loan A/c No</th> <th style="width: 15%;">Facility</th> <th style="width: 15%;">Sanctioned Limits</th> <th style="width: 10%;">D.P</th> <th style="width: 15%;">Balance O/S</th> <th style="width: 15%;">Overdue/excess</th> </tr> </thead> <tbody> <tr> <td> </td> <td> </td> <td> </td> <td> </td> <td> </td> <td> </td> </tr> </tbody> </table>	Loan A/c No	Facility	Sanctioned Limits	D.P	Balance O/S	Overdue/excess							
Loan A/c No	Facility	Sanctioned Limits	D.P	Balance O/S	Overdue/excess									
	i) Particulars of security: A) Primary: B) Secondary													
3	What is the asset code: (Standard, Sub-standard, Doubtful or Loss Assets)?													
4	Whether advance is sanctioned on Consortium Basis? Is so, the position of each of the banks? <table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="width: 15%;">Name of the Bank</th> <th style="width: 15%;">Limit sanctioned</th> <th style="width: 15%;">Value of security</th> <th style="width: 15%;">Balance Outstanding as on -----</th> <th style="width: 15%;">Overdrawn amount</th> </tr> </thead> <tbody> <tr> <td> </td> <td> </td> <td> </td> <td> </td> <td> </td> </tr> </tbody> </table>	Name of the Bank	Limit sanctioned	Value of security	Balance Outstanding as on -----	Overdrawn amount								
Name of the Bank	Limit sanctioned	Value of security	Balance Outstanding as on -----	Overdrawn amount										

				--		
5	Insurance Particulars:					
	Policy No	Assets covered/ Location	Amount Insured	Date of expiry of Policy	Whether Bank clause exists in the policy	
6	Whether additional risks like theft, earthquake, and machinery breakdown are included as per sanction terms and are complied with by the borrower?					
7	Whether the address/ location of goods is properly stated and includes Door No./ Survey No. Municipal no etc?					
8	Whether goods sent to the processing units, sub-contractors are insured/ transit insurance obtained?					
9	Whether all locations/ all industry specific risks are covered?					
10	Whether proper documents, including charging of primary and secondary securities have been obtained?					
11	What is the date of documentation?					
12	Whether documents are properly stamped?					
13	Whether equitable/ registered mortgage of property created?					

14	Whether search report has been got done up to the date of equitable/ registered mortgage?	
15	Wherever required whether charge has been registered with ROC within prescribed time?	
16	Have you verified the periodical stock statements submitted by the borrower with reference to any conditions stipulated in the sanction regarding: a) Quantity of stocks, b) Place of storage, c) Value of stocks d) Composition of stocks- Proportion of raw material, work – in- process and finished goods	
17	Have you verified that the stock statements are? a) signed by authorized persons only b) sent in bank’s format c) sent within the stipulated time to the bank	
18	Have you verified the Godown stock register in case of pledged accounts to ascertain the nature and quantity of stock pledged in each godown, age and turnover in the stocks?	
19	Have you verified the operations in the account to ensure that the a) Operations and utilization of the funds and turnover are satisfactory b) Drawings are allowed within the drawing power and sanction stipulations are complied with c) Sale proceeds of hypothecated stocks are routed	

	through the account only	
20	Have you verified the previous stock audit/ branch inspection reports to ascertain whether any steps have been taken to rectify irregularities pointed out?	
21	Have you obtained a representation letter from the borrower clearly indicating the places /branches where the goods are stored?	
22	<p>Have you obtained the following documents to from the borrower?</p> <p>1) A written representation from management concerning:</p> <p>(a) The completeness of information provided regarding the Inventories; and</p> <p>(b) Assurance with regard to adherence to laid down procedures for physical Inventories count.</p> <p>2) Balance Sheet & Profit & Loss Account of the borrower for last 3 years</p> <p>3) Inventories Statement & Book Debts Statement as on the last day of the quarter and for the year & preceding 3 months before the date of inspection</p> <p>4) Copy of Memorandum of association, Articles of association along with form No. 32 & 18, partnerships deed, Trust deed & its byelaws as may be applicable</p> <p>5) Copy of Audited financial statements</p>	
23	Have you inquired about the Associations of which borrower party is member?	
24	<p>Have you done documentary checking of ownership or lease?</p> <p>Have you taken a copy of the same?</p>	

25	Have you taken phone numbers of CA's – Statutory Auditor, Tax Auditor etc?	
26	Have you made a comparison of previous 2 to 3 years financial position of the borrower?	
27	Have you checked whether the account is a suit filed account?	

B) Physical verification of stocks

I. Verification of Hypothecated Stock

Sr No	Particulars	Yes/ No/ Not applicable
1	Is there any difference between the stocks as shown in the stock statement and the actual stock?	
2	Whether any reconciliation for the difference has been made?	
3	Whether the stocks represent those reflected in the stock statements sent to the Banks?	
4	Is the level of Inventories held found to be too high?	
5	Is the material control system employed by the borrower proper?	
6	Whether the borrower has maintained up to date records?	
7	Whether the borrower is having adequate internal control system commensurate with the size of the concern?	
8	What is the Accounting software used by the borrower?	
9	Whether borrower is following consistent and	

	accepted accounting principles for valuation of stocks?	
10	Whether the quality and sale ability of the stocks are good?	
12	Whether the following records of the borrower have been checked? a) Excise records b) Raw materials consumption, Production register, Purchase and sales records c) Purchase and sales invoice d) Cost records and order books e) Sales, Purchase, Sundry creditors and Debtors ledgers	
13	Has the stock been stored properly?	
14	Is there a direct access to the godown?	
15	What is the value of a) Obsolete stock b) Slow- moving stock c) Damaged/ Rejected stocks d) Unpaid stock	
16	Whether Sundry creditors have been deducted as per policy of bank and as per sanction terms?	
17	Whether stipulated margin as per sanction terms has been deducted?	
18	Whether stocks received under usance L/C, co-acceptances and guarantees for purchase of raw materials have been reduced?	
19	Whether the Bank Hypothecation Board has been displayed?	
20	Whether stocks belonging to sister concerns,	

	received for job- work etc are properly segregated?	
21	Whether the movement of stock in and out of the godown is properly accounted and monitored?	
22	What is the Work in progress and level of completion?	
23	Whether the goods which require any specialized preservation, are properly preserved?	
24	Whether rent/ property tax/ municipal tax receipts pertaining to godowns have been verified?	
25	Whether , in case of stocks which have expiry dates(such as drugs, food items) the same have been excluded for calculation of drawing power	
26	Whether , stocks have been examined at laboratories(in case of chemicals, dyes etc)	
27	Whether goods-in transit are included in the stock statements? Is the inclusion of such goods as per sanction terms? Whether the relative bills/ challans/ invoices have been verified?	
28	Whether goods sent to third parties for job work, finishing or machining etc. have been inspected?	
29	Whether any written confirmation is on record for stock with third parties?	
30	Whether the sanction terms permit storage of goods with clearing agents?	
31	If so, whether the agents are in the approved list of the bank and within the limits fixed by the bank?	
32	Whether clearing agents charges and other dues have been paid?	
33	Whether any irregularities pointed out in the last	

	Concurrent audit/ Inspection report have been rectified?	
34	Whether a written declaration has been obtained from the borrower that the stocks will not be hypothecated to other banks without the prior consent of the bank?	
35	Whether, in case of consortium advances, information is exchanged between the banks?	
36	Whether the hypothecated Plant & Machinery is maintained properly and found in working condition?	
37	Were there any instances of breakdown causing interruptions in the working of the unit in the recent past?	
38	Whether fire protection measures are satisfactory?	
39	Whether security arrangements at the godown/ Factory are satisfactory?	
40	Have you checked up the Sales Tax Provision?	
41	Have you checked Income Assessment Orders?	
42	Have you checked the provisions relating to ESIS Challans?	
43	Have you checked provisions relating to PF – Challans, assessment order?	
44	Has the factory license been renewed?	
45	Have you received the details of no. of skilled and unskilled employees, office staff? Have you checked up the Salary register?	
46	Have you considered the inherent control and detection risks, and materiality related to Inventories?	

47	Whether adequate procedures are established and proper instructions issued for physical Inventories counting?	
48	Whether persons involved in stock taking differ from those responsible for store-keeping?	
49	Whether store procedures provide for the use of pre-numbered forms	
50	Whether a system of cross-checking exists for checking data generated by different departments?	
51	Whether controls exist for receipts and issues of stores?	

II)

Hypothecation of book- debts

Sr. No.	Particulars	Yes / No/ Not applicable
1.	Are standard price lists maintained?	
2.	Are prices that are not based on a standard price list, required to be approved by a senior executive outside the sales department?	
3.	Are written orders received from customers?	
4.	If oral / telephonic orders are received from customers, whether the same are recorded	

	immediately in the standard forms?	
5.	Is there a numerical control over all customers' orders?	
6.	Are credit limits fixed in respect of individual customers? Does an official independent of the sales department approve these limits?	
7.	Are credit limits reviewed periodically?	
8.	Are customers' credit limits checked before orders are accepted? Is this done by a person independent of the sales department?	
9.	If sales to employees are made at concessional prices: a) Is there a limit to the value of such sales? b) Are the amounts recovered in accordance with the terms of sale? a) Is there an adequate procedure to see that the limits are not exceeded?	
10.	Are dispatches of goods authorized only by Dispatch Notes/Gate Passes or similar documents?	
11.	Do such Dispatch Notes/Gate Passes or similar documents bear pre-printed numbers?	
12.	Are they under numerical control?	
13.	Are they prepared by a person independent of: a) The Sales Department? b) The processing of invoices?	
14.	Except when all documents are prepared in one operation, are the Dispatch Notes/Gate Passes matched with? a) Excise Duty Records?	

	<p>b) Sales invoices?</p> <p>c) Freight payable to carriers (where applicable)?</p>	
15.	Are unmatched Dispatch Notes/Gate Passes reviewed periodically?	
16.	Are the goods actually dispatched checked independently with the Dispatch Notes/Gate Passes and customer's orders?	
17.	Are acknowledgements obtained from the customers, for the goods delivered?	
18.	Are the customer's orders marked for goods delivered?	
19.	Are shortages in goods delivered to the customers investigated?	
20.	Are credits to customers for shortages, breakage & losses in transit match the claim lodged against carriers/insurers?	
21.	Are sales invoices pre-numbered?	
22.	<p>Are invoices checked for:</p> <p>a) Prices?</p> <p>b) Calculations (including excise duty and sales tax)?</p> <p>c) Terms of payment?</p>	
23.	Are 'no charge' invoices authorized by a person independent of the custody of goods or cash?	
24.	Are invoices mailed direct to the customers promptly?	
25.	Are credits to customers for remittance posted only from the entries in the cash book (or	

	equivalent record)?	
26.	Does cashier notify immediately: a) Sales Department, b) Debtors Ledger Section and c) Credit Controller; i) Of all dishonored cheques or other negotiable instruments? ii) Of all documents sent through bank but not returned by the customers?	
27.	Is immediate follow-up action taken on such notification?	
28.	Are the bills of exchange, etc. periodically verified with the bills on hand?	
29.	Is a record of customers claims maintained? a) Are such claims properly dealt with in the accounts?	
30.	Does the Receiving Department record them on sales Return Note?	
31.	Does the Receiving Department count, weigh or measure the goods returned?	
32.	Are copies of Sales Returns Notes sent to: a) Customer? b) Sales Department? c) Debtors' Ledger Section?	
33.	Are the returned goods taken into stock immediately?	
34.	Is a Credit Note issued to the customer for the goods returned?	
35.	Are all Credit Notes pre-numbered?	
36.	Are Credit Notes numerically controlled?	

37.	Are Credit Notes authorized by a person independent of: a) Custody of goods? b) Cash receipts? c) Debtors' ledger?	
38.	Are Credit Notes: a) Compared with Sales Returns Notes or other substantiating evidence? b) Checked for prices? c) Checked for calculations?	
39.	Are corresponding recoveries of sales commissions made when Credit Notes are issued to customers?	
40.	Are units of sales (as per sales invoices) correlated and reconciled with the purchases (or production) and stock on hand?	
41.	Is the Sales Ledger balanced periodically and tallied with the General Ledger Control account?	
42.	Are ageing schedules prepared periodically?	
43.	Does a responsible person review them?	
44.	Are statements of accounts regularly sent to all customers?	
45.	Are the statements checked with the Debtors' Ledger before they are issued?	
46.	Does a person independent of the ledger keeper mail the statements?	
47.	Are confirmations of balances obtained periodically?	
48.	Do a person independent of the ledger-keeper and	

	the person preparing the statement verify the confirmations?	
49.	Is special approval required for: a) Payments of customers' credit balances? b) Writing of bad debts?	
50.	Is any accounting control kept for bad debts written off?	
51.	Is any follow-up action taken for recovering amounts written off?	
52.	In the case of export sales: a) Is a record maintained of import entitlements due? b) Does the record cover the utilization disposal of such entitlements? c) Is there a procedure to ensure that claims for incentives etc., receivable are made in time?	
53.	Are sales of scrap and wastage subject to the same procedures and controls as sales of finished goods?	
54.	Is age wise classification of debtors done? Has care been taken to exclude long outstanding debtors from drawing power calculation?	
55	Whether the debt represents sales and service transactions only?	
56	Whether all realizations from debtors are routed through the borrower's account?	
57	Whether care is taken to ensure that receivables already advanced by way of bills purchased/ Bills discounted have been excluded?	
58	Whether reasons for non-realisation of overdue debts have been examined?	

59	Whether Power of Attorney in favour of the bank, wherever prescribed has been duly registered?	
60	Whether the statement of book debts submitted to the bank is as per Bank's format?	
61	Whether the drawing power is revised from time to time on the basis of the statements and the required margin is maintained in the account?	

III) Pledged Inventories

Sr. No.	Particulars	Yes / No/ Not applicable
1	Have you verified that a board is prominently displayed at the entrance and within the godown, clearly stating that the goods are hypothecated or pledged with the respective bank or financial institution?	
2	Have you examined the lock to ensure that Bank's / financial institution's name is engraved there on?	
3	Have you examined the layout of the godown where inventories are stored?	
4	If the godown is rented, have you inspected the rent receipt and ensured that it is in the name of the borrower? Have you ensured that the rent is not in arrears?	
5	If the godown is in ownership, have you verified the ownership agreement and ensured that it is in the name of the borrower?	

6	Have you ensured that there is no other gate or entrance to the godown and if it is there, it is properly locked from inside?	
7	Have you ensured that the godown is located at the address given to the bank and as mentioned in the insurance policy and other documents?	
8	Have you ensured that the ventilators are covered by grills?	
9	Have you ensured that no hazardous material is stored nearby the godown.(If so, it should be specifically mentioned in the insurance policy)	
10	Have you verified that no other inventories other than those pledged to the bank are stored in the godown without the specific prior authority and if they are stored, then adequate insurance cover is taken?	
11	Have you verified that the godown is in a good condition without and leakage or Seepage of water and dampness?	
12	Have you verified that the bin cards are signed by the godown keeper and by all inspecting officers?	
13	Have you verified that there is proper stacking of goods?	

14	Have you ensured that the deteriorated goods are not stored in the godown?	
15	Have you verified that the goods are not re-pledged?	
16	Have you verified that manufactured goods are stored in their original packing?	
17	Have you ensured that goods are delivered only in the presence of the Bank's representative?	
18	Have you ensured that the turnover of the stocks is satisfactory and that there is no old stock?	

17.2 Specimen Engagement letter

{The following letter is for use as a guide in conjunction with the considerations outlined in SA 210 [Earlier AAS 26] and will need to be varied according to individual requirements and circumstances relevant to the engagement.

To the Regional/ Zonal Manager

You have requested that we audit the inventory and receivables of (Name of the Borrower) as -----, 2XXX. We are pleased to confirm our acceptance and our understanding of this engagement by means of this letter. Our audit will be conducted with the objective verification of the assets so as to indicate their physical existence, valuation and safety aspects.

We will conduct our audit in accordance with the auditing standards generally accepted in India and with the requirements of the applicable laws and regulations. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in

the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

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 of financial statements, resulting from fraud, and to a lesser extent error, if either exists, may remain undetected.

The responsibility for the preparation of financial statements on a going concern basis is that of the management. The management is also responsible for selection and consistent application of appropriate accounting policies, including implementation of applicable accounting standards along with proper explanation relating to any material departures from those accounting standards. The management is also responsible for making judgements and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the entity at the end of the financial year and of the profit or loss of the entity for that period.

The responsibility of the management also includes the maintenance of adequate accounting records and internal controls for safeguarding of the assets of the company and for preventing and detecting fraud or other irregularities. As part of our audit process, we will request from management written confirmation concerning representations made to us in connection with the audit.

We look forward to full cooperation with your staff and we trust that they will make available to us whatever records; documentation and other information are requested in connection with our audit.

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

XYZ & Co.
Chartered Accountants

.....

(Signature)

17.3 Specimen Management Representation Letter

[Client's Letterhead]

[Date]

To,

[Name]

Chartered Accountants,

We are providing this letter in connection with the Inventories Audit for the period _____ for the purpose of expressing an opinion as to whether the stock records have been properly maintained or not and whether they are in conformity with the generally accepted accounting principles.

We confirm to the best of our knowledge and belief as under:

- 1) The financial statements referred to are in conformity with generally accepted accounting principles. (We have complied with all accounting standards issued by Institute of Chartered Accountants of India)
- 2) There have been no communications from regulatory agencies regarding non-compliance or differences, if any, in financial reporting practices
- 3) There are no material transactions which have not been properly recorded in the accounting records underlying the financial statements
- 4) There has been no

- a) Fraud involving management or employees who have significant say in internal control
 - b) Fraud involving other than that would have a material effect on the financial statements
- 5) The company has no plans or intentions that may materially affect the carrying value of assets and liabilities
- 6) The following have been properly recorded or disclosed in the financial statements:
- a) Related party transactions including sales, purchases, loans, transfers, and guarantees and amounts receivable from or payable to related parties
 - b) Guarantees whether written or oral under which the company is contingently liable
- 7) The company has satisfactory title to all owned assets and there are no liens or encumbrances on such assets nor has any asset been pledged as collateral
- 8) We further state as under:

Accounting Policies:

Method of Accounting:

The Financial statements are prepared on accrual method of accounting.

Inventories:

Raw material is valued at cost on FIFO.

Finished Goods is valued at lower of cost or net realizable value. Excise duties on goods manufactured by the company and remaining in Inventories are included as a part of values on of finished goods.

9) The Insurance for building and furniture is Rs. -----, Plant & Machinery Rs. ----- Stock in process Rs. ----- & for other items Rs -----, which will be expiring on -----.

10) a) The Installed capacity of the company is ---- millions pieces.

b) Actual production for the year ended 31.03.2008 on -----
Was -----pieces

11) a) The total quantity produced during the month ----to -----
was ----- pieces.

b) Total quantity cleared during the month ----- to -----
was ----- pieces and the value for the same was Rs. ----- ----

c) Actual production for the year ended 31.03.2008 was -----
pieces.

1. The performance of the company for last 3 years was as follows:

Particulars	For the year ended 31.03.2007	For the year ended 31.03.2008	For the year ended 31.03.2009
Sales (including excise duty but exclude Sales tax)			
b) Purchases			
c) Net Profit			
d) Opening Stock			
e) Closing Stock			

13. Insurance Policy.

- a) Period of Insurance policy.
- b) Risks Covered.
- c) Place of Insurance
- d) Conditions of claim
- e) Name of insured
- f) Period of Validity of Policy & Time

14. Godown.

- a) Address along with Tele/Fax/E-mail.
- b) Ownership/Rented
(If leased/ rented obtain lease/ rent agreement)
- c) Period of Rent/ Lease agreement
- d) Monthly Rent/ Lease
- e) Name & Address of Owner (when it is rented / leased)

15. Office

a) Address along with Tele/Fax/E-mail

b) Ownership/Rented

(Obtain copy of Rent/ Leased agreement if taken on Lease/ Rent)

c) Period of Rent/ Lease agreement

d) Monthly Rent/ Lease

e) Name & Address of Owner (when it is rented / leased)

Tele/Fax/E-mail

16. Factory

a) Address along with Tele/Fax/E-mail

b) Ownership/Rented

(Obtain copy of Rent/ Leased agreement if taken on Lease/ Rent)

c) Period of Rent/ Lease agreement

d) Monthly Rent/ Lease

e) Name & Address of Owner (when it is rented / leased)

Tele/Fax/E-mail

17)The total value of book debts less than 90 days as on -----

was ----- and receipted challans was -----

18) The Total Value of the following items is as under:

I Raw Material

- i. Average Stock as per
Project report for the year ended 31.03.2009
- ii. Average stock of
Last 12 months.
- iii. Value of Stock on date of physical Verification.
- iv. Comparison of last 12 months
Stock as per records & as per
Statement
(reason for discrepancies)

II Work In Progress

i.

ii.

iii.

iv.

III Finished Goods

i.

ii.

iii.

iv.

19. Ratios.

For the year ended 31.03.2009	For the year ended 31.03.2008	For the year ended 31.03.2007
----------------------------------	----------------------------------	----------------------------------

- a) Current Ratio.
- b) Liquid Ratio.
- c) Gross Profit Ratio.
- d) Stock Turnover Ratio.
- e) Debtors Turnover Ratio.

For [Borrower's Name]

(_____)

Director/ Partner/ Proprietor

17.4 Specimen Letter of confirmation from third party

[Client's Letterhead]

To

[Date]

[Name & Address of Customer]

Dear Sir,

Our auditors [name and address] are conducting an audit of our financial statements. Please examine the accompanying statement and either confirms its correctness or report any differences to our auditors.

Your prompt attention to this request will be appreciated. An envelope is enclosed for your reply.

For XYZ Ltd.

(_____)

Director

Confirmation: The balance receivable from us of [amount] as of [date] is correct except as noted below:

17.5 Specimen Letter of confirmation of inventories held by others

(Letterhead of entity)

Date: _____

(Name & address of holder of inventories)

Dear Sir /Madam,

For audit purposes, kindly furnish directly to our auditors (Name & Address of the auditors) details concerning our inventories held by you for (state the reasons/ purpose of holding of inventories by the third party) as on __(date)___.

According to our records, you held the following inventories as on - date.

Description	Quantity
-------------	----------

In case you identify certain items of inventories as defective or damaged, the details thereof may be furnished separately, indicating the quantities and giving a general description of the condition of such items. Also, please confirm that our inventories held by you are free of any charge or encumbrance.

A stamped envelope addressed to our auditors is enclosed for your convenience.

Yours faithfully

(Signature of responsible official of entity)

Similarly, the auditor should also obtain confirmation from such third parties for whom the entity is holding significant amount of stocks.

17.6 Specimen Letter of confirmation of inventories held by the entity on behalf of others

(Letterhead of entity)

Date: _____

(Name & Address of owner of inventories)

Dear Sir / Madam

Ownership / Rented:

II) Factory & Go down:

Ownership / Rented:

Date of establishment:

5) Constitution:

6) Name of the Partners /directors:

7) Nature of business:

8) Inspected by:

9) Date of inspection:

10) Name and designation of
Attendant:

11) Position of account:

Nature Of Facility	Sanctioned Limit (Rs.)	Drawing Power (Rs.)	Outstanding As On (Rs.)	Overdue Excess, If Any. (Rs.)
Term Loan Specify the assets d) Land & Building e) Plant & Machinery				

f) Others				
Cash Credit (Inventories & Book- Debts.)				

Remarks on the payment of interest & installments:

12) Latest Sanction:

Authority:

Date:

13) Particulars of the godown & factory premises :

(a) Address:

(b) Whether owned or rented:

(c) Total Area:

(d) Constructed Area:

(e) Condition of the godown :

(f) Whether rented in borrower's name:

(g) Whether rent is paid regularly

14) Inventories: (As on _____):
 (Preferably on the last day of the previous month)

(a)

Value of Inventories / hypothecated Value of book – debts / hypothecated (Less Than 90 days.)	
Total Less : Creditors	
Working Capital Gap Less :Margin 25%	
Drawing Power Outstanding (As on _____) Excess over drawing power, if any	

(b) Age and quantity of Inventories for more than six months old / amounts of old Inventories:

(c) Condition of inventories: (Whether properly stored / arranged.)

(d) Whether the mode of valuation is satisfactory:

Whether trade discount, if any, allowed is deducted while arriving at the price of inventories as mentioned in the Inventories statement checked with purchase bills:

Comments on verification and reconciliation of Inventories (quantity and value) as per Inventories statement and as per actual record such as purchase register, etc.:

(e) Value of entire book – debts:

- Less Than 90 Days : _____
- More Than 90 Days : _____
- Bad Debts (If Any) : _____

- (f) Whether book – debts of associate / sister concerns are included in statement:
- (g) Whether sales bills are accompanied by copy of lorry receipt / receipt challans:
- (h) Whether bills discounted are included in book-debts statement:
- (i) Whether book debts are arising out of genuine trade transactions:
- (j) Whether accommodation bills are observed:
- (k) Whether party wise book – debt accounts / registers are maintained properly and kept up – to – date? :
- (l) Whether the outstanding book – debts are arisen out of normal business transaction, which Bank has financed:
- (m) Normal time limit taken for realisation of book – debts vis – a – vis past trend or the industry trend. Give comments in case of abnormal delay :
- * Book – Debts outstanding for 60 days is _____
- * Outstation Customers are _____
- (n) Are there any cases of diversion of funds for other than business needs? :
- (o) Whether production / sales achievements found in line with production. If not, offer comments

Year ended	Projected sales (Rs.)	Actual sales achieved (Rs.)
2009		
2008		
2007		

15) Insurance Cover:

16) Other conditions whether satisfied:

(a) Bank's name board whether displayed / painted / affixed / engraved:

(b) Whether godown-keeper / godown chowkidar is appointed?

(c) Whether the branch receives Inventories statements certified by borrower?

17) Books and records:

(a) Whether the following records have been verified and found in order:

a) Sales register:

b) Purchase register:

c) Sales bill:

d) Purchase bills:

e) Inventories register:

f) Debtors register:

g) Cash book:

(b) Whether proper records are evidenced for goods in transit or sent to outsiders for processing or lying with sales depots branches is available:

(c) On physical verification whether the individual items of Inventories appearing in Inventories statement submitted to the bank found in agreement with the Inventories register or excise records? :

(d) Do Inventories registers tally with records provided to the bank?

(e) Turnover in the account during last twelve months:

(f) Sales during the last twelve months ending on _____ :

(g) Sales tax paid up to :

(h) Sales tax assessment completed up to :

(i) Excise duty returns filed upto:

(j) Excise duty assessment completed upto:

(k) Advance income tax paid:

(l) Income tax assessment completed unto

(m)ESIS paid up to :

(n) Provident fund paid up to :

(o) Municipal taxes paid up to :

(p) Rent paid up to :

(q) Shop & establishment/factory license renewed up to :

No of fire extinguishers :

Date of expiry _____ :

No of sand buckets _____ :

(r) Watch and ward arrangement :

(s) Service Tax returns filed up to:

(t) Service Tax assessment completed up to:

18) Movement of inventories:

a) Is turnover in Inventories satisfactory? :

b) Is turnover in account satisfactory? :

19) Particulars of machinery:

Name of machines (with full description on like, make other details etc.)	Whether purchased new or second hand?	Date of Invoice	Purchased Value	Latest Value Basis of Valuation	Written down Value as per B/S as on (Rs.)

20) No of employees :

Skilled :

Unskilled :

Office staff :

21) Information about shifts:

No of shifts :

Working hours:

22) Comments on working and capacity utilisation :

23) Are the machines working in full capacity?

Whether the plant and machine is maintained properly and found in working condition?

24) Value of fixed assets:

(As per latest balance sheet as on)

25) Value of current assets:

(As per latest balance sheet as on)

26) Was there any instance of breakdown of plant and machinery causing hindrance in progress of the unit during last six months?

27) Other remarks/ observations

28) Computation of Ratios

Current Ratio:

Debt – Equity Ratio:

Debtor's Turnover Ratio: