Azadi Ka Amrit Mahotsav

HANDBOOK ON STOCK AND BOOK DEBTS AUDIT

(Revised and enlarged 2nd Edition)

THE INSTITUTE OF COST ACCOUNTANTS OF INDIA
(Statutory Body under an Act of Parliament)
www.icmai.in
Headquarters: CMA Bhawan, 12. Sudder Street, Kolkata – 700 016
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Behind every successful business decision, there is always a *CMA*

Mission Statement

"The CMA professionals would ethically drive enterprise globally by creating value to stakeholders in the socio-economic context through competencies drawn from the integration of strategy, management and accounting."

Vision Statement

"The Institute of Cost Accountants of India would be the preferred source of resources and professionals for the financial leadership of enterprise globally."

About The Institute

The Institute of Cost Accountants of India is a statutory body set up under an Act of Parliament in the year 1959. The Institute as a part of its obligations, regulates the profession of Cost and Management Accountancy, enrolls students for its courses, provides coaching facilities to the students, oragnises professional development programmes for the members and undertakes research programmes in the field of Cost and Management Accountancy. The Institute pursues the vision of Cost Competitiveness, Cost Management, Efficient use of Resources and Structured Approach to Cost Accounting as the key drivers of the profession. In today's world, the profession of conventional accounting and auditing has taken a back seat and Cost and Management Accountants are increasingly contributing towards the management of scarce resources apply strategic decisions. This has opened up further scope and tremendous opportunities for cost accountants in India and abroad.

After an amendment passed by Parliament of India, the Institute is now renamed as "The Institute of Cost Accountants of India" from "The Institute of Cost and Works Accountants of India". This step is aimed towards synergising with the global management accounting bodies, sharing the best practices which will be useful to large number of trans-national Indian companies operating from India and abroad to remain competitive. With the current emphasis on management of resources, the specialized knowledge of evaluating operating efficiency and strategic management the professionals are known as "Cost and Management Accountants (CMAs)". The Institute is the 2nd largest Cost & Management Accounting body in the world and the largest in Asia , having approximately 5,00,000 students and 85,000 members all over the globe. The Institute is headquartered at Kolkata and an office in Delhi operates through four Regional Councils at Kolkata, Delhi, Mumbai and Chennai and 113 Chapters situated at important cities in the country as well as 11 overseas Centres. It is under the administrative control of Ministry of Corporate Affairs, Government of India.

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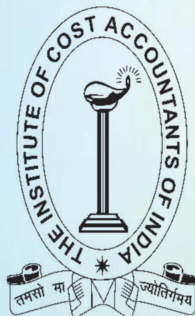

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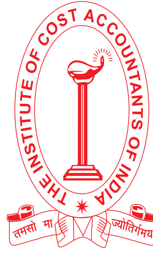

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THE INSTITUTE OF COST ACCOUNTANTS OF INDIA

(Statutory Body under an Act of Parliament)

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President's Message

In any business or other organization, all functions are interlinked and connected to each other and are often overlapping. Some key aspects like supply chain management, logistics, and inventory form the backbone of the business delivery function.

Inventory management is a very important function that determines the health of the supply chain and also impacts the financial health of the balance sheet. Finance against such inventories is generally granted by banks in the shape of a cash credit facility where drawings will be permitted against stocks of goods. It is a running account facility where deposits and withdrawals are permitted. Stock audit acts as a warning signal to those accounts which are likely to turn into NPA. Stock audit also helps in the prevention and early detection of fraud.

I congratulate CMA Chittaranjan Chattopadhyay, Chairman, Banking, Financial Services & Insurance Board, and other Members of the Board for bringing out this 2nd enlarged edition of the "Handbook On Stock And Book Debts Audit (Revised and enlarged 2nd Edition)".

This Guidance Note will help the Members to ensure that the requirements of the banks or any other organization are met and early detection of the lapses and inconsistencies is made.

I am confident that this Guidance Note would serve the Members as a one-stop practical guide for performing an effective 'Handbook On Stock And Book Debts Audit (Revised and enlarged 2nd Edition)' and for ensuring quantity, quality, composition, and actual value of the stock and the debtors.

CMA Vijender Sharma
President,
The Institute of Cost Accountants of India, Kolkata

Vice President's Message

In the era of the ever-changing global business environment, a healthy, as well as well-balanced banking system, is considered to be essential for any economy striving for growth and prosperity. The Indian banking system has witnessed numerous reforms and changes over the past two decades. Indian banks have enlarged their business portfolios not only in the domestic market but also in a globally competitive market.

An auditor of the bank today, be it at the branch level or the head office level, is faced with challenges of growing complexities in the operating environment of banks attributable to the transactional, customer and regional spread of the activities of the bank, frequent regulatory directions issued by the banking regulator coupled with increasing use of sophisticated technology not only for providing services but also for accounting.

In the above scenario, the internal auditors of banks, to be able to provide quality audit services, require a proper understanding of the bank and its environment, and application of that knowledge. Considering this, the Banking, Financial Services & Insurance Board of This Institute of Cost Accountants of India has brought out this revised publication titled "Handbook On Stock And Book Debts Audit (Revised and enlarged 2nd Edition)" which was first published in 2017 to provide extensive knowledge to the Members. Its scope is not restricted only to the circulars issued by the Reserve Bank of India but extends to knowledge of the industry, regulatory and other external factors, including financial reporting framework, nature of the client, viz., its operations, ownership and governance structure, sources of its finances, selection and application of accounting policies, its objectives, including those related to its business risk, etc.

This publication is comprehensive and self-contained in itself, touching upon almost all critical aspects of stock and receivable audits of banks. For easy understanding and practical implementation, the publication contains a variety of checklists and is written in a very lucid and logical manner.

I congratulate CMA Chittaranjan Chattopadhyay, Chairman, Banking, Financial Services & Insurance Board, and other Members of the Board for bringing out this 2nd enlarged edition of the "Handbook On Stock And Book Debts Audit (Revised and enlarged 2nd Edition)".

I firmly believe that this publication would serve as an indispensable guide for the Members and other readers interested in the subject.

CMA Rakesh Bhalla
Vice-President,

Immediate Past President's Message

CMAs are included in stock audit assignments of various banks including UCO Bank, Indian Bank, PNB, Indian Overseas Bank and many others and in order to equip members to undertake the assignment of stock and receivable audit the thought of assigning the task to the BFSI Board came to our mind. We felt that with professional development through issue of various publications in areas of interest for CMAs are to be regularly updated and printed for the benefit of the members.

I congratulate CMA Chittaranjan Chattopadhyay, Chairman, Banking, Financial Services & Insurance Board, and other Members of the Board for bringing out this "Handbook On Stock And Book Debts Audit (Revised and enlarged 2nd Edition)". The handbook has been written by CMA Dr. P. Siva Rama Prasad, Former AGM of State Bank of India with various inputs from various senior members of the Institute. We also felt that a comprehensive publication is indeed the need of the hour and we thank all the IAASB members for providing inputs on the publication which has been suitably incorporated. We also thank the reviewer of the publication who is also a former senior banker who has provided inputs for the publication and suitably inserted.

This Handbook is also a ready reckoner and will help the Members to ensure early detection and prevention of various frauds and lapses and revealing various inconsistencies which would help the management in the long run.

I am confident that this Guidance Note would serve the Members as a one-stop practical guide for performing an effective 'Handbook On Stock And Book Debts Audit (Revised and enlarged 2nd Edition)' and for ensuring quantity, quality, composition, and actual value of the stock and the debtors.

CMA P. Raju Iyer
Immediate Past President
The Institute of Cost Accountants of India
15th December, 2022

Foreword by Chairman, BFSI Board

The Institute of Cost Accountants of India

Working Capital Finance in the form of Cash Credit/Overdraft facility against the security of 'Hypothecation of Stock and Debtors' is one of the most common modes of Finance frequently adopted by various Scheduled Commercial Bankers.

The borrowers in such cases are expected to submit the details of 'Stock and Debtors' every Month/ Quarter (in certain Loan Products) on the basis of which 'Drawing Power' after reducing the prescribed margin is calculated by the Banks. Stock and Debtors being the 'Primary Security', Bankers for ascertaining the 'Genuineness & Correctness' of such Statements appoint Cost Accountants at frequent time intervals to conduct 'Stock and Receivables Audit' specifically where the exposure exceeds the predetermined threshold limit.

A Company's Stocks represent Cash. They should be stored, checked, and valued periodically, especially at the end of a given period. The Value of a Stock is usually much greater than the Cash held at a particular time. And also, the value of the Stocks will increase due to 'Demand for the Stock' and also increase their prices over a period of time in the Market.

It is, therefore, necessary to verify stock value from time to time to ensure that the materials purchased and stored are, in fact, in the store-house and that their Quality and Quantity have not deteriorated during the storage process. This is, for this reason, a need for Physical Verification of Stocks. Physical Stock Verification is the process used to ascertain the Correctness of Goods (e.g., In Terms of Quality and Quantity) in the Store on a given date.

In Physical Stock Verification, emphasis is laid on the Verification of Quantity by Counting or Weighing (or Adopting any other Suitable means).

The following are the main purposes of the Physical Verification of Materials lying in the stores:

- *To Examine the Correctness of the Stock Records.*
- *To Examine the Correctness of the Values Entered in the Stock Record.*
- *To Detect Discrepancies, if any.*
- *Find Weaknesses, if any, and to Suggest Improvements.*
- *Safeguard against Staff Abuses.*

This Book Covers all the aspects mentioned above and it helps a lot to 'Stock and Receivables Auditors' in discharging their Role as 'Stock and Receivables Audit of Banks' in an effective and efficient manner.

I wish to express my sincere gratitude to CMA.Dr. P. Siva Rama Prasad for sparing his precious professional and personal time and sharing a wealth of his experience in the area of Stock Audit . I also wish to thank CMA Vijender Sharma, President, and CMA Rakesh Bhalla, Vice President of the Institute for their continuous support and encouragement of the initiatives of the Board. I must also thank my colleagues from the Council at the Banking, Financial Services & Insurance Board for their invaluable guidance as also their dedication and support to the various initiatives of the Board. I would also thank Shri Y Sanjeeva Reddy, Former AGM of Union Bank of India who had reviewed the publication. I will also thank Shri Syamal Ghosh Ray, Consultant of the BFSI Board and Former General Manager of eAndhra Bank and Shri B. Raj Kumar, Former Dy. Chief Executive of IBA for their support and guidance for the publication.

All the Best in Your Profession.

CMA Chittaranjan Chattopadhyay

Chairman, BFSIB

President (2016-17)

Past presdent's message

It is my great pleasure and privilege to place before you **"Hand Book on Stock and Book Debts Audit"**, being brought out by the Professional Development, Banking & Insurance Committee of the Institute. This publication is an important endeavor of the Institute for capacity building of the CMA professionals in the area of stock and book debts audit.

Banks are prominently in the business of lending money against hypothecation and pledge of stocks, book debts and securities. Hence they have to consistently monitor the activities of the borrower in order to ensure the proper utilization of the borrowed money. Banks have also to ensure the safety and recovery of the loan. The importance of stock audit can be understood by the fact that before releasing huge amount of loans, in addition to annual stock audit, Consortium of Banks may ask for the monthly stock report certified by the professionals.

The role of stock audit is quintessential as it gives an early warning signal for probable NPA cases to the Credit and Compliance team of the Bank and helps in taking necessary corrective actions. It is an effective tool for early detection of lapses/fraud /inconsistency and facilitates prevention of same. Inventories Audit, thus, acts as a safeguard against occurrence of both Internal and External Frauds. The basic objective is to indicate the physical existence and safety aspects of the assets.

I am thankful to CMA Amit Anand Apte, Chairman, Professional Development Banking & Insurance Committee (PDB&I) and members of Committee for their contribution in bringing out this publication in the present form. I also acknowledge the role of PD Directorate of the Institute for coordinating this important activity.

I am sure that this publication will serve as a base for understanding the concept by its readers. I request readers of this publication to send their constructive suggestions for improvement of the text of document in its next edition.

Synopsis

One of the primary objectives of the banks is to collect deposits from the public and lend those deposits for various sectors of the economy such as Agriculture, Trade & commerce, Industry and personal segment. Banks and financial institutions lend money against security or without security. The security may be charge on fixed assets, movable assets, bills or book debts. Normally the charge on fixed assets is by way of mortgage, charge on movable assets such as stock and machinery is either hypothecation or pledge, and book debts by way of hypothecation.

It is in the interest of the banks to monitor the activities of the borrower to ensure that the money has been utilized for the purpose for which it was borrowed and not for speculation since funds lent to them are public funds not to be squandered. It also has to ensure that the money is safe and there should be stake of borrower by way of adequate margin and the activity generates income for the recovery of the loan.

Stocks and Debtors are two very important areas requiring attention because they are the essence of every business activity and they provide the true indication of the strength and liquidity of a business.

The primary objective of stock verification of the borrower, from the point of view of bank/financial institution, is to ascertain whether they are realizable in cash for the value stated. There should be adequate movement of stock and there is no stale or obsolete stock.

Stock verification is a process to verify the Inventory Management Systems are followed by the Organization or the procedure adopted by them to compile with the quantities of stocks on a given date and the Valuation there off applied for evaluation. The audit objectives remain the same even though the accounting procedures differ from business to business, country to country, and product to product.

This book endeavours to provide the readers with practical guidance on the various aspects of stock audit of inventory and book debts.

-oOo-

Glossary

	Explanation
Cash Credit	~~A~~ Cash credit is a facility under which a customer draws up to the pre-set limit, subject to the availability of drawing power based on sufficient security with the bank. Overdraft is a facility under which the customer draws upto the pre-set limit and not linked to the drawing power. Overdraft is extended where monitoring of stock/securities is possible. Cash credit facility is unique to India, as in most countries it is called overdraft. Cash credit facility is renewed from time to time so long as the business is continuing. Internationally, at the end of a 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 augmenting the 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 the bank.) *Cash Credit-Pledge:* Possession of the goods is with the bank and drawing~~s~~ power is linked with the goods under possession of the bank. Physical control of the goods is exercised by the bank. *Cash Credit-Hypothecation*: 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 drawing~~s~~ power in the account is based on stock statements submitted by the borrower from time to time.
Causes of NPA	From the point of view of the Bank/Financial Institution, NPA (non performing asset) is an asset which ceases to generate income. To explain in simple, a loan or advance for which principal or interest payments are not received. A loan/overdraft/cash credit becomes NPA ~~arises~~ due to several factors or causes like the following: *Speculation:* Investing in high-risk assets to earn a high income. *Default:* Wilful default by the borrowers. *Fraudulent Practices:* Fraudulent \practices like advancing loans to ineligible persons, advances without security or references, etc. *Diversion of Funds:* Most of the funds are diverted for unnecessary expansion and diversion of business. *Internal Reasons*: Many internal reasons like inefficient management, inappropriate technology, labour problems, marketing failure, etc. result in poor performance of the companies. *External Reasons*: External reasons like recession in the economy, infrastructural problems, price rise, delay in the release of sanctioned limits by banks, delays in settlements of payments by the Government, natural calamities, etc.

	Explanation
Charge on Assets of a Company	A charge means an interest or right that a lender or creditor obtains in the property of the borrowing firm/company by way of mortgage, hypothecation, pledge, etc., till the debt is fully satisfied. Charges are of the following two types: *Fixed charge*: Such a charge is against a specific identifiable and defined property and it is identified at the time of the creation of the charge. The property charged as such cannot be sold or disposed of without the lender's authorisation. *Floating charge:* Floating charge is applied to business assets as a whole available only to companies as borrowers. A floating charge covers the property of a fluctuating nature such as stock-in-trade, debtors, etc. A floating charge on crystallization becomes a fixed charge.
Consortium Lending	This approach to lending was introduced by the RBI in 1974. Advantages of consortium lending are: a) Several Banks financing a single borrower, who requires a large credit limit with common appraisal, common documentation, joint supervision and follow up exercises. b) It enables banks to spread the risk of lending and split 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. Prevents multiple financing of the same account. Each consortium has a lead bank, which has normally the largest share in the loan and which processes the loan, low rates proposal, calls the meetings of the consortium for sanction of limits and review of accounts, obtains RBI permission for credit limits, and conducts joint inspection of the borrower's 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.
Creditors	An entity (person or institution) that extends finance by giving another entity permission to borrow money with a stipulation for repayment at a later date.
Debtors/ Receivables	A person or entity that owes an amount of money underlying trade or non-trade arrangement.
Drawing Power	It is the limit up to which the borrower can utilize the cash credit. Drawing power is the value of stock/book debts as on specific date duly deducting margin of the borrower as specified in the sanctioned terms and conditions. Drawing power is required to be arrived at based on the current stock statement. 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 the drawing power based on stock and debtors statements, care must be taken to exclude old, obsolete and non-moving stock and long outstanding debtors.
Inventories	Inventories denote tangible property held for sale in the ordinary course of business or the process of production for such sale or 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 refer to the inventories which are fully paid, i.e., excluding Sundry creditors.

	Explanation
Inventory System	An **inventory system** is a process used to track stock, supplies and sales through an entire supply chain. Companies use inventory systems to ensure they know exactly what items they have available and where they are located.
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	Margin is stake of the borrower in the business entity i.e., borrower's stake in value of securities charged to the Bank which is normally expressed as percentage in the value. The credit limit is sanctioned by the banks after reducing a margin on the value of the security offered. The percentage of margin requirements varies as per bank's credit policy / 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 Companies Act,2013 with the Registrar of Charges. The satisfaction of charges must be filed with the Registrar within 30 days from the date of such payment of loan release of the charge. On receipt of intimation ~~to~~ from the company, the Registrar gives notice to the charge-holder calling upon him to show cause within a time not exceeding 14 days as to why the payment of satisfaction should not be registered. If no cause is shown within the time stipulated the Registrar must enter the satisfaction of the payment of the charge. If some cause is shown, the Registrar must record notes to that effect in the register and inform the company accordingly.
Mortgage	A mortgage is the transfer of an interest in the specific immovable property to secure the payment of money advanced or to be advanced by way of loan, an existing or future debt, or the performance of a promise that 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 Asset	A debt obligation where the borrower has not paid any previously agreed upon interest or principal repayments to the designated lender for an extended period. The non-performing asset is, therefore, not yielding any income to the lender in the form of principal and interest payments. If the borrowers do not repay the principal amount and interest for a certain period as specified by RBI from time-to-time then such loans become non-performing assets (NPA). The Banks are not allowed to book the interest on such loans as profit on accrual basis till actually paid by the borrower. Thus, non-performing assets are non=income generating assets in the books of the bank.
Out of Order/ Irregular Account	An account should be treated as 'out of order' if the outstanding balance in overdraft/cash credit account is more than the sanctioned limit/drawing power. Where the outstanding balance is less than the sanctioned limit/ drawing power, but there are no credits continuously for six months or credits are not enough to cover the interest debited during the same period, such accounts should be treated as 'out of order' and also marked as NPA.
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.

	Explanation
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, value of stocks expressed in both invoice rate and market rate. It also contains the drawing powers i.e., value of stocks minus margin of borrower as stipulated in sanction. It should indicate the movement of the stock during the period. Unpaid stock 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.
Types of NPA	The assets of the Bank (loans, overdrafts/cash credits) are classified into the following four types: *Standard Assets:* A standard asset is a performing asset. Standard assets generate continuous income and repayments as and when they fall due. Such assets carry a normal risk. Hence no special provisions are required for standard assets. *Sub-Standard Assets*: All those assets (loans, overdrafts/cash credits) which are considered non-performing assets (NPA) if principal and interest are not paid continuously for 90 days and remained as NPA for 12 months are called sub-standard assets. *Doubtful Assets:* All those assets which are considered non-performing assets (NPA) for more than 12 months are called doubtful assets. *Loss Assets:* All those assets which cannot be recovered are called loss assets. It is considered as uncollectible and it is not warranted to continue as bankable asset since there is little scope for salvage or recovery value
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.

01

Introduction

(About Working Capital Loans)

Objective of this Chapter

The main purpose of conducting the Inventories (Stock) and Book Debts 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 and Book Debts 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, quality and proper storage.

The Auditor's role assumes great significance in this regard as his report is considered veritable and neutral. He is therefore expected to be objective and unbiased while undertaking the Inventories (Stock) and Book Debts Audit.

Cash credit facility is unique to India, as in most countries it is called overdraft. Further, the cash credit facility is more or less permanent so long as the business is continuing and renewed from time to time. Internationally at the end of a 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 to meet the working capital requirement*s. The operations are similar to overdraft. A cash credit facility is of two types (depending upon the type of charge on goods taken as security by the bank.)

Cash Credit-Pledge: When the possession of the goods is with the bank and drawing power is linked with the goods under possession of the bank. The physical control of the goods is exercised by the bank.

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 drawing power in the account is based on stock statements submitted by the borrower from time to time.

Cash credit is a facility under which a customer draws up to the pre-set limit, subject to the availability of drawing power based on sufficient security with the bank.

Overdraft is a facility under which the customer draws upto the pre-set limit and not linked to the drawing power.

The difference between an overdraft and cash credit account is that while the former is extended where monitoring of stock/securities is possible whereas in the latter it is not so.

ABOUT WORKING CAPITAL LOANS

'Working capital' of industrial and trading establishments means the sum of the funds invested by them in various current assets (like raw material (RM), work in process (WIP), finished goods (FG), and the outstanding receivables on goods sold.

The working capital finance extended to a borrower by the banks will depend upon the nature of current assets; suitable margin is to be provided by the borrower within the overall permissible bank finance.

Current assets reflected in the balance sheet are the assets of the company like cash or cash equivalent of assets which can be converted into cash within one year from the date of the balance sheet.

Examples of current assets are raw material work in process, finished goods, and receivables.

Current liabilities shown on the balance sheet signify all-term liabilities or debts of the company which are payable by the company within the next twelve months of the balance sheet date.

Example of current liabilities are amounts payable to sundry creditors, payroll liabilities, current portion of long-term loans payable within the next twelve months, dividend payable, etc.

'Working capital' means the total amount of ~~capital~~ funds that a company has invested in the *operating cycle*.

Net working capital is an accounting concept that represents the excess of current assets over current liabilities which is sometimes referred to as 'working capital".

Working capital is of two categories viz.

- Gross working capital and
- Net working capital.

"Gross working capital" means the total current assets, whereas "net working capital" is defined as current assets less current liabilities. The changes in the total amount of current assets change the amount of gross working capital. However, changes in current assets do not automatically change the amount of working capital (NWC).

For example, when identical changes take place both in current assets and current liabilities there won't be any change in NWC. Changes in net working capital take place only when the changes in current assets and current liabilities are not identical.

A manufacturing unit needs to purchase raw material, incur expenditure for labour and other overheads in the production process. The portion of current assets which are not financed by current liabilities is known as the *working capital gap*. The working capital gap would be financed either from own source or from borrowings.

The working capital gap is to be filled in by the contribution from long-term sources (known as net working capital) available with the entity and *working capital finance from the bank*, wherever necessary. Therefore, it is important for the bank, to first appraise the gross working capital, net-working capital and working capital gap for assessment of working capital limits.

Working Capital Requirements Based on Operating Cycle

"Operating cycle" means the length of time required to convert cash into current assets', (like raw material, work-in-process, finished goods bills receivables) into cash.

A manufacturing unit needs to hold the stock of raw material, work-in-process, and finished goods for a length of time in the workplace before dispatching the final products to the customers. In case of credit sales, the period of credit to be included.

The tendency of some manufacturing units to hold current assets (stocks and receivables) beyond the requirement of the holding period has financial implications, as more interest is payable on current liabilities for the time taken in converting the current assets into cash.

Calculation of Holding Period for Raw Material

The holding period of raw material in months is measured by the average stock of RM divided by RM consumption multiplied by twelve.

[Holding period of raw material in months = Average stock of RM ×12 / RM consumption]

The average stock of RM is measured by the opening balance of RM plus the closing stock of RM divided by 2.

The raw material consumption is measured by opening stock of RM plus purchase of RM minus closing stock of RM.

The holding period of raw-materials is mainly dependent on the lead time involved in the procurement and quantity required to ensure uninterrupted production.

Calculation of holding period for work in Process

The holding period of work in process in months is measured by the average stock of WIP divided by the cost of production (COP) multiplied by 12

a) [Holding period of WIP in months = Average stock of WIP × 12 / Cost of production].

b) The average stock of WIP is measured by the opening balance of WIP plus the closing stock of WIP divided by 2. [Average stock of WIP = Opening balance of WIP + Closing stock of WIP/ 2].

c) The cost of production (COP) is measured by raw materials consumed plus manufacturing expenses plus depreciation, plus opening stock of work in process minus closing stock of work in process. [Cost of production = Raw materials consumed + Manufacturing expenses + Depreciation, + Opening stock of work in process – Closing stock of work in process.]

The holding period of work-in-progress is dependent on the length of the production cycle i.e., from the time Raw-materials are issued till the finished goods are ready for dispatch.

Calculation of holding period for Finished Goods:

The holding period of finished goods in months is measured by the average stock of FG multiplied by twelve and divided by the cost of sales (COS) [Holding period of finished goods in months = Average stock of FG×12/ Cost of sales.

The average stock of FG is measured by the opening balance of FG plus the closing stock of

FG divided by 2. [Average stock of FG = Opening balance of FG+ Closing stock of FG / 2.

Cost of sales is measured by cost of production plus opening stock of finished goods minus closing stock of finished goods. [Cost of sales = Cost of production + Opening stock of finished goods- Closing stock of finished goods.

The holding period of finished goods is dependent on the length of the sales cycle i.e., the period of finished goods to be kept in the warehouse before sales.

Calculation of Debt Collection Period

The debt collection period in months is measured by average receivables outstanding multiplied by twelve and divided by gross credit sales.

[Debt collection period in months= Average receivables outstanding×12/Gross credit sales]

Average receivable outstanding is found out by adding sundry debtors, bills receivables (inland), and bills purchased and discounted by the bank (inland). Similarly, the debt collection period is calculated for inland bills, and the debt collection period for export receivables.

Bankers who appraise the working capital limits shall decide the working capital based on maximum operating cycle tenure. Normally the length of the operating period is measured by months. The length of the holding period is also calculated in days multiplied by 360 in place of 12. The computation of the holding period taken for holding raw materials, work-in-process, finished goods and the collection of receivables is of great interest in evaluating the working capital limit.

The term “working capital” means the sum of the funds invested at various current assets used in the operating cycle, by the industrial/ trading establishments.

Following types of loans and advances are considered as working capital finance:

1) Cash credit/ overdraft against inventories and book debts.

2) Demand loan portion under loan system for delivery of bank credit.

3) Packing credit against inventories.

4) Bills purchased /discounted (inland & foreign).

5) Cash credit against book debts/cheque purchase.

6) Working capital term loan (for excess borrowing).

The level of limit for each type of facility will depend upon the nature of current assets and suitable margin, within the overall permissible bank finance. RBI, from time to time, prescribes the norms for working capital to be financed by banks. The financial documents like operating statements, balance-sheet, and funds flow statements, should be examined by the banks to find whether the borrower is capable of repaying the amount borrowed.

Bankers have to look into the following for arriving at assumptions of future production and sales:

- Past trends in production/sales.
- Extent of installed and available production capacities.
- Availability of raw materials, labour, power supply, etc.
- Competitive strength of the borrower.
- Pricing policy of the management.
- Research, renovation, and development.
- Economic factors like demand for the product, import restrictions, etc.

After being satisfied with the validity of the projection of production and sales, capacity utilization, break-even point, economic conditions, cost consciousness, pricing policies, etc., the next step is to compute the following profitability ratios and see how they compare with the past trends and with the similar type of units in the same business:

- Raw materials consumption to cost of production.
- Power and fuel to cost of production.
- Direct labour to the cost of production.
- Repairs and maintenance to the cost of production.
- Interest in net sales.

- Selling, general and administrative expenses to net sales.
- Gross profit to net sales.
- Operating profit to net sales.
- Net profit before tax to net sales
- Net profit after tax to net sales.

The above ratios help bankers to assess the ability of the enterprise to earn profit from the sales, return on equity test of the management's pricing policy compared to others in the business, return on total assets, accounts receivable turnover etc.

The time taken for holding raw materials, work-in-process, finished goods, and the collection of receivables is of great importance in evaluating working capital.

Working capital requirement as per Turnover

Banks in India have evolved their method of lending as they have been given free hand by the Central Bank (that is RBI) to decide the lending methods. The assessment of working capital limits under the turnover method is called limits assessed under Nayak Committee norms. Under the turnover method, the aggregate fund-based working capital limits are computed based on a minimum of 20 per cent of their projected annual turnover. The borrower has to bring a margin of 5 per cent of the annual turnover of such borrowers as margin money.

Example:

If projected sales turnover is	₹ 100, 000.00
Then, the working capital gap is 25 per cent of the turnover:	₹ 25,000.00
Maximum permissible bank finance should be 20 per cent of the turnover	₹ 20,000.00
Margin money from the borrower should be 5 per cent of ₹1,00,000.00	₹ 5,000.00

The following loans and advances are considered as working capital finance.

- Cash credit/ overdraft against inventories and book debts.
- Demand loan portion under loan system for delivery of bank credit
- Where the permissible bank finance is ₹ 10 Crore and above.
- Packing credit against inventories.
- Bills purchased / discounted (inland & foreign).

- Cash credit against book debts/cheque purchase.
- Working capital term loan (for excess borrowing).

Working Capital requirement as per Cash Budget pattern (suitable for of Financing Seasonal Productions like Sugar, Tea, Construction activities, etc.)

The request for financial assistance from business enterprises dealing in seasonal products like sugar, tea, construction activities, film industries, order-based activities, etc. is facilitated by the banks through "Cash Budget" financing plans. For such business dealings, the requirement of finance is not uniform throughout the year. The demand for financial assistance may peak during some calendar months, given the realization of sale proceeds taking place over a period of time.

However, in some months during the year, these business enterprises may have excess cash due to an increase in cash collection from debtors, as well as the seasonal increase in cash sales. The bank finance to such units will therefore, be planned on the basis of projected monthly cash flows estimated by the borrower and approved by the bank.

The current ratio for this kind of facility is normally 1.33: 1 (1.25:1 for MSE) as a benchmark. Some Banks consider lower ratios on a case-to-case basis depending upon the components and quality of current assets and current liabilities. In exceptional cases, excess drawings are allowed up to 10 per cent if the need is considered by the bank as genuine. However, the borrower must submit the statement containing actual cash receipts and payments to the bank within a week from the end of the previous month. Thus, this arrangement facilitates the banks not only to sanction the need-based finance but also safeguards the end use of bank funds.

Illustration:

The pattern of calculation of the working capital requirement of a unit is illustrated in the following chart. (₹ 00,000 Omitted)

Particulars	April	May	Jun	July	Aug	Sept	Oct
a) Cash receipts: Cash sales, cash collection from debtors	34	41	52	44	28	18	12
b) Cash payments: Cash payments to trade creditors, office expenses, wages taxes, etc.	22	31	56	62	65	29	22
c) Net cash flow (A-B)	12	10	(-) 4	(-)18	(-) 37	(-11)	(-) 10
d) Cash at the start of the month	6	18	28	24	6	5	5
e) Cumulative cash (C+D)	18	28	24	6	(-) 31	(-)16	(-) 5

Particulars	April	May	Jun	July	Aug	Sept	Oct
f) Minimum balance required	5	5	5	5	5	5	5
g) Surplus (+)/Deficit (-) [E-F]	(+) 13	(+) 23	(+) 19	1	(-) 36	(-) 21	(-) 10
h) Limit/DP required	–	–	–	–	36	21	10

Note: Movement of cash is generally classified under the following three heads.

Cash flow from Operating Activities: The revenue generated from the principal activity of the company.

Cash flow from Investing Activities: Capital expenditure on purchase of tangible and intangible assets. The money received from the disposal of old machines, interest received on deposits, or lending activities are included in the cash flow from investing activities.

Cash flow from Financing Activities: Money received from issue of shares, bonds, debentures and repayments of the loan are examples of cash flow from financing activities.

PURPOSE OF INVENTORY AUDIT

Like any other audit, the rationale for conducting Inventories Audit also lies in the prevention and early detection of frauds and errors. Inventories Audit acts as a safeguard against the occurrence of both internal and external frauds. An Inventories Audit is essential for the following purposes:

1) To give the bankers an assurance that -

   a. Suitable environment for the preservation of inventories exists.

   b. A responsible person for safeguarding the inventories is always present.

   c. Degraded inventories have been written off.

   d. Adequate safeguards exist against fire and natural calamities.

   e. Physical inventories tally with the inventory's statements submitted to the bank.

   f. Pledged/hypothecated inventories are realizable.

   g. Inventories are owned by the borrower.

   h. All sanctioned terms have been adhered to.

   i. Inventories are not stagnating and becoming obsolete.

2) To investigate cases where the borrower is not submitting periodic inventories statements regularly.

3) To investigate cases where the accounts have been marked as substandard.

4) To find out the 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 suspicious dealings in the lending procedure.

6) To make the banks aware of their rights of enforcement of the security interest provided in the Securitization and Reconstruction of Financial Assets and Enforcement of the Security Interest Act, 2002.

7) To fulfil Head Office requirements.

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's finance. In other words, it deals with the matters that have an effect on the security and liquidity given to 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, the 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 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.

i. Review of the inventories valuation system.

j. Age-wise and value-wise qualification of debtors.

k. Determination of the drawing power.

l. Determining the adequacy of the insurance cover.

m. Verification of documents/ securities.

n Commenting upon the comparative profitability and inventories ratio.

o. Ensuring compliance with the terms and conditions of the limit sanctioned.

p. Verification of transactions with sister concerns, unsecured loans to directors, and others.

q. Any other matter of interest to the bank.

Under the following circumstances, it is advisable for the banks to get an annual Inventories Audit done by an independent agency:

a) When there are overdubs in term loans or other accounts and 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 a 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 auditor's report on the balance sheet of a borrower.

g) Where the accounts are marked as sub-standard.

h) Suspect dealings in the lending procedure, jeopardizing advances given.

i) An errant borrower, where an 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 an Inventories Audit done .

Working capital is the lifeblood of a company. Without it, a company cannot stay in business. The most critical use of working capital is providing the ongoing investment in short-term assets that a company needs to operate. A business requires a minimum cash balance to meet basic day-to-day expenses and to provide a reserve for unexpected costs. It also needs working capital for prepaid business costs, such as licenses, insurance policies, or security deposits. Furthermore, all businesses from a professional firm's stock of office supplies to the large inventories needed by manufacturers, retailers, and wholesalers invest some amount in inventory. Without some amount of working capital businesses cannot operate.

The other purpose of working capital is to address seasonal or cyclical financing needs. Here, working capital finance supports the build-up of short-term assets needed to generate revenue, but which come before the receipt of cash. Since most businesses do not receive prepayment for goods and services, they need to finance these purchase, production, sales, and collection costs prior to receiving payment from customers.

Stock audit by external CMAs is one of the important tools of credit monitoring for banks. Apart from ensuring the safety of realizable security, it also helps the banks to discipline the borrowers or may act as a warning signal against probable future NPA. It would help the banks to take timely remedial measures to avoid substantial future losses. It also highlights the weaknesses, if any in the existing monitoring system of the branches through comments about maintenance of the drawing power (DP) register, scrutiny of statements, review of accounts, and compliance with audit findings. Over and above, Stock and Book Debts Audit also has the utility for the borrower. Comments about insurance inadequacies, wrong product description and locations stated in the policies, if rectified in time may save the borrower from avoidable future losses.

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02 Inventory Management

Objective of this Chapter

Inventory is the 'life line' of the Manufacturing Organization. Either excess or short Inventory impacts the profitability of the firm. Now-a-days, most organizations are maintaining a fine inventory balance (to avoid the carrying costs) and some organizations are using the techniques like Just-in-Time Model also.

Banks / Financial institutions are lending to inventory to the Manufacturing Units. At the same time, the borrowing units are to be followed the best 'Inventory Management' techniques/ practices so that the working capital finance is not wasted. The Stock and Book Debts Auditors are to be highlighted whether the borrowing units followed the best inventory management techniques or not in the Stock and Book Debts Audit Report.

In this chapter, we have covered the best inventory management practices, if these are practiced by the manufacturing units, the profitability of the unit will increase, and also working capital loans provided by the bank's end use of funds' will be satisfied.

Inventory is the accounting of items, parts, and raw materials that a company either uses in production or sells. Business leaders, are to practice inventory management to ensure that they have enough stock on hand and to identify when there's a shortage.

The verb "inventory" refers to the act of counting or listing items. As an accounting term, inventory is a current asset and refers to all stock in the various production stages. By keeping stock, both retailers and manufacturers can continue to sell or build items. Inventory is a major asset on the balance sheet for most companies, however, too much inventory can become a practical liability.

Inventory, which describes any goods that are ready for purchase, directly affects an organization's financial health and prosperity.

While there are many types of inventories, the four major ones are raw materials and components, work in progress, finished goods and maintenance, repair, and operating supplies.

While there are many ways to count and value the inventory, the importance lies in accurately tracking, analysing, and managing it. Insights gained from inventory evaluations are necessary for success as they help companies make smarter and more cost-efficient business decisions.

An organization's inventory, which is often described as the step between manufacturing and order fulfilment, is central to all of its business operations as it often serves as a primary source of revenue generation. Even though inventory can be described and classified in numerous ways, it's ultimately its

management that directly affects an organization's order fulfilment capabilities.

For example, in keeping track of raw materials, safety stock, finished goods, or even packing materials, businesses are collecting crucial data that influences their future purchasing and fulfilment operations. Understanding purchasing trends and the rates at which items sell determines how often companies need to restock inventory and which items are prioritized for re-purchase. Having this information on hand can improve customer relations, cash flow, and profitability while also decreasing the amount of money lost to wasted inventory, stock outs, and re-stocking delays.

Types of Inventories:

Raw Materials: Raw materials are the materials a company uses to create and finish products. When the product is completed, the raw materials are typically unrecognizable from their original form, such as oil used to create shampoo.

Components: Components are similar to raw materials in that they are the materials a company uses to create and finish products, except that they remain recognizable when the product is completed, such as a screw.

Work In Progress (WIP): WIP inventory refers to items in production and includes raw materials or components, labour, overhead, and even packing materials.

Finished Goods: Finished goods are items that are ready to sell.

Maintenance, Repair, and Operations (MRO) Goods: MRO is inventory-often in the form of supplies-that support making a product or the maintenance of a business.

Packing and Packaging Materials: There are three types of packing materials. Primary packing protects the product and makes it usable. Secondary packing is the packaging of the finished good and can include labels. Tertiary packing is bulk packaging for transport.

Safety Stock and Anticipation Stock: Safety stock is the extra inventory a company buys and stores to cover unexpected events. Safety stock has to carry costs, but it supports customer satisfaction. Similarly, anticipation stock comprises raw materials or finished items that business purchases based on sales and production trends. If a raw material's price is rising or peak sales time is approaching, a business may purchase safety stock.

Decoupling Inventory: Decoupling inventory is the term used for extra items or WIP kept at each production line station to prevent work stoppages. Whereas all companies may have safety stock, decoupling inventory is useful if parts of the line work at different speeds and only applies to companies that manufacture goods.

Cycle Inventory: Companies order cycle inventory in lots to get the right amount of stock for the lowest storage cost.

Service Inventory: Service inventory is a management accounting concept that refers to how much service a business can provide in a given period. A hotel with 10 rooms, for example, has a service

inventory of 70 one-night stays in a given week..

Transit Inventory: Also known as pipeline inventory, transit inventory in stock that's moving between the manufacturer, warehouses, and distribution centres. Transit inventory may take weeks to move between facilities.

Theoretical Inventory: Also called book inventory, theoretical inventory is the least amount of stock a company needs to complete a process without waiting. Theoretical inventory is used mostly in production and the food industry. It's measured using the actual versus theoretical formula.

Excess Inventory: Also known as obsolete inventory, excess inventory is unsold or unused goods or raw materials that a company doesn't expect to use or sell, but must still pay to store.

Real-world examples can make inventory models easier to understand.

The following examples demonstrate how the different types of inventory work in retail and manufacturing businesses.

Raw Materials/Components: A company that makes T-shirts has components that include fabric, thread, dyes, and print designs.

Finished Goods: A jewellery manufacturer makes charm necklaces. Staff attaches a necklace to a pre-printed card and slips it into cellophane envelopes to create a finished good ready for sale. The cost of goods sold (COGS) of the finished good includes both its packaging and the labour exerted to make the item.

Work In Progress: A cell phone consists of a case, a printed circuit board, and components. The process of assembling the pieces at a dedicated workstation is WIP.

MRO Goods: Maintenance, repair, and operating supplies for a condominium community include copy paper, folders, printer toner, gloves, glass cleaner, and brooms for sweeping up the grounds.

Packing Materials: At a seed company, the primary packing material is the sealed bag that contains, for example, flax seeds. Placing the flax seed bags into a box for transportation and storage is the secondary packing. Tertiary packing is the shrink wrap required to ship pallets of product cases.

Safety Stock: A veterinarian in isolated community stocks up on disinfectant and dog and cat treats to meet customer demand in case of highway floods and delays in delivery trucks.

Anticipated/Smoothing Inventory: An event planner buys discounted spools of ribbon and floral tablecloths in anticipation of the June wedding season.

Decoupled Inventory: In a bakery, the decorators keep a store of sugar roses with which to adorn wedding cakes–so even when the ornament team's supply of frosting mix is late, the decorators can keep working. Because the flowers are part of the cake's design, if the baker ran out of them, they couldn't deliver a finished cake.

Cycle Inventory: As a restaurant uses its last 500 paper napkins, the new refill order arrives. The napkins fit easily in the dedicated storage space.

Service Inventory: A café is open for 12 hours per day, with 10 tables at which diners spend an average of one hour eating a meal. Its service inventory, therefore, is 120 meals per day.

Theoretical Inventory Cost: A restaurant aims to spend 30% of its budget on food but discovers the actual spend is 34%. The "theoretical inventory" is the 4% of food that was lost or wasted.

Book Inventory: The theoretical inventory of stock in the inventory record or system, which may differ from the actual inventory when performing a count.

Transit Inventory: An art store orders and pays for 40 tins of a popular pencil set. The tins are en-route from the supplier and, therefore, in transit.

Excess Inventory: A shampoo company produces 50,000 special shampoo bottles that are branded for the summer Olympics, but it only sells 45,000 and the Olympics are over-no one wants to buy them, so they're forced to discount or discard them.

In manufacturing, inventory consists of in-stock items, raw materials, and the components used to make goods. Manufacturers closely track inventory levels to ensure there isn't a shortage that could stop work.

Accounting divides manufacturing stock into raw materials, WIP, and finished goods because each type of inventory bears a different cost. Raw materials typically cost less per unit than finished items.

Every company has stock that supports its regular business. For service companies, this inventory is intangible. A law firm's inventory, for example, includes its files, white paper on which to print legal documents is the firm's MRO.

Inventory control helps companies buy the right amount of inventory at the right time. Also known as stock control, this process helps optimize inventory levels, reduces storage costs, and prevents stockouts.

The business saying "if you can't measure it, you can't manage it" applies to inventory management and best practices. While the first best practice is keeping track of inventory, others include:

Carry Safety Stock: Also known as buffer stock, these products help keep companies from running out of materials or high-demand items. Once companies deplete their calculated supply, safety stock serves as a backup should the level of demand increase unexpectedly.

Invest in a Cloud-based Inventory Management Program: Cloud-based inventory management systems let companies know in real-time where every product is. This data helps an organization be more responsive, up-to-date, and flexible.

Start a Cycle Count Program: Cycle counting benefits extend well past the warehouse by keeping stock reconciled and customers happy while also saving businesses time and money.

Use Batch/Lot Tracking: Record information associated with each batch or lot of a product. While some businesses log precise details, such as expiration dates that provide information about their product's sellable dates, companies that do not have perishable goods use batch/lot tracking to understand their products' landing costs or shelf lives.

An inventory process tracks inventory as companies receive, store, manage, and withdraw or consume it as a work in progress. Essentially, the inventory process is the lifecycle of goods and raw materials.

An inventory count is the physical act of counting and checking the condition of items in storage or a warehouse. An inventory count also checks the condition of items. For accounting purposes, inventory counts help assess assets and debts.

Inventory counts help understand which stock is moving well and inventory managers often use this information to forecast stock needs and manage budgets.

The two methods of recording inventory are periodic and perpetual. In periodic inventory, count stock at specific times and add the totals to the general ledger. In the perpetual method, record changes in stock as they occur.

Although any type of business can use periodic inventory, small organizations frequently use it, especially when there are no plans to scale the business. Organizations that use perpetual inventory recording methods and require real-time counting often use scanners.

Inventory turnover is the number of times a company sells or uses an item in a specific timeframe, which can reveal whether a company has too much inventory on hand. To determine inventory turnover, use the following equations:

Average Inventory = (Beginning Inventory + Ending Inventory) / 2

Inventory Turnover = Sales / Average Inventory.

Inventory Analysis is the study of how product demand changes over time and it helps businesses stock the right amount of goods and project how much customers will want in the future.

A well-known method for performing inventory analysis is ABC Analysis. To perform an ABC analysis, group goods into three categories:

"A" inventory: A inventory includes the best-selling products that require the least space and cost to store. Many experts say this represents about 20% of inventory.

"B" inventory: B items move at a similar rate to A items but cost more to store. Generally, this represents about 40% of inventory.

"C" inventory: The remainder of stock costs the most to store and returns the lowest profits. C inventory represents the other 40% of inventory.

ABC analysis leverages the Pareto, or 80/20, principle and should reveal the 20% of inventory that garners 80% of profits. A company will want to focus on these items to increase sales and net profit margins.

Inventory analysis may influence the choice of inventory control methods, whether just-in-time or just-in-case.

Inventory analysis raises profits by lowering costs and supporting turnover. It also:

Improves Cash Flow: Inventory analysis helps to identify and reorder items that sell often, so don't spend money on inventory that moves slowly.

Reduces Stock outs: When understanding which inventory customers want most, can better anticipate demand and prevent stock outs.

Increases Customer Satisfaction: Analysing inventory offers insight into what and how customers purchase goods.

Reduces Wasted Inventory: Understanding what, when, and how much people buy minimizes the need to store obsolete products, as well as when products expire so can have a strategy behind using them.

Reduces Project Delays: Learning about supplier lead times helps to understand when to reorder and how to avoid late shipments.

Improves Pricing from Suppliers and Vendors: Inventory analysis can lead to ordering high volumes of products regularly rather than small volumes on a less reliable schedule. This regularity can put in a stronger position to negotiate discounts with suppliers.

Expands Understanding of the Business: Reviewing inventory provides insights into stock, customers, and business.

Demand forecasting is the practice of predicting customer demand by looking at past buying trends, such as promotions and seasonality. Accurately predicting demand provides a better understanding of how much inventory will need and reduces the need to store surplus stock.

A good inventory management strategy and accurate inventory counts can help save companies money because they'll only provide items that customers buy and therefore, simplify their operations.

Accounting for inventory is the system that counts and records changes in the value of stock such as raw materials, WIP, and finished goods, which are all considered assets. Financial accounting for inventory provides an accurate valuation of these stock assets.

Inventory accounting determines the value of stock items and the correct item count. These figures establish the costs of goods sold and the ending inventory value, which factor into the company's overall value.

The average cost of inventory is a method for calculating the per-unit cost of goods sold. To calculate the average cost, get the sum of the cost of all stock for sale, and divide it by the number of items sold.

Managing Inventory is a Daunting Task:

The process and results impact every aspect of the business.

Inconsistent Tracking: Using manual inventory tracking procedures across different software and spreadsheets is time-consuming, redundant, and vulnerable to errors. Even small businesses can benefit from a centralized inventory tracking system that includes accounting features.

Warehouse Efficiency: Inventory Management Controls at the warehouse is labour-intensive and involve several steps, including receiving and putting away, picking, packing, and shipping. The challenge is to perform all these tasks in the most efficient way possible.

Inaccurate Data: At any given moment, exactly what inventory has. Gone are the days when inventory could be counted once a year with an all-hands-on-deck approach.

Changing Demand: Customer demand is constantly shifting. Keeping too much could result in obsolete inventory being unable to sell while keeping too little could leave unable to fulfill customer orders. Order strategies for core items, as well as technology to create and execute an inventory plan, can help compensate for changing demand.

Limited Visibility: When inventory is hard to identify or locate in the warehouse, it leads to incomplete, inaccurate, or delayed shipments. Receiving and finding the right stock is vital to efficient warehouse operations and positive customer experiences.

Manual Documentation: Managing inventory with paperwork and manual processes is tedious and not secure. And it doesn't easily scale across multiple warehouses with lots of stock.

Problem Stock: Perishable and fragile stock needs specialized plans for care and storage. And high-value inventory needs specific loss-prevention strategies and inventory controls.

Supply Chain Complexity: Global supply chains shift daily, placing a burden on inventory planning and management operations. The manufacturers and wholesale distributors that dictate when, where, and how inventory ships require flexibility and offer unpredictable lead times.

Managing Warehouse Space: Efficiently managing space is an intimidating task. Planning and designing warehouse spaces with inventory management platforms help better control the timing of new stock deliveries. It can account for important factors, such as available space. Read more about the differences between warehouse management and inventory management.

Insufficient Order Management: One of the most common challenges to sound inventory management is preventing the overselling of products and running out of inventory. Using historical and seasonal data trends can help accurately predict customer orders.

Increasing Competition: Globalized supply chains are subject to unpredictable economic shifts and

market forces that impact the competition for raw materials. Small businesses are sometimes faced with choosing between competing for high-demand materials or holding enough inventory to control costs.

Evolving Packaging: Compostable packaging or removing packaging altogether to reduce waste presents new obstacles for warehouse design and storage. It may even mean new equipment or shorter shelf life for some items.

Expanding Product Portfolios: Many online retail strategies remove the need for large warehouse distribution centres. These strategies make it easier to expand inventory and diversify product portfolios, but demand technology and resources for ordering, shipping, and tracking.

Overstocking: Keeping too much stock on hand can be as problematic as having too little. Overstock impacts business cash flow and leads to inventory-related problems, such as storage and loss.

Inventory Loss: The loss of inventory due to spoilage, damage, or theft can be a supply chain problem. It requires identifying, tracking, and measuring problem areas.

Poor Production Planning: Production planning is vital for avoiding delayed manufacturing and cost overruns. If not done well, it can impact sales forecasts and project schedules.

Lack of Expertise: It can be tough to find skilled inventory managers who are adept at the latest technology and can improve inventory strategy. Simply upgrading the inventory management platform with a host of features isn't enough.

Poor Communication: Communication and collaboration are key. When departments are apathetic about sharing information, it makes identifying inventory trends and finding ways to improve much more difficult.

Inefficient Processes: Low-tech, manual inventory management procedures don't seem like a daunting challenge when inventory is small and there's only one warehouse location to manage. But as sales volume increases and inventory expands, inefficient, labour-intensive, and low-tech standard operating procedures are difficult to scale.

Inadequate Software: To scale inventory management software to support complex logistics, it needs to integrate with existing business process platforms. The difficult task is choosing from hundreds of inventory management solutions and mastering a host of features that require training and ongoing support.

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03

Accounting Standard (AS) 2*

Objectives of this Chapter

This Standard deals with the determination of the value at which inventories are carried in the financial statements, including the ascertainment of the cost of inventories and any write-down thereof to net realizable value [AS-2: Valuation of Inventories - As on 01/02/2022].

This Standard prescribes the accounting treatment for inventories and sets the guidelines to determine the value at which the inventories are carried in the financial statements. It explains the different methods of accounting for the inventory or closing stock which has a huge impact on the business revenue and assets.

Whether the borrowing unit adopts AS-02 in valuing the inventory to be verified by the stock Auditors and the findings are to be mentioned in the Audit Report.

Valuation of Inventories

[This Accounting Standard includes paragraphs set in bold italic type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of its objective, the Preface to the Statements of Accounting Standards and the 'Applicability of Accounting Standards to Various Entities'.]

Objective

A primary issue in accounting for inventories is the determination of the value at which inventories are carried in the financial statements until the related revenues are recognized. This Standard deals with the determination of such value, including the ascertainment of the cost of inventories and any write-down thereof to net realizable value.

Scope

1. This Standard should be applied in accounting for inventories other than:

a) work in progress arising under construction contracts, including directly related service contracts [See Accounting Standard (AS) 7, Construction Contracts];

b) work in progress arising in the ordinary course of business of service providers;

c) shares, debentures, and other financial instruments held as stock-in-trade; and

d) producers' inventories of livestock, agricultural and forest products, and mineral oils, ores, and gases to the extent that they are measured at the net realizable value in accordance with well-established practices in those industries.

2. The inventories referred to in Paragraph 1(d) are measured at the net realizable value at certain stages of production. This occurs, for example, when agricultural crops have been harvested or mineral oils, ores, and gases have been extracted and sale is assured under a forward contract or a government guarantee, or when a homogenous market exists and there is a negligible risk of failure to sell. These inventories are excluded from the scope of this Standard.

Definitions

3. The following terms are used in this Standard with the meanings specified:

3.1. 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.

3.2. Net realizable 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.

4. 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. Inventories do not include spare parts, servicing equipment and standby equipment which meets the definition of property, plant, and equipment as per AS 10, Property, Plant, and Equipment. Such items are accounted for in accordance with Accounting Standard (AS) 10, Property, Plant, and Equipment.

Measurement of inventories

5. Inventories should be valued at a lower cost and net realizable value.

Cost of Inventories

6. The cost of inventories should comprise all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

Costs of Purchase

7. The costs of purchase consist of the purchase price including duties and taxes (other than those subsequently recoverable by the enterprise from the taxing authorities), freight inwards and other expenditures directly attributable to the acquisition. Trade discounts, rebates, duty drawbacks, and other similar items are deducted in determining the costs of purchase.

Costs of Conversion

8. The costs of conversion of inventories include costs directly related to the units of production, such as direct labour. They also include a systematic allocation of fixed and variable production overheads

that are incurred in converting materials into finished goods. Fixed production overheads are those indirect costs of production that remain relatively constant regardless of the volume of production, such as depreciation and maintenance of factory buildings and the cost of factory management and administration. Variable production overheads are those indirect costs of production that vary directly, or nearly directly, with the volume of production, such as indirect materials and indirect labour.

9. The allocation of fixed production overheads for the purpose of their inclusion in the costs of conversion is based on the normal capacity of the production facilities. Normal capacity is the production expected to be achieved on an average over a number of periods or seasons under normal circumstances, taking into account the loss of capacity resulting from planned maintenance. The actual level of production may be used if it approximates normal capacity. The amount of fixed production overheads allocated to each unit of production is not increased as a consequence of low production or idle plant. Unallocated overheads are recognized as an expense in the period in which they are incurred. In periods of abnormally high production, the amount of fixed production overheads allocated to each unit of production is decreased so that inventories are not measured above cost. Variable production overheads are assigned to each unit of production on the basis of the actual use of the production facilities.

10. A production process may result in more than one product being produced simultaneously. This is the case, for example, when joint products are produced or when there is the main product and a by-product. When the costs of conversion of each product are not separately identifiable, they are allocated between the products on a rational and consistent basis. The allocation may be based, for example, on the relative sales value of each product either at the stage in the production process when the products become separately identifiable or at the completion of production. Most by-products as well as scrap or waste materials, by their nature, are immaterial. When this is the case, they are often measured at net realizable value and this value is deducted from the cost of the main product. As a result, the carrying amount of the main product is not materially different from its cost.

Other Costs

11. Other costs are included in the cost of inventories only to the extent that they are incurred in bringing the inventories to their present location and condition. For example, it may be appropriate to include overheads other than production overheads or the costs of designing products for specific customers in the cost of inventories.

12. Interest and other borrowing costs are usually considered as not relating to bringing the inventories to their present location and condition and are, therefore, usually not included in the cost of inventories.

Exclusions from the Cost of Inventories

13. In determining the cost of inventories in accordance with Paragraph 6, it is appropriate to exclude certain costs and recognize them as expenses in the period in which they are incurred. Examples of such costs are:

    a. abnormal amounts of wasted materials, labour, or other production costs;

b. storage costs, unless those costs are necessary for the production process prior to a further production stage;

c. administrative overheads that do not contribute to bringing the inventories to their present location and condition; and

d. selling and distribution costs.

Cost Formulas

14. ***The cost of inventories of items that are not ordinarily inter-changeable and goods or services produced and segregated for specific projects should be assigned by specific identification of their individual costs.***

15. Specific identification of cost means that specific costs are attributed to identified items of inventory. This is an appropriate treatment for items that are segregated for a specific project, regardless of whether they have been purchased or produced. However, when there are large numbers of items of inventory which are ordinarily inter-changeable, specific identification of costs is inappropriate since, in such circumstances, an enterprise could obtain pre-determined effects on the net profit or loss for the period by selecting a particular method of ascertaining the items that remain in inventories.

16. ***The cost of inventories, other than those dealt with in Paragraph 14, should be assigned by using the first-in, first-out (FIFO), or weighted average cost formula. The formula used should reflect the fairest possible approximation to the cost incurred in bringing the items of inventory to their present location and condition.***

17. A variety of cost formulas is used to determine the cost of inventories other than those for which specific identification of individual costs is appropriate. The formula used in determining the cost of an item of inventory needs to be selected with a view to providing the fairest possible approximation to the cost incurred in bringing the item to its present location and condition. The FIFO formula assumes that the items of inventory which were purchased or produced first are consumed or sold first and consequently, the items remaining in inventory at the end of the period are those most recently purchased or produced. Under the weighted average cost formula, the cost of each item is determined from the weighted average of the cost of similar items at the beginning of a period and the cost of similar items purchased or produced during the period. The average may be calculated on a periodic basis, or as each additional shipment is received, depending upon the circumstances of the enterprise.

Techniques for the Measurement of Cost

18. Techniques for the measurement of the cost of inventories, such as the standard cost method or the retail method, may be used for convenience if the results approximate the actual cost. Standard costs take into account normal levels of consumption of materials and supplies, labour, efficiency, and capacity utilization. They are regularly reviewed and if necessary, revised in light of current conditions.

19. The retail method is often used in the retail trade for measuring inventories of large numbers of rapidly changing items that have similar margins and for which it is impracticable to use other costing methods. The cost of the inventory is determined by reducing from the sales value of the inventory the appropriate percentage gross margin. The percentage used takes into consideration inventory which has been marked down to below its original selling price. An average percentage for each retail department is often used.

Net Realisable Value

20. The cost of inventories may not be recoverable if those inventories are damaged, if they have become wholly or partially obsolete, or if their selling prices have declined. The cost of inventories may also not be recoverable if the estimated costs of completion or the estimated costs necessary to make the sale have increased. The practice of writing down inventories below cost to net realizable value is consistent with the view that assets should not be carried in excess of amounts expected to be realized from their sale or use.

21. Inventories are usually written down to net realizable value on an item-by-item basis. In some circumstances, however, it may be appropriate to group similar or related items. This may be the case with items of inventory relating to the same product line that have similar purposes or end uses and are produced and marketed in the same geographical area and cannot be practicably evaluated separately from other items in that product line. It is not appropriate to write down inventories based on a classification of inventory, for example, finished goods, or all the inventories in a particular business segment.

22. Estimates of net realizable value are based on the most reliable evidence available at the time the estimates are made as to the amount the inventories are expected to realize. These estimates take into consideration fluctuations of price or cost directly relating to events occurring after the balance sheet date to the extent that such events confirm the conditions existing at the balance sheet date.

23. Estimates of net realizable value also take into consideration the purpose for which the inventory is held. For example, the net realizable value of the quantity of inventory held to satisfy firm sales or service contracts is based on the contract price. If the sales contracts are for less than the inventory quantities held, the net realizable value of the excess inventory is based on general selling prices. Contingent losses on firm sales contracts in excess of inventory quantities held and contingent losses on firm purchase contracts are dealt with in accordance with the principles enunciated in Accounting Standard (AS) 4, Contingencies and Events Occurring After the Balance Sheet Date #.

24. Materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at or above cost. However, when there has been a decline in the price of materials and it is estimated that the cost of the finished products will exceed the net realizable value, the materials are written down to net realizable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realizable value.

25. An assessment is made of net realizable value as at each balance sheet date.

Disclosure

26. ***The financial statements should disclose:***

    a. the accounting policies adopted in measuring inventories, including the cost formula used; and

    b. the total carrying amount of inventories and its classification appropriate to the enterprise.

27. Information about the carrying amounts held in different classifications of inventories and the extent of the changes in these assets is useful to financial statement users. Common classifications of inventories are:

    a. Raw materials and components.

    b. Work-in-progress.

    c. Finished goods.

    d. Stock-in-trade (in respect of goods acquired for trading).

    e. Stores and spares.

    f. Loose tools.

    g. Others (specify nature).

* The Standard was originally issued in June 1981. The Standard was revised by the Ministry of Corporate Affairs, Government of India, vide Notification dated 30th March 2016, which was relevant for companies following Companies (Accounting Standards) Rules, 2006, and which should be used for the preparation of accounts for accounting periods commencing on or after the date of notification. The Standard was revised for entities other than companies in 2016 by the Council of the ICAI and is mandatory for accounting periods commencing on or after April 1, 2017 (see Announcement XLV). Consequent to this revision, Paragraphs 4 and 27 of AS 2 were revised. The Standard has been notified as part of Companies (Accounting Standards) Rules, 2021, under the Companies Act, 2013.

All paragraphs of AS 4 that deal with contingencies are applicable only to the extent not covered by other Accounting Standards prescribed by the Central Government. For example, the impairment of financial assets such as impairment of receivables (commonly known as provision for bad and doubtful debts) is governed by AS 4.

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04 Management of Receivables

Objective of this Chapter

Management of receivables is a science as well as art. Quick recovery of receivables improves the liquidity position and profitability of the firm. Efficient recovery of receivables reduces bad and doubtful debts. To reduce bad debts in credit sales, credit rating of the buyers is an important tool.

Banks are financing not only for the stock but also book-debts in working capital finance with margins ranging from 40 to 50 per cent. The Stock and Book Debts Auditor's role is to verify the quality of book debt mentioned in the books and the genuineness of receivables.

In this Chapter, we have covered the management of receivables of the firm. This helps to understand and evaluate the quality of book debts / bills receivables of the firm by the Auditors and accordingly, the auditor has to comment in the Audit Report to be submitted to the banks / financial institutions.

Management of receivables refers to planning and controlling of 'debt' owed to the firm from customers on account of credit sales. It is also known as trade credit management.

The basic objective of the management of receivables (debtors) is to optimize the return on investment on these assets.

Large amounts are tied up in receivables; there are chances of bad debts and there will be a cost of collection of debts. On the contrary, if the investment in receivables is low, the sales may be restricted, since the competitors may offer more liberal terms. Therefore, management of receivables is an important issue and requires proper policies and their implementation.

There are three aspects of the management of receivables:

Credit Policy: The credit policy is to be determined. The decision on credit standards, credit terms, and collection efforts are included in the credit policy. It involves a trade-off between the profits on additional sales that arise due to credit being extended on the one hand and the cost of carrying those debtors and bad debt losses on the other. This seeks to decide credit period, cash discount, and other relevant matters. The credit period is generally stated in terms of net days. For example, if the firm's credit terms are "Net 50". It is expected that customers will repay credit obligations no later than 50 days.

Further, the *cash discount policy* of the firm specifies:

a. the rate of cash discount

b. the cash discount period and

c. the net credit period.

For example, the credit terms may be expressed as “3/15 Net 60”. This means that a 3 per cent discount will be granted if the customer pays within 15 days; if he does not avail of the offer, he must make payment within 60 days.

Credit Analysis: This requires the finance manager to determine as to how risky it is to advance credit to a particular party.

Control of Receivable: This requires the finance manager to follow up with debtors and decide on a suitable credit collection policy. It involves both laying down credit policies and the execution of such policies.

There is always a cost of maintaining receivables which comprises of following costs:

a. The company may require additional funds as resources are blocked in receivables which involves a cost in the form of interest (loan funds) or opportunity cost (own funds).

b. Administrative costs which include record keeping, investigation of credit worthiness, etc.

c. Collection costs.

d. Defaulting costs.

The credit policy is an important factor in determining both the quantity and the quality of accounts receivables. Various factors determine the size of the investment a company makes in accounts receivables. They are, for instance:

1. Effect of credit on the volume of sales.

2. Credit terms.

3. Cash discount.

4. Policies and practices of the firm for selecting credit customers.

5. Paying practices and habits of the customers.

6. Firm’s policy and practice of collection.

7. Degree of operating efficiency in billing, record keeping, and adjustment functions, other costs such as interest, collection costs, bad debts, etc., would also have an impact on the size of the investment in receivables. The rising trend in these costs would depress the size of investment in receivables.

The firm may follow a lenient or stringent credit policy. The firm which follows a lenient credit policy sells credit to customers on very liberal terms and standards.

On the contrary, a firm following a stringent credit policy sells credit on a highly selective basis only to those customers who have proper credit worthiness and who are financially sound.

Any increase in accounts receivables that is, an additional extension of trade credit not only results in higher sales but also requires additional financing to support the increased investment in accounts receivables. The costs of credit investigations and collection efforts and the chances of bad debts also increase.

The finance manager has operating responsibility for the management of the investment in receivables. His involvement includes:

1. *Supervising* the administration of credit.

2. *Contributing* to top management decisions relating to the best credit policies of the firm.

3. *Deciding* the criteria for selection of credit applications.

4. *Speeding up* the conversion of receivables into cash with an aggressive collection policy.

Thus, the finance manager has to strike a balance between the cost of increased investment in receivables and profits from the higher levels of sales.

Pledging of accounts receivables and factoring have emerged as important sources of financing of accounts receivables now-a-days.

Pledging: This refers to the use of a firm’s receivables to secure a short-term loan. A firm’s receivables can be termed as its most liquid assets and they serve as prime collateral for a secured loan. The lender scrutinizes the quality of the accounts receivables, selects acceptable accounts, creates a lien on the collateral, and fixes the percentage of financing receivables which ranges from around 50 to 90 per cent. The major advantage of pledging accounts receivables is the ease and flexibility it provides to the borrower. Moreover, financing is done regularly. This, however, suffers on account of the high cost of financing.

Factoring: Factoring is a relatively new concept in the financing of accounts receivables. This refers to an outright sale of receivables to a Factor or a financial agency. A Factor is a firm that acquires the receivables of other firms. Factoring lays down the conditions of the sale in a factoring agreement. The non-factoring agency bears the right to the collection and services of the accounts for a fee. Normally, factoring is the arrangement on a non-recourse basis where in the event of default the loss is borne by the Factor. However, in a factoring arrangement with recourse, the accounts receivables will be turned

back to the firm by the factor for resolution.

There are several financial institutions providing factoring services in India. Some banks and other financial agencies also provide this service. The biggest advantages of factoring are the immediate conversion of receivables into cash and the predicted pattern of cash flows. Financing receivables with the help of factoring can help a company to have liquidity without creating a net liability on its financial condition. Besides, factoring is a flexible financial tool providing timely funds, efficient record keeping, and effective management of the collection process. This is not considered to be a loan. There is no debt repayment, no compromise to the balance sheet, and no long-term agreements or delays associated with other methods of raising capital. Factoring allows the firm to use cash for the growing needs of the business.

In recent years, several tools, techniques, practices, and measures have been invented to increase the effectiveness of accounts receivable management.

The following are the major determinants for significant innovations in accounts receivable management and process efficiency.

1. **Re-engineering receivable process:** In some cases, an organization's real cost reductions and performance improvements have been achieved by re-engineering the accounts receivable process. Re-engineering is a fundamental re-think and re-design of business processes by incorporating modern business approaches. The nature of accounts receivables is such that decisions made elsewhere in the organization are likely to affect the level of resources that are expended on the management of accounts receivables.

The following aspects provide an opportunity to improve the management of accounts receivables:

a. ***Centralization:*** Centralization of high nature transactions of accounts receivables and payables is one of the practices for better efficiency. This focuses attention on specialized groups for a speedy recovery.

b. ***Alternative payment strategies:*** Alternative payment strategies in addition to traditional practices result in efficiencies in the management of accounts receivables. It is observed that payment of accounts outstanding is likely to be quicker where several payment alternatives are made available to customers. Besides, this convenient payment method is a marketing tool that is of benefit in attracting and retaining customers. The following alternative modes of payment may also be used along with traditional methods like cheque book etc., for making timely payments, added customer service, reducing remittance processing costs and improved cash flows, and better debtor turnover.

i. ***Direct debit:*** Authorization for the transfer of funds from the purchaser's bank account.

ii. ***Integrated voice response (IVR):*** This system uses human operators and a computer-based system to allow customers to make payments over the phone. This system has proved to be beneficial in organizations processing a large number of payments regularly.

iii. ***Collection by a third party:*** Payments can be collected by an authorized external firm. The payments can be made by cash, cheque, credit card, or electronic fund transfer. Banks may also be acting as collecting agents of their customers and directly depositing the collections in the customers' bank accounts.

iv. ***Lock box processing:*** Under this system, an outsourced partner captures cheques and invoice data and transmits the file to the client firm for processing in that firm's systems.

v. ***Payments*** via the Internet using fund transfer methods like RTGS, NEFT, IPMS UPIs, and App-based payments like Paytm, Phone Pe, etc.

c. Customer Orientation: Where individual customers or a group of customers have some strategic importance to the firm, a case study approach may be followed to develop good customer relations. A critical study of this group may lead to the formation of a strategy for prompt settlement of the debt.

2. **Evaluation of \risk:** Risk evaluation is a major component in the establishment of an effective control mechanism. Once risks have been properly assessed controls can be introduced either to contain the risk to an acceptable level or eliminate them. This also provides an opportunity for removing inefficient practices. This involves a re-think of processes and questioning the way that tasks are performed. This also opens the way for efficiency and effectiveness benefits in the management of accounts receivables.

3. **Use of latest technology:** Technological developments now-a-days provide an opportunity for improvement in the accounts receivables process. The major innovations available are the integration of systems used in the management of accounts receivables, automation and the use of e-commerce.

a) **E-commerce** refers to the use of computer and electronic telecommunication technologies, particularly on an inter-organizational level, to support trading in goods and services. It uses technologies such as Electronic Data Interchange (EDI), Electronic Mail, Electronic Funds Transfer (EFT), and Electronic Catalogue Systems to allow the buyer and seller to transact business by exchange of information between computer application systems.

b) **Automated accounts receivable management systems:** Now-a-days all the large companies develop and maintain automated receivable management systems. Manual systems of recording the transactions and managing receivables are not only cumbersome but also costly. These integrated systems automatically update all the accounting records affected by a transaction. For example, if a transaction of credit sale is to be recorded, the system increases the amount the customer owes to the firm, reduces the inventory for the item purchased and records the sale. This system allows the application and tracking of receivables and collections, using the automated receivables system and also allows the company to store important information for an unlimited number of customers and transactions and accommodate efficient processing of customer payments and adjustments.

4. **Receivable collection practices:** The aim of debtors' collection should be to reduce, monitor,

and control the accounts receivable while at the same time maintaining customer goodwill. The fundamental rule of sound receivable management should be to reduce the time lag between the sale and collection. Any delays that lengthen this span may cause unnecessary build-up of receivables and increase the risk of bad debts. This is equally true for the delays caused by billing and collection procedures as it is for delays caused by the customer.

The following are major receivable collection procedures and practices:

i. Issue of invoice.

ii. Open an account or open-end credit.

iii. Credit terms or time limits.

iv. Periodic statements.

v. Use of payment incentives and penalties.

vi. Record keeping and continuous audit.

vii. Export factoring: Factors provide comprehensive credit management, loss protection collection services, and provision of working capital to the firms exporting internationally.

viii. Business process outsourcing: This refers to a strategic business tool whereby an outside agency takes over the entire responsibility for managing a business process.

5. ***Use of financial tools / techniques:*** The finance manager while managing the accounts receivables uses several financial tools and techniques. Some of them have been described in the following paragraphs.

i. ***Credit Analysis:*** While determining the credit terms, the firm has to evaluate individual customers in respect of their credit worthiness and the possibility of bad debts. For this purpose, the firm has to ascertain the credit rating of prospective customers.

Credit Rating: An important task for the finance manager is to rate the various debtors who seek credit facilities. This involves decisions regarding individual parties to ascertain how much credit can be extended and for how long. Elsewhere in the world specialized agencies are engaged in the task of providing rating information regarding individual parties. Dun and Broad Street is one such agency.

The finance manager has to look into the credit-worthiness of a party and sanction credit limit only after he is convinced that the party is sound.

This would involve an analysis of the financial status of the party, its reputation, and previous record of meeting commitments.

The credit manager here has to employ several sources to obtain credit information. The following are the important sources:

- Trade references.
- Bank references.
- Credit bureau reports.
- Experience
- Published financial statements
- Salesman's interviews and reports.

Once the credit-worthiness of a client is ascertained, the next question is to set a limit of the credit. In all such enquiries, the credit manager must be discreet and should always have the interest of high sales in view.

ii. ***Decision Tree Analysis of granting credit:*** The decision whether to grant credit or not is a decision involving costs and benefits. When a customer pays, the seller makes a profit but when he fails to pay the amount of cost going into the product also goes. If the relative chances of recovering the dues can be decided it can form a probability distribution of payment or non-payment. If the chances of recovery are 9 out of 10 then the probability of recovery is 0.9 and that of default is 0.1.

Illustration: Credit evaluation of a customer shows that the probability of recovery is 0.9 and that of default is 0.1; the revenue from the order is ₹ 5 lakhs and the cost is ₹ 4 lakhs. The decision is whether credit should be granted or not.

The weighted net benefit is ₹ [1,00,000 × 0.9 i.e., 90,000 – 0.1 × 4,00,000 i.e., 40,000] = ₹ 50,000. , Hence credit should be granted.

iii. ***Control of receivables:*** Another aspect of the management of debtors is the control of receivables. Merely setting of standards and framing a credit policy is not sufficient; it is, equally important to control receivables.

iv. ***Collection policy:*** Efficient and timely collection of debtors ensures that the bad debt losses are reduced to the minimum and the average collection period is shorter. If a firm spends more resources on a collection of debts, it is likely to have lesser bad debts. Thus, a firm must work out the optimum amount that it should spend on a collection of debts. This involves a trade-off between the level of expenditure on the one hand and a decrease in bad debt losses and investment in debtors on the other.

The collection cell of a firm has to work in a manner that does not create too much resentment amongst the customers. On the other hand, it has to keep the amount of outstanding in check. Hence, it

has to work in a very smooth manner and diplomatically.

Clear-cut procedures regarding credit collection must be established. Such procedures must answer questions like the following:

a. How long should a debtor balance be allowed to exist before the collection process is started?

b. What should be the procedure of follow up with a defaulting customer? How reminders are to be sent and how should each successive reminder be drafted?

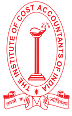
c. Should there be collection machinery whereby personal calls by the company's representatives are made?

d. What should be the procedure for dealing with doubtful accounts? Is legal action to be instituted? How should the account be handled?

Monitoring of Receivables

(i) Computation of average age of receivables: It involves computation of the average collection period.

(ii) Ageing Schedule: When receivables are analysed according to their age, the process is known as preparing the ageing schedules of receivables. The computation of the average age of receivables is a quick and effective method of comparing the liquidity of receivables with the liquidity of receivables in the past and also comparing the liquidity of one firm with the liquidity of the other competitive firm. It also helps the firm to predict the collection pattern of receivables in the future. This comparison can be made periodically. The purpose of classifying receivables by age groups is to have closer control over the quality of individual accounts. It requires going back to the receivable ledger where the dates of each customer's purchases and payments are available. The ageing schedule, by indicating a tendency for old accounts to accumulate, provides a useful supplement to the average collection period of receivables/sales analysis. An analysis of receivables in terms of associated dates of sales enables the firm to recognize the recent increases and slumps in sales. To ascertain the condition of receivables for control purposes, it may be considered desirable to compare the current ageing schedule with an earlier ageing schedule in the same firm and also to compare this information with the experience of other firms. The following is an illustration of the ageing schedule of receivables:



AGEING SCHEDULE

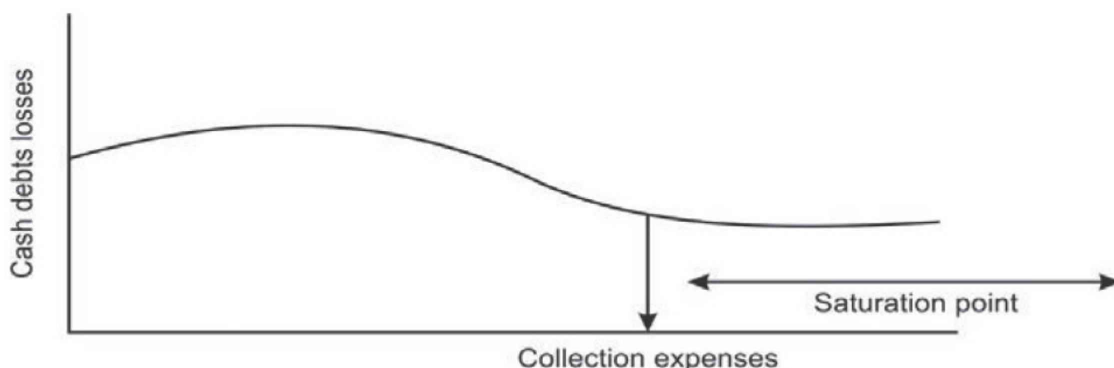
Age Classes (Days)	As on 30th June 2021			As on 30th September 2021		
	Monthof Sale	***Balance of Receivables***	***Percent-ageto total***	***Month of Sale***	***Balance of Receivables***	***Percentageto total***
		(₹)			***(₹)***	
1-30	June	41,500	11.9	Septem-ber	1,00,000	22.7
31-60	May	74,200	21.4	August	2,50,000	56.8
61-90	April	1,85,600	53.4	July	48,000	10.9
91-120	March	35,300	10.2	June	40,000	9.1
121 and more	Earlier	**10,800**	3.1	Earlier	**2,000**	**0.5**
		3,47,400	100		**4,40,000**	100

The above ageing schedule shows a substantial improvement in the liquidity of receivables for the quarter ending September 2021 as compared with the liquidity of receivables for the quarter ending June 2021. It could be possible due to greater collection efforts of the firm.

(iii) Collection Programme:

Monitoring the state of receivables.
Intimation to customers when the due date approaches.
E-mail and telephonic advice to customers on the due date.
Reminding the legal recourse on overdue A/cs.
Legal action on overdue A/cs.

The following graphical depiction shows the relationship between collection expenses and bad debt losses which have to be established as an initial increase in collection expenses may have only a small impact on bad debt losses.



These days, most business transactions are in credit. Most companies, when they face competition, use credit sales as an important tool for sales promotion. As a sales promotion tool, credit sale enhances a firm's sales revenue and ultimately pushes up profitability.

But after a credit sale has been made, the actual collection of cash may be delayed for months. As these late payments stretch out over time, they may cause a substantial drop in a company's profit margin. Since the extension of credit involves both cost and benefits, the firm's manager must be able to measure them to determine the ultimate effect of credit sales. In this perspective, we define receivable management as the aspect of a firm's current assets management, which is concerned with determining the optimum credit policy associated with a firm, such that the benefit from the extension of credit is greater than the cost of maintaining investment in accounts receivables.

The basic purpose of a firm's receivable management is to determine an effective credit policy that increases the efficiency of the firm's credit and collection department and contributes to the maximization of the value of the firm. The specific purposes of receivable management are to :

1. Evaluate the creditworthiness of customers before granting or extending the credit.

2. Minimize the cost of investment in receivables.

3. Minimize the possible bad debt losses.

4. Formulate the credit terms in such a way that results in maximization of sales revenue while still maintaining minimum investment in receivables.

5. Minimize the cost of running the credit and collection department.

6. Maintain a trade-off between costs and benefits associated with credit policy.

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05

Registration of Charge with ROC

Objective of this Chapter

Creation Registration of charge on company's assets gives additional security to the lending institutions. If the charge is not registered properly with ROC, financial institutions will lose the priority of right and the charge becomes void against the liquidator on the assets financed by the financial institutions.

The Stock and Book Debts Auditor has to verify the Filing of Charge on Primary and Collateral Security" of the loans sanctioned by the Bank with Registrar of Companies. This is to be confirmed in the audit report by the Stock and Book Debts Auditor.

A charge is a right created by any person including a company referred to as "the borrower" on its assets and properties, present and future, in favour of a financial institution or a bank, referred to as "the lender", which has agreed to extend financial assistance.

Section 2(16) of the Companies Act, 2013 defines' charge' to mean interest or lien created on the property or assets of a company or any of its undertakings or both as security and includes a mortgage

The following are the essential features of a charge:

1. There should be two parties to the transaction, the creator of the charge and the charge holder.

2. The subject matter of the charge, may be current or future assets and other properties of the borrower.

3. The intention of the borrower to offer one or more of its specific assets or properties as security for repayment of the borrowed money together with payment of interest at the agreed rate should be manifested by an agreement entered into by him in favour of the lender, written or otherwise.

A charge may be fixed or floating depending upon its nature.

"Charge" as defined in Transfer of Property Act, 1882

According to section 100 of the Transfer of Property Act, 1882, where an immovable property of one person is by an 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 which apply to a simple mortgage shall, so far as may be, apply to such charge.

Need for Creating charge on Company's Assets

Almost all companies, big or small, depend upon share capital and borrowed capital for financing their projects. Borrowed capital may consist of funds raised by issuing debentures, which may be secured or unsecured, or by obtaining financial assistance from financial institutions or banks.

Financial institutions/banks do not lend their monies unless they are sure that their funds are safe and they would be repaid as per the agreed repayment schedule along with payment of interest. To secure their loans they resort to creating right in the assets and properties of the borrowing companies, which is known as a charge on assets. This is done by executing loan agreements, hypothecation agreements, mortgage deeds and other similar documents, which the borrowing company is required to execute in favour of the lending institutions/ banks etc.

As a matter of convenience and practice, as and when more funds are required by companies, they approach the same institutions/banks or certain new institutions/ banks and offer the same assets as security for fresh loans. However, when the same assets are charged for second and subsequent times, a very important question arises as to priority in respect of the charges in favour of different institutions. This situation is managed by securing the consent of the earlier lending institutions to the creation of second and subsequent charges on the same assets. With their consent, the charges of all the lending institutions rank pari passu, i.e., on the same footing.

However, the earlier lending institution may not give its consent to the creation of a second charge on the ground that the realisable value of the asset charged in its favour is not adequate to cover its loan and as such, it cannot share its right of charge with the lending institutions which seek second and subsequent charges.

The real question which alerts the lending institutions is how to ensure that the assets being offered as security for their proposed loans are not already encumbered.

Duty to Register Charge: Primarily, under section 77 of the Companies Act, 2013 every company creating a charge shall register the particulars of the charge signed by the company and its charge–holder together with the instruments created with the ROC. Important points in the Act relating to charge creation are:

- Any charge can be created within or outside India.
- On property or assets or any of the company's undertakings.
- Whether tangible or otherwise, situated in or outside India.

Hence all types of charges are required under the Act to be registered whether created within or outside India.

The time limit for Registration of a Charge

A charge created by a company is required to be registered with the Registrar of Companies within

thirty days of its creation in such form and on payment of such fees as may be prescribed. According to Companies (Registration of Charges) Rules, 2014 e-forms prescribed to create or modify the charge in Form No.CHG-1 (for other than Debentures) or Form No.CHG-9 (for debentures including rectification).

Condonation of delay by Registrar: The Registrar may, on an application by the company, allow registration of charge within three hundred days of creation or modification of charge on payment of an additional fee. The Registrar may, on being satisfied that the company had sufficient cause for not filing the particulars and instrument of charge, if any, within thirty days of the date of creation of the charge, allow the registration of the same after thirty days but within a period of three hundred days of the date of such creation of charge or modification of charge on payment of an additional fee. The application for delay shall be made in Form No.CHG-10 and supported by a declaration from the company signed by its secretary or director that such belated filing shall not adversely affect the rights of any other intervening creditors of the company.

Condonation of delay by the Central Government: If the company fails to register the charge within this period of three hundred days, it may seek an extension of time under section 87 from the Central Government.

Application for registration of charge by the charge-holder

According to section 78 where a company fails to register the charge within the period specified above, the person in whose favour the charge is created may apply to the Registrar for registration of the charge along with the instrument created for the charge in Form No.CHG-1 or Form No.CHG-9, as the case may be, is duly signed along with the fee. The registrar may, on such application, give notice to the company about such application. The company may either itself register the charge or show sufficient cause why such charge should not be registered. On failure on part of the company, the Registrar may allow registration of such charge within fourteen days after giving notice to the company.

Where registration is effected on the application of the person in whose favour the charge is created, that person shall be entitled to recover from the company, the amount of any fee or additional fees paid by him to the Registrar for registration of the charge.

Certificate of Registration of Charge

Where a charge is registered with the Registrar, he shall issue a certificate of registration of charge in Form No.CHG-2 and for registration of modification of charge in Form No.CHG-3 to the company and to the person in whose favour the charge is created.

The certificate issued by the Registrar whether in case of registration of charge or registration of modification, shall be conclusive evidence that the requirements of Chapter VI of the Act (Registration of Charges) and the rules made there under as to registration of creation or modification of charge, as the case may be, have been complied with.

Further, the Act provides that no charge created by the company shall be taken into account by the liquidator or any other creditor unless it is duly registered and a certificate of registration is given by the Registrar. However, this does not prejudice any contract or obligation for the repayment of the money secured by a charge.

Acquiring property under Charge and Modification of Charge

Section 79 of the Act makes it clear that the requirement of registering the charge shall also apply to a company acquiring any property subject to a charge or any modification in terms and conditions of any charge already registered.

It provides that the provisions of section 77 relating to registration of charge shall apply to:

a) a company acquiring any property subject to a charge within the meaning of that section; or

b) any modification in the terms or conditions or the extent or operation of any charge registered under that section.

The provisions relating to condonation of delay shall apply, mutatis mutandis, to the registration of charge on any property acquired subject to such charge and modification of charge under section 79 of the Act.

Verification of Instruments:

According to the Rules, a copy of every instrument evidencing any creation or modification of charge and required to be filed with the Registrar in pursuance of sections 77, 78 or 79 shall be verified as follows:

a) Where the instrument or deed relates solely to the property situated outside India, the copy shall be verified by a certificate issued either under the seal of the company or under the hand of any director or Company Secretary of the company or an authorised officer of the charge holder or under the hand of some person other than the company who is interested in the mortgage or charge.

b) Where the instrument or deed relates, whether wholly or partly, to the property situated in India, the copy shall be verified by a certificate issued under the hand of any director or company secretary of the company or an authorised officer of the charge holder.

Satisfaction of Charges

According to section 82 read with the Rules, the company shall give intimation to the Registrar of the payment or satisfaction in full of any charge within thirty days from the date of such payment or satisfaction in Form No.CHG-4 along with the fee. Where the satisfaction of the charge is not filed within thirty days from the date on which such payment of satisfaction, the Registrar shall not register the same unless the delay is condoned by the Central Government.

On receipt of such intimation, the Registrar shall issue a notice to the holder of the charge calling a show cause within such time not exceeding fourteen days, as to why payment or satisfaction in full should not be recorded as intimated to the Registrar. If no cause is shown, by such holder of the charge, the Registrar shall order that a memorandum of satisfaction shall be entered in the register of charges maintained by the registrar under section 81 and shall inform the company. If cause is shown to the Registrar, he shall record a note to that effect in the register of charges and shall inform the company accordingly

However, the aforesaid notice shall not be sent, in case of intimation to the Registrar is in a specified

form and is signed by the holder of charge.

Powers of Registrar to make entries of satisfaction in absence of intimation from the company:

There may be times when a company may fail to send intimation of satisfaction of charge to the Registrar but according to section 83 of the Act, the Registrar may enter in the register of charges memorandum of satisfaction on receipt of evidence to his satisfaction that:

a) the debt for which the charge was given has been paid or satisfied in whole or in part; or

b) part of the property or undertaking charged has been released from the charge or has ceased to form part of the company's property or undertaking.

The Registrar shall inform the affected parties within thirty days of making the entry in the registrar of charges.

Certificate of registration of satisfaction of charge: Where the Registrar enters a memorandum of satisfaction of charge in full in pursuance of section 82 or 83, he shall issue a certificate of registration of satisfaction of charge in Form No.CHG-5.

Notice of Charge

According to section 80, where any charge on any property or assets of a company or any of its undertakings is registered under section 77, any person acquiring such property, assets, undertakings or part thereof or any share or interest therein, shall be deemed to have notice of the charge from the date of such registration. The section clarifies that if any person acquires a property, assets or undertaking on which a charge is already registered, it would be deemed that he has complete knowledge of the charge from the date the charge is registered.

Register of Charges maintained in ROC's Office

Section 81 and the Rules require that the Registrar of Companies shall maintain a register containing particulars of the charges registered in respect of every company. The particulars of charges maintained on the Ministry of Corporate Affairs portal (www.mca.gov.in/MCA21) shall be deemed to be the register of charges for section 81 of the Act.

This charge register (ROC) shall be open to inspection by any person on payment of a fee for each inspection to ROC.

Intimation of Appointment of Receiver or Manager

Section 84 provides that if any person obtains an order for the appointment of a receiver of, or of a person to manage, the property, subject to a charge, of a company or if any person appoints a such receiver or a person under any power contained in any instrument, he shall, within thirty days from the date of the passing of the order or the making of the appointment, give notice of such appointment to the company and the Registrar along with a copy of the order or instrument and the Registrar shall, on payment of the prescribed fees, register particulars of the receiver, person or instrument in the register of charges.

Any person so appointed shall, on ceasing to hold the such appointment, give to the company and the Registrar a notice to that effect and the Registrar shall register such notice.

The notice of appointment or cessation of a receiver of, or a person to manage, the property, subject to charge, of a company shall be filed with the Registrar in Form No. CHG.6 along with the fee.

Company's Register of Charges

Section 85 provides that every company shall keep at its registered office a register of charges in Form No. CHG.7 which shall include therein all charges and floating charges affecting any property or assets of the company or any of its undertakings, indicating in each case such particulars as may be prescribed.

The entries in the register of charges maintained by the company shall be made forthwith after the creation, modification or satisfaction of charge, as the case may be.

Such register of charges shall contain the particulars of all the charges registered with the Registrar on any of the property, assets or undertaking of the company and the particulars of any property acquired subject to a charge as well as particulars of any modification of a charge and satisfaction of charge.

All the entries in the register shall be authenticated by a Director or the Company Secretary of the Company or any other person authorised by the Board for the purpose.

The register of charges shall be preserved permanently and the instrument creating a charge or modification thereon shall be preserved for eight years from the date of satisfaction of charge by the company.

A copy of the instrument creating the charge shall also be kept at the registered office of the company along with the register of charges.

Inspection of Charges: The register of charges and instrument of charges shall be kept open for inspection during business hours by members, creditors or any other person subject to the reasonable restriction of the company by its Article impose. The register of charges and the instrument of charges kept by the company shall be open for inspection:

a) by any member or creditor of the company without fees;

b) by any other person on payment of a fee.

Rectification by Central Government in Register of Charges / Condonation of Delay

Section 87 of the Companies Act, 2013 provides:

(1) The Central Government on being satisfied that:

(i)(a) the omission to file with the Registrar the particulars of any charge created by a company or any charge subject to which any property has been acquired by a company or any modification

of such charge; or

(b) the omission to register any charge within the time required under this Chapter or the omission to give intimation to the Registrar of the payment or the satisfaction of a charge, within the time required under this Chapter; or

(c) the omission or misstatement of any particular concerning any such charge or modification or any memorandum of satisfaction or other entry made in pursuance of section 82 or section 83, was accidental or due to inadvertence or some other sufficient cause or it is not of a nature to prejudice the position of creditors or shareholders of the company; or

(ii) on any other grounds, it is just and equitable to grant relief, it may on the application of the company or any person interested and, on such terms, and conditions as it may seem to the Central Government just and expedient, direct that the time for the filing of the particulars or the registration of the charge or the giving of intimation of payment or satisfaction shall be extended or, as the case may require, that the omission or mis-statement shall be rectified.

(2) Where the instrument creating or modifying a charge is not filed within a period of three hundred days from the date of its creation (including the acquisition of a property subject to a charge) or modification and where the satisfaction of the charge is not filed within thirty days from the date on which such payment of satisfaction, the Registrar shall not register the same unless the delay is condoned by the Central Government.

The section implies that the Central Government has the power to condone delay beyond a period of three hundred days. This section empowers Central Government to condone delay for registration of modification of particulars of any charge and filing of intimation for the satisfaction of charges. Further, this section empowers the Central Government to rectify the omission or misstatement in the register of charges. The application may be filed by the company or any other person interested with the Central Government in Form No.CHG-8 along with the fee.

Where the Central Government extends the time for the registration of a charge, the order shall not prejudice any rights acquired in respect of the property concerned before the charge is registered.

The order passed by the Central Government under sub-section (1) of section 87 of the Act shall be required to be filed with the Registrar in Form INC.28 along with the fee as per the conditions stipulated in the said order.

Consequences of Non-Registration of Charge

According to section 77 of the Companies Act, 2013, all types of charges created by a company are to be registered by the ROC. Where they are non-compliant and are not filed with the Registrar of Companies for registration, it shall be void as against the liquidator and any other creditor of the company. This does not, however, mean that the charge is altogether void and the debt is not recoverable. So long as the company does not go into liquidation, the charge is good and may be enforced.

“Void against the liquidator” means that the liquidator on winding up of the company can ignore the charge and can treat the concerned creditor as an unsecured creditor. The property will be treated free

of charge i.e., the creditor cannot sell the property to recover its dues.

"Void against any creditor of the company" means that if any subsequent charge is created on the same property and the earlier charge is not registered, the earlier charge would have no consequence and the latter charge if registered would enjoy priority. In other words, the latter charge holder can have the property sold to recover its money.

Thus, non-filing of particulars of a charge does not invalidate the charge against the company as a going concern. It is void only against the liquidator and the creditors at the time of liquidation. The company itself cannot have a cause of action arising out of nonregistration.

Particulars of Charges

The following particulars in respect of each charge are required to be filed with the Registrar:

a. Date and description of instrument creating charge.

b. Total amount secured by the charge.

c. Date of the resolution authorising the creation of the charge (in case of issue of secured debentures only).

d. General description of the property charged.

e. A copy of the deed/instrument containing the charge duly certified or if there is no such deed, any other document evidencing the creation of the charge to be enclosed.

f. List of the terms and conditions of the loan. and

(g) Name and address of the charge holder.

Procedure for Registration of Creation / Modification / Satisfaction of Charge

If a company has passed special resolutions under section 180(3)(c) of the Companies Act, 2013, authorising its Board of Directors to borrow funds for the requirements of the company and under Section 180(1)(a) of the Companies Act, 2013, authorising its Board of Directors to create a charge on the assets and properties of the company to provide security for repayment of the borrowings in favour of the financial institutions/banks or lenders and in the exercise of that authority has signed the loan documents and now proposes to have the charge, created by it registered with the ROC, should follow the procedure detailed below:

1. Where the special resolution is passed as required under section 180 of the Companies Act, 2013, Form MGT14 of the Companies (Management and Administration) Rules, 2014 is to be filed with the registrar.

2. According to section 77 of the Companies Act, 2013 every company creating any charge created within or outside India on property or assets or any of the company's undertakings whether tangible

or otherwise, situated in or outside India shall have to be registered., to create/modify a charge file particulars of the charge with the concerned Registrar of Companies within thirty days of creating the charge in Form No.CHG -1 m No.CHG -1 (for other than Debentures) or Form No.CHG - 9 (for debentures including m No. CHG - 9 rectification), as the case may be.

3. Attach the following documents with e-Form CHG9 / CHG -1: 9/ CHG -1:

A certified true copy of every instrument evidencing any creation or modification of charge.

In the case of joint charge and consortium finance, particulars of other charge holders.

Instrument(s) evidencing creation or modification of charge in case of acquisition of property which is already subject to charge together with the instrument evidencing such acquisitions.

4. Payment of fees can be made online vide Annexure 'B' of Companies (Registration Offices and Fees) Rules, 2014. Electronic payments through the internet can be made either by credit card or by internet banking facility.

5. If the particulars of charge cannot be filed within thirty days due to unavoidable reasons, then it may be filed within three hundred days of such creation after payment of such additional fee as prescribed in Annexure 'B' of the Companies (Registration Offices and Fees) Rules, 2014.

6. Such application for the delay to the Registrar shall be made in Form CHG-10 and supported by a declaration Form-10 by the company signed by its Secretary or Director that such belated filing shall not adversely affect the rights of any other intervening creditors of the company.

7. Verification of every instrument evidencing any creation or modification of charge: Where the instrument or deed relates solely to the property situated outside India, the copy shall be verified by a certificate issued either under the seal of the company or under the hand of any director or Company Secretary of the company or an authorised officer of the charge holder or under the hand of some person other than the company who is interested in the mortgage or charge.

8. Verification of every instrument evidencing any creation or modification of charge: Where the instrument or deed relates, whether wholly or partly, to the property situated in India, the copy shall be verified by a certificate issued under the hand of any Director or Company Secretary of the company or an authorised officer of the charge holder.

9. Where a charge is registered with the Registrar obtain a certificate of registration of such charge in Form CHG2. Where the particulars of modification of charge are registered the Registrar shall issue a certificate of modification of charge in Form. CHG-3.

10. A company shall within thirty days from the date of the payment or satisfaction in full of any charge registered, give intimation of the same to the Registrar in Form CHG-4 along with the fee as prescribed in with Annexure 'B' of Companies (Registration Offices and Fees) Rules, 2014.

11. Where the Registrar enters a memorandum of satisfaction of charge in full and obtains a certificate

of registration of satisfaction of charge in Form CHG-5.

12. Incorporate changes about creation, modification and satisfaction of charge in the register of charges maintained by the company in Form CHG.7 and Form CHG.7 enter therein particulars of all the charges registered with the Registrar on any of the property, assets or undertaking of the company and the particulars of any property acquired subject to a charge as well as particulars of any modification of a charge and satisfaction of charge. Such register is to be kept at its registered office of the company.

13. All the entries in the register shall be authenticated by a Director or the Secretary of the company or any other person authorised by the Board for the purpose.

14. The register of charges shall be preserved permanently and the instrument creating a charge or modification thereon shall be preserved for eight years from the date of satisfaction of charge by the company.

15. Where the satisfaction of the charge is not filed with the Registrar within thirty days from the date on such payment of satisfaction, an application for condonation of delay shall be filed with the Central Government in Form CHG-8 along with the fee as prescribed in Annexure 'B' of Companies (Registration Offices and Fees) Rules, 2014.

16. Where the instrument creating or modifying a charge is not filed with the Registrar within a period of three hundred days from the date of its creation (including the acquisition of a property subject to a charge) or modification of an application for condonation of delay shall be filed with the Central Government in Form CHG-8 along with the fee as prescribed in Annexure 'B' of Companies (Registration Offices and Fees) Rules, 2014.

17. The order passed by the Central Government shall be required to be filed with the Registrar in Form INC.28 along with the fee as per the conditions stipulated in the said order.

18. For all other matters other than condonation of delay, the application shall be made to the Central Government in Form CHG-8 along with the fee.

Registration of Charge with ROC

The stock auditor can have a quick reference of the Charges with ROC by referring to the MCA portal under the head Master Data

MCA Services

- Home > Master Data >Index of Charges

Gist of E-filing Under Charge Management

Sl. No.	E-Form	Purpose
1	CHG-1	Creating or modifying the charge (for other than debentures)
2	CHG-2	Certificate of registration
3	CHG-3	Certificate of modification of charge
4	CHG-4	Intimation of the satisfaction to the Registrar
5	CHG-5	Memorandum of satisfaction of charge
6	CHG-6	Notice of appointment or cessation of receiver or manager
7	CHG-7	Register of charges
8	CHG-8	Application for condonation of delay shall be filed with the Central
		Government
9	CHG-9	Creating or modifying the charge in (for debentures including rectification)
10	CHG-10	Application for the delay to the registrar

All the fees shall be paid vide Annexure 'B' of Companies (Registration Offices and Fees) Rules, 2014 issued by the Ministry of Corporate Affairs as a circular dated 01/04/2014 which is available at: w

http://www.mca.gov.in/Ministry/pdf/tableoffee_01042014.pdf

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06

Central Registry of Securitisation, Asset Reconstruction and Security Interest of India (CERSAI)

Objective of this Chapter

Entering the security particulars of various loans sanctioned by the bank in the CERSAI portal is mandatory as per SARFAESI Act, 2002. Movable and immovable assets particulars are to be entered by paying requisite fees. If any default is there, banks are to pay the fine for the delayed registration.

Stock Auditors are to check whether the security particulars (primary & collateral) of loans given to different entities have been entered by the financial institutions/ banks in the CERSAI portal or not. A copy of the registration in CERSAI Certificate is available along with the loan documents of the financial institutions / banks sanctioned to different entities.

If the banks / financial institutions are not registered with CERSAI, suitable remarks are to be made in the Stock and Book Debts Audit Report by the Auditor.

The Central Registry of Securitisation, Asset Reconstruction and Security Interest of India [CERSAI] was created to restrain fraudulent activity in lending transactions against equitable mortgages.

CERSAI has been established as a company under section 8 of the Companies Act, 2013 by the Government of India. CERSAI was formed to identify and check fraudulent activity in lending transactions against equitable mortgages. In other words, the CRESAI was established to discourage and prevent the practice of taking out various loans from several banks using the same asset or property.

Major shareholders of the CERSAI are the Government of India, National Housing Bank and public sector banks, out of which the Central Government incidentally holds 51 per cent shares in the company. Before the setting up of the CERSAI, a property's encumbrance details rested solely with the borrower and the lender.

The reason behind this was the disjointed system of registration that was in place at the time. Due to this, persons would take out various loans from several banks using the same asset or property.

These loans from banks were obtained using counterfeit title deeds or through other doubtful means of replicating the original deed. Unfortunately, for genuine buyers, these assets or properties were then sold with unpaid loans still attached to them. It ultimately landed the potential buyers in a soup due to the lack of information about the existing liability of the property/asset.

- The Registration with CERSAI can be initiated on the official website of CERSAI.
- The person seeking registration will be required to fill out the registration form electronically available under the 'Entity Registration' option on the CERSAI website.
- The user must possess a Digital Signature Certificate (DSC) to gain access to the CERSAI portal and to fill out the relevant details.
- Once all the information required for the registration has been filled in, the same is required to be printed and signed by the authorized signatory.
- These printed forms, along with all relevant documents as mentioned in the forms are to be sent to the official address of CERSAI.

Any bank, financial institution, or individual can access the registration platform of CERSAI for a certain fee. By registering themselves with CERSAI, the lenders can pull up the information on an asset or property to validate whether any previous security interest has been created by a different lender ((banks, financial institutions, etc.) in the past.

Usually, this is done before the sanction of a loan to a borrower. This is exceptionally beneficial for the genuine buyers of the property, as CERSAI permits them to pull up all the relevant information from the registry to check whether the property in which they are interested is free of any liability that may have been created by another lender.

Current Information

Updated till 24.01.2020: Sections 17 to 19 of the 2016 Act have been notified on December 26, 2019, by the Ministry of Finance in the official gazette ("SARFAESI Amendments") and came into effect from January 24, 2020.

By sections 17 to 19 of 2016 Act, inter alia section 23 has been amended as follows:

1. Section 23 has been numbered as sub-section (1) by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016. (w.e.f. 24-1-2020).

2. Removal of the words "within thirty days after the date of such transaction or creation of security, by the securitization company or reconstruction company or the secured creditor, as the case may be". It means the timeline of 30 days has been dispensed with for the secured creditors to file certain types of security interests in their favour with CERSAI.

3. To provide a right to the Central Government to notify the types of transactions (about the creation

of security interest over the property) that require registration with the CERSAI.

4. Security interest and attachment orders of banks and financial institutions, Government agencies, local authorities, or any other parties who have not duly registered the security interest with the CERSAI shall not be entitled to exercise the right of enforcement of securities under Chapter III. (for details read: SARFAESI Amendments 2019)

5. New sub-rules (2E), (2F), and (2G) have been inserted in rule 4.

The Government of India has amended the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (Central Registry) Rules, 2011(Referred to as Principal Rules). The amendment to Principal Rules came into force from the date the same was published in the Gazette of India Part II section3 sub-section. (i) (January 22, 2016).

The Central Registry of Securitisation Asset Reconstruction and Security Interest of India (CERSAI) is a Government Company licensed under Section 25 of the Companies Act 1956. It has been incorporated to operate and maintain the Central Registry under the provisions of the SARFAESI Act, 2002. Initially, transactions relating to securitization and reconstruction of financial assets and those relating to mortgage by deposit of title deeds to secure any loan or advance granted by banks and financial institutions, as defined under the SARFAESI Act, are to be registered in the Central Registry. The records maintained by the Central Registry will be available for search by any lender or any other person desirous of dealing with the property. The availability of such records would prevent fraud involving multiple lending against the security of the same property as well as the fraudulent sale of property without disclosing the security interest over such property. It may be noted that under the provisions of section 23 of the SARFAESI Act, 2002 particulars of any charge creating the security interest over property are required to be filed with the registry (the timeline within 30 days from the date of creation has been omitted w.e.f., 24.01.2020).

As per the old rules, only the secured creditors were required in respect of equitable mortgages created in their favour to register the same with CERSAI. However, the new rules with the insertion of sub-rules (2A), (2), (2), and (2D) in rule 4 makes it mandatory for creditors to register with CERSAI for the other types of charges.

Sub-rule (2A) states: “the particulars of creation, modification or satisfaction of security interest in the immovable property by mortgage other than a mortgage by deposit of title deeds shall be filed in Form I or Form II, as the case may be, and shall be authenticated by a person specified in the Form for such purpose by use of a valid digital signature”. Section 4(2D) conditions that the particulars of creation, modification, or satisfaction of security interest in any under construction, residential or commercial building, or a part thereof by an agreement or instrument other than by mortgage, shall be filed with CERSAI.

Sub-rule (2B) makes it mandatory to file particulars regarding creation, modification, or satisfaction of security interest in the hypothecation of plant and machinery, stocks, and debt including book debt or receivables, whether existing or future.

In terms of sub-rule (2C), particulars of creation, modification, or satisfaction of security interest in intangible assets, being know-how, patent, copyright, trademark, license, franchise, or any other business or commercial right of similar nature shall be filed.

Sub-section (2D) requires that the particulars of creation, modification, or satisfaction of security interest in any under construction, residential or commercial building, or a part thereof by an agreement or instrument other than by mortgage, shall be filed with CERSAI.

By SARFAESI (Amendment) Act 2019 after rule 4, sub-rule (2D) the following new sub-rules have been inserted namely:

(2E) Particulars of creation, modification, or satisfaction of a right, title, or interest of any kind, including those referred to in sub-clauses (i) and (ii) of clause (ZF) of sub-section (1) of section 2 of the Act created by a borrower in favour of other creditors shall be filed in Form. I, through (i) e sign (through an Aadhaar based onetime password validation); or (ii) digital signature; or (iii) CKYC number, as the case may be.

(2F) Particulars of attachment orders as referred to in sub-section (4) of section 26B of the Act with the particulars of the assesses and details of tax or other Government dues shall be filed electronically by the officers authorized on that behalf by such authority of the Central Government or the State Government or local authority in Form I, and particulars of modification or satisfaction of such attachment orders shall be filed in Form I or Form II as the case may be.

(2G) Particulars of attachment orders passed by a court or other authority referred to in sub-section (5) of section 26B shall be filed electronically by the person in whose favour such orders have been passed in Form I and the particulars of modification or satisfaction of such attachment orders shall be filed in Form I or Form number II through (i) e sign (through an Aadhar based onetime password validation); or (ii) digital signature; or (iii) CKYC number, as the case may be.

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07

Drawing Power

Objective of this Chapter

Drawing power is based on the stock and book debts of a unit. The borrower unit has to submit stock statement on regular basis as per the condition stipulated in sanction letter.

Based on the stock and book debts statement, the drawing power shall be determined. The periodicity of the stock and book debts statement differs from the activity and also the quantum of loan etc.

It The frequency may be monthly / quarterly / half-yearly/ yearly. If the quantum of the loan is very small, banks will insist on the submission of a stock statement on yearly basis.

The Stock and Book Debt Auditor has to verify the periodicity of the submission of the stock and book debts statement and verify whether the Branch is arriving at the drawing power as per the Bank's guidelines or not. If any deviations are there, those are to be mentioned in the Stock and Book Debts Audit Report.

The cash credit limit (known as the working capital limit) is sanctioned by banks and financial institutions to industrial and trading establishments for their investment in various types of current assets used in the operating cycle. This facility offers the borrowers flexibility and comfort to withdraw funds from the bank as per their financial requirements from time to time. The working capital facility is sanctioned for one year and the same may be renewed by the bank (or financial institution) every year with the same limit or enhanced limit or reduced limit to the borrower firm/company which is assessed based on the its financial results of the preceding (reporting) year as well as the projected balance sheet for the ensuing (subsequent) year.

Drawing power (DP) is an important concept for fund-based working capital financing facilities. It is the limit up to which a borrower can withdraw funds within the cash credit limit. The drawing power shall be arrived at based on the stock, book debts and creditors' statement submitted by the borrower on the closing position of the earlier month. The borrower is allowed to utilize the funds from the cash credit account within the sanctioned cash credit limit or drawing power arrived at by the bank for the particular month whichever is less. The purpose of arriving at DP every month is to keep a tab on the performance of the firm or company to whom the limits are sanctioned. The calculation of DP every month also reveals the health of the concerned firm/company month on month. If bills are not paid in time and become sticky or the amounts of creditors are increasing due to unpaid stock it gives an early warning to the bank about the unit. In such an event, the concerned \bank has to take a timely step towards safeguarding its exposure.

Calculation of DP

Drawing Power is calculated as under:

[{Fully Insured Total Stock *minus* Unpaid Stock (Creditors) minus Margin} plus {Book Debts* minus Margin}]

Usually, book debts, not more than 90 days old are considered for DP calculation. However, if the business has a longer credit cycle, more than 90 days of debtors might be considered as per sanction terms. Margin is the owner's contribution to the business. Normally, in most cases, a margin on the stock is 25 per cent and for book debts, 40 to 50 per cent of net debtors is stipulated, However, it may vary from bank to bank and industry to industry.

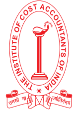
Illustration:

ABC company enjoys a CC limit of ₹12,00,000/-. The details of stock and book debts statement as at the end of July are as under.

Total stock ₹ 15,00,000/-, Creditors, ₹ 3,00,000/-, Total book debts ₹ 50,000/-, Of which more than 90 days old is ₹ 1,00,000/- (As per sanction more than 90 days old are not considered for DP).

From the above detail, we have to find out the drawing power for August based on a stock statement submitted by ABC Company.

A	Total Stock (fully insured)	₹ 15,00,000
B	Less: Creditors	₹ 3,00,000
C	Net paid Stock	₹ 12,00,000
D	25 per cent margin on "C"	₹ 3,00,000
E	DP on stock (C-D)	₹ 9,00,000
F	Total Book debts	₹ 5,00,000
G	Less: Book debts more than 90 days	₹ 1,00,000
H	Book debts up to 90 days old	₹ 4,00,000
I	40 per cent margin on "H"	₹ 1,60,000
J	DP on book debts (H-I)	₹ 2,40,000
K	Total DP (E+J)	₹ 11,40,000



DP available to ABC Company is ₹ 11,40,000/- against the sanctioned limit of ₹ 12,00,000/-. Hence ABC Company can withdraw funds up to ₹ 11,40,000/ (maximum outstanding) within the cash credit limit of ₹ 12,00,000/-.

Under the revised "Loan System for Delivery of Bank Credit," the total fund-based working capital limit is bifurcated into working capital loan component and cash credit component at the proportion of 60 per cent and 40 per cent respectively for those large borrowers who enjoy aggregate fund-based working capital limit of ₹1500 million.

The above revision is applicable from July 1, 2019. Many large corporates do not utilize or under-utilize the working capital sanctioned to them.

This would cause loss to lender banks as they do not earn interest income on the idle funds reserved for the facility sanctioned to these borrowers.

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08 Early Warning Signals

Objective of this Chapter

In this Chapter, we have covered the "early warning signals" of borrowing units financed by the banks. These are also called red alerts. If these signals arise, immediately the bank branches should be alerted to take remedial action. Otherwise, the loan accounts may turn into NPA or result in possible diversion of funds by the borrowing units to a purpose other than the purpose for which the loan was sanctioned or it may lead to fraudulent transactions.

These are useful to the Stock and Book Debts Auditors in discharging their duties as efficaciously.

These are useful as guidance and any such events are happening in the auditee firm, the relevant findings (not all) related to stock and book debts / working capital loans are brought to the notice of the bank management through Stock Audit Report.

Increasing gross non-performing assets (GNPA) is a cause of concern for both public sector as well as private sector banks.

Gross non-performing assets (GNPAs) of banks have hit six-year low of 5.9 per cent as of March 2022. But India's NPA ratio is one of the highest among comparable countries. Barring Russia, which has a bad loan of 8.3 per cent, every large market has bad loans below India. China has NPA ratio of 1.8 per cent, while it is 2.6 per cent for Indonesia and 5.2 per cent for South Africa. Most of the developed economies have NPAs below 3 per cent.

Early warning systems are specialized tools, built using a set of parameters and processes that identify probable risks at a nascent stage. A comprehensive and well-structured EWS assists the top-level management to predict possible defaults from borrowers that may adversely affect the institution. Such systems can prevent manual omissions and other oversights, thereby securing the bank's asset portfolio.

Instances of some negative signs while reviewing / renewing loans of the prospective borrowing companies which require funding from banks and financial institutions are set out in the following paragraphs.

1. ***Default in Undisputed Payment to the Statutory Bodies as declared in the Annual Reports:*** Delays in payment of undisputed dues to the statutory bodies indicate two possibilities namely:

- Liquidity issue of the company or

- Mala fide intentions to clear statutory dues.

Both instances ultimately lead the company to prosecution and compulsory payment of penalty, interest, etc. with a high risk of solvency.

2. ***Bouncing of High-Value Cheques:*** If the company is a current account holder in the bank, then, the company is required to operate its account as specified by the banker. Depositing cheques as received from the customers and withdrawing from the same bank account for expenses and payments to suppliers are the standard operating systems for the company.

   Frequent bouncing of high value cheques of the customers denotes, that the company has not appraised properly the credit rating of debtors before giving credit to the customers.

   If the credit policy of the company is strong, this type of bouncing of cheques will not happen. Hence, the quality of debtors showing the balance sheet is not up to the mark and probably the bad debt will increase.

   Similarly, if the company issues cheques to the creditors and due to the non-availability of funds in the account, the cheque is to be returned by the bank, then the supplier will file an application in court under sections 138 to 142 of the Negotiable Instrument Act, 1881. This denotes that the company is having liquidity problem and without adequate balance in its account, the company is issuing cheques to creditors, etc. This is also an early warning signal.

3. ***Frequent Change in the Scope of the Project to be undertaken by the Company:*** Poor project valuation, poor monitoring and effects of global overcapacity on prices and imports are major reasons for the delay or frequent changes in the scope of the project which result in the unjustifiable extension of time for the project and overrun of cost. The final project takes a shape that is very different from what was envisaged at the initial appraisal stage and as a result many of the associated aspects e.g., management competency for executing the revised project of different scales and complexity, may not have been assessed properly. And the company is not following the project control techniques like PERT, CPM, etc.

4. ***Foreign Bills remaining outstanding with the Bank for a Long Time and Tendency for Bills to remain Overdue:*** International trade-based money laundering schemes are difficult to detect because almost all are layered within the mass of legitimate payments flowing through the complicated web of Global trade. Its techniques range from fraud to the leveraging of complex networks of trade and financial transactions.

   Pendency of export bill's realization is more possible in case of export against confirmed orders and bills sent under collection basis only due to possibilities of unhealthy tie-ups between the exporter and importer.

   Longer the age of the overdue position of foreign bills, the more the 'reasons for doubt' to view it with caution. Hence, the company is not following the FEMA guidelines and UCPDC 600 guidelines properly.

5. ***Delay Observed in Payment of Outstanding Dues:*** Delays in payment of outstanding dues to creditors of goods or services are contractual liabilities and these are required to be mentioned in the Auditors Report if the delay is beyond the specified threshold limit.

   Whether it is a habit of making delay in payment of all outstanding dues or it becomes a circumstantial compulsion for the delay is to be seen. Both the conditions shall compel the company to think about the financial health and intention of the promoters to run the show.

   Here age-wise analysis of creditors is to be verified like debtors of more than 90 days is the probability of doubtful debts. If the creditors are not paid on time, the creditworthiness of the company will deteriorate.

6. ***Frequent Invocation of Bank Guarantee (BGs) and Devolvement of Letter of Credits (LCs):*** The Company has to adhere to the various Master Circulars and Directions issued by the RBI in respect of Bank Guarantees and Letter of Credits. To defraud the bank, siphoning-off, and Parking fund, related party transactions have been entered into by the company resulting in invocation of BGs and devolvement of LCs thereby converting non-fund-based limits to the fund-based limit. Even a known party may become a supplier, comply with all terms and conditions laid down by the LC issuing bank and then the issue relating to defective goods comes into the picture which will also result in the devolvement of LCs.

7. ***Under-Insured or Over-Insured Inventory:*** Generally, working capital limits and credit facilities are granted by the bank based on the valuation of inventory and debtors. Fake and false sales and purchase invoices without e-way bills, purchase orders mixing up a stock of related parties into the main inventory section and a substantial increase in sales and purchase without any effect over other overheads and net profit indicate alarming situations. Overvaluation of inventory is the main headache of the industry at the time of recession.

8. ***Invoices devoid of TAN and other details:*** It is mandatory to deduct tax at source (TDS) and pay to the Department before the specified period. Instances of invoices devoid of TAN / PAN / GST are EWS for further deep dive into the transactions. The genuineness of such financial transactions must be put under the scanner.

9. ***Dispute on Title of Collateral Securities:*** When the title of the collateral securities is not in the name of the company then the consent of the owner of the property must be obtained. Avoidance or unwillingness to obtain the consent of the owner of the property might be the reason for dispute on the title which is an early warning signal (EWS).

10. ***Funds coming from other banks to liquidate the outstanding loan amount unless in the normal course:*** If funds come from other banks to liquidate the outstanding loan amount in the normal course of the business-like takeover of a loan account by another bank with a competitive rate of interest, second charge in favour of another bank is permissible. However, if a major chunk of the fund comes from the unknown party's bank account for repayment of instalment by the last moment of the due date, then the corporate manager ought to look deep into such transaction.

11. ***In merchanting trade, import leg not revealed to the bank:*** As defined in Chapter -33 (Merchanting Trade) of DIFC guideline issued by the Union Bank of India read with RBI Circular RBI/2013-14/545A.P. (DIR Series) Circular No.115 March 28, 2014, in the Indian context, the trade is called merchanting trade when,

    ✔ The supplier of goods is resident in one foreign country.

    ✔ The buyer of goods is resident in another foreign country.

    ✔ The merchant or the intermediary is resident in India.

    Thereby, the merchanting transaction involves the shipment of goods from one foreign country to another foreign country involving an Indian intermediary termed 'intermediary trade' in which chances of non-disclosure/hiding of transactions are very high.

    Such transactions are highly tempting and risky. It is very difficult to put merchanting transactions under the scanning eyes. Only based on sufficient KYC, documentation and infrequent payment cycle and own experience can alarm the KMP to look into such transactions.

12. ***Request received from the borrower to postpone the inspection of the godown for flimsy reasons:*** When the management prefers to postpone inspection by the officials of the bank or any other regulatory body, of the godown for flimsy reasons like non-availability of concerned staff or internal vehicle of the factory, own illness, heavy work orders and productions activities, renovations, few days' closure in the factory due to heavy inventory, electricity-cut in the factory area, etc., then doubt must arise in the mind of the KMP regarding irregularities in inventory management and working of the factory.

13. ***Funding of the interest by sanctioning additional facilities:*** If the company avails of any credit facilities, or loan from the bank then it has to pay interest to the bank. However, in case of failure or unviable project, siphoning off or diversion of the business fund, inadequate or excess credit facilities are dangerous acts that ultimately lead to the incapacity of paying even the interest amount to the bank. When the Company avails of further additional credit facilities or loans for the funding of interest, it is a real danger and EWS for the financial health of the company.

14. ***Exclusive collateral charged to several lenders without NOC of existing charge holders:*** In the era of new technology and MCA21, it is difficult to create a second charge over the property without permission of the first charge holder bank even for collateral securities and properties. Yet, if promoters show such courage and create the second charge without the NOC of the first charge holder then havoc may be created later on and hence it shall be treated as EWS.

15. ***Concealment of certain vital documents like master agreement, and insurance coverage:*** As Secretarial Auditors, we know the list of applicable licenses, approvals, and registrations and concerned regulatory bodies for the company. When, situations like inspection, receipt of show cause notices, etc arise from any regulatory body or bank or FI, it becomes the duty of the company to produce all master agreements, insurance coverage, etc before the said authority/ body. Unwillingness or concealment of such vital documents such as stock statement, book debt

statement, latest unaudited financial result, franchisee agreement, purchase order book, insurance policy, factory license approval letter, pollution control board permission, import bill, original valuation report, e-way bills, etc., raise doubts in the mind of the Auditor about the bonafides of the company.

16. ***Floating front/associate companies by investing borrowed money:*** To run multiple businesses under the vertical tree of companies is a practice of the day for promoters. All the segments of the industries are not always in a booming market due to which one company may incur loss, liquidity crunch and another company of the same group may reap profits. In such a situation, the promoters get tempted to divert funds and invest in the support of a loss-making company or associate companies may be floated by borrowing funds from the main company only with the ulterior motive of siphoning off the funds. All such situations ultimately break the backbone of the main company and hence the KMP must view it as EWS.

17. ***Critical issues highlighted in the stock audit report:*** Submission of monthly stock statement to the bank (in case of bank loan/ cash credit limit) is compulsory. When an independent Auditor appointed for a stock audit highlights critical issues in his stock audit report then such a report must be reviewed not only by way of mere material discrepancy but also from the perspective of fraudulent activities.

18. ***Liabilities appearing in the ROC search report, not reported by the borrower in its annual report:*** It is advisable to compare the ROC search report and secured/unsecured loan portion of the annual report before the printing of annual report. In case there is a major material discrepancy like any charge ID that appeared in the search report but no such loan is shown in the annual report the facts must be checked. There is the possibility that charges id is created for cash credit limit but no such limit is utilized and hence annual report does not speak about the such loan. At the same time, it might be possible that the cash credit (CC) account has not been taken into consideration either due to oversight or mala fide during the audit process. Such error shall be analysed in both ways before considering it as EWS.

19. ***Frequent requests for general purpose loans:*** Management's frequent requests in the form of loan applications to the bank even for the general purpose of business is a matter of concern. It must raise a question in the minds of the KMPs as to why, even though all credit facilities are available, management is frequently preferring general-purpose loans because, it will make repayment capacity, more and more weak and lead the company to a liquidity crisis.

20. ***Frequent ad hoc sanctions:*** Ad hoc sanctions from the bank are required for maintaining the working capital cycle of the company. Sudden bulk orders may require further ad hoc sanctions of credit facilities from the bank. However, inefficient fund management, siphoning off fund, increase in the frequency of related party transactions and escalation of the project cost are also out of box reasons which compel the finance team to seek frequent ad hoc sanctions from the bank.

21. ***Not routing of sales proceeds through consortium/member bank/lenders to the company:*** It is a prima facie condition to route all sale proceeds through consortium/member bank/lender at the time of availing of cash credit and other working capital facilities. At the time of periodical review and renewal of such credit facilities, the drawing power will be judged by the bank mainly, based

on sale proceeds routed from the CC Account. However, unbilled revenue, unaccounted high sea sales, related party transactions siphoning of funds are instances in which the promoters of the company do not prefer to route sale proceeds through a specified bank which will lead to a risk to the solvency of the company and hence must be viewed as EWS.

22. ***LCs issued for local trade/related party transactions without underlying trade transactions:*** LCs are non-fund-based credit facilities and guarantee payment. In the case of related party transaction and accommodation entries also, such LCs have been mis-utilized where the workplace and godown of both the parties are either adjoining or the same. Possibility of actual transfer of goods and sale and purchase of goods at arms' length price is very less. These are also a few of the ways of siphoning of business funds and hence the KMP must treat them as early warning signals.

23. ***High-value RTGS payment to unrelated parties:*** "Unrelated parties" mean such parties with whom no sale/purchase transactions or agreements are executed by the company. High-value RTGS payment to an unrelated or unidentified or fictitious party with illogical reasons must be termed as a fraudulent transaction and reviewed in the strict purview of EWS by the KMP.

24. ***Heavy cash withdrawal in loan accounts:*** In the digital payment and plastic money era, the necessity of cash is reduced in the business depending upon the type of industry. Organizations must avoid withdrawing cash from loan accounts unless required to maintain the business cycle. Otherwise, it may be termed differently and negatively and become a point of inquiry even for the regulatory body in the event of a collapse.

25. ***Non-production of original bills for verification upon request:*** All original bills are required to be kept in the safe custody of the company. Section 128(5) of the Companies Act, 2013 states that the books of account of every company relating to a period of not less than eight financial years immediately preceding a financial year, or where the company had been in existence for a period less than eight years, in respect of all the preceding years together with the vouchers relevant to any entry in such books of account shall be kept in good order. When the company fails to produce or gives a flimsy reason for the non-production of original bills for verification upon request of the bank or any regulatory body then such act must be treated as EWS.

26. ***Significant movements in inventory, disproportionately differing vis-a-vis change in the turnover:*** All the listed companies are required to publish and submit to Stock Exchange, a financial statement as mentioned in SEBI (LODR) Regulations, 2015 and all companies enjoying cash credit facilities are required to submit a periodic stock statement and financial statement to the bank. Inventory of finished goods and raw materials has a direct relation with the creditors and debtors. Hence, disproportionate movement of inventory in the stock statement compared with the GST/TDS returns and figures of turnover indicate the possibility of fishy circumstances in the business cycle of the company.

27. ***Significant movements in receivables, disproportionately differing vis-à-vis change in the turnover and/or increase in ageing of the receivables:*** It becomes necessary to know the general working capital cycle of the business segment in which the company operates. If the age of receivables is much higher than that permissible under the same business segment, or if loans and advances from the "known party" are wrongly included in the sundry debtors'/ trade receivables then, the

movements in receivables must become disproportionate when comparing with the turnover of the company which must alarm in the mind of the KMP.

28. ***Disproportionate change in other current assets:*** Current assets tend to get converted into cash or cash equivalent during the working capital business cycle of the company. Such turn-on and on, give breathing to the working capital cycle. However, diversion of or siphoning off funds, frequently related party transactions and wrongful accounting entries compel disproportionate change in other current assets of the company, which is one of the EWS and disturb the working capital cycle.

29. ***Significant increase in working capital borrowing as a percentage of turnover:*** It is always observed that an unexpected increase in the working capital transactions without any favourable factors to the industry for an increase in turnover, may create a strong possibility of diverting excess funds of working capital limit to another business or self-motive of KMP.

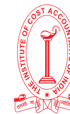
30. ***Increase in Fixed Assets, without a corresponding increase in long-term sources (when the project is implemented):*** It is a prudent management practice to finance fixed assets from long-term sources. Where fixed assets are financed from short-term sources, that is to say, fixed assets will increase without a corresponding increase in long-term sources then it will increase the chances of financial pressure and failure on the part of the management of the company.

31. ***Increase in borrowings, despite huge cash and cash equivalents in the borrower's balance sheet:*** If the management tends to pay out an old loan from the new loan, then borrowing of the company will be increased despite huge cash and cash equivalent in the balance sheet of the company. Ultimately, it will disturb all ratios and financials of the company and lead to a financial crunch also. Review of such EWS must be the demand of the day for KMPs.

32. ***Frequent change in the accounting period and/or accounting policies:*** Change in the accounting period and/or accounting policies are not fraudulent activities since they might be a requirement of the organisation with the expert's advice. However, frequent change is not advisable since it might result in the intention to show inflated earnings, reserves, and assets, to show eccentric pictures to investors and to avoid loss booking. The corporate compliance manager must treat such a situation as EWS with a proper review.

33. ***Costing of the project which is in wide variance with the standard cost of installation of the project:*** The time factor is very important for the implementation of any project. If time is overrun, the project cost would get escalated in almost all cases. Sometimes, the circumstances may not be favourable and genuinely the time factor overruns but many times, errors in calculations and their implementations might become major reasons for wide variance with standards and the actual cost of installation of the project. This will not only increase the uncontrollable financial burden but also increase the possibility of project failure resulting in the evaporation of shareholders' funds and borrowed funds also.

34. ***Claims not acknowledged as debt high:*** Generally, any legal claim or future liability under any pending litigation with regulatory body or private party has been treated as a contingent liability. When the management conceals such information and does not prefer to acknowledge it as debt



then the chances of increase in liability and liquidity crunch are very high and must be viewed as EWS.

35. ***Substantial increase in unbilled revenue year after year:*** It is very difficult to trace out unbilled revenue since it mainly generates cash only. Such unbilled revenue may be the compulsion for "kick back", "cash back" for obtaining a new contract from the Government, or tax evasion or like reasons. If unbilled revenue increases substantially then fear of search, inquiry, etc. from the \regulatory Departments like Income Tax, GST will increase which ultimately disturbs the operations and business of the \company and hence it must be treated as EWS.

36. ***A large number of transactions with inter-connected companies and large outstanding from such companies:*** Arm's length transactions with proper compliance with the Regulations are not a matter of worry. But other than such permissible transactions of sales and purchase, loan payables and receivables are highly indicative transactions of circulations and/or diversion of the business fund. Economic rationality needs to be checked in cases of large number of transactions with inter-connected companies and large outstanding from such companies.

37. ***Substantially related party transactions:*** The Companies Act, 2013, the SEBI (LODR) Regulations, 2015, and the applicable accounting standards (AS 18 or Ind AS 24, etc.), speak about the identification and monitoring of related party transactions (RPTs), with disclosure requirements up to certain extent at arms' length basis. When the company's management prefers to cross or smartly try to violate the provisions due to which substantially related party transactions happen, then it becomes the main instance of siphoning off / diversion of the business fund and EWS.

38. ***Material discrepancies in the annual report and significant inconsistencies within the annual report (between various sections):*** The Companies Act, 2013, RBI Prudential norms issued for NBFCs, and SEBI (LODR) Regulations, 2015 have prescribed timeline for submission of annual report in the specified format. Delay in the submission of the annual report must be justifiable. When the company avoids sticking to the specified format of the presentation of the annual report by way of non-disclosure of information, improper format, or any error, omission, material discrepancies, or significant inconsistencies found in the annual report then there are reasons to believe about existence of some fishy matter which the management does not want to present before the shareholders. It must be reviewed and taken as an early warning transaction.

39. ***Poor disclosure of materially adverse information and no qualification by the statutory auditors:*** Disclosure in the annual report requirement is governed by Companies Accounting Standards Rules, 2006, Companies Act, 2013, SEBI (LODR) Regulations, 2015, RBI Prudential norms and directions issued thereunder by the RBI as amended from time to time till date. Any deviation in terms of less disclosure, non-disclosure, or wrong disclosure of materially adverse information must be viewed as EWS.

40. ***Raid by Income tax /GST/ TDS/central excise duty officials:*** As we know, raids, searches, surveys, and seizures are undertaken by the officials of the Income Tax/GST/TDS/ Central excise based on various information, inquiry, and documents. E.g., if the GST department has conducted a raid and tax evasion is confirmed during such raid then it becomes a fraudulent and risky indicator for which KMP must review the situation with a serious note.

41. ***Significant reduction in the stake of promoter/director or increase in the encumbered shares of promoter/director:*** The situation of reduction in the stake of promoter/director or increase in the encumbered shares of promoter/director indicates the intention of the promoter towards the overall business of the company which may be an exit, either by way of encash and dilution of stake to the open market or re-organization of share capital by way of amalgamation or invitation to private equity in the company or such compulsive situation. It must be counted and viewed as EWS.

42. ***Resignation of the key personnel and frequent changes in the management:*** All corporates have their knowledgeable team, funds, strategy, policy, slogan, and goal to remain competitive in the market. Promoters, Board of directors, managers, and key managerial personnel are the backbone, symbol, and identity of the company. The famous proverb "when ship is sinking, rats are leaving it first" needs to be analysed when frequent changes in the management of the company happen due to the resignation of KMP. Deteriorating financial health, management dispute, inefficiency of management in the operation of a business and continuous losses may be reasons for the resignation of the KMP which is a risk indicator.

RBI issued Master Directions on Frauds – Classification and Reporting by commercial banks and select FIs vide Circular No. DBS.CO.CFMC.BC.No.1/23.04.001/2016-17 Dated July 01, 2016 (Updated as of July 03, 2017). In the context of increasing incidence of frauds in general and loan portfolios in particular, the objective of this framework is to direct the focus of banks on aspects relating to the prevention, early detection, prompt reporting to the RBI (for system-level aggregation, monitoring & dissemination) and the investigative agencies (for instituting criminal proceedings against the fraudulent borrowers) and timely initiation of the staff accountability proceedings (for determining negligence or connivance, if any) while ensuring that the normal conduct of the business of the banks and their risk-taking ability is not adversely impacted and no new and onerous responsibilities are placed on the banks.

To achieve this objective, the framework also seeks to stipulate timelines with the action incumbent on a bank. The timelines/stage-wise actions in the loan life-cycle are expected to compress the total time taken by a bank to identify fraud and aid more effective action by the law enforcement agencies. The early detection of fraud and the necessary corrective action are important to reduce the quantum of loss that the continuance of the fraud may entail. The Government is separately looking into the issue of timely and coordinated action by the law enforcement agencies.

Early Warning Signals and Red Flagged Accounts

The concept of a red flagged account (RFA) is being introduced in the current framework as an important step in fraud risk control. An RFA is one where a suspicion of fraudulent activity is thrown up by the presence of one or more early warning signals (EWS). These signals in a loan account should immediately put the bank on alert regarding a weakness or wrongdoing which may ultimately turn out to be fraudulent. A bank cannot afford to ignore such EWS but must instead use them as a trigger to launch a detailed investigation into an RFA.

The threshold for EWS and RFA is an exposure of ₹ 500 million or more at the level of a bank irrespective of the lending arrangement (whether solo banking, multiple banking or consortium). All accounts beyond Rs. 500 million classified as RFA or 'frauds' must also be reported on the CRILC data platform together with the dates on which the accounts were classified as such. The CRILC data platform was enhanced to provide this capability from June 1, 2015. As of now, this requirement is in addition to

the extant requirements of reporting to RBI.

The modalities for monitoring loan frauds below the ₹ 500 million threshold are left to the discretion of banks. However, banks may continue to report all identified accounts to CFMC and RBI as per the existing cut-offs.

The tracking of EWS in loan accounts should not be seen as an additional task but must be integrated with the credit monitoring process in the bank so that it becomes a continuous activity and also acts as a trigger for any possible credit impairment in the loan accounts, given the interplay between credit risks and fraud risks. In respect of large accounts, banks must undertake a detailed study of the annual report as a whole and not merely of the financial statements, noting particularly the Board report and the managements' discussion and analysis statement as also the details of related party transactions in the notes to accounts. The officer responsible for the operations in the account, by whatever designation called, should be sensitized to observe and report any manifestation of the EWS promptly to the Fraud Monitoring Group (FMG) or any other group constituted by the bank for the purpose immediately. To ensure that the exercise remains meaningful, such officers may be held responsible for non-reporting or delays in reporting.

The FMG should report the details of loan accounts of ₹ 500 million and above in which EWS are observed, together with the decision to classify them as RFAs or otherwise to the CMD/CEO every month.

A report on the RFA accounts may be put up to the Special Committee of the Board for monitoring and follow-up of frauds (SCBF) providing, inter alia, a synopsis of the remedial action taken together with their current status.

Early Detection and Reporting

At present, the detection of frauds take an unusually long time. Banks tend to report an account as fraud only when they exhaust the chances of further recovery. Among other things, delays in reporting frauds also delay the alerting of other banks about the modus operandi through caution advice by RBI that may result in similar frauds being perpetrated elsewhere. More importantly, it delays action against the unscrupulous borrowers by the law enforcement agencies which impacts the recoverability aspects to a great degree and also increases the loss arising out of the fraud.

The most effective way of preventing fraud in loan accounts is that the banks should have a robust appraisal and an effective credit monitoring mechanism during the entire life-cycle of the loan account. Any weakness that may have escaped attention at the appraisal stage can often be mitigated in case the post-disbursement monitoring remains effective. To strengthen the monitoring processes, based on an analysis of the collective experience of the banks, the inclusion of the following checks/investigations during the different stages of the loan life-cycle may be carried out:

Pre-sanction: As part of the credit process, the checks being applied during the stage of pre-sanction may consist of the Risk Management Group (RMG) or any other appropriate group of the bank collecting independent information and market intelligence on the potential borrowers from the public domain on their track record, involvement in legal disputes, raids conducted on their businesses, if any, strictures passed against them by Government agencies, validation of submitted information/data from other

sources like the ROC, gleaning from the defaulter's list of RBI/other Government agencies, etc., which could be used as an input by the sanctioning authority. Banks may keep the record of such pre-sanction checks as part of the sanction documentation.

Disbursement: Checks by RMG during the disbursement stage may focus on the adherence to the terms and conditions of sanction, rationale, for allowing dilution of these terms and conditions and the level at which such dilutions were allowed, etc. The dilutions should strictly conform to the broad framework laid down by the Board in this regard. As a matter of good practice, the sanctioning authority may specify certain terms and conditions as 'core' which should not be diluted. The RMG may immediately flag the non-adherence of core stipulations to the sanctioning authority.

Annual review: While continuous monitoring of an account through the tracking of EWS is important, banks also need to be vigilant from the fraud perspective at the time of the annual review of accounts. Among other things, aspects of diversion of funds in an account, adequacy of stock vis-a-vis stock statements, stress in group accounts, etc., must also be commented upon at the time of review. Besides, the RMG should have the capability to track market developments relating to the major clients of the bank and provide inputs to the credit officers. This would involve collecting information from the grapevine, following up on stock market movements, subscribing to a press clipping service, monitoring databases continuously, and not confining the exercise only to the borrowing entity but to the group as a whole.

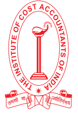
Staff empowerment: Employees should be encouraged to report fraudulent activity in an account, along with the reasons in support of their views, to the appropriately constituted authority, under the Whistle Blower Policy of the bank, who may institute scrutiny through the FMG. The FMG may 'hear' the concerned employee to obtain necessary clarifications. Protection should be available to such employees under the whistle blower policy of the bank so that the fear of victimization does not act as a deterrent.

Role of Auditors: During the audit, auditors may come across instances where the transactions in the account or the documents point to the possibility of fraudulent transactions in the account. In such a situation, the auditor may immediately bring it to the notice of the top management and if necessary, to the Audit Committee of the Board (ACB) for appropriate action.

Staff Accountability: As in the case of accounts categorized as NPAs, banks must initiate and complete a staff accountability exercise within six months from the date of classification of an account as fraud. Wherever felt necessary or warranted, the role of sanctioning official(s) may also be covered under this exercise. The completion of the staff accountability exercise for frauds and the action taken may be placed before the SCBF and intimated to the RBI at quarterly intervals as hitherto.

Incentive for Prompt Reporting: In the case of accounts classified as 'fraud', banks are required to make provision to the full extent immediately, irrespective of the value of the security. However, in case a bank is unable to make the entire provision in one go, it may now do so over four quarters provided there is no delay in reporting (Circular DBR.No.BP.BC.92/21.04.048/2015-16 dated April 18, 2016). The option of providing fully for fraud accounts over a period not exceeding four quarters as mentioned in the above circular will not be available to accounts classified as 'loss accounts' otherwise.

Banks may bifurcate all fraud cases into vigilance and non-vigilance. Only vigilance cases should be



referred to the investigative authorities. Non-vigilance cases may be investigated and dealt with at the bank level within six months. In cases involving very senior executives of the bank, the Board /ACB/ SCBF may initiate the process of fixing staff accountability. Staff accountability should not be held up on account of the case being filed with law enforcement agencies. Both criminal proceedings and domestic enquiry should be conducted simultaneously.

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09

Unit Inspection

Objective of this Chapter

In cases where working capital loans / term loans are sanctioned to the borrowing units by the Banks, it is mandatory for bank officials are to regularly visiting the borrowing units to ensure whether the end-use of funds sanctioned by them is happening or not. If the Stock and Book Auditor verifies the unit inspection register, he will get a fair idea of the functioning of the unit.

The periodicity of unit inspection depends on the type of advance / quantum of advance etc. If the Stock Auditor verifies the terms and conditions/arrangement letter of the loan/sanction letter obtained by the bank at the time of sanction of the loan, he will get full information on the periodicity of the unit inspection to be done by the bank officials / credit officer / credit analyst, etc.

The banker's responsibility does not end up with the sanctioning of the loan after pre-sanction procedures. When the unit borrows loans from financial institutions, it comes up with certain rules and regulations. The banks should verify the end use of the loan. For this, post-sanction inspection should be conducted by banks.

Purpose of Post Sanction Inspection

1. The main purpose of post sanction inspection by banks is to verify the actual use of the loan to see whether it has been used for the purpose for which it was originally sanctioned.

2. During post-sanction inspection, the bankers verify whether the borrower has complied with all sanction stipulations.

3. Bankers also look for the progress in the project and whether it correlates with the estimates and if there is any variation, the reasons for the same should also be notified.

4. The existence and maintenance of security. The value of the security should be ascertained at periodic intervals. Adverse changes, if any, should be carefully noted and steps taken to secure the advances.

5. Post-sanction inspections by banks are conducted to verify inventory from the balance sheet and also the stock registers; the banker should verify the level of inventory and also the financial position of the unit.

6. If there is any default in the repayment of the loan by the borrower, reasons for the same should

be ascertained and steps to rectify the same should also be initiated.

7. Care should be taken to ensure that all stocks and properties of the borrower are insured fully and insurance premium is paid regularly.

8. During the post-sanction inspection process, the production and sales records should be compared with the stock level and inventory level.

9. Collection from debtors and payment to creditors should also be verified to ensure smooth working of the unit. If the banker notices any deviation during the post-sanction inspection, he may nominate a person of his confidence on the Board of Directors of the borrowing concern to rectify matters

10. The banker should verify whether the borrowing unit has paid all statutory dues, applicable taxes and had followed the labour laws etc.

With the economy hit by the COVID-19 crisis, banks are now preparing for a possible spike in bad loans. In this context of default risk by the COVID-induced lockdown continuing to exacerbate the repayment capabilities of borrowers, credit monitoring is of paramount importance.

The lenders in this situation have to cut losses and save possible humiliations of being named as a bank with a huge volume of bad loans. Credit monitoring is the process of periodically reviewing your credit reports for accuracy and changes in the creditworthiness of the borrower that could be indicative of fraudulent activity. Hence regular inspection of the borrowers' unit (factory, godown, etc.) is one of the utmost important activities of post-sanction monitoring.

The unit /godown inspection conducted by the lenders at regular intervals is to verify the actual use of the loan to see whether it has been used for the purpose for which it was originally sanctioned. Bankers have developed expertise in the method of assessing the value of stock inspected by them out of many years of experience.

By conducting regular inspection of borrower's unit /factory, bankers notice on many occasions, irregularities like shortage of stock, stoppage of work in the factory, presence of other bank's name board indicating multiple financing on the same security, etc.

Factory units/godown inspection also helps to identify the obsolete stock /rejected/returned goods being included in the stock register to compute drawing power. Hence bankers shall conduct site inspections with an element of surprise. Experienced bankers have a knack for measuring and ascertaining the value of stock according to the activities of the borrower. For example, in rice mills, chemical factories, etc., where raw material/finished goods are stored in huge storage vessels.

They ascertain the value of such stock by measuring the length, breadth and height of the container. The value of work in process is verified through the logbook by noting down the issues and deliveries. Verification of electric meters for the consumption of electricity and electric bills helps bankers to ascertain the value and volume of production, by computing the consumption in relating it to the annual bill to arrive at a certain level of production for a given period.

The cost of goods purchased and sold can be verified through invoices thereby ascertaining the paid stock and receivables. The information gathered from employees on the conversation during factory/ godown inspection can be early warning signals that may have an impact on the recovery of money lent or affect the security charged to the lender. The method of inspection is not uniform; it varies according to the type of activities of the borrower, the size of the borrowing and the reputation of the borrower. It is also a practice to conduct a stock audit once a year through professional auditors, in the cases of large borrowal accounts.

One of the effective tools of credit monitoring is the drill for obtaining and scrutinizing the stock statements and conducting periodical factory/godown inspections. Bankers can neglect these only at their peril. The main purpose of the factory/godown inspection by the bankers is to ensure that the business of the borrower is running without any problem and that material and machinery, hypothecated to a bank are available and are being properly maintained. Inspection also shows the extent of the borrower's involvement in the business.

Inspection enables the lender to verify that the money borrowed is utilized by the borrower for the purpose for which it was obtained. Inspection entails the following:

- ✔ The inspecting official should study the sanction terms and conditions before visiting.
- ✔ The visit should be at times without prior information to the borrower.
- ✔ The inspecting official should take the latest stock statement with him/her along with details of outstanding/DP, security details, insurance detail and irregularities in the account if any. (Stock statements are required to be submitted by the borrower on a weekly/fortnightly or monthly basis as per sanction terms.).
- ✔ In the case of pledge form of advances (key cash credit) banks will have symbolic delivery of the inventory and banks will also be accountable for loss if any.
- ✔ There is a need for godown inspection even where the working capital limit is in the form of bill finance only. This helps banks to check whether the unit is producing bills for purchase even when there is stoppage of work in the factory or the unit is closed.
- ✔ The visiting official needs to check the following.

    a) The working of factory/ business.

    b) The items of security offered.

    c) Bank's hypothecation board is placed at the appropriate place.

    d) Registers maintained for production, sales, goods movement, power consumption, etc.

    e) Inspections to be done regularly on advances related to inventory financing and also block assets such as land building and machinery, etc.

✔ In the case of machinery being hypothecated to the bank, inspecting officials should ensure that old/defunct machinery is not shown to them as new machinery.

Ultimately the unit/godown inspection should mainly serve the following purposes:

✔ The level of raw materials, semi-finished goods and finished goods are not only maintained in the records but are also physically available.

✔ A bank should not finance the same security already financed by another bank. A shortage of stock or stoppage of work is immediately noticed.

✔ Drawing power is being arrived at only on paid stock excluding redundant or unpaid stocks.

It is the primary responsibility of banks to be vigilant and ensure proper end use of bank funds /monitor the fund's flow. It is, therefore, necessary for banks to evolve such arrangements as may be considered necessary to ensure that drawings from cash credit/overdraft accounts are strictly for the purpose for which the credit limits are sanctioned by them. There should be no provision of working capital finance for acquisition of fixed assets, investments in associate companies/subsidiaries and acquisition of shares, debentures, units of Unit Trust of India and other mutual funds and other investments in the capital market. This has to be so, even if there is sufficient drawing power/undrawn limit to effect drawls from the cash credit account.

Post-sanction follow-up of loans and advances should be effective to ensure that the security obtained from borrowers by way of hypothecation, pledge, etc. is not tampered with in any manner and is adequate.

Drawls against clearing cheques should be sanctioned only in respect of first-class customers and even in such cases the extent of limits and the need therefore should be subjected to thorough scrutiny and periodical review. Banks should not issue bankers' cheques/pay orders/demand drafts against instruments presented for clearing unless the proceeds thereof are collected and credited to the account of the party. Further, banker's cheques /pay orders/ demand drafts, should not be issued by debit to cash credit /overdraft accounts that are already overdrawn or likely to be overdrawn with the issue of such instruments.

✷ Drawls against clearing instruments should be normally confined to bank drafts and government cheques and only to a limited extent against third-party cheques.

✷ Cheques against which drawls are allowed should represent genuine trade transactions and strict vigilance should be observed against assisting kite-flying operations.

✷ Drawls against cheques of allied /sister concerns should not be permitted and the facility of drawl against clearing cheques should normally be temporary and should not be allowed regularly without proper scrutiny and appraisal.

✷ Bills of accommodation nature should never be purchased and the officials responsible for the purchase of such bills should be punished suitably.

* In case a borrower is found to have parted finance for purposes, other than for which it was granted, banks must recall the amounts so diverted. In addition, banks may charge penal interest on such amounts.

Where borrowers fail to repay the amounts diverted from cash credit accounts for uses other than for which the limit was sanctioned, banks should reduce the limits to the extent of the amount diverted. The above aspects relating to safeguards are only illustrative and not exhaustive.

The primary responsibility for preventing misuse of funds rests with the management of banks. For this purpose, the highest standards of integrity and efficiency are imperative in urban banks which are the trustees of public money. The banks should, therefore, take appropriate steps to review and tighten their internal administration and control measures to eliminate the scope for misuse of funds and malpractices.

Banks should take a serious view of instances of misuse of power, corruption, and other malpractices indulged by the members of staff and erring staff members should be given punishments befitting the seriousness of the irregularity. Light punishments such as the issue of warning, stoppage of increments, transfer, etc. may not prove a deterrent in all cases. Quick disposal of enquiries by the banks and award of deterrent punishment would be necessary in all such cases, The Board should take a more active interest in these matters.

Annual Review of Advances:

For effective monitoring of the advances, the banks must undertake an exercise to review the advances regularly. Apart from the usual objective of such a review of assessing the quality of operation, safety of funds, etc., the review should specifically attempt to assess the working capital requirements of the borrower based on the latest data available, whether limits continue to be within the need-based requirements and according to the bank's prescribed lending norms.

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10

Materials Storage and Preservation System

Objective of this Chapter

Proper storage of stock/goods gives various benefits like retrieval, counting, identification of slow-moving goods, determining the quantity, and verification with bin cards, etc., etc. The Stock Auditor has to comment on the quality of storing and preservation of goods financed by the banks / financial institutions in the audit report.

This Chapter covers important aspects of material storage and preservation systems of stock/goods by the manufacturing/trading organizations.

Storage and preservation are important aspects of the storekeeping function. When materials remain idle in the store these should be taken care of and looked after properly.

Otherwise, these materials may perish due to natural /chemical reactions like rusting by moisture, melting by heat, etc and also may get affected by pest's, insects, etc.

To protect the materials from various adverse effects, the following actions should be taken:

1. Materials should be stocked above from the ground. No material should be stocked on the floor as it may be affected by dampness, white ants, etc.

2. Materials should be stocked in the appropriate place according to the nature of the materials.

For example:

a) Stationery, electrical, civil engineering, cleaning, and similar items may be stored in steel racks.

b) Medicine items may be stored in fridge/cold storage rooms.

c) Perishable items may be stored in cold rooms.

d) Explosives / hazardous materials are to be kept in open place / separate place.

e) Film and fuse items may be stored in AC room.

f) Attractive items may be stored on shelves under lock and keys.

3. Daily and periodical cleaning should be carried out.

4. Daily and periodical verification of stock should be carried out to ensure there is no pilferage.

5. Proper methods of handling should be followed to avoid damage to the stored materials.

6. Preservation material should be applied to protect the items.

7. Hazardous materials should be segregated and stored v in a separate storehouse away from other storehouses.

8. Safety precautions should be taken and safety appliances should be provided.

Receiving Materials

After all the pre-purchase actions are completed, like selecting the supplier, placing a purchase order, follow-up, etc., the materials are supplied by the supplier. While receiving materials, a systematic record of the consignment received, carrier details and descriptions of materials should be prepared so that inspection can be arranged before acceptance.

Many organizations have a separate central receiving section for this purpose. As mentioned earlier a copy of the purchase order is sent to the central receiving section for reconciling purposes.

Invoice Checking

The supplier normally sends the invoice for the materials supplied for payment. The invoice must be matched against the receipt details, quantity accepted and rejected so that payments can be made within the discount period or provisions be made whic1h will enable funds planning. Normally invoices are sent to the buyer’s finance department.

Close coordination between the finance and materials management departments is necessary.

Opening and Checking of Consignment

The bulk consignment should be opened at the central receiving section in the presence of a properly constituted committee of officers comprising of a presiding officer and some members from the concerned departments.

Several packages mentioned in the packing notes, if available should be opened and the materials checked against the invoice. The materials should be checked for quantity, quality, specification, condition, etc. If the quantity is found less in comparison with the invoice, a discrepancy/shortage report will be prepared and sent to the supplier to make good the deficiency.

If any material is found to be of substandard quality and found not in confirmation with the specification or found in a damaged condition, such materials will be rejected and the supplier should be informed of this matter. The supplier shall collect the rejected materials at his cost and shall provide suitable replacement as per the terms and conditions laid down in the purchase order. The materials will be

accepted and taken into store stock and the bill be passed for payment.

Receiving Materials Supplied as Door Delivery

The materials supplied by the supplier as door delivery will be checked in comparison with the invoice in the presence of the supplier. If everything is OK, the materials will be accepted and one copy of the invoice or the delivery challan will be signed and returned to the supplier.

Stores Management

Stores play a vital role in the operations of an organization. It is in direct touch with the user department in its day-to-day activities. The most important purpose served by stores is to provide uninterrupted service to the various user departments.

Example: In the case of a hospital, we can say the operation theatre, wards, specialty clinics, units, refraction departments, registration, admission departments, etc., are the user departments.

Further stores are often equated directly with money, as materials have money value.

The store's function can be detailed as under:

1. To receive ordered materials such as components, tools, equipment and other items and account for them.

2. To provide adequate and proper storage for the preservation of various items.

3. To meet the demands of the consuming department by proper issues and account for the issues.

4. To minimize the stock holding through proper codification and handling to avoid the materials becoming surplus, obsolete and scrap.

5. To highlight stock accumulation, discrepancies- and abnormalities

6. Consumptions and effect suitable control measures.

7. To ensure good house-keeping so that material handling, preservation, receipt, and issue can be done smoothly.

8. To assist in verification and provide supporting information for effective purchase activity.

To carry out the above function the following are essential:

a) Accommodation.

b) Layout of stores.

c) Central receiving and dispatching location.

d) Cold storage etc.

e) Comfortable working conditions.

- Proper lighting in the storage place.
- **Safety**
  - ✔ Safety consciousness.
  - ✔ Safety Appliances.
- **Store**
  - ✔ Location: Easily accessible to transport.
  - ✔ Near to the user department.
- Space: Sufficient space for accommodating all kinds of materials.
- Building: Pucca building to withstand natural calamities.
- Separate Areas: For receipt of materials, issue of materials, office of storekeepers. Ramps for t handling of materials. Convenient for the movement of the men and materials.
- Infrastructure: Cold rooms, fridge, racks, shelves, fireproof storage, etc. Proper ventilation. Firefighting equipment. Sufficient light and pleasant working atmosphere.

Separate store for drugs, rubber goods, plastic goods, and inflammable items.

Trollies/hand cart for handling the materials.

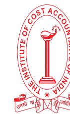
- Vendor Selection

Introduction: To procure materials at the most competitive rates and ensure a fair selection amongst suppliers, a tender system is normally adopted. A major disadvantage of procurement through the tender system is the prolonged lead time.

When the requirements are urgent, procurement is invariably done through the limited tender system. In such cases, enquiries are sought from genuine bidders and the lead time is also reduced.

Registration of firms should be done after scrutiny and analysis of their financial reliability credentials.

Criteria for Registration: The following criteria should be fulfilled for registering a firm as a supplier of pharmaceutical products and equipment (example purpose).



1. The firm should have been in business for at least two years in the country dealing with equipment for which the registration is sought.

2. The latest balance sheet should be obtained to know the financial health of a firm. Turnover for the last two years should be obtained.

3. Income tax clearance certificate should be obtained for the previous year.

4. GST registration certificate, wherever applicable.

5. Financial standing of the firm should be enquired from the bankers.

6. A record of the last one to two years' performance of the firm is to be obtained from other similar organizations where the firm was registered for the supply of hospital equipment/pharmaceutical products.

7. Proof of ownership, partnership, etc. should be obtained along with verification of address, telephone numbers, and Fax numbers.

8. It should also be ensured that the firm has remitted the prescribed fee for registration.

9. The suitability of the firm should be verified by referee to be appointed by the firm.

10. The firm must furnish an undertaking on a non-judicial stamp paper that the firm has not been blacklisted in the past and no CBI / vigilance case is pending against it.

11. Authority letter from the manufacturer/principals, if applicable, should be obtained.

If the firm is not fulfilling the terms and conditions, it should be removed/blacklisted, or banned.

Role of Purchase Manager

The role of the purchase manager in any company, public or private or State sector, small scale industry, partnership concern or any other entity is becoming more and more difficult and complex due to the fact that , he has to satisfy various departments internally and statutory authorities, suppliers, transport agencies, insurance companies, banking sectors and the like, externally.

The role is more complex as each department looks upon its needs only and is not able to appreciate the problems faced by the purchase executive. Scarcity of the goods in the market, uncertainty in the supply of raw materials, frequent changes in the taxes and duties, acts of God, acts of Governments, power failure transport problems, industrial relationships, low productivity, etc, have been the major problems faced by the business entities.

Above all, queries/audit objections have to be answered satisfactorily.

Issue Verification and Accounting

The main role of the Stores of any organization is to ensure an uninterrupted supply of materials to the

various departments so that the smooth and efficient functioning of the organization so that production department is not affected.

To ensure smooth issue of materials, a systematic procedure should be followed. Good store systems can greatly help the store's manager in smooth issues, accurate stock status reports, timely detection of discrepancies, prompt clearance of goods inward notes to expedite bill payment, reduction in losses, etc. For this purpose, a store's manual incorporating all the features is mentioned in many organizations.

On receipt of an indent in-store, the storekeeper scrutinizes it for correctness in all respects. If any shortcoming or mistake is found the same will be intimated to the indenter for rectification. If the indent is found Ok in all respects, the materials will be issued and the signature of the person receiving the materials will be obtained in the appropriate column.

Then the original copy will be detached from the indent book and kept by the stores for feeding in the computer for writing-off the quantity of materials issued from the inventory stock. The counterfoil will remain in the indent book itself for the reference of the department. After all the issue action throughout the day and feeding to the inventory ledger, the stock position will be checked and ensured that the stock is correct. Some of the organizations follow on FIFO method while issuing the stocks to the concerned departments.

Management Training & System Development - Materials Management System:

Introduction: -

The material management department is an essential part of any organization. Especially in manufacturing organizations, the materials management department plays a vital role in the smooth and efficient functioning of the entity.

Importance of Materials in Hospital Sector:

A hospital is a labour oriented entity. Labour in this context means the skilled medical, nursing, paramedical, and other personnel. The hospital depends upon the technical skill and knowledge of the hospital personnel. These personnel, in turn, depend on various materials, without which their skills cannot be converted into diagnostic and therapeutic services.

Example: A surgeon without sutures and surgical blades, a nurse without syringes and needles, a radiologist without x-ray film, and so on. Thus, it is obvious that materials play a vital role in hospitals. Proper knowledge and experience in acquisition, storage, distribution, replenishment, and allied functions is, therefore, a must in a hospital.

Therefore, the science of material management comes in very handy and to the rescue of the hospital administrators.

Importance of the Material Management System in a Hospital

In the present fast-developing health care system the material management department has to face

tremendous challenges and responsibilities in its job. The task is Herculean as lacs/crores worth of materials are involved in the process of purchase and issue. The task is so tough as the money tied up in Inventory aggregates to a major portion of the budget of the organization. In many organizations, materials form the largest single expenditure item that accounts for nearly 60 per cent of the total expenditure. Thus, the importance of materials management lies in the fact that any significant contribution made by materials management in reducing the materials cost will go a long way in improving the profitability and in achieving economy.

Roll of Material Management System

The role of the material management system is to provide various kinds of materials uninterruptedly to the different user departments of a hospital to ensure smooth and efficient functioning of the hospital.

Interruption in the availability of materials in an industry may result in loss of productivity.

In a hospital, it may even mean the death or suffering of human beings, both of which cannot be valued in terms of money.

Types of Materials Management Systems (MMS)

There are two types of material management systems.

1. Integrated type

2. Decentralized type

Integrated Type of MMS:

This is the system in which the entire functions of the materials management system are done under a single department under one manager.

Decentralized Type of MMS

Under this system, the entire functions of MMS have been divided into two parts, viz purchase department and stores department.

Both these systems are having their pros and cons.

Scope of MMS

The scope of materials management is vast. We can broadly identify the following functions:

✔ Materials planning and control.

✔ Purchasing.

✔ Inventory control.

✔ Receiving and storage.

- ✔ Issuing.
- ✔ Documentation.
- ✔ Disposal of scrape.
- ✔ Feedback.

AIM of MMS

- ✔ To optimize the usage of resources to meet the needs efficiently.
- ✔ To purchase the right materials, at right time, at the right quantity at the right rate, and of course through the right sources.
- ✔ To keep stock of all items.
- ✔ Avoid overstock.
- ✔ Avoid understock/stock out.
- ✔ Proper storage to avoid loss, obsolescence and difference.
- ✔ Proper and prompt issues to departments.
- ✔ Cut costs and achieve profitability and economy.

Stock or stock inventory is the collection of all the materials and goods stored, whether for use to complete the production process or for sale to the customers. Efficient management of warehouse stock is a challenge for logistics companies or companies that have a warehouse or distribution centre since the management of the stock stored will largely depend on the business's profitability.

Stock accumulation and storage are important because:

- ✔ Having stock in hand ensures that there is no shortage in the product the company works with;
- ✔ More units, the lower will be the unit cost of the product in general;
- ✔ Having the product stored enables immediate availability to meet the customer's demand.

What's more, stock management is just as important as the stock itself. Any imbalance (depletion of stock, excess stock, etc.) in the stock stored may reduce the company's competitiveness.

Types of stock from the functional perspective:

1. ***Cycle stock:*** This is the stock of a warehouse to meet regular demand over a long period.

2. ***Safety stock:*** This is the stock to meet unexpected demand or demand in exceptional circumstances that have caused problems (for example, unexpected delays).
3. ***Seasonal stock:*** This is the seasonal stock for products with sales that increase sharply at certain times.
4. ***Recovery stock:*** These are those products that can be reused partly or totally.
5. ***Dead stock:*** This is the inventory of obsolete merchandise that cannot be reused and which must therefore be removed from the warehouse.
6. ***Speculative Stock:*** If it is expected that the sales of a particular product are going to increase in the short term, the stock of that product is increased before there is any increase in demand and it is therefore stored at a lower cost.

Types of Stock from the Operational Perspective

Optimal Stock: The optimal stock level is that stock that offers us maximum profitability. Rather, it is the stock that maintains the balance between an adequate response to demand and maximum profitability of storage costs.

Zero Stock: It is the amount of stock associated with the Just in Time (JIT) management concept. which is characterized by serving on demand and therefore minimizing the inventory of stock in the warehouse. Zero stock is characteristic of the automotive sector.

Physical Stock: Physical stock is the amount of stock available at any given moment in the warehouse.

Net Stock: This is the result of subtracting unmet demand from existing stock in the warehouse.

Available Stock: This is the result of adding to the inventory or physical stock in the warehouse and the orders in progress to suppliers less the unmet demand.

Stock Management Variables

Stock management is the way of organizing stock flows in the warehouse. It is highly important for the competitiveness of companies. It must be primarily focused on having an adequate level of stock in the warehouse to competently meet customer demand at an optimal cost for the company.

Following are the main variables that affect the stock or inventory management of a warehouse:

- ✔ Planning and management of purchases.
- ✔ Desired quality of the service.
- ✔ Sales forecast.
- ✔ Product storage system- Finding the ideal industrial storage solution for companies may make a difference in stock management and therefore, the viability of the business. Optimizing the space in warehouses and distribution centres plays a key role.
- ✔ Supplier delivery times.

Following are the main inventory or stock management systems that logistics companies use:

FIFO (First in First Out) Method

With the FIFO stock management system, the first goods to leave the warehouse racks will be the first ones that entered it. It enables optimum stock rotation and is perfectly adapted to the storage of perishable products.

Some of the industrial racking systems that are adapted to this management method are the live storage systems for pallets and the drive-through compact system. The pallet shuttle system is also adapted in this method. To determine whether this is the appropriate method for managing warehouse stock, discover the advantages of the FIFO system.

LIFO (Last in, First Out) Method:

With the LIFO inventory management method, the last unit load to enter the warehouse will be the first one to leave it. It is an ideal method for non-perishable products, that do not expire or lose value over time. The stock is stacked accessibly on the racks, with easy access to it when required, without having to move the rest of the unit loads.

The push-back racking or drive-in pallet racking systems are ideal solutions for applying the LIFO stock management method in the warehouse. The shuttle system offers plenty of versatility and can also be applied in this stock management system. See more key aspects of the LIFO system.

ABC Management Method

In the ABC stock management method, the stock is classified into three categories: A, B, and C.

Category A: These are the products of the highest stock inventory value and which therefore require closer observation. They normally occupy 20 per cent of the stock. The control of this stock is vital to avoid stock depletion and all the problems associated with this.

Generally, these products occupy the lowest positions of more direct access on the industrial racking.

Category B: According to the ABC management method, this stock requires less control by the company, as it rotates less, and therefore the inventory is normally updated in batches, not by units. It represents about 30 per cent of warehouse stock.

It is placed at an intermediate height on the racking or in another less central area of the warehouse.

Category C: These are the items that rotate the least and can represent up to 50 per cent of the inventory. This stock is simple to control because it hardly rotates.

Generally, it is replenished as soon as it leaves the warehouse. It normally occupies the highest parts of the racking or other less central areas of the warehouse.

Just in Time (JIT) Model

Any organization that is managed by the Just in Time (JIT) inventory management model has just the right amount of raw materials for each moment of the production process, with minimal storage needs. It requires a very strict organization to avoid delays or cause stock depletion. The automotive sector is the apt example of this.

Wilson's Model or Optimal Order Model

Wilson's model for stock management determines the volume or quantity of the order to be placed to optimize the stock management system. It is calculated when and in what quantity it is necessary to order the stocks. The mathematical formula takes into account the annual demand for the raw material, the cost of the order, and the cost of storage.

Warehouse Stock Management Costs

A variable to be taken into careful consideration in warehouse stock or inventory management is the cost of managing the stock to the company, which will greatly affect the return.

There are four main types of stock costs which are discussed hereunder.

Purchasing or Acquisition Cost

This is essentially the amount paid to suppliers for each order made. Generally, this amount will be reduced if the quantity of goods is greater and will increase if small orders are made.

Cost of Making the Order

This category includes the administrative and management costs of each order made by the company.

Stock Depletion Cos:

This cost must include revenues not generated for not having been able to meet a customer's demand but may also imply other types of indirect costs that affect a company's credibility and potential future lost orders.

Stock Maintenance Cost

The mere fact of having the product in stock in the warehouse generates a cost for companies which will make it necessary to include staff costs, warehouse management system costs, storage system installation costs, rental or purchase of the warehouse and its monthly expenses, depreciation and insurance and the possible depreciation of stored stock.

In conclusion, warehouse stock management is a differentiator in an organization's performance and there are many factors to consider when deciding how to manage the flow of goods: the type of stock, resources to control it, planning and forecasting of purchases, relationship with suppliers and the storage capacity of the facilities.

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11

Inventory Counting

Objective of this Chapter

The basic purpose of the Stock and Book Debts Audit is to arrive at the value of the stock that is available in the company's storage points. This should be tallied with the stock statements submitted by the borrowing firm and also drawing power given by the banks / financial institutions from time to time.

The Stock Auditor has to devise a 'suitable plan' to count the total inventory of the borrowing unit and also other important areas related to the working capital terms and conditions are to be verified; accordingly, he has to submit the Audit Report to the banks / financial institutions.

In this Chapter, various inventory counting methods are discussed; these are useful to the Stock Auditor in the inventory counting process and also to arrive at the value of the inventory.

A physical inventory count is a structured approach to counting a company's stock where staff uses a predetermined method to count the goods. Companies schedule a physical inventory count at the end of a reporting period.

Four Types of Physical Inventory Counts

There are four types of inventories counts namely manual, electronic, cycle counting, and full inventory counting. The methods vary but choosing the right technique can be the difference between good and bad data for the company.

Pros and Cons of the Types of Inventory Counts

Inventory Method	*Description*	*Pros*	*Cons*
Manual Completion	This count uses paper count cards or sheets and pencils to record inventory.	Low cost for materials	High rate of errors

Inventory Method	*Description*	*Pros*	*Cons*
Electronic Counting	This count can use scanners, RFID, barcodes, or mobile devices.	Cuts down significantly on counting errors.	This method still takes extra time and resources to complete.
Cycle Counting	Staff count random portions or rotating sections of the inventory at any given time.	It cuts down on extra time or resources necessary to count and companies may not need to stop operations during counts.	Depending on the cycle counting method, some companies count inventory less than the ideal number of times.
Full Inventory	Companies deploy existing staff from other departments or bring in temp staff to count all the stock at one time.	This method provides accurate inventory records for creating the annual financial document.	This method may require an operational shutdown and is labor and time-intensive.

Physical Inventory vs. Cycle Counting

A physical inventory is a comprehensive, often annual count of the stock a company has on hand. Cycle counting is a more systematic method of counting portions of the stock. Companies sometimes conduct cycle counting as often as daily and it is advisable to perform this at least quarterly.

Physical inventory is not always automated. Cycle counting is typically automated. Automation streamlines the inventory process overall, whether physical or cycle counts. It saves time, eliminates most human error and enables real-time and useful data. The most accurate inventory counts are those which combine cycle counts with automation.

Annual Physical Inventory Count

Business firms usually perform their annual physical inventory count before compiling their annual financial reports. Performing inventory only once a year does not always yield the most accurate results. The best inventory count practice depends on business type and goals.

The types of businesses that perform annual physical inventories include retailers, manufacturers, wholesale distributors, and e-commerce-based companies. They can do a full inventory once or do cycle counting. In cycle counting, staff count sections of stock on a rotating or systematic basis.

Even if the company has an automated system that manages inventory, experts agree the need to perform at least some physical inventory. A computerized system cannot replace a physical inventory count. Businesses with small amounts of stock may still want to perform annual physical inventories.

Companies with large amounts of stock, such as distributors, find freezing stock to count inventory quite disruptive. Therefore, they may prefer implementing a perpetual inventory system to appease their auditors and reconcile their stock numbers, instead of a full annual count.

Benefits of Doing a Physical Inventory Count

Physical inventory counts are essential aspect of keeping inventory records accurate and current. Up-to-date inventory records provide for better forecasts of sales and purchases and ensure that always have the right amount of product on hand.

Performing physical inventory benefits the customers and accurate physical inventory counts are a necessity. No end-user, be it consumer, reseller, or wholesaler, wants to deal with uncertain stock levels in this modern day of instant gratification. Customer satisfaction is paramount. Updated inventory levels ensure that the company can fulfil orders for customers promptly or tell them when they can be fulfilled.

Another benefit of physical counting of inventory is to plan for possible loss. Loss can come from theft or breakage. Every day an item remains in inventory, its value decreases. As the value lessens, the risks of the cost to stock the item outweighing its value becomes very real.

Performing physical inventories improves the profits overall. The company can classify certain products in the warehouse as obsolete inventory, which is a valuable method for identifying which items to market and merchandise for quick sale. This process also reduces the liability and break even, at least, for questionable products.

Effective inventory forecasting can mean the difference between profitability and piles of unsold goods that eat up the available cash. The bottom-line impact of inventory forecasting is clear: less money is tied up in inventory, the stock is maintained at a realistic threshold and order becomes much more precise.

Issues with Physical Inventory Count

The biggest problem companies cite with conducting physical inventories is that they take up a lot of time and resources. Some companies shut down parts or all operations to perform their physical inventory. When this happens, they risk poor customer service.

Some businesses do not have the staff to complete a full physical inventory.

Usually, discrepancies happen in a physical count because internal or temporary staff don't accurately record some of the inventory, or they classify items or record new items incorrectly. Regardless of accuracy levels, there are some things staff should not be counting during the physical inventory. These include:

- Supplier receipts after the count's decided-upon cut-off date.
- Any known thefts.
- Any known shipments that departed without invoices.

Best Practices When Preparing for a Physical Count

The best way to perform a successful inventory count is through detailed planning. Using a comprehensive written policy and instructions streamline the physical inventory count.

Other suggestions to improve the accuracy of the physical counting by staff include:

- Using scanners or other stock counting technology.
- Selecting staff who are attentive counters.
- Addressing discrepancies immediately.
- Performing a mock count during the planning.
- Ensuring that the cost of the item counted is not displayed during the count.
- Stopping operations when performing a complete physical inventory.
- Ensuring that staff on-site during a full physical inventory are only there for the count.
- Securing the stock area on the day of the inventory.
- Using inventory software.

Purpose of a Physical Inventory Count

A physical inventory can ensure an accurate inventory tally. Staff physically count each piece of stock. This physical inspection of goods should confirm what's in the inventory management system report. Any discrepancy should alert the company.

Businesses perform physical inventories for other reasons, such as when preparing a balance sheet for tax season. Additional objectives of an inventory count include:

Check and Balance Inventory Levels: Physical inventories can help the auditors to see any discrepancies between their inventory management system reports and what items are under storage.

Manage or Monitor Theft: The difference between what appears in the inventory management system and what is present can be due to missing, stolen, lost, or broken items. Unless staff manually enter when these scenarios occur, the system would not recognize them.

Create an Accurate Budget: Companies with precise inventory counts can better plan their budget for the next year's inventory orders.

Report Accurate Earnings: An inaccurate inventory means a company will report an incorrect amount for the cost of goods sold, the gross profit and net income. Public companies are primarily accountable to their stakeholders to provide correct figures in their annual reporting.

The types of inventory stock that companies need to count physically include raw materials, works-in-process (WIP), finished goods, packing materials and maintenance, repair and operations (MRO). Using the right inventory metrics can help the company measure the relative success of how the company stocks and manages these inventory categories. The company can use inventory turnover as a metric of success for all of these categories. However, there are additional metrics that are good practice for each type of inventory.

The chart below shows examples metrics of good practice, based on each category.

How to Measure the Success of Inventory Management Practice by Type of Stock

Types of Inventories	*Metric*	*Metric Formula*	*Benchmark for Metric*
Raw Materials	Inventory Turnover Ratio	(Cost of goods sold for the year) / (Average value of month-end raw material inventory)	Top performers are at ~16.5 times per year.
Works-in-Process (WIP)	WIP Inventory/ Turns	(Cost of goods sold) / (Average inventory used to produce the goods)	Compare this figure with previous years to evaluate performance.
Finished Goods	Order Cycle Time	Calculate the amount of time from when a customer places an order to when they receive their product.	Report this metric in days. Industry leaders are two to three days.
Packing Materials	Packing Costs	Add together packaging, boxes, filler, and overall labour costs.	This figure is different for every business, but each company should strive for constant improvement.
Maintenance, Repair, and Operations	Inventory Accuracy	(The number of items listed as in-stock) / (The total found within spare part and raw material caches)	~95 per cent

Step-by-Step Physical Inventory Count Instructions

Performing successful physical inventories requires appropriate planning, preparation and staff guidance. Involve managers in every step to provide advice and oversight to get the best results. Start planning physical inventory at least three months in advance.

When providing counting instructions, the auditor could use a written company policy that always follows or prepare a new plan each year. Make sure to cover the following activities before any scheduled inventory count:

Start with a Plan: If the company has one already, great. If the auditors are making the plan, start by figuring out if the company is already controlling inventory with a periodic or perpetual inventory system.

Decide on the Interval Between Counts: As part of the plan, decide how often to count inventory. An accurate record of the inventory is required for tax purposes in publicly traded companies but can choose to count stock more often.

Draft the List of Inventory Items to Count: This draft list should include stock quantities. Knowing this number should help to determine how long a physical inventory count will take.

Select an Inventory Date: Ideally, this date to do inventory has minimal effect on regular business operations, as physical inventory counts are time-consuming. Choosing a time that won't cause any workplace disruption isn't always possible with bigger businesses or supplier warehouses but try to pick a time that's not particularly busy.

Choose Who Will Take Inventory: Once an inventory date is finalised, figure out what staff can do the counting. One good practice is to perform a cost analysis of staff salaries and overtime to determine how much it costs to perform a count. It may be more economical to hire and train outside temporary help in large businesses. Outside supplemental staff can free up some of the regular staff to continue necessary operations.

Select Staff Training Dates: In the same way the auditor chooses inventory date the auditor needs to choose one (or two, in the case of larger staff) dates to train staff on the inventory counting process. This training should occur no more than one week before the scheduled count, preferably workday(s) right before the count.

Notify Outside Partners and Storage Locations: Suppliers and partners should know well in advance as physical count will affect their operations; therefore, send a message intimating the date, time and how the count will affect them. Earlier communication allows partners to revert with questions and concerns.

Notify Staff: Begin the process by notifying staff of the training and counting schedule. Decide, based on seniority or already-existing delineations, who will be on each counting team. Some companies prefer to pair an experienced staff member with a fresher.

Order Necessary Equipment: Whether audit staff will use clipboards and pencils, count tags, or scanners, order them in enough time to arrive for training. Count tags are heavy cards with sequential numbering stamped on the top and bottom that counters use to track inventory.

Check Electronic Equipment: If the auditor uses electronic counting equipment, plan to check it well before the count. The auditor may need to order parts, change batteries, or charge devices.

Review Any Apps and Software: Don't forget about software updates! If the auditor is planning to use apps or inventory software, verify that the audit staff are using the latest/ current version.

Preview the Inventory: Take a walk around the stock room or warehouse. The auditor may get an idea as to how to deal with any challenges the counters may face. For example, there may be temporary physical barriers that can slow them down.

Prepare the Space for the Inventory Count: Designate any additional areas needed for counting or staff. For example, if the auditor will pull out small parts to count in this area, set up bins to use during the count. The inventory area should be free from any clutter or trash.

Do an Inventory Clean-Up: Storage areas should always be the neat in any warehouse. However, there should not be any product waiting to be put away or out of their normal storage area.

Identify Stock That's Not in the Count: Use signs to show stock that's not in the count. It is easy for staff to get confused during a long session and start counting these items without clear markings.

Prepare Final Item Count List: Create a final version including quantities of the initial inventory list that staff will count.

Train Staff on the Procedure: Staff will need written instructions on how to perform the count. Consider any contingencies that may happen, such as duplications, missing items and those in the wrong place. Decide how to handle these scenarios in advance. For example, staff may encounter the wrong product in a location. Decide whether they should stop their count and report back in, fill out a new card for the item present and count it or investigate the discrepancy.

Train Staff on the Equipment: During this training, if staff use count cards, teach them how to complete them. If electronic equipment like scanners are used , train the team on how to use all the functions necessary and troubleshoot any equipment issues. Include directions about what they should do if the equipment malfunctions.

Perform a Demonstration: During the training, a demonstration of how to count the stock is helpful for staff.

Stop Entering Data Before the Count: Before printing the line-item list for counting, be sure to freeze any data entry in the inventory management system to decrease discrepancies.

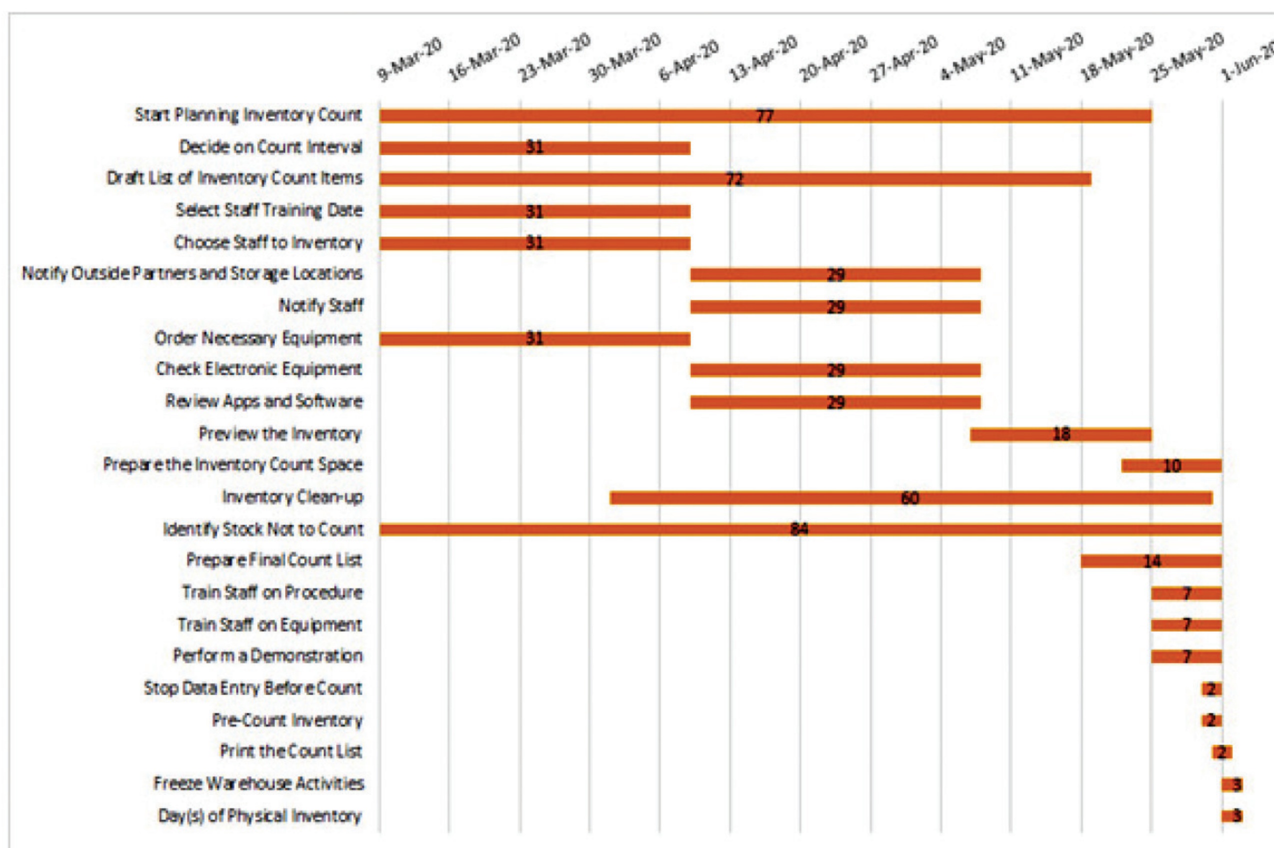
Pre-Count the Inventory: If possible, pre-count some pieces of the stock as a sort-of dry run. Look for counting issues and find if the pre-count area needs recounting or can be considered to be complete.

Print Count List: If counting staff is using pencil and paper, print the final list the evening before or the morning of the count to ensure to capture any last-minute details.

Freeze Other Activities: In the case of a full count, freeze any other company activities related to inventory. In other words, do not receive or adjust any stock in the company until the count is complex and reconciled.

The illustrative chart below shows one physical inventory count, lasting three days. This scenario is for a large company or a supplier-warehouse. The staff start planning the physical count for 12 weeks.

Example of Physical Inventory Count Steps in Days



Physical Inventory Counting Process

After producing a detailed, appropriate inventory counting plan, it's time to execute the physical inventory process. Assign a supervisor to each team of counters to whom they report and all the equipment they need.

The process on the day of the count begins with the managers freezing the inventory items. They should also have printouts of the list of inventories that will get counted. The next steps in a physical inventory count are:

1. Assign maps, inventory to-be-counted printouts and equipment to staff.

2. Staff will; count the assigned inventory.

3. Staff will fill out spreadsheets or count tags.

4. Staff will return the spreadsheets or count tags to the managers. If they are using count tags, they need to affix the top portion of the tag to the stock or stock holding area.

5. Managers will enter the data into the inventory system.

6. Managers will compare the counting data to data in the system.

7. Managers will compare data against yield and pack reports.

8. Managers will then assign staff to investigate any discrepancies.

9. Staff will recount or justify the discrepancies.

10. Staff will resubmit any data changes to managers.

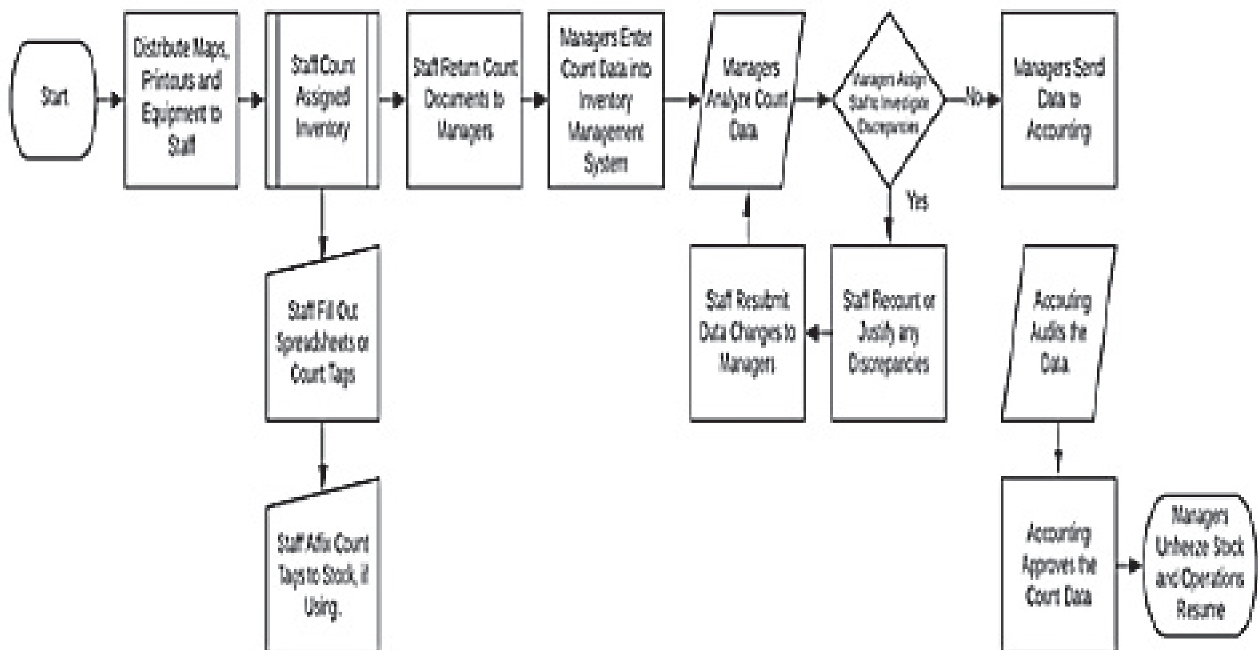
11. Once managers validate the count data, they would send it to the accounting department.

12. Accounts department will audit the inventory count data.

13. Accounts department approves the inventory count.

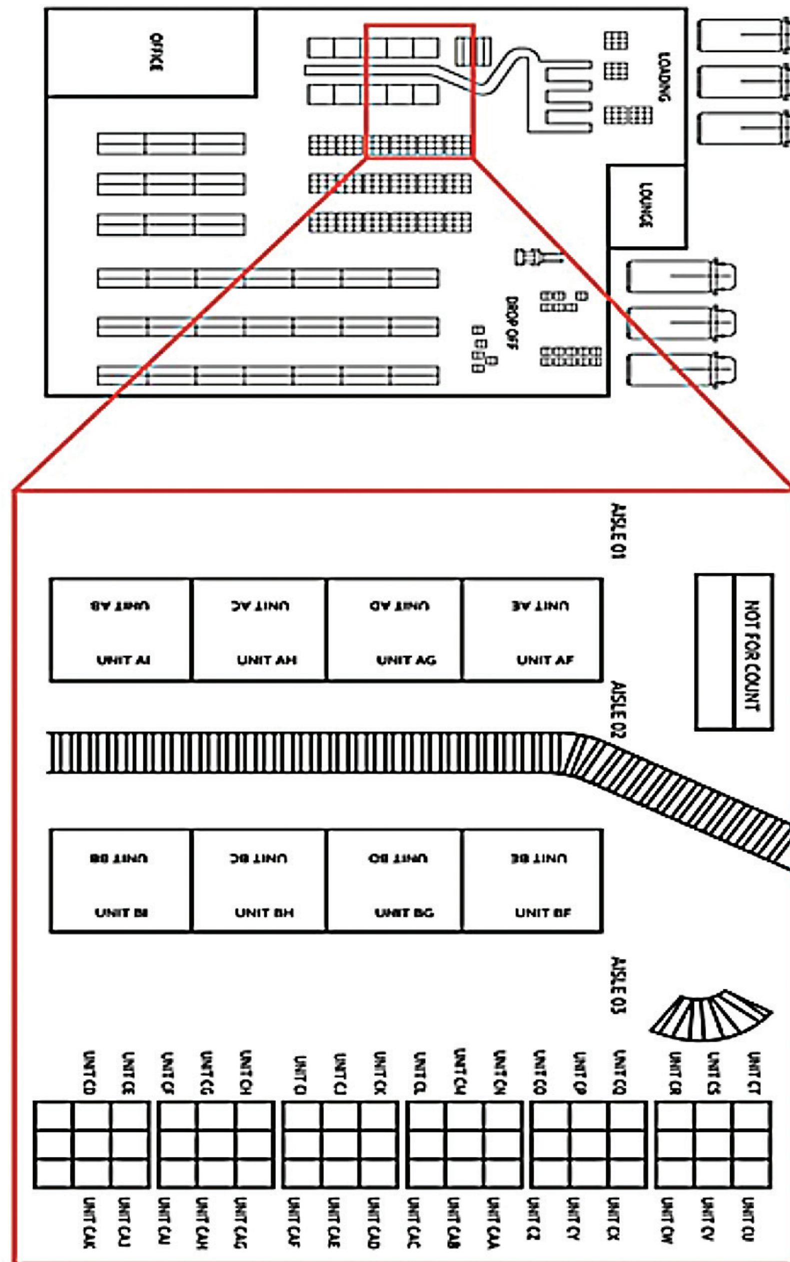
14. Managers unfreeze the stock and return to normal operations.

Flowchart of Physical Inventory Count Process

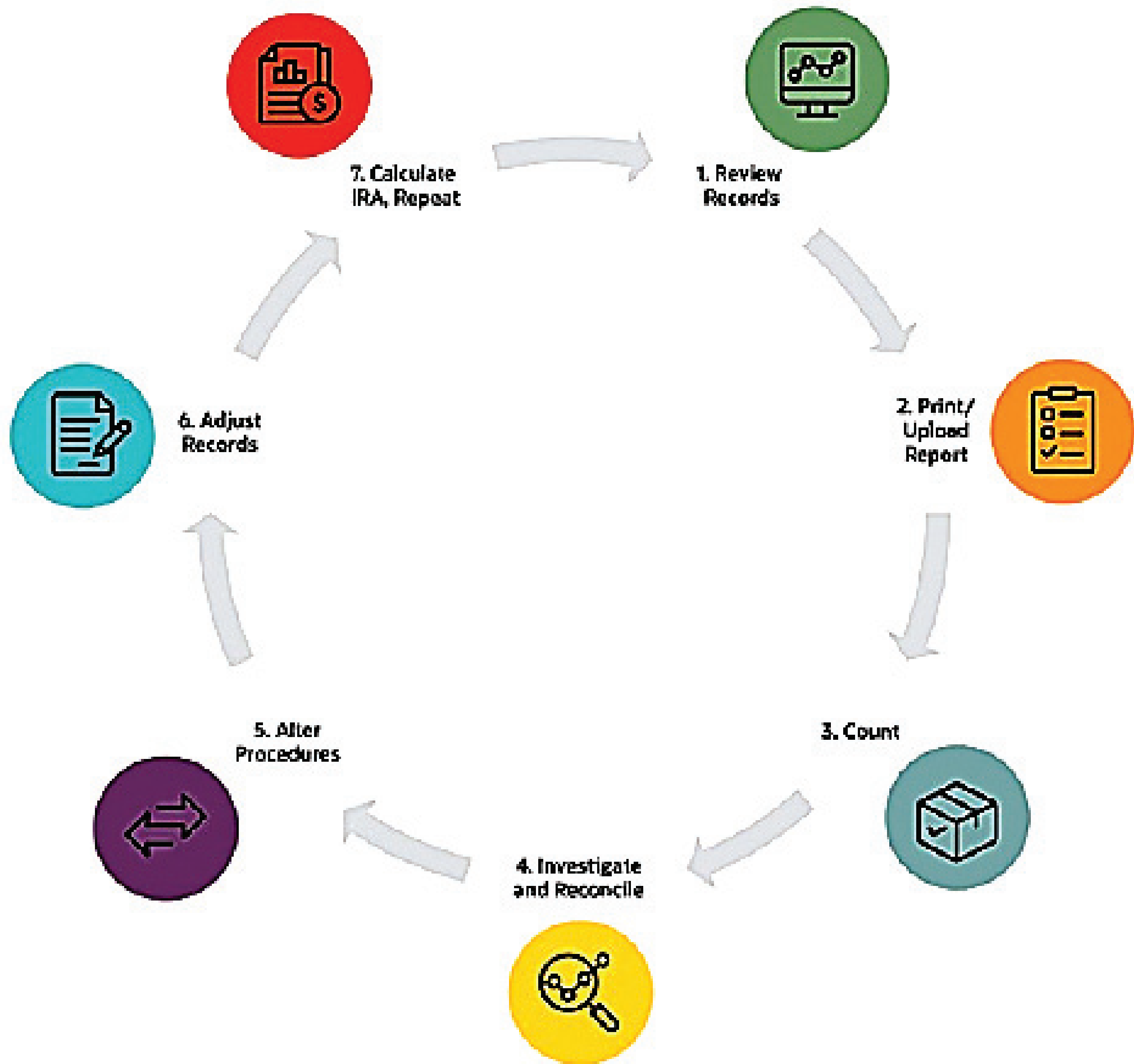


Use a regular warehouse or storage area map and delineate the areas where each count team will work. Notice how the blown-up section in the image below shows the labelling of each storage space. Assign staff to specific locations.

Warehouse Layout Map for Inventory Day



A typical count includes the location, item description, part number, quantity present, and unit of measure. Staff should verify any tags still on items and their information. Auditors should follow up with each section counted as soon as the team completes it. Random checks throughout the process are also a good idea. Finally, reward the staff for their part in the inventory. Although an inventory is essential, it may not be the staff's favourite activity.



Analysis

If the study shows any stock irregularities, cause an investigation to be conducted. Pinpoint any zones in storage that are high-risk, or more likely to have anomalies. Determine any additional metrics that will report, such as inventory turnover.

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12

.Stock and Book Debts Audit Procedure

Objective of this Chapter

Planning and time management is essential for the Stock and Book Debts Auditor to complete the audit work assigned by the banks / financial institutions.

This Chapter the total view of the Stock and Book Debts Audit procedure which helps in the completion of the audit work in an efficient and effective manner.

The auditor has to prepare a rough plan of the total audit work without leaving any aspects and complete the task in a timely and efficient manner.

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 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 number, banking facilities enjoyed by the borrower.
    f) If the advance is a consortium lending, the names of the 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 Policy 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 the following aspects:

1. Nature of business.

2. Nature of goods, especially the storage where the goods are preserved.

   i. Whether stored at multiple locations?

   ii. Whether they are of deteriorating nature etc.

3. The processes involved in the manufacture, production and ascertaining whether any part of the work is to be outsourced.

4. The key personnel involved in the preparation and submission of inventories statements and financial statements to the bank.

5. The business of the entity 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.

Audit Planning

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

1. 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. Timing of the count.

5. Locations at which inventories are held and their nature.

6. Whether an expert's assistance is needed.

When inventories are 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. Borrower's plant.

3. In transit.

4. On consignment.

5. Public warehouse.

6. For processing.

Substantive Procedures

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

Before Visiting 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 the party and the limits thereof.

4. List down the date of sanction, sanction limit, drawing power and 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 and book debts.

6. See whether the insurance policy has been issued in the favour of the bank.

7. See the amount of the insurance policy and date of expiry.

8. Go through previous visit records made by the 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 instalment payments of term loan.

10. See whether the operation of the account is satisfactory or not.

11. Get an appointment before visiting the party's office.

12. Check the due diligence certificate in case of lending under consortium arrangement / multiple banking arrangements.

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 and creditor ledger, etc.

3. Check if all statutory dues have been paid

4. Check whether the prescribed particulars of charges along with the instrument by which the charge is created have been filed with the Registrar for registration within 30 days after the date of its creation.

5. Check sales and purchase invoices.

6. Bank nameplate stating "Hypothecated to -------- Bank/Financial Institution—Branch" should be affixed in inventories premise

7. Damaged inventories, should not be taken into account for the 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 on the premises, which should be free from water leakages, fire, and other hazards, etc. so that inventories are not damaged.

11. Fire-fighting equipment must be available in the inventories premises and it should be regularly checked to preserve its utility.

12. Specify the name of the person who has co-ordinated with the auditor.

Documents to be Obtained from the Borrower

Copies of the following should be obtained from the party:

The auditor should obtain a written representation from the management concerning:

a) the completeness of the information provided regarding the inventories; and

b) assurance about adherence to the laid down procedures for physical count

Inventories Count

1. Premium receipt concerning 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 the last three years.
4. Inventories statement and book debts statement as on the last day of the quarter and for the year & preceding three months before the date of inspection.
5. Copy of Memorandum of Association, Articles of Association, Partnerships Deed, Trust deed & its Byelaws as may be applicable.
6. Copy of audited financial statements.

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 thereon.
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 owned by the entity, 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 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 inventory's statements and the actual inventories on the date of inspection due to 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 the inventories statement. The audit should be designed in such a manner that if the inventories are large, an extensive check should be made on the material control system.

1. Verify the actual inventories in the godown physically with that declared in the inventories statement.

2. Verify that the record-keeping is proper and that there are no indications of dishonest or inefficient management.

3. Verify that there are adequate internal control systems commensurate with the size of the concern

4. The auditor should review management's instructions regarding:

   a) application of control procedures, for example, collection of used stock sheets, accounting for unused stock sheets, tagging, and count and re-count procedures;

   b) 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

   c) appropriate arrangements made regarding the movement of inventories between areas and the shipping and receipt of inventories before and after the cut-off date.

5. The auditor should also consider cut-off procedures including details of the movement of inventories just before, 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.

6. Verify whether consistent and accepted accounting principles are adopted for the valuation of inventories.

7. Evaluation of the security measures for prevention of theft and pilferage.

8. Costing system in operation to ensure the value of the system in use.

9. Examine 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 entries made as in these registers.

10. If there is any difference between the physical verification of the inventories and the records, the same should be noted and recorded.

11. In case the inventories are lying with processors, verify whether the branch has obtained a letter of no-lien from the processors.

12. Scrutinize at least 20 per cent of the total raw material and 85 per cent of the total finished goods and semi-finished goods lying in the godown (It will differ from unit to unit and also quantum of finance by the Bank for working capital and also bank guidelines).

13. Prepare the age-wise list of the inventories in the following manner:

a) More than 12 months old.

b) More than 6 months old and less than 12 months old.

c) More than 3 months old and less than 6 months old.

d) More than 1 month old and less than 3 months old.

e) Less than 1 month old.

14. Bifurcate the inventories into paid and unpaid and ensure that only paid inventories are taken for the calculation of drawing power.

15. In case of unpaid inventories, the bank/financial institution should not provide any assistance or credit facility to that extent.

16. Check whether insurance policies cover the following risks:

a. Fire.

b. Marine.

c. Theft.

d. Other natural calamities.

17. The inventories hypothecated should be well within the norms as suggested by the permissible bank finance / Naik / 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

18. 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 bank without the prior consent of the bank is taken on record.

19. Also, verification of the production register should be done.

20. Details of the inventories as regards to quantity, quality, life, date of purchase, and price must be verified.

21. Check whether goods require any specialized preservation and if so, then proper arrangements should be made for facilitating such storage.

22. Check the method, which has been employed for ascertaining the final value of closing inventories.

23. Check whether the borrower follows the method consistently or not.

24. Verify the movement of inventories.

25. 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.

    a. More than 12 months old.

    b. More than 6 months old and less than 12 months old.

    c. More than 3 months old and less than 6 months old.

    d. More than 1month-old and less than 3 months old.

    e. Less than 1 month old.

The age of the book debts should not be more than stipulated in the sanction. The debts over a period of 3 months (or as stipulated in the 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 an undue concentration of debt involving large amounts from 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 debtor's ledger to ascertain the genuineness of the debt, aging of debt, and cases of non-realization of long outstanding debts.

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

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

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

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

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 dishonoured.

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.

Debtors Ageing:

The customer's balance and the aged debtors report don't match.

This usually because customer balance includes all sales invoices, payments and credit, including those dated in the future. Aged debtors report only shows transactions up to the date specified on the report.

What you need to check

Review all open invoices (unpaid invoices), review the advances, credit notes and debit notes of the particular customer and insist the company to adjust the advances, credit notes and debit notes in the system against the open invoices and then generate the Debtors Ageing report.

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 loans from financial institutions or banks, 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 a 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 before 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 totalling 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 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 have zero balances.

3. Accounts with old unpaid balances especially when subsequent sales have been paid off.

4. Accounts are 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 debtor 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 the 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 are adequately insured.

2. Check whether insurance policy is in force.

3. Check whether inventories with third parties are also covered.

4. Check whether the bank clause is included in the policy.

5. Check whether the inventories are 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 on documentation and gather the following records as documentary evidence to facilitate the process of audit:

1. Auditor's report on inventories for the previous three years.

2. Bank statements for 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 the last 12 months, taking on an average of at least 3 entries per month and checking the process of collection.

6. Copies of purchase invoices for the last 12 months, taking on an average of at least 3 entries per month and checking the process of collection.

7. A certified copy of the constitution of the entity represented by either the Partnership Deed or the Memorandum and Articles of Association or the Trust deed for Trust, etc.

8. The statement of Profit and Loss Accounts for the last 3 years.

9. Month-wise inventories statement of the last year.

10. Month-wise book debt statement of the last year.

11. In case of a manufacturing concern, a summary of the manufacturing process

12. A list of books and records maintained for inventories, debtors, and security.

13. An organization chart giving an overview of the organization's hierarchy, along with their respective responsibility.

14. A flowchart depicting the movement of raw materials, work in progress, and finished goods.

15. The credit policy is employed by the company.

16. A detailed statement of debtors showing the date of the bill and age-wise classification of debtors.

17. Inventories statement as on the date of physical verification along with the date of purchase with the detailed breakup of its components.

18. A copy of the agreement of ownership / lease agreement / rent agreement for office / factory / godown.

19. A list of sundry creditors with the date of the bill for goods purchased on the date of physical verification.

20. A certified copy of the insurance policy in force.

21. A certified copy of the loan sanction letter.

22. Comprehensive management representation letter.

23. A certified copy of excise return, GST return, and income tax return of the previous year.

24. Copy of registration certificate under Shops and Establishments Act, Registrar of Firms, Pollution Control Board, Food and Drugs Approval Authority-other laws as applicable.

25. A note specifying the accounting policies that are followed.

26. A detailed note on the 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.

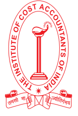
Instead, the banks should be asked to call for these documents.

Reporting

1. The report has to be submitted to the authority appointing the Auditor.
2. It should be in the prescribed format and should be exhaustive and inclusive of all facts and a summary
3. It should include the date, time, location of the 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.
4. Copies of confirmations, management representations, etc. should be submitted along with the report.
5. 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 refer to a scope of limitation in his audit report.
6. If the inventories are not disclosed appropriately in the financial statements, the Auditor should issue a qualified opinion.

Common Lapses observed in most of Stock & Book debt Audit

1. Inventories / book debts / QIS statements not furnished in time.
2. Inventories statement received from borrower filed routinely without scrutiny. Non-moving inventories not identified.
3. Age-wise analysis of debtors not done. Debtors for more than 90 days are 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 concerning projections, QIS statements, audited accounts, etc.
7. In case of consortium advances the 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 a third party not obtained or physical verification of inventories not done.

11. Material received from third parties for job work is 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 intervals.

14. Monitoring of accounts where sub-limit is transferred to branches.

15. Borrower having operations with another bank.

16. To cover the valuation of security, revaluation of assets done which may not be genuine.

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13

A Specimen of Stock & Book Debts Audit Policy of Banks

(Policy Differ from Bank to Bank)

Objective of this Chapter

In commercial banks / financial institutions, there are several policy guidelines for different activities of the banking / finance business. The different policies in banks are credit policy, investments policy, KYC/AML policy, etc. These are drafted and vetted by the different departments and after getting approval from the Bank's Board, they will be implemented in the bank through the branches / operating offices, etc.

The Stock and Book Debts Audit Policy of the bank is one among them. It is an aid or guidance to the Stock and Books Debt Auditor to complete his assignment effectively and efficiently as per the bank policy guidelines. These policy guidelines are dynamic and from time to time based on the feedback from Operating Offices (Branches / Administrative Offices), these are modified and the latest will be circulated to the Branches / Operating Offices. The Stock and Book Debt Auditor has to get the latest policy guidelines; and to ensure that his report comply with all the policy guidelines as stipulated by respective bank / financial institution.

In the context of rapid growth of credit, effective supervision and monitoring of advances have assumed considerable importance. In the case of working capital finance, one of the measures that are deployed by the lenders for ensuring the end use of funds and monitoring the borrower account is the system of periodical Stock Audit by independent qualified Stock Auditors.

The Stock Audit system was introduced in banks to monitor the borrower accounts enjoying working capital limits of ₹ 5.00 Crore and above (It may differ from bank to bank).

Many banks' loan policy stipulates as the following:

"Stock Audit be conducted by appointing Cost Accountants / Chartered Accountants, who are in bank's panel as Stock Auditors, for working capital limits normally of ₹ 3.00 Crore and above (both fund based and non-fund-based limits – It differs from bank to bank) where the primary security is hypothecation of Stock and/or book debts once in a year".

To have uniform procedure and practice and to regulate the system of the Stock Audit process, a policy

document on Stock Audit was considered necessary by the banks.

The main objective of the Stock Audit is to ascertain whether the security (borrower's stock and debtors) against which working capital finance has been made is safe and valued correctly. The Stock Auditor must verify the physical existence and absolute ownership of inventory / movable property charged to the bank and examine the genuineness of the sundry debtors list submitted by the borrower.

The various purposes expected to be achieved through Stock Audit may be summarized as follows:

- To physically verify the value of paid stock (by excluding the total value of the unpaid stock concerning the level of trade creditors and the total value of stock procured under the non-fund based credit limits viz., LC / BG) available in the borrower's location and confirm the same together with the eligible book debts are sufficient to cover the total amount outstanding in the working capital limits (fund based) along with the required level of margin.

- To verify whether the value the of stock (procured under non-fund-based limits) available on the date of physical verification along with the eligible book debts emanated from the sale of such goods is sufficient to cover the total amount of bill liability under the non-fund-based limits including bank guarantee limit for supply of goods.

- To verify related records/registers / books of accounts such as stock register, purchase register, sales register, purchase invoices, sales invoices, credit notes, debit notes, etc., maintained by the borrower.

- To carry out a physical examination of stock to ascertain the quality, value, and age of the inventory thereby identifying whether there exists any obsolete stock and if yes, whether it has been segregated and written off and excluded while arriving at the drawing power.

- To ensure proper preservation/storage and handling of stock.

- To ensure that the stock under hypothecation has not been hypothecated to other bank/banks.

- To examine the end use of the funds and verify whether any diversion of funds or interlocking of funds among sister concerns.

- To verify the operation of the accounts such as cash withdrawal, cheque returns, clearing cheque outstanding, number of times the account remained overdrawn, adjustment of returned discounted cheques, packing credit loan (PCL) overdue, letter of credit (LC) devolvement, invoked bank guarantees, etc.

- To confirm whether all the sanction conditions have been complied with.

- To verify whether the stock is adequately and properly insured against fire and other natural calamities (in appropriate cases against other risks like theft, burglary, marine, riots, etc. as per sanction conditions) and kept in a secured manner.

- To ascertain whether physical stock tally with the stock statement submitted to the banker.
- To ascertain whether a hypothecated stock is realizable.
- To confirm that stock is owned by the borrower and finance is made against the value of paid stock only.
- To examine the age-wise debtors outstanding as per books and as per statement submitted by the borrower, steps taken for recovery of long pending debtors and likely instances of debtors turning bad, if any.
- To ensure timely submission of stock / book debts statements, QIS statements, etc.

The Credit Audit & Monitoring Department of the banks is responsible for the drafting of the stock audit policy and also for the periodical review of the relative policy and processes.

Borrower accounts having working capital limits of ₹ 3.00 Crore and above (both fund based and non-fund-based limits-differ from bank to bank) where the primary security is hypothecation of stock and/or book debts come under the purview of Stock Audit. In exceptional cases, the Stock Audit may be conducted for the working capital limits below ₹3.00 Crore based on the specific request of the Credit Department/ Regional Office of the bank.

Moreover, in the case of NPA borrowal accounts having working capital limits of ₹ 3.00 crore and above where the primary security of stock and/ or book debts are available also come under the purview of Stock Audit.

Fund based limit includes all types of working capital limits sanctioned such as cash credit (stock), cash credit (book debts), overdraft, term loan / demand loan (for working capital purpose), bill limits packing credit limit, key loan, ware house receipts loan, etc.

Non-fund-based limits sanctioned for working capital purposes such as bank guarantees, etc., for the supply of goods on credit terms.

In case of advances coming under consortium / multiple banking arrangement, the banks may fall in line with the leader of the consortium or highest lender, as the case may be.

In certain industries, business activities, and projects, by the very nature of the business model, the primary security charged to the bank is tangible, not easily verifiable. In such cases, the Stock Audit is conducted by outsourcing a Stock Auditor who is having specialised/ specific knowledge about the nature of goods.

Stock Audits are conducted for the eligible borrower accounts once a year. It is to be ensured that there is no omission either in the eligible accounts or in the area of coverage. It is to be arranged in such a way that Stock Audits, post-credit supervision, etc. of the branch are carried out not simultaneously in a branch but within a reasonable time gap.

The Stock Auditor has to apply to the Head Office / Regional Office in whose jurisdiction his office is situated for empanelling him as the banks' Stock Auditor. The Head Office / Regional Office has to recommend his request to Credit Audit & Monitoring Department, Head Office of the bank (differs from bank to bank) after satisfying the criteria.

A consolidated list will be prepared by Credit Audit & Monitoring Department and put up to the committee of executives for empanelling them as banks' Stock Auditors at regular intervals. The permitted list will be placed before banks top management for approval authorized in this regard by the Board of Directors.

The Credit Audit & Monitoring Department will select the Stock Auditor from the available panel every year for conducting Stock Audit (differs from bank to bank). The Credit Audit & Monitoring Department submits the list of Stock Auditors along with the borrowal accounts allotted to them to the top management for his prior permission.

It is the responsibility of the Credit Audit & Monitoring Department to review the Stock Auditors who are in the bank's panel every year by placing a review note to top management (differs from bank to bank).

Criteria for Appointment of Stock Auditor

While the criteria for the appointment of Stock Auditor differs from bank to bank, the following general criteria are applied while selecting the Stock Auditors:

1. The firm of the Stock Auditor shall contain at least two Cost Accountants / Chartered Accountants of which one of the partners should have at least two / three years of experience. If the Cost Accountant / Chartered Accountant is an individual or Sole proprietary concern, he should have at least 3 to 5 years of experience.

2. The Cost Accountant / Chartered Accountant firm/proprietor/individual should have conducted bank Audit in any Commercial Bank at least for two years.

3. The Cost Accountant / Chartered Accountant firm/proprietor/individual should have an office as far as possible at the centre where the   is located for which the Stock Audit is to be conducted.

4. Specialized Auditors i.e., Auditors knowing the industry or having expertise in the industry should be considered to the extent possible to achieve an efficient and effective Stock Audit.

5. Banks ensure that the Auditor who has been appointed to conduct the Stock Audit for the particular borrower account is not the Auditor for the same borrower.

6. Concurrent Auditors can be appointed to conduct Stock Audits with a condition that they should not be the Concurrent Auditors for the same branch where they are appointed to conduct Stock audits and there should not be any negative remarks on the Concurrent Auditors.

Stock Auditors are appointed taking into consideration the firm's constitution, experience, etc. Some of the stock/goods may be graded depending on the composition, durability and other technical specifications

which cannot be assessed by a layman. Cost Accountant / Chartered Engineer who is technically / professionally qualified, may be engaged by the Stock Auditors with the prior permission of the bank's credit department. In such cases, if the Stock Auditor engages the services of a Chartered Engineer who is registered with the Institution of Engineers (India), such engineers should possess special knowledge / practical experience about the stock/ product such as chemicals, oils, etc., in which the borrower is dealing with. Before engaging the services of such outsourced personnel, clearance should be obtained from the top management of banks by the branches.

The outsourced Chartered Engineer will accompany the Stock Auditor during the unit / godown visit. The outsourced Chartered Engineer will certify the quality of the product and also provide the market rate (per unit) for the stock/ goods to the Stock Auditor. Based on the rate provided by the Chartered Engineer, the Stock Auditor will ascertain the quantity of stock and arrive at the total value of stock available.

The reimbursement to such outsourced Chartered Engineer will be fixed by the concerned Regional Office of the bank after consultation with the Stock Auditor. The fees may vary from product to product and also depend upon the availability of testing centres/equipment etc. However, the decision of the bank in this regard is final.

The bank's appointment letter will be signed and sent only by the in charge of the Credit Audit & Monitoring Department of the banks (differs from bank to bank) to ensure audit independence and integrity. The appointment letter will contain the name of the borrower unit(s) to be inspected and the details of tasks to be performed such as carrying out physical verification of stock and ascertaining the existence, ownership, quantum, and value of different items of inventories such as raw materials, work in progress and finished stocks as per standard accounting practices and pointing variances if any and verification of debtors, etc.

The Auditors will be provided with necessary guidelines issued by the Bank and expected to have adequate knowledge of regulatory requirements.

In the appointment letter, the Auditor will be advised to take up his assignment within 30 days of the intimation. If not another Auditor/s may be appointed in his/ their place and the same auditor should not be considered for the next/subsequent audit. Moreover, the submission of a stock audit report even after two months of completion of a stock audit is not acceptable by the banks.

The appointment letter should also contain a suitable confidentiality clause to the effect that the Auditor should not divulge any information/statements/particulars furnished to him by the bank and maintain them in strict confidence.

The appointment of the Stock Auditor normally is up to three years (differs from bank to bank). The Stock Auditor is normally appointed before June every year (differs from bank to bank). Any additional appointment /refusal/cancellation of Stock Auditors could be after obtaining prior permission from the top management of the banks as and when needed.

Normally, there is a cooling period for the Stock Audit of at least one year and thereafter they can be shifted to another branch. Rotation of Stock Auditors is made in such a way that the same auditor does

not generally audit the same unit/sister/associate units next time or repetitively. The number of accounts to be allotted to a Stock Auditor is done on a fair basis without any discrimination based on previous experience by the banks.

The remuneration/fees payable to the Stock Auditors depends upon the location of units/godown visited and the number of days spent by them. The fee structure along with other terms and conditions for payment of fees are provided to the Auditors by the banks.

Stock Audit should be completed within 30 days from the date of intimation to the Stock Auditor by the bank i.e.,

1. Commencement of Audit work - Within 10 days from the date of intimation.

2. Conclusion of Audit - Within 10 days from the date of commencement.

3. Submission of Audit Report - Within 10 days from completion of Audit.

The Stock Auditor verifies the borrower's unit/godown as to their position on stock/book debts and submits the report immediately as under:

- Two copies to the Credit Audit & Monitoring Department,
- One copy to the respective Head Office / Regional Office of the Banks through the Branch
- One copy to the branch of the bank (differs from bank to bank).

The final certificate is submitted by the branches within one month from the date of receipt of the Stock Audit Report by the concerned branch of the bank. The concerned Regional Office of the bank verifies the full compliance and obtains a final certificate from the respective branches and submits the same to Credit Audit & Monitoring Department. The entire process till the final certificate from the respective Regional Office is being monitored at the Credit Audit & Monitoring Department of the banks.

The Credit Audit & Monitoring Department will furnish the details to the Audit Committee of the Board regarding the conduct of Stock Audit in the bank branches, every quarter i.e., on 30th June, 30th September, 31th December, and 31st March of every year.

The Stock Audit policy of the banks will be in force up to March every year and it will be reviewed once a year.

The Stock Audit Policy normally is to be placed before Board for approval after getting approval from the Audit Committee of the Board every year.

Conditions stipulated by Banks:

- Stock Audit be made by any of the qualified Auditors; one assistant may accompany him.

- Vehicle may be provided by the Banks to the Stock Auditor for godown inspection.

- Bank branches have to plan with the Stock Auditor regarding the sequence of the Audit and the number of days required.

- Stock Audit fees, (with deduction of GST, and income-tax thereon) should be fixed after getting necessary sanction from the Bank's Regional Office / Head Office.

- If the Stock Auditor verifies the stock of more than one account, the expenses are shared equally by all the borrower accounts.

- The expenses for conducting Stock Audit, will have to be informed to the borrowers by the bank.

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14

Summary

Objective of this Chapter

To summarise the areas of Stock and Book Debts Audit, and understand some of the important points to be noted by the Stock and Book Debts Auditor while performing/discharging the audit work.

Depending on the type of industry / business the activities may differ, but the common areas mentioned in this Chapter are most appropriate for smooth completion of the audit work.

Working capital finance in the form of cash credit/overdraft facility against the primary security of hypothecation of stock and debtors is one of the most common modes of bank finance. The borrowers in such cases are expected to submit the details of stock and debtors every month based on which the drawing power after deducting the prescribed margin is calculated by the banks. Stock and debtors being the primary security, bankers for ascertaining the genuineness and correctness of such statements appoint Chartered Accountant firms at frequent intervals to conduct Stock Audits specifically where the exposure exceeds the predetermined threshold limit (\generally over ₹ 100 Lacs. but in some banks, it is over ₹ 300 Lacs. etc.).

Stock Audit involves an audit of the latest stock and debtor's information of the borrower and the report should give the position of stock and debtors ideally on the date of visit. Further, the Auditor will examine past data submitted by the borrower to the bank and appearing in the books of accounts of the borrower, to check the reliability of the information submitted by the borrower.

Appointing the audit firms for conducting stock audit has the main objective of ascertaining whether the security (borrower's stock and debtors) against which finance has been made is safe and is valued correctly.

Objectives of Stock Audit

The various purposes expected to be achieved through stock audit could be summarized as follows:

- To ensure proper preservation/storage and handling of stock.
- To identify whether there exists any obsolete stock and if yes, whether it has been segregated and written off.

- To verify whether the stock is adequately insured against fire and other natural calamities (in appropriate cases against other risks like theft, burglary, marine, riots, etc. as per sanction terms) and bank clause is inserted in the policy.
- To ascertain whether physical stock tallies with the stock statement submitted to the banker checking for diversion of funds.
- To find out the reasons when there are too many qualifying remarks about stocks and receivables in the Auditor's report on the balance sheet of the borrower
- Ensuring that the terms and conditions of the limit sanctioned have been complied with.
- To ascertain whether the hypothecated stock is realizable.
- To confirm that stock is owned by the borrower and finance is against the value of paid stock only.
- To examine the age-wise debtors outstanding as per books and as per statement submitted by the bank, steps taken for recovery of long pending debtors, and likely instances of debtors turning bad, if any.
- Any other matter of interest to the bank.

Steps involved in Stock Audit

Stock Audit is necessarily required to be conducted at the borrower's place for obvious reasons. But before visiting the borrower, understanding the entity, its banking operations, and financial affairs is a must. Therefore, it is advisable to visit the respective branch where the borrower is having the account to gather the information relating to sanction, account operations, nature of business, performance of the borrower, and other fundamental information along with the comments/observations noted by other Auditors (like Internal Auditors, Concurrent Auditors, etc.) to have a brief understanding about the borrower and its financial affairs. The Auditor should get an appointment before visiting the branch as well as the borrowers' office.

1. Visit Borrower's Branch

Banks generally have the system of maintaining two folders (in a few cases only one folder) for each borrower of which one is used for keeping original documents executed by the borrower (viz. demand promissory note, hypothecation deed, guarantee bond, etc.) while another folder contains the application form, project report, sanction letter, audited financial statements, previous stock audit report, etc. Stock statements submitted each month by the borrower are filed with the correspondence file or may be kept in a single file meant for keeping stock statements of all the borrowers. Scrutiny of both the files along with the account operations and DP Register concerning terms of the sanction helps the Stock Auditor to gain an insight into the borrower's affairs and conduct an audit of the account.

If the borrower operates any other bank account like for instance term loan, the Auditor has to verify for diversion of funds.

Documents required from the bank branch officials:

- Sanction letter and latest renewal letter.
- Stock statements (latest 6).
- Bank statement for the last 6 months.
- Turnover report for last financial year and current financial year (till date)
- In the case of a company, copy of Form No. 8 & 32 for creation/ modification of charge or ROC search report or CERSAI copy in other cases (other than company).
- Balance outstanding in all accounts with the bank.
- DP register.
- QMR/QMS/QIS/QPR for the last 2 quarters.
- Branch inspection report (for the last 2 quarters).
- Three latest GST returns (It could be taken from borrower also).
- Valuation report for collateral securities.
- Audited FS for the last financial year ended (It could be taken from borrower also).
- Half-yearly/Quarterly book debt - certified book debt statement.
- Insurance policy copy for both primary and collateral securities (It could be taken from borrower also).
- If the major transactions with the same party is reflected in the account statement, then the relationship with such party and the genuineness of such transaction should be verified at the party's place.
- Any other document related to Stock Audit to conduct a more effective audit or reporting.

2. Visit borrower and verification of stock

Once the basic information is collected from the bank branch, it is time to visit the borrower. It is advisable to carry an audit questionnaire at the time of visit so that no important point/area is missed out (The Auditor should draft a detailed questionnaire with the help of audit format). The visit to the borrower's premises involves verification of stock and debtors, inquiry about internal control, and analysis of past results and bank operations. Although the audit is related to stock and debtors only, understanding of the overall financial scenario and inquiry into to sister concerns and their businesses may also help the Stock Auditor to finalize the report in a better manner.

Before the Auditor commence stock verification, he needs to understand the nature of goods, especially about the storage, whether stored at multiple locations, whether they are deteriorating in nature, etc.

The Auditor should examine the process involved in manufacturing, production and ascertain whether any part of the work is to be sent out of the entity for further processing.

Physical verification of stock

- Godown inspection, its location, condition, rent payments (if godown is on rent), maintenance, etc.
- Actual counting of stock and matching it with book figures) reconciliation with the book figures if there is any difference.
- Check opening stock, purchases, production, sales, and closing stock.
- Age-wise analysis of stock and movement of stock.
- Check abnormal increase/decrease in stock.
- Auditors have to verify all major creditors and debtors.

Documents required from the Borrower

- Stock position as on date of verification.
- Trial balance or provisional balance sheet as on date of verification.
- Copy of latest audited balance sheet.
- Insurance policy (Include bank hypothecation clause for primary as well as secondary collateral security.
- Figures of purchase and Sales for last 6 months as well as for current month till the date of Verification.
- Invoices of Purchases and sales, stock register and other supporting documents for verifying internal controls.
- Method of valuation followed for inventory with detailed working.
- Copy of latest GST returns filed.
- Break up of sales into export and domestic.
- Details of non-moving and obsolete stock and also stock held for more than 6 months.

- ABC analysis of stocks based on the value of annual consumption of major items. (only if available)
- Products manufactured with details of licensed capacity, installed capacity, and actual utilized capacity.
- Month-wise details of purchases and sales, stock, debtors, and creditors for the last 6 months
- Major creditors (operational) and debtors and their transactions should be verified on a random basis.

Common irregularities/observations in the Stock Audit

The common irregularities that may be observed by the audit firm during a Stock Audit can be summarized as follows:

a) Observations about statement submission and scrutiny:

- Stock book debts statements not submitted/ submitted but not within time.
- Inadequate details viz. rate, quantity, and amount of different types of stock items not stated in the statement.
- DP Register not written up to date.
- Age-wise analysis of debtors not given/done.
- Debtors over 90 days (or as per sanction) are considered for drawing power.
- Drawing power not correctly calculated.
- Latest visit report by branch official not on record.
- Operations in the accounts not scrutinized concerning projections.
- QIS statements, audited accounts, etc. not in records.
- Defects pointed out by the Internal Auditors / Concurrent Auditors not complied with ?
- Account not renewed / belated review.

b) Observations about account operations

- All sales as per financial statements are not routed through the account.
- Account not operated actively.

- Cash withdrawal during the current period is abnormal.
- Frequent overdrawing in the account.
- Balance overdrawing power although within sanctioned limit.

c) Observations about Insurance coverage

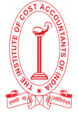
- Under insurance of stock.
- Insurance expired and not renewed.
- Premium for renewal policy paid but policy not on record.
- Insurance policy without bank clause.
- No coverage of all risks as per sanction.
- Wrong items/description of goods on insurance policy.
- Location of goods wrongly stated.
- All locations of stock not covered.

d) General Observations:

- Stock book not maintained/ not updated.
- Obsolete stock is not excluded from stock figures submitted to the bank.
- Deteriorating stock turnover ratio.
- Stock, debtors, and creditors figures submitted at the year-end in a stock statement and as per financial statement not matching.
- Confirmation for inventory with a third party not obtained or physical verification of inventory not done.
- Material received from third parties for job work is not excluded while calculating drawing power.

Findings of Stock Audit and its uses

Stock audit by an external audit firm is one of the important tools of credit monitoring for the bank. Apart from ensuring the safety of realizable security, it also helps the bank to discipline the borrower or may act as a warning signal against probable future NPA. It may aid the bank to take timely remedial measures to avoid substantial future losses. It also highlights the weaknesses, if any in the existing



monitoring system of the branch through comments about maintenance of the DP register, scrutiny of statements, review of accounts, and compliance with audit findings.

Over and above, the stock audit also has utility for the borrower. Comments about insurance inadequacies, wrong product descriptions and locations stated in the policies, if rectified timely may save the borrower from avoidable future losses.

Therefore, unlike a Statutory Audit where there is thrust only on compliance under the respective statutes, Stock Audit is a knowledge value addition exercise for both bankers as well as borrowers.

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15

Specimen of Stock and Book Debts Audit Report

Objective of this Chapter

The specimen of the Stock and Book Debts Audit Report given in this Chapter would be - useful for the Stock and Book Debts Auditors in completing their assignment.

However, some banks, have devised their own format in this regard but almost all formats devised by the banks are more or less similar with marginal, variations but contain all the aspects that are to be covered by the Stock and Book Debts Audit.

This specimen given in this Chapter would be useful to understand the various areas to be covered by the Auditor.

As a good practice at the beginning of the Audit Report, there should be the following two parts:

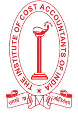
A. An ***Executive Summary*** reflecting major adverse findings which would help the higher officials of the bank (Zonal Manager / Regional Manager etc.,) to have an impression about the borrower without going through the detailed Audit Report.

B. A Note on ***Non-Compliance with Audit Findings*** reflecting the non-compliance of various findings of the Concurrent Auditor, Internal Auditor, Statutory Auditor, previous Stock Auditor, etc., would help the bank to form an impression about the efficiency of the concerned credit officer.

A standard stock report should have the following contents:

A. General Information:

1. Details of bank & branch:
2. Details of the borrower account:
3. Details of facility:
4. Current position:
5. Details of unit visit:



B. Comments on unit visit

1. Godown condition:
2. Stock verification and monitoring:
3. Stock reconciliation as on date of inspection:
4. Capacity utilization:
5. Method of valuation of stock:
6. Ageing of stock:
7. Value of stock as on date of inspection:
8. System of inventory control:
9. Insurance coverage:

C. Insurance coverage

1. Inventory:
2. Collateral security:

D. Receivable management

1. Ageing analysis:
2. Debtors reconciliation as on date of inspection:
3. Exposure with sister concerns:
4. Valuation of debtors:
5. Receivable management:
6. Routing of sales proceeds:
7. Checking of sales bill:

E. Sundry creditor:

1. Ageing analysis of creditor:
2. Credit allowed by the suppliers:
3. Checking of purchase bill:

F. Statutory compliances:

G. Calculation of drawing power:

H. Projection versus Actual achievement of the last financial year:

I. Bank limit utilization:

J. Fund flow statement:

K. Ratio Analysis:

Details of Stock Audit Report

A. GENERAL INFORMATION:

1. **Details of bank and branch:** Name and address of the Branch and Zonal Office

2. **Details of the borrower account:**

   (a) Name of the account:

   (b) Constitution-Proprietorship /Partnership/Ltd Company (If Limited Company mention CIN)

   (c) Date of establishment:

   (d) Nature and line of business:

   (e) Details of partners, promoters' shareholders and their percentage of the share of profit or the shareholding

   (f) Contact details: E-Mail, Phone No. Fax No etc.

   (g) Borrowers' address-both registered office godown, factory, etc.

   (h) Own or rented:

3. **Details of Facility**:

	Sanction Memo.	Vide Letter No.:			Dated:
Sl. No.	**Facilities**	**Limit (Rs. In Lacs)**	**Margin**	**ROI/ Commission**	**Security**
1	Cash Credit		25%	BR+4.50%	25% on Stock and 40 % on book debts up to 60 days

	Sanction Memo.	Vide Letter No.:			Dated:
Sl. No.	**Facilities**	**Limit (Rs. In Lacs)**	**Margin**	**ROI/ Commission**	**Security**
2	LC/BG		LC:15%, BG:20%	As per Bank Circular	
3	**Total**				

4. Current Position:

Cash Credit:	
Sanction Limit:	₹ Lacs.
Drawing power advice by borrower as on --/--/----.	₹ Lacs. (Copy of stock statement dated --/--/---- is attached herewith as Annexure)
Drawing power as calculated by branch	₹ Lacs.
Outstanding as on the last date of the previous month	₹ Lacs.
Outstanding as on date of inspection	₹ Lacs.
Bank Guarantee	
Sanction limit:	₹ Lacs.
Utilized amount as on the last date of the previous month	₹ Lacs.
Outstanding as on date of inspection	₹ Lacs.
Fixed deposits as on the last date of the previous month	₹ Lacs.
Fixed deposits as on date of inspection	₹ Lacs.

5. Details of Unit Visit:

Name of Persons Contacted	*Venue*	*Designation*	*Contact Number*	*Date*
	Office	Accountant		
	Stores-1	Stores-in-Charge		
	Stores-1	Stores-in-Charge		
	Stores-1	Stores-in-Charge		

B. COMMENTS ON UNIT VISIT:

1. Godown Condition:

a) Whether the bank's name plates with hypothecation clause are properly and visibly displayed:

b) Whether proper security management is there:

c) Are there sufficient fire extinguishers as a safety measure?

d) Whether proper arrangement is there for preventing water logging to save the inventory:

2. Stock Verification & Monitoring:

Verify the list of stock with Stock Register or GST Register (if applicable) both physical and accounting software.

Prepare the report of findings of physical verification in the following format which will be a part of the stock audit report:

Sl. No.	***Stock Item***	***Specification***	***Quantity as per Customers Record***			***Qty. as per Physical Verification***	***Difference Between Physical Stock and List***
			Stock List	*Stock Ledger*	*Difference*		

3. Stock Reconciliation as on date of Inspection

Reconcile the stock as per the stock list as on the date of inspection with the last stock submitted by the borrower.

Sl. No.	*Stock Item*	*Quantity*	*Balance as per last Stock Statement*	*Purchase*	*Issue*	*Balance as on date of Inspection*

4. Capacity Utilization:

a) For manufacturing company: Installed capacity: Kgs.

Month	*Actual Production*	*% Of Utilization*	*Previous Year's Figures*	*Growth*
Apr-21				
May-21				
Jun-21				
Jul-21				
Aug-21				
Sep-21				
Oct-21				
Nov-21				
Dec-21				
Jan-22				

Month	*Actual Production*	*% Of Utilization*	*Previous Year's Figures*	*Growth*
Feb-22				
Mar-22				

b) For Trading Concerns:

Month	Purchase			Sales		
	Current Year	Previous Year	Growth	Current Year	Previous Year	Growth
Apr-21						
May-21						
Jun-21						
Jul-21						
Aug-21						
Sep-21						
Oct-21						
Nov-21						
Dec-21						
Jan-22						
Feb-22						
Mar-22						

5. Method of Valuation of Stock

Check the rate and value given in the list w.r.t. the purchase bill and valuation policy of the borrower.

6. Ageing of Stock

The Auditor should check the stock records and prepare the ageing of stock in the following format

Sl. No.	*Stock Item*	*Specification*	*0-20 Days*	*21-90 Days*	*91-180 Days*	*181-365 Days*	*> 365 Days*	*Total Stock Quantity*	*Value of Stock*	

7. Value of stock as on date of inspection

Calculate the value of the stock based on suitable rate as per accepted valuation policy and exclude the non-moving and obsolete stock. Comments should be made also on the valuation of work in process and finished goods.

Sl. No.	*Stock Item*	*Quantification*	*Quantity*	*Rate*	*Value*

8. System of Inventory Control

Comment on the following points:

a) Physical verification of stock and action taken report by the borrower

b) Stock movement and holding level of Raw Material, Work in Process, and Finished Goods

c) Maintenance of records like Stores Ledger Bin Card, etc.

C. INSURANCE COVERAGE

Both the insurance policy on stock and collateral securities need to be checked and details need to be reported:

Sl. No.	Name of the Insurance Company	Policy Details			Assets Covered	Location	Sum Assured	Coverage (%)	Type of Risk	Bank Clause
		No	From Date	Date of Exp.						

D. RECEIVABLE MANAGEMENT:

1. **Ageing Analysis:** Ageing of debtors as on the date of inspection need to be given along with the findings:

Sl. No.	*Name of Debtors*	*0-30 Days*	*30-60 Days*	*> 60 Days*	*Total*

2. Debtors' reconciliation as on date of inspection:

Sl. No.	*Name of Debtors*	*Balance as Per Last Stock Statement*	*Sales*	*Collection*	*Balance as on Date of Inspection*

3. Exposure with sister concern: Identify the sister concern or related party based on the balance sheet and calculate the exposure and report the same:

Sl. No.	*Name of Related Party*	*Sales up to Date of Inspection*	*Outstanding as on Date of Inspection*

4. **Valuation of debtors:** Consider the value of sundry debtors in 0-30 days and 31-60 days bucket as mentioned above and deduct the exposure on the related party.

5. **Receivable Management:** Check the high-value debtors and the credit limit provided to them. If the outstanding exceeds the limits what action the borrower has taken needs to be examined. Also, calculate the debtor turnover ratio in the following format:

Month	*Opening Balance*	*Sales*	*Collection*	*Closing Balance*	*Average Balance*	*Debtor Turn Over Ratio*
	A	**B**	**C**	**D=A+B-C**	**E=(A+D)/2**	**F=E/B*365 (In Days)**
Apr-21						
May-21						
Jun-21						
Jul-21						
Aug-21						
Sep-21						
Oct-21						
Nov-21						
Dec-21						
Jan-22						
Feb-22						
Mar-22						

6. **Routing of sales proceeds**: Check whether all the collections from receivables are deposited in the cash credit account. If any amount is found deposited in another current account, then enquire the reason for such routing. Also, the following tabulation will help for some conclusions:

Month	*Sales*	*Average Utilization of Cash Credit Account*	*Sales / Average Utilization*	*Credit in Bank Statement*	*Collection*	*Difference*
Apr-21						
May-21						

Month	*Sales*	*Average Utilization of Cash Credit Account*	*Sales / Average Utilization*	*Credit in Bank Statement*	*Collection*	*Difference*
Jun-21						
Jul-21						
Aug-21						
Sep-21						
Oct-21						
Nov-21						
Dec-21						
Jan-22						
Feb-22						
Mar-22						

7. **Checking of sales bill:** Check some bills and report if there any discrepancy is found.

E. **Sundry creditor**: Check the sundry creditors w.r.t purchase bills and ascertain from the borrower the credit period allowed by the individual creditor. If payment is not made within the specified period enquire the reason behind it. Prepare ageing analysis of creditors and report the same in the following format:

Sl. No.	*Name of Creditor*	*Credit Period*	*0-30 Days*	*30-60 Days*	*> 60 Days*	*Total*

Also, calculate the average creditor turnover ratio every month and report the same:

Month	***Opening Balance***	***Purchase***	***Payment***	***Closing Balance***	***Average Balance***	***Creditor Turn Over Ratio***
	A	***B***	***C***	***D=A+B-C***	***E=(A+D)/2***	***F=E/B*365 (In Days)***
Apr-21						
May-21						
Jun-21						
Jul-21						
Aug-21						
Sep-21						
Oct-21						

Month	*Opening Balance*	*Purchase*	*Payment*	*Closing Balance*	*Average Balance*	*Creditor Turn Over Ratio*
	A	*B*	*C*	*D=A+B-C*	*E=(A+D)/2*	*F=E/B*365 (In Days)*
Nov-21						
Dec-21						
Jan-22						
Feb-22						
Mar-22						

F. STATUTORY COMPLIANCES:

1. Check whether GST, central excise, and customs duty have been paid .

2. Check whether relevant returns are files.

3. Check whether TDS is regularly made ..

4. Check whether TDS returns are filed.

5. Check whether any monetary penalty or fine is levied for non-compliance with any law or regulation or delay in payment of statutory dues.

6. Check whether income tax return and ROC returns under the Companies Act are submitted in time.

7. Provident Fund Recovery from employees - whether payment made within time limit.

8. ESI Recovery from employees-whether payment made within time limit.

G. CALCULATION OF DRAWING POWER:

Recalculate the drawing power of the last month and as of the date of inspection in the following format with reasons.

Particulars	*DP Calculated by Borrower*	*DP Calculated by Auditor*	*Difference*
Value of stock (Hypothecated)			
Less: Sundry creditors (trade)			
Paid for Stocks			
Less: Stipulated margin			
D.P on Stock (A)			
Value of sundry debtors (less than 90 days)			
Less: Exposure to Group Companies.			
Less: Customer which has an outstanding more than 90 days.			
Actual debtors			
Less: Stipulated margin			
D.P on book debts (B)			
Aggregate DP (A+B)			

H. PROJECTION VS ACTUAL ACHIEVEMENT OF THE LAST FINANCIAL YEAR

Prepare a variation statement for both profit & loss account and balance sheet based on last year's projection and actual achievement as per audited financial statements. Also prepare a comparison statement of profit & loss account with the figures of current year's estimation, achievement up to the date of inspection and percentage of achievement.

I. BANK LIMIT UTILIZATION

The Stock Auditor should check the bank statement and prepare the following statement which is self-explanatory.

Month	*Sanctioned Limit*	*Drawing Power*	*Average Utilization*	*Maximum Balance*	*Minimum Balance*	*No of Days Overdrawn*
Apr-21						
May-21						
Jun-21						
Jul-21						
Aug-21						
Sep-21						
Oct-21						
Nov-21						
Dec-21						
Jan-22						
Feb-22						
Mar-22						

Also, the Stock Auditor should mention whether proper approval is there for overdrawing.

J. FUND FLOW STATEMENT

The **Stock** Auditor should prepare a fund flow statement for the last 2 years and the current period and make appropriate comments.

Particulars	₹ in Lakhs		
	2019-20	**2020-21**	**2021-22**
Cash Flow from Operating Activities			
Net profit before tax			
Adjustments for:			
Depreciation and amortization expense			
Finance Costs			
Unrealized foreign exchange gains (Net)			
Bad debts and provision for doubtful debts and advances (Net)			
Interest income			
Dividend income			
Profit on sale of investments (Net)			
Loss on sale/discard of fixed assets (Net)			
Rent income			
Operating profit before working capital changes			
Adjustments for:			
Increase in trade payables and other liabilities			
Decrease/(Increase) in inventories			
Decrease/(Increase) in trade and other receivables			
Cash generated from operations			

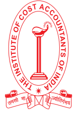
Direct taxes paid (Net)			
Net cash from operating activities			
Cash Flow from Investing Activities			
Purchase of fixed assets/capital work-in-progress and intangibles			
Sale of fixed assets			
Investment in subsidiaries			
Investment in associates			
Investment in a joint venture			
Share application money			
Purchase of other Investments			
Sale of other investments			
Interest received			
Dividend received			
Rent received			
Loans repaid by/ (given to) subsidiaries (Net)			
Net cash used in investing activities			
Cash Flow from Financing Activities			
Proceeds from share capital			
Proceeds from short-term borrowings			
Repayment of short-term borrowings			
Proceeds from long-term borrowings			
Repayment of long-term borrowings			

Interest paid			
Dividend paid			
Net cash from/ (used in) financing activities			
Net increase/(decrease) in cash and cash equivalents			
Cash and cash equivalents as at the beginning of the year			
Cash and cash equivalents as at the end of the year			

K. RATIO ANALYSIS

The Stock Auditor should prepare a ratio analysis for the last 2 years and the current period and make appropriate comments.

Sr.	Particulars	2019-20	2020-21	2021-22
1	Current ratio			
2	Quick / liquid ratio			
3	Inventory turnover ratio			
4	Average collection period			
5	Average payment period			
6	Debt to equity			
7	Long-term debt to equity			
8	Fixed assets to net worth			
9	Fixed assets to capital employed			
10	Capital employed to total liabilities			
11	Fixed assets to total assets			



12	Gross margin			
13	Return on capital employed			
14	Interest coverage ratio			
15	Debt service coverage ratio			
16	The raw material input output ratio			

STATEMENT OF STOCK AND BOOK DEBTS AS ON --------

Name of the Company/Unit: _ _ _ _ _ _ _ _ _ _ _ __ _ _ _ _

PART A:

INVENTORIES:

(₹ in thousands)

	Opening stock			Stocks In			Stocks Out			Closing Stock			
	Quantity	Unit Rate	**Value**	Quantity	Unit Rate	**Value**	Quantity	Unit Rate	**Value**	**Qty in Store**	Qty in Transit	Unit Rate	**Value**
I- Raw Materials 'A' Items* (Specify whether imported or indigenous)													
1.													
2.													
… Others													
II- Stock in Process													
III- Finished Goods: 'A' Items*													
1.													
2.													
… Others													
IV- Stores - 'A' Items*													
1.													
2.													
… Others													
V- Spares - 'A' Items*													
1.													
2.													
… Others													

PART B: **BOOK DEBTS** (₹ in thousands)

1. Ageing analysis of book debts considered good (including bills discounted but excluding deferred receivables).

2. Only where drawings are permitted directly against book debts. (List of major debtors, i.e., covering at least 60 percent of total book debts mentioned above).

Dues from	**Up to 3 months**		**More than 3 months**		**Total book debts**		**Out of the total book debts, bills discounted with the Bank**	
	Number	*Amount*	*Number*	*Amount*	*Number*	*Amount*	*Number*	*Amount*
Government and Semi-Government Organizations								
Associates/Affiliates/ Subsidiaries								
Others								
TOTAL								

Name of the debtor	**Outstanding's up to 3 months**		**Outstanding more than 3 months**	
	Number	**Amount**	**Number**	**Amount**

PART C: **OTHER INFORMATION:**

Particulars	**Projected for the current accounting year**	**Up to the end of the last month**	**During the month under report**
Sales			
Production			
Consumption of raw materials			
Consumption of stores			
Sundry creditors	Year-end:	XXXX	At the end of the month:

NOTES:

1. 'A' item should cover at least 60 percent of the value of stock under each hand. Other items may be clubbed together.

2. The stocks should be exclusive of materials received for job work but inclusive of materials sent out for processing etc. Particulars of the latter should be shown separately indicating the quantity, value, and names of such processors, etc., along with appropriate certificates from such parties, to the effect that they have received such materials from the borrower for processing, etc., hold the goods in trust for the bank and undertake to deliver such stocks to the bank or its authorized agents without demur whenever called upon to do so.

3. Particulars (items, quantity, and value) of stock more than a year old and included hereinabove should be shown separately.

4. Particulars of tailor-made/custom-built products found defective / rejected by the designated buyer should be shown separately.

5. Valuation of stock, etc., should be on the same basis as adopted for the statutory balance sheet and applied consistently. If the market value of any item is less than the value disclosed in this statement, the market value should be indicated by way of a footnote.

6. This statement should be furnished for all the units financed by the bank, unit-wise.

7. Where the stock statement represents only a part of the total stocks of a borrower, a summary of the total stock inclusive of stock shown in this statement should be submitted along with this statement classified into raw materials, stock-in process stores, and spares, finished goods, and book debts, if necessary, e.g., where a single line of activity is financed by the bank and some other banks; where different lines of activity are financed by the bank and some other banks.

CERTIFICATE:

a) I / We hereby certify that:

a) The quantity and quality of the above-noted stocks and other assets pledged/hypothecated to the bank are true and that the said stock and assets are the absolute property of the ……………………………………… company and that the said stocks and assets are not subject to any lien, claim or charges whatsoever.

b) The stock and other assets above noted have been valued in the same manner and on the same basis and principles as adopted for the company's last audited and published accounts for the year ended ………………….

c) The stock lying with outside processors included hereinabove and charged to the bank, the company have valid documents of title thereto, and are the absolute property of the company and are not subject to any liens, claims, or charges whatsoever.

d) In the case of stock and assets shown as being in transit and charged to the bank, the company has a valid document of title thereto and that the company's title to such stocks & assets is not subject to any liens, claims/charges whatsoever.

e) Book debts hypothecated to the Bank shown above are good and do not include any book debts which in our opinion are bad or doubtful of recovery.

f) No order of attachment or any notice or process from any Court or any other statutory authorities has been received by the company in respect of the whole or part of the said stocks and assets charged to the Bank.

g) The above-noted stocks and assets (excepting those which are not subject to fire hazards) are fully insured against fire and .... risks as per the statement of insurance policies attached and that all the conditions and warranties contained in the insurance policies have been complied with and the said policies are valid enforceable.

h) The particulars of stock of assets and all the other information furnished hereinabove have been taken from and agree with the company's books of accounts maintained in the normal course of business and or other books and records maintained by statutory or other requirements.

Summary of stock and book debts position as per the stock statement dated_ _ _ _ _ _

(₹ in thousand)

Valuation is done at the lowest cost, market, or controlled rates	Items	**Value of stocks**	Margin		Advance value	**Sub-limit, if any**	**Drawing power**
			Amount	**%**	**(3-4)**		
1	**2**	**3**	**4**	**5**	**6**	**7**	**8**
	(i) Raw Materials						
	(ii) Stores						
	(iii) Stock-in-Process						
	(iv)Finished Goods						
	(v) Spares						
	(vi) Book-Debts including bills discounted						
	Total of (i) to (vi)						

-oOo-

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Application & Undertaking for Stock Auditors

A. Applicant's Basic Information

<table>
<tr><td>1. Name:</td><td colspan="2"></td><td colspan="3"></td></tr>
<tr><td>2. Constitution:</td><td colspan="5">Proprietorship concern/Partnership firm/Private Limited/Public Limited Company/ Limited Liability Partnership (Copies of memorandum and articles ofassociation/partnership deed, as applicable, to be enclosed)</td></tr>
<tr><td>3. Date of Registration / Incorporation</td><td>__/__/_____</td><td>4. Date of commencement of business</td><td>__/__/____</td><td>5. Email</td><td></td></tr>
<tr><td>6. Principal Person</td><td colspan="2"></td><td colspan="3">Landline/Cell /Fax numbers</td></tr>
<tr><td colspan="3"></td><td colspan="3"></td></tr>
<tr><td>7. Contact Person</td><td colspan="2"></td><td colspan="3">Landline/Cell /Fax numbers</td></tr>
<tr><td colspan="3"></td><td colspan="3"></td></tr>
<tr><td colspan="6">8. Details of Registered Office, Administrative Office, and branches, if any</td></tr>
<tr><td>Location</td><td colspan="2">Addresses</td><td colspan="2">Telephone Number/ Fax Number</td><td>Email</td></tr>
<tr><td></td><td colspan="2"></td><td colspan="2"></td><td></td></tr>
<tr><td colspan="6">9. If there has been a change in the name/constitution/management in the past, please furnish details along with supporting documents.</td></tr>
</table>

10. Brief particulars of activities			
B. Applicant's Financial Information (In Lacs.)			
Particulars	As on 31.03.18	As on 31.03.19	As on 31.03.20
1. Paid up capital			
2. Net worth			
3. Income/revenue			
4. PAT			
5. Borrowings			
6. Debt-equity ratio			
Particulars of Major Shareholders			
Name of the shareholder	Resident or non-resident	Address	Shareholding (%)

Please enclose copies of the past three years audited financial statements/annual reports or copies of provisional financial statement in the absence of audited accounts and income tax returns.

C. Applicant's Knowledge Resources

1. Personal and professional details of promoters/partners/directors:

Sl. No.	Name	Designation	Date of Birth	Qualification(s)	Experience in the field of Stock Audit	Whether Fellow ofthe Institute of Chartered Accountants of India / Institute of Cost Accountants of India If yes, give details.

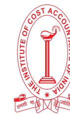
2. Personal and professional details of professional staff (part-time/full-time/associate)

Sl. No.	Name	Designation	Date of Birth	Qualification(s)	Experience in the field of Stock Audit	Whether Fellow ofthe Institute of Chartered Accountants of India/ Institute of Cost Accountantsof India. If yes, give details.

Note: The above information must be supported by:

Detailed bio-data of all the persons mentioned above.

3. Professional Credentials



a) Whether empaneled with other Commercial Banks / NBFCs If yes, give details. Please provide the date of empanelment and the statusof its validity. (Copies of letters empaneling the consultant to be enclosed)	
b) Membership/registration with the Institute of Chartered Accountants of India / Institute of Cost Accountants of India.	

4. List of important assignments handled (In India)

Name & address of the client	Details of services rendered	Month & year in which the assignment wascompleted	Fee earned	Other relevant information

(Relevant documentary evidence such as letters of assignments from clients, reports, etc.)

D

D. Declaration

I/we declare that the particulars furnished above are true to the best of my/our knowledge and belief. I/we, further confirm that all the necessary supporting documents are enclosed with the application.

I/we hereby undertake that the firm/company, if empaneled, shall have arm's length distance with the proposed clients for whom stock verification is done, will not have any business dealings with them or give them undue favor and will not demand additional remuneration than what is initially settled nor will unnecessarily delay the stock verification report.

I/we have not been debarred by RBI/Institute of Chartered Accountants of India / Institute of Cost Accountants of India / any other statutory body.

I/we hereby apply to the bank to empanel firm/company on the bank's panel as independent Chartered Accountant / Cost Accountant for undertaking stock/receivable verification.

I/we understand that any discrepancy/wrong information/breach of undertaking would lead to cancellation of empanelment with immediate effect.

I/we understand that mere fulfilling all the eligibility criteria shall not confer any right for empanelment of the independent Chartered Accountants / Cost Accountant for stock/ receivables verification. Bank's decision in this respect shall be final and binding to applicants.

Further, I/we understand that the empanelment would not amount to any commitment on the part of the bank to provide any professional assignment.

For

Seal of the company/firm
Place Partner/Authorised Signatory
Date. ....

Format of Undertaking to be submitted by the Chartered Accountant / Cost Accountant firm / Stock Auditor for Empanelment

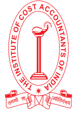
UNDERTAKING

I/we... do hereby solemnly affirm and state that

I/we have not been convicted of any offence and sentenced to a term of imprisonment,

- I/we have not been found guilty of misconduct in a professional capacity
- I/we am/are not undischarged insolvent/s.
- I/we have read, understood and fulfilled all the conditions of criteria for empanelment of independent Chartered Accountant / Cost Accountant for stock / receivables verification.
- I/we have not been de-panelled by any bank/FI from carrying out stock / receivable verification work.
- I/we undertake to keep you informed of any events or happenings which would make me/us ineligible for empanelment as an Independent Chartered Accountant / Cost Accountant for stock / receivables verification,
- I/we have not concealed or suppressed any material information, facts, and records and have made full disclosure.
- I/we are not empaneled with/have not sought empanelment from any Zonal office of the bank.

Dated……………………………
Signature………………………
Name……………………………
Address………………………………………………………………..



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Checklist for Audit of Inventories and Receivables

Bank: **Branch:** **Region:**

Name of the Account:

Address:

I) Office:

II) Factory and Godown:

Constitution:

Name of the Partners / Directors:

Nature of Business:

Latest Sanction: Authority: Date:

Position of Account:

Name of Facility	Sanctioned Limit	Drawing Power ₹	Outstanding As on --/--/----. ₹	Overdue Excess (If any) ₹
Term Loan Specify the Assets a) Land & Buildings b) Plant & Machinery c) Others Cash Credit (Inventories & Book Debts)				

Remarks on the Payment of Interest and Instalments:

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 to the unit?	
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 company, LLP, public company)

d) Nature of Business:

e) Date of establishment and date of commencement of commercial production:

f) Particulars of Credit Limits:

Loan A/c No:	***Facility***	***Sanctioned Limits***	***D.P***	***Balance O/S***	***Overdue / Excess***

g) 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? If so, the position of each of the banks?

Name of the Bank	***Limit Sanc-tioned***	***Value of Security***	***Balance Out-standing As on --/--/----***	***Overdrawn Amount***

<table>
<tr><td>5</td><td>Insurance Particulars:
<table><tr><th>Policy No.</th><th>Assets Covered / Location</th><th>Amount Insured</th><th>Date of Expiry of Policy</th><th>Whether Bank Clause included</th></tr><tr><td></td><td></td><td></td><td></td><td></td></tr><tr><td></td><td></td><td></td><td></td><td></td></tr></table></td><td></td></tr>
<tr><td>6</td><td>Whether additional risks like theft, earthquake and machinery breakdown are included as per sanction terms and complied with by the borrower?</td><td></td></tr>
<tr><td>7</td><td>Whether the address/location of goods is properly stated and includes Door No. / Survey No. Municipal No. etc.?</td><td></td></tr>
<tr><td>8</td><td>Whether goods sent to the processing units or sub-contractors are insured / transit insurance obtained?</td><td></td></tr>
<tr><td>9</td><td>Whether all locations/all industry-specific risks are covered?</td><td></td></tr>
<tr><td>10</td><td>Whether proper documents, including charging of primary and secondary securities, have been obtained?</td><td></td></tr>
<tr><td>11</td><td>What is the date of documentation?</td><td></td></tr>
<tr><td>12</td><td>Whether documents are properly stamped?</td><td></td></tr>
<tr><td>13</td><td>Whether equitable / registered mortgage of property created?</td><td></td></tr>
<tr><td>14</td><td>Whether search report has been got done up to the date of equitable / registered mortgage?</td><td></td></tr>
<tr><td>15</td><td>Wherever required whether the charge has been registered with ROC within the prescribed time?</td><td></td></tr>
<tr><td>16</td><td>Have you verified the periodical stock statements submitted by the borrower regarding any condition stipulated in the sanction?
a) Quantity of Stocks:
b) Place of Storage:
c) Value of Stocks:
d) Composition of stocks-portion of raw material, work-in-process, and finished goods.</td><td></td></tr>
</table>

17	Have you verified if 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 the following: 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 working capital account only.	
20	Have you verified the previous stock audit/branch inspection reports to ascertain whether any steps have been taken to rectify the irregularities pointed out?	
21	Have you obtained a representation letter from the borrower indicating the places/branches where the goods are stored?	
22	Have you obtained the following documents from the borrower: 1) A written representation from the management concerning: a) the completeness of the information provided regarding the Inventories; and b) assurance about adherence to laid down procedures for physical Inventories count. 2) Balance Sheet, Profit & Loss Account for the borrower for the last 3 years. 3) Inventories statement, book debts statement as on the last days of the quarter and for the year and preceding 3 months before the date of inspection. 4) Copy of Memorandum of Association, Articles of Association, Partnership Deed, Trust Deed & its Bye-Laws as may be applicable. 5) Copy of audited financial statements.	
23	Have you inquired about the associations of which the borrower party is a member?	
24	Have you done documentary checking of ownership or lease? Have you taken a copy of the same?	
25	Have you taken the phone members of the CMAs-Statutory Auditor etc.?	

26	Have you made a comparison of the 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:**

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 an adequate internal control system commensurate with the size of the concern?	
8	Whether the borrower is following consistent and accepted accounting principles for the valuation of stocks?	
9	Whether the quality and saleability of the stocks are good?	
10	Whether the following records of the borrower have been checked: a) Excise records. b) Raw materials consumption. c) Production register, purchase, and sales records. d) Purchase and sales invoice. e) Cost records and order books. f) Sales, purchase, sundry creditors, and debtors ledgers.	
12	Are the stock stored properly?	
13	Is there direct access to the godown?	

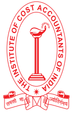
Sr. No.	*Particulars*	*Yes/ No/ Not applicable*
14	What is the value of: a) Obsolete stock. b) Slow-moving stock. c) Damaged/ Rejected stocks. d) Unpaid stock.	
15	Whether Sundry creditors have been deducted as per the policy of the bank and sanctioned terms?	
16	Whether stipulated margin as per sanction terms has been deducted?	
17	Whether stocks received under L/C, co-acceptances and guarantees for the purchase of raw materials been reduced?	
18	Whether the bank hypothecation board has been displayed?	
19	Whether stock belonging to sister concerns received for job- work, etc., properly segregated?	
20	Whether the movement of stock in and out of the godown is properly accounted for and monitored?	
21	What is the work-in-progress and level of completion?	
22	Whether the goods that require any specialized preservation are properly preserved?	
23	Whether rent/ property tax/ municipal tax receipts relating to godown have been verified?	
24	Whether the stock that have expiry dates (such as drugs, and food items) been excluded for the calculation of drawing power.	
25	Whether stock have been examined at laboratories (in the case of chemicals, dyes, etc.,)	
26	Whether goods-in transit included in the stock statements? Is the inclusion of such goods as per sanction terms? Whether the relative bills/ challans/ invoices have been verified?	
27	Whether goods sent to third parties for job work, finishing or machining, etc. have been inspected?	
28	Whether any written confirmation is on record for stock with third parties?	

Sr. No.	*Particulars*	*Yes/ No/ Not applicable*
29	Whether the sanction terms permit storage of goods with clearing agents?	
30	If so, whether the agents are in the approved list of the bank and within the limits fixed by the bank?	
31	Whether clearing agents' charges and other dues have been paid?	
32	Whether irregularity if any pointed out in the last concurrent audit/ inspection report been rectified?	
33	Whether a written declaration has been obtained from the borrower to the effect that the stocks will not be hypothecated to other banks without the prior consent of the bank?	
34	Whether, in case of consortium advances, information is exchanged between the member banks?	
35	Whether the hypothecated plant and machinery are maintained properly and found in working condition?	
36	Were there was any instance of breakdown causing interruptions in the working of the unit in the recent past?	
37	Whether fire protection measures are adequate and satisfactory?	
38	Whether security arrangements at the godown/factory is satisfactory?	
39	Have you checked the GST provision?	
40	Have you checked Income Assessment Orders?	
41	Have you checked the provisions relating to ESIS challans?	

Sr. No.	*Particulars*	*Yes/ No/ Not applicable*
42	Have you checked the provisions relating to PF-challans and assessment orders?	
43	Has the factory license been renewed?	
44	Have you received the details of number of skilled and unskilled employees and office staff? Have you checked the salary register?	
45	Have you considered the inherent control and detection risks, and materiality related to Inventories?	
46	Whether adequate procedures are established and proper instructions issued for physical Inventories counting?	
47	Whether persons involved in stock taking differ from those responsible for store-keeping?	
48	Whether store procedures provide for the use of pre-numbered forms.	
49	Whether a system of cross-checking exists for checking the data generated by different departments?	
50	Whether controls exist for receipts and issues of stores?	

c) **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 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 by the terms of sale? c) 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 person processing the invoices?	
14.	Except when all documents are prepared in one operation, are the dispatch notes/gate passes match with? • Excise duty records? • Sales invoices? • Is freight payable to carriers (where applicable)?	
15.	Are unmatched dispatch notes/gate passes reviewed periodically?	
16.	Are the goods dispatched checked independently with the dispatch notes/gate passes and customer's orders?	

17.	Are acknowledgmentsobtained 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.	Are invoices checked for: ≈ Prices ≈ Calculations (including excise duty and sales tax) ≈ Terms of payment	
23.	Are 'no charge' invoices authorized by a person independent of the one having the custody of goods or cash?	
24.	Are invoices mailed directly 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 the cashier notify immediately: ≈ Sales Department, Debtors Ledger Section, and Credit Controller of all dishonoured cheques or other negotiable instruments. ≈ Of all documents sent through the 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? Are such claims properly dealt with in the accounts?	
30.	Does the Receiving Department record them on the sales Return Notes?	
31.	Does the receiving department count, weigh or measure the goods returned?	

32.	Are copies of sales returns notes sent to: ≈ Customer ≈ Sales Department ≈ 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 the one having: ≈ Custody of goods ≈ Cash receipts ≈ Debtors' ledger	
38.	Are credit notes: ≈ Compared with sales returns notes or other substantiating evidence ≈ Checked for prices ≈ 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 the ageing schedules.?	
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.	Whether a person independent of the ledger-keeper and the person preparing the statement verifies the confirmations?	
49.	Is special approval required for: ≈ Payments of customers' credit balances ≈ Writing off bad debts	
50.	Is there any accounting control for bad debts written off?	
51.	Is any follow-up action taken for recovering amounts written off?	
52.	In the case of export sales: ≈ Is a record maintained of import entitlements due? ≈ Does the record cover the utilization disposal of such entitlements? ≈ 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 the non-realization of overdue debts have been examined?	
59	Whether the Power of Attorney in favour of the bank, wherever prescribed, 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 based on the statements and the required margin is maintained in the account?	

d) **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 owned by the entity, have you verified the ownership documents 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 except the main one 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 with 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 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 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?	

SPECIMEN ENGAGEMENT LETTER

(The following letter is for use as a guide and will need to be modified according to individual requirements and circumstances relevant to the engagement.)

To the Board of Directors (OR) the appropriate representative of senior management

-----Bank has requested that we audit the Inventories and receivables of (Name of the company) as--/--/2022. We are pleased to confirm our acceptance given to the Bank to undertake Stock and Book Debts of your company. Our audit will be conducted with an objective verification of the assets to indicate their physical existence, valuation and safety aspects and the report we have to submit to your bankers as per the terms and conditions of the loan taken from the bank.

We will conduct our audit in accordance with the Auditing Standards generally accepted in India. 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, the 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, may remain undetected.

The responsibility for the preparation of statements/records of Stock and Book Debts of the company is on a going concern basis is that of the management. The management is also responsible for the 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 judgments and estimates that are reasonable and prudent 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 control measures for safeguarding 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 a written confirmation concerning representations made to us in connection with the Audit.

We look forward for full and close co-operation from your staff and we trust that they will make available to us whatever records; documentation and other information which are requisitioned in connection with our Audit.

XYZ & Co.

Cost Accountants

…………………………

(Signature)

SPECIMEN MANAGEMENT REPRESENTATION LETTER

[on client's letterhead]

[Date………]

To

[Name]

Cost Accountants,

We are providing this letter in connection with the Inventories Audit for the period --/--/----to --/--/---- to express 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:

The financial statements conform with Generally Accepted Accounting principles.

There has been no communication from regulatory agencies regarding non-compliance or deviations if any, in financial reporting practices.

There are no material transactions that have not been properly recorded in the accounting records underlying the financial statements.

There has been no:

Fraud involving management or employees who have significant say in internal control.

Fraud involving other than that which would have a material effect on the financial statements.

The company has no plans or intentions that may materially affect the carrying value of assets and liabilities

The following have been properly recorded or disclosed in the financial statements:

Related party transactions including sales, purchases, loans, transfers, and guarantees, and amounts receivable from or payable to related parties

Guarantees whether written or oral under which the company is contingently liable

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

We further state as under:

Accounting Policies:

Method of Accounting: The financial statements are prepared on accrual method of accounting.

Inventories:

The raw material is valued at cost on FIFO.

Finished Goods are valued at a 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 the values of finished goods.

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

The Installed capacity of the company is ……. of pieces.

Actual production for the year ended 31.03.2022 on ------- was……. pieces

The total quantity produced during the month -----was -----pieces.

Total quantity cleared during the month ----------was ---------- pieces and the value for the same was ₹ -----.

Actual production for the year ended 31.03.2022 was ------ pieces.

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

Particulars	For the Year 31.03.2020 Ended	For the 31.03.2021 Year Ended	For the Ended 31.03.2022 Year
Sales (including excise duty but excluding GST?			
b) Purchases			
c) Net Profit			
d) Opening Stock			
e) Closing Stock			

Insurance Policy.

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

1. 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):

2. Office:
a) Address along with Tele/Fax/E-mail:
b) Ownership/Rented:
(Obtain a copy of the 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:

3. Factory:
a) Address along with Tele/Fax/E-mail:
b) Ownership/Rented:
(Obtain a copy of the 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:

4. The total value of book debts less than 90 days as on -------- was ---------- and receipted challans was ---------.

5. The total value of the following items was as under:

a) Raw Material
   i. Average stock as per project report for the year ended 31.03.2022
   ii. Average stock of last 12 months.
   iii. Value of stock on the date of physical verification.
   iv. Comparison of last 12 months' stock as per records & as per statement (reason for discrepancies).

b) Work in progress:

i.
ii.
iii.
iv.

c) Finished Goods:

i.
ii.

iii.

iv.

6. Ratios:

Ratios	**For the Year Ended 31.03.2022**	**For the Year End-ed 31.03.2021**	**For the Year Ended 31.03.2020**
Current Ratio			
Liquidity Ratio			
Gross Profit Ratio			
Stock Turnover Ratio			
Debtors Turnover Ratio.			

For [Borrower's Name]

( )

Director/ Partner/ Proprietor

SPECIMEN LETTER OF CONFIRMATION FROM THIRD PARTY

[On client's letterhead]

To [Date]

[Name & Address of Customer]

Dear Sir,

Our Auditors [name and address] are conducting an audit of our Stock and Book Debts. Please examine the accompanying statement and either confirm its correctness or report differences if any to our Auditors.

Your prompt action on 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:

SPECIMEN LETTER OF CONFIRMATION OF INVENTORIES HELD BY OTHERS

(On the letterhead of the entity)

Date:

(Name & address of the 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 hold 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 a responsible official of entity)

[Similarly, the auditor should obtain confirmation from such third parties for whom the entity is holding a significant amount of stock.]

SPECIMEN LETTER OF CONFIRMATION OF INVENTORIES HELD BY THE ENTITY ON BEHALF OF OTHERS

(On the letterhead of the entity)

Date:

(Name & Address of owner of inventories)

Dear Sir / Madam

For audit purposes, kindly furnish directly to our Auditors (name and address of Auditors) details concerning your inventories held by us for (state here the purpose of holding of inventories by the entity) as on------ (date).

According to our records, we held the following inventories as of that date.

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

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

Yours faithfully

(Signature of a responsible official of entity)

SPECIMEN INVENTORIES /RECEIVABLES AUDIT REPORT

1. Bank: Branch: Zone:

2. Name of the account:

3. Office Address:

   Ownership / Rented:

4. Factory & Godown:

   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 (₹)*	*Drawing Power (₹)*	*Outstanding As On (₹)*	*Overdue Excess, If any. (₹)*
Term Loan Specify the assets: a) Land & Building b) Plant & Machinery c) Others Cash credit (inventories & book debts)				

Remarks on the payment of interest and instalments:

12. Latest Sanction: Authority: Date

13. Particulars of the godown and 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 / assignment (less than 90 days.)	

Total Less: Creditors	
Working capital gap Less: Margin 25%	
Drawing Power Outstanding (As on--/--/----) Excess overdrawing power, if any	

b) Age and quantity of inventories more than six months old / Value 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 the statement:

g) Whether sales bills are accompanied by a copy of lorry receipt/receipt challans:

h) Whether bills discounted are included in the 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 maintained properly and kept up-to-date?

l) Whether the outstanding book debts have arisen out of the normal business transactions, which the bank has financed:

m) Normal time limit taken for the realization of book debts vis-a-vis past trends 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 other than business needs?

o) Whether production/sales achievements are found in line with production. If not, offer comments

Year Ended	*Projected Sales (₹)*	*Actual Sales Achieved (₹)*
2022		

2021		
2020		

15. Insurance Cover:

16. Whether other conditions satisfied:

    a. Whether bank's name board displayed / painted / affixed / engraved:

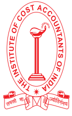
    b. Whether godown-keeper / godown chowkidar is appointed?

    c. Whether the branch receives Inventories statements certified by the borrower?

17. Books and records:

    a) Whether the following records have been verified and found to be in order:
        i. Sales register.
        ii. Purchase register.
        iii. Sales bill.
        iv. Purchase bills.
        v. Inventories register.
        vi. Debtors register.
        vii. Cash book.

    b) Whether proper records are available in respect of 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 the inventories statement submitted to the bank are found in agreement with the inventories register or excise records?

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

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

f) Sales during the last twelve months ending on :

g) GST paid up to:

h) GST assessment completed up to:

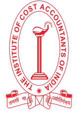
i) Excise duty returns filed up to:

j) Excise duty assessment completed up to:

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) Shops & establishments/factory license renewed up to:

i. No of fire extinguishers:
ii. Date of expiry :
iii. No of sand buckets :

r) Watch and ward arrangement:

s) GST returns filed 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 like, make 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 (₹)*

20. No of employees:

Skilled :

Unskilled :

Office staff:

21. Information about shifts:

No of shifts:

Working hours:

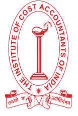
22. Comments on working and capacity utilization:

23. Are the machines working at full capacity?

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

24. Value of fixed assets:

(As per the latest balance sheet as on--/--/----)



25. Value of current assets:

    (As per the latest balance sheet as on --/--/----)

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

27. Other remarks/ observations

28. Computation of Ratios

    Current Ratio:

    Stock Turnover Ratio:

    Creditors Ratio:

    Quick Ratio:

    Debt Equity Ratio:

    Debtor's Turnover Ratio:

    Working Capital Cycle Period (No. of Days)

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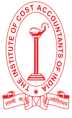


18 Common Irregularities in Stock and Book Debts Audit

Objective of this Chapter

An Auditor should compare the movement of stock/book debts from month to month with the turnover in the account and the purchase and sale declared by the borrower in the stock statements. The stock and book debts declared in the statement for March of the previous year is to be compared with similar figures given in the audited or unaudited financial statements of the concern. Many banks insist that the book debts statement should be certified by a cost accountant every year. For non-submission of these statements, penalty is levied. It is also necessary to verify whether the stock includes unpaid stock (represented by sundry creditors), stock under L/C, stock under packing credit, etc. All these stocks being "unpaid stock" have to be deducted from the total stock considered for DP limit.

Sometimes, for convenience or statutory requirements, the borrower is permitted by the bank to open a current account near the factory premises to pay certain legal dues or salary or such expenses of the factory. In all such cases, an Auditor should insist on verifying the statement of such accounts to ensure that only permissible transactions are routed through these accounts since the possibility of use of such accounts to divert funds from the business cannot be ruled out.

The following common irregularities found during Stock and Book Debts Audit would be useful to the Auditors as guidance.

Working capital finance in the form of cash credit against the security of hypothecation of stock and debtors is one of the most common modes of finance frequently adopted by various bankers. The borrowers in such cases are expected to submit the details of stock and debtors every month based on which drawing power after reducing the prescribed margin is calculated by the banks. Stock and debtors being the primary security, bankers for ascertaining the genuineness and correctness of such statements appoint Chartered Accountant firms periodically to conduct Stock Audits specifically where the exposure exceeds the pre-determined threshold limit (generally over ₹ 300 Lacs). [it differs from bank to bank.]

Common irregularities that may be observed by the CMA firms during a stock audit can be summarized as follows:

Observations about Statement Submission and Scrutiny

✔ Stock book debts statements not submitted / not submitted in time.

✔ Inadequate details viz. rate, quantity, and amount of different types of stock items not stated in the statement.

✔ Scrutiny of stock statements not done.

✔ DP Register not written up to date.

✔ Age-wise analysis of debtors not given/done. Debtors over 90 days (or as per sanction) are considered for drawing power.

✔ Drawing power not correctly calculated.

✔ Latest visit report by branch official not on record.

Observations about Verification of Stock and Creditors

✔ Stock book not maintained/not updated.

✔ Obsolete stock not excluded from stock figures submitted to the bank.

✔ Deteriorating stock turnover ratio.

✔ Stock figures submitted at the year-end and as per financial statement not matching.

✔ Stock debtors as per statements submitted and as per books not matching.

✔ Confirmation for inventory with a third party not obtained or physical verification of inventory not done.

✔ Material received from third parties for job work not excluded while calculating drawing power.

Observations about Account Operations

✔ Operations in the accounts not scrutinized concerning projections, QIS statements, audited accounts, etc.

✔ Defects pointed out by the Internal Auditors / Inspectors / Concurrent Auditors are not complied with.

✔ No/belated review/renewal of A/c.

✔ All sales as per financial statements are not routed through the account.

✔ Account not operated actively.

✔ Cash withdrawal during the current period is abnormal.

✔ Frequent overdrawing in the account.

- ✔ Balance over drawing power although within Sanctioned Limit.

Observations about Verification of Sundry Debtors

- ✔ Existence of long pending debtors.
- ✔ Long pending debtors showed as below 90 days debts to the bank.
- ✔ Increase in the average collection period of debtors.
- ✔ Dispute with debtors and pending court cases.
- ✔ Amount receivable from sister concern considered for calculation of drawing power.
- ✔ Advances received from debtors not reported resulting in lower DP than calculated by the bank.

Observations about Insurance Coverage

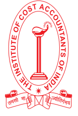
- ✔ Under insurance of stock.
- ✔ Insurance expired and not renewed.
- ✔ Premium for renewal policy paid but policy, not on record.
- ✔ Insurance policy without bank clause.
- ✔ No coverage of all risks as per sanction.
- ✔ Wrong items/description of goods on insurance policy.
- ✔ Location of goods wrongly stated.
- ✔ All locations of stock not covered.

General Observations

- ✔ Diversion of funds and inter-account transfers are not properly monitored.
- ✔ Borrower having operations with another bank for which permission of lender not obtained.
- ✔ Bank name plate not displayed.
- ✔ The above list is illustrative only and not exhaustive. In actual practice, there may be other observations/irregularities.

Findings of Stock Audit and its uses

Stock audit by external CMA firms is one of the important tools of credit monitoring for the bank. Apart from ensuring the safety of realizable security, it also helps the bank to discipline the borrower or may act as a warning signal against probable future NPA. It may aid the bank to take timely remedial measures to avoid substantial future losses. It also highlights the weaknesses, if any in the existing monitoring system of the branch through comments about maintenance of the DP register, scrutiny of



statements, review of accounts, and compliance with audit findings.

Over and above, the Stock Audit also has utility for the borrower. Comments about insurance inadequacies, wrong product descriptions, and locations stated in the policies, if rectified timely may save the borrower from avoidable future losses.

Therefore, Stock Audit is a knowledge value addition exercise for both bankers as well as the borrowers.

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Case Study

Instances of fraud perpetrated by five companies in this sector have been analysed. The companies were in the business of manufacturing textile, ferrous metals, pharmaceuticals products and various ranges of steel products. The companies had started availing credit facilities in the form of working capital (fund based & non-fund based) from the banks under a consortium arrangement.

Modus operandi

- ✔ One of the companies had exported the goods against the shipping bills and had discounted export bills on different dates. Since the bills were long outstanding, the lead bank requested the Commissioner of Customs Duty to verify the genuineness of these bills.
- ✔ As per Commissioner's report, out of all shipping bills, only a small number were genuine, a few shipping bills pertained to ICD, Ludhiana, and the rest of the shipping bills were not genuine, and were forged.
- ✔ The other company made purchases to the tune of ₹ 6,740 crores. Out of this, ₹ 1,679.45 crore was for the purchase of fancy shirting.
- ✔ Review of purchase invoices and stock records of this item indicated that the purchase invoice did not define any code, grade, make, etc. It was unable to confirm the physical movement of fancy shirting material.
- ✔ Mismatches were found in products mentioned in LC invoice documents and products mentioned as per books of the company.
- ✔ In the case of another company, the turnover was inflated. There was no actual purchase or movement of stocks as depicted by the borrower company in its books of accounts and financial statements.
- ✔ There had been misappropriation of funds by the management of the company. They explored all possible avenues to divert the funds. There was a mismatch of accounting data vis-à-vis the banking statements and the non-reporting of the same in the audited financials by the auditors of the company.
- ✔ Payments made to the beneficiaries of LCs was diverted to the accounts of the debtors of the company from where it was finally routed either to the account of the borrower company or to its subsidiaries.

- ✔ Another company had been importing pharmaceutical products and chemicals from overseas suppliers based in Singapore and was exporting its products to Hong Kong and Singapore having a branch office in Dubai. The exporting company is owned by the same proprietor as the supplier company.
- ✔ The company was dealing in computers, computer peripherals, and other commodities. There were consignment transactions of computers and computer peripherals, whereby the company was sending computers and computer peripherals to its branch office in Dubai by way of Branch transfers.
- ✔ The export and import documents submitted to the bank by the company in respect of the merchanting trade transactions purported to be relating to pharmaceutical and allied products appeared to have been falsified.
- ✔ The other company finalized its balance sheet for the year 2020-21 and got it audited on 30.04.2021 showing a profit of Rs.23.74 crores. Based on the balance sheet, the company got credit facilities from consortium banks. Subsequently, the company revised its audited B/S for 2020-21 on 05.09.2021 without informing any of the member banks. The profit in the revised balance sheet was reduced to ₹ 0.34 crore.
- ✔ The company was maintaining current accounts with the banks, which were not part of the consortium. The credit turnover in these accounts was ₹ 176.96 crore. The company had incurred a loss of ₹ 241.83 crore during 2021-22 as against a profit of ₹ 0.34 crore during 2020-21 against the same volume of turnover of ₹ 2,178 crore in both years.
- ✔ The company routed sales proceeds through an account with non-consortium banks without prior permission of the consortium. The company had not submitted book debt statements certified by CA.
- ✔ The companies had defrauded the banking system by unscrupulous activities such as manipulation of books of accounts, removal, depletion and disposing of hypothecated stocks without the bank's knowledge.

Loopholes/Lapses

- ✷ The company had submitted forged bills of entries/postal documents to banks and huge amounts of foreign exchange were remitted to various overseas accounts.
- ✷ The status of the bill of entry in the ICEGATE system under the option "Bill of entry at ICES" was not checked and the "Out of Charge" (OOC) date in the concerned column of OCC was not verified with the print out of exchange control copy of the Bill of Entry submitted by the importer as proof of import.
- ✷ The company had generated an entire set of documents for exporting the goods but cancelled later on. Directorate of Revenue Intelligence had submitted details of 13 shipping bills.

- It was also found that 35 shipping bills were issued by CFS (Container Freight Station) and the rest of the shipping bills were not genuine but were forged.

- Apart from bank accounts with consortium members, transactions were carried out in other bank accounts of the company. The nature and purpose of these transactions could not be ascertained.

- Incorrect and non-existing debtors were included in the debtors' statement of the company. The company resorted to circular transactions to report higher sales/purchases figures and mismatch was noticed in the stocks/debtors as per the books of the company and as per the stock statement submitted by the company.

- In circular transactions, the parties were related to each other either by way of common directorship in other companies in an individual capacity or through family members.

- Majority of the transactions reflected in their respective bank statements were in nature the same day fund transfers to connected parties. Majority of LC payments used for circular rotation of money had been made against the purchase of fancy shirting which was the trading product of the company.

- Most of the debtors were not available. The debt confirmation letters were sent by the consortium leader by Regd. Posts were returned undelivered in most of the cases. Confirmations were received only from 22 debtors, but they denied the dues reported by the borrower company to the consortium lenders.

- A perusal of the statement of bank accounts of beneficiaries of the LCs revealed that the payments received were re-routed through various accounts and channelized back either to the account of the borrower company or one of its subsidiary/associates' concerns.

- Out of the 12 transport operators, two were fictitious and enquiries in the vicinity revealed that no such transport operators ever existed at these addresses. Two available transport companies informed us that the lorry receipts attached with the invoices were fake and were not issued by them.
- To find out the authenticity of the data of the debtors, the audit company selected 10 top buyers of the borrower company and found that all the 10 parties were not traceable at the given addresses.
- The company/ firms to whom payments were made by banks were dealing with products not related to the business of the borrower company.

- The company had made sale/purchase transactions of the same products with the same companies/ related companies. There was no evidence of any processing value addition to the products.

- The company had sold goods to a firm on a merchant export basis which was dealing in information and technology, telecommunications, office automation, and electrical appliances. The com-

pany had made purchases from a firm that was engaged in the manufacturing and distribution of computer components, consumer electronics, and digital electronics.

- Three associates/subsidiaries were shown on the balance sheet of the company. However, these companies virtually existed on paper without any functional or business activities.
- The bills of lading were wrongly generated by non-existent forwarders. Their Dubai office responded that they could not trace the details of bills of lading. Four companies were involved in fake merchant trade transactions with the company.
- A complaint lodged by the bank with CBI has revealed that the Directors of the company in collusion with each other fabricated the records and faked non-existent transactions as genuine transactions and indulged in the fabrication of purchases and sales of the same products from firms that were dealing in IT, telecommunication, electric and electronic products.
- Stock Audit was conducted on 20.05.2022 and 21.05.2022. It was observed that drawing power comes to ₹ 20.64 crores against the total sanctioned limit of ₹ 465.00 crores whereas the company submitted a stock statement showing drawing power (D.P.) of ₹ 467.59 crores in Feb 2022. The company did not submit a stock statement after Feb2022.
- The company had reduced the holding of sundry debtors at the end of March 2022 in the age group of 90 days from ₹ 525.76 crores to ₹ 216.04 crores. It could not produce documentary evidence for such reduction.
- From the stock statement, it was observed that holding had substantially increased from ₹ 58.74 crores as on 31.03.2021 to ₹ 1,216.17 crores as on 31.03.2022 which represented an increase of 114.78% in comparison to the previous year.
- No records were maintained for stores and consumables which amounted to ₹ 47 crores during 2021-22 indicating a lack of internal control system. Due to a lack of detailed information the auditors had not commented in respect of the end use of funds.
- The company had not complied with the bank's instruction to submit a book debt statement certified by CA along with GST returns for the financial year 2020-21 and 2021-22 which implied that the book debt statement submitted to bank were inflated.

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Working Capital Loans–Export Credit

Objective of this Chapter

An Auditor should compare the movement of stock/book debts from month to month with th
Objective of this Chapter
In the cases of commodity exports, the exporters have to procure raw material, manufacture the export product and keep the same ready for shipment, in anticipation of export orders from overseas buyers.

This is in view of the seasonal availability of raw materials or when the time taken for manufacture and shipment of goods is more than the delivery schedule as per export contracts. Having regard to the difficulties of the exporters in availing of adequate pre-shipment credit in such cases, RBI has authorized the banks to extend packing credit running account for commodity exports.

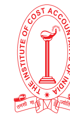
Running account facility is available only to those exporters whose track record has been good. The facility is also for Export Oriented Units (EOUs) or Units in Free Trade Zones or Export Processing Zones (EPZs) and Special Economic Zones (SEZs).

Under Pre-shipment Credit 'Running Account' facility, the bank opens a separate cash credit account for exporters and allows them to withdraw the money to procure raw materials, and manufacture the export products without insisting on prior lodgement of letters of credit / firm export orders. Nevertheless, it is obligatory on the part of the exporter to produce letters of credit/firm orders within a reasonable period to be decided by the banks for such facility.

'Stock and Book Debts Audit' is not only the units financed by the banks in the domestic market (manufactured goods) but also to Audit the stocks financed by banks to the exporters under packing credit advance. The following information gives an idea of pre-shipment/packing credit i.e., working capital / cash credit loans provided by the banks to the exporters.

Pre-shipment / Packing Credit Rupee Export Credit

'Pre-shipment / packing credit' means any loan or advance granted or any other credit provided by a bank to an exporter for financing the purchase, processing, manufacturing, or packing of goods before shipment / working capital expenses towards rendering of services based on the letter of credit opened in his favour or in favour of some other person, by an overseas buyer or a confirmed and irrevocable



order for the export of goods/services from India or any other evidence of an order for export from India having been placed on the exporter or some other person unless lodgement of export orders or letter of credit with the bank has been waived.

Period of Advance

i. The period for which a packing credit advance may be given by a bank will depend upon the circumstances of the individual case, such as the time required for procuring, manufacturing, or processing (where necessary) and shipping the relative goods/rendering of services. It is primarily for the banks to decide the period for which a packing credit advance may be given, having regard to the various relevant factors so that the period is sufficient to enable the exporter to ship the goods / render the services.

ii. If pre-shipment advances are not adjusted by submission of export documents within 360 days from the date of advance, the advances will cease to qualify for the prescribed rate of interest for export credit to the exporter ab initio.

Disbursement of Packing Credit

a. Ordinarily, each sanctioned packing credit should be maintained as a separate account to monitor the period of sanction and end-use of funds.

b. Banks may release the packing credit in one lump sum or in stages as per the requirement for executing the orders / LC.

c. Banks may also maintain different accounts at various stages of processing, manufacturing, etc. depending on the types of goods/services to be exported e.g., hypothecation, pledge, etc., accounts and may ensure that the outstanding balance in accounts is adjusted by transfer from one account to the other and finally by proceeds of relative export documents on purchase, discount, etc.

d. Banks should continue to keep a close watch on the end-use of the funds and ensure that credit at lower rates of interest is used for genuine requirements of exports. Banks should also monitor the progress made by the exporters in the timely fulfilment of export orders.

Liquidation of Packing Credit

The packing credit / pre-shipment credit granted to an exporter may be liquidated out of proceeds of bills drawn for the exported commodities on its purchase, discount, etc., thereby converting pre-shipment credit into post-shipment credit. Further, subject to mutual agreement between the exporter and the banker it can also be repaid/prepaid out of balances in Exchange Earners Foreign Currency A/c (EEFC A/c) as also from rupee resources of the exporter to the extent exports have taken place.

Packing credit over export value

a) Where by-products can be exported: Where the exporter is unable to tender export bills of equivalent value for liquidating the packing credit due to the shortfall on account of wastage involved in the processing of agro products like raw cashew nuts, etc., banks may allow exporters, inter alia,

to extinguish the excess packing credit by export bills drawn in respect of by-product like cashew shell oil, etc.

b) ***Where the partial domestic sale is involved:*** However, in respect of the export of agro-based products like tobacco, pepper, cardamom, cashew nuts, etc., the exporter has necessarily to purchase a somewhat larger quantity of the raw agricultural produce and grade it into exportable and non-exportable varieties and only the former is exported. The non-exportable balance is necessarily sold domestically. For the packing credit covering such a non-exportable portion, banks are required to charge the rate of interest applicable to the domestic advance from the date of advance of packing credit.

c) ***Export of de-oiled /defatted cakes:*** Banks are permitted to grant packing credit advances to exporters of HPS groundnut and de-oiled/defatted cakes to the extent of the value of raw materials required even though the value thereof exceeds the value of the export order. The advance over the export order is required to be adjusted either in cash or by the sale of residual by-product oil within a period not exceeding 30 days from the date of advance.

Banks have, however, operational flexibility to extend the following relaxations to their exporter clients who have a good track record:

i. Repayment/liquidation of packing credit with proceeds of export documents will continue; however, this could be with export documents relating to any other order covering the same or any other commodity exported by the exporter. While allowing substitution of contract in this way, banks should ensure that it is commercially necessary and unavoidable. Banks should also satisfy themselves with the valid reasons as to why packing credit extended for shipment of a particular commodity cannot be liquidated in the normal method. As far as possible, the substitution of contract should be allowed if the exporter maintains an account with the same bank or if it has the approval of the members of the consortium if any.

ii. The existing packing credit may also be marked-off with proceeds of export documents against which no packing credit has been drawn by the exporter. However, the exporter might avail of EPC with one bank and submit the documents to another bank. Given this possibility, banks may extend such a facility after ensuring that the exporter has not availed of packing credit from another bank against the documents submitted. If any packing credit has been availed of from another bank, the bank to which the documents are submitted has to ensure that the proceeds are used to liquidate the packing credit obtained from the first bank.

iii. These relaxations should not be extended to transactions of sister/associate/group concerns.

'Running Account' Facility

i. Pre-shipment credit to exporters is normally provided on lodgement of LCs or firm export orders. It is observed that the availability of raw materials is seasonal in some cases. In some other cases, the time taken for manufacture and shipment of goods is more than the delivery schedule as per export contracts. In many cases, the exporters have to procure raw material, manufacture the export product and keep the same ready for shipment, in anticipation of receipt of letters of credit /

firm export orders from the overseas buyers. Having regard to the difficulties being faced by the exporters in availing of adequate pre-shipment credit in such cases, banks have been authorized to extend Pre-shipment Credit 'Running Account' facility in respect of any commodity, without insisting on prior lodgement of letters of credit / firm export orders, depending on the bank's judgment regarding the need to extend such a facility and subject to the following conditions:

Banks may extend the 'running account' facility only to those exporters whose track record has been good as also to export oriented units (EOUs)/ Units in Free Trade Zones / Export Processing Zones (EPZs) and Special Economic Zones (SEZs).

In all cases where Pre-shipment Credit 'Running Account' facility has been extended, letters of credit/firm orders should be produced within a reasonable period to be decided by the banks.

Banks should mark off individual export bills, as and when they are received for negotiation/ collection, against the earliest outstanding pre-shipment credit on a 'first in first out' (FIFO) basis. Needless to add, while marking off the pre-shipment credit in the manner indicated above, banks should ensure that export credit available in respect of individual pre-shipment credit does not go beyond the period of sanction or 360 days from the date of advance, whichever is earlier.

Packing credit can also be marked-off with proceeds of export documents against which no packing credit has been drawn by the exporter.

ii. If it is noticed that the exporter is found to be abusing the facility, the facility should be withdrawn forthwith.

iii. In cases where exporters have not complied with the terms and conditions, the advance will not be treated as export credit ab initio.

iv. Running account facility should not be granted to sub-suppliers.

Export Credit against proceeds of Cheques, Drafts, etc. representing Advance Payment for Exports

a. Where exporters receive direct remittances from abroad using cheques, drafts, etc. in payment for exports, banks may grant export credit to exporters of good track record till the realization of proceeds of the cheque, draft, etc. received from abroad, after satisfying themselves that it is against an export order, is as per trade practices in respect of the goods in question and is an approved method of realization of export proceeds as per extant rules.

b. If pending compliance with the above conditions, an exporter has been granted accommodation at the normal commercial interest rate, banks may give effect to the prescribed rate for export credit rate retrospectively once the aforesaid conditions have been complied with and refund the difference to the exporter.

Rupee Pre-shipment Credit to Specific Sectors/Segments

Rupee export packing credit to manufacturer suppliers for exports are routed through STC/MMTC/ Other Export Houses, Agencies, etc.

Banks may grant export packing credit to manufacturer suppliers who do not have export orders/letters of credit in their name and goods are exported through the State Trading Corporation/Minerals and Metal Trading Corporation or other export houses, agencies, etc.

Rupee Export Packing Credit to Sub-Suppliers

Packing credit can be shared between an export order holder (EOH) and sub-supplier of raw materials, components, etc. of the exported goods as in the case of EOH and manufacturer suppliers, subject to the following:

1. Running an account facility is not contemplated under the scheme. The scheme will cover the LC or export order received in favor of Export Houses/Trading Houses/Star Trading Houses etc. or manufacturer exporters only. The scheme should be made available to exporters with a good track record.
2. Bankers to an EOH will open an inland LC specifying the goods to be supplied by the sub-supplier to the EOH against the export order or LC received by him as a part of the export transaction. Based on such an LC, the sub-supplier's banker will grant EPC as working capital to enable the sub-supplier to manufacture the components required for the goods to be exported. On supplying the goods, the LC opening bank will pay the sub-supplier's banker against the inland documents received based on inland LC. Such payments will thereafter become the EPC of the EOH.
3. It is up to the EOH to open any number of LCs for the various components required with the approval of his banker/leader of a consortium of banks within the overall value limit of the order or LC received by him. Taking into account the operational convenience, it is for the LC opening bank to fix the minimum amount for opening such LCs. The total period of packing credit availed by the sub-supplier (s), individually or severally, and the EOH should be within the normal cycle of production required for the exported goods. Normally, the total period will be computed from the date of the first drawl of packing credit by any one of the sub-suppliers to the date of submission of export documents by EOH.
4. The EOH will be responsible for exporting the goods as per export order or overseas LC and any delay in the process will subject him to the penal provisions issued from time to time. Once the sub-supplier makes available the goods as per inland LC terms to the EOH, his obligation of performance under the scheme will be treated as complied with and the penal provisions will not apply to him for delay by EOH, if any.
5. The scheme is an additional window beside the existing system of sharing packing credit between EOH and the manufacturer in respect of exported goods. The scheme will cover only the first stage of the production cycle. For example, a manufacturer exporter will be allowed to open domestic LC in favour of his immediate suppliers of components, etc. that are required for the manufacture of exportable goods. The scheme will not be extended to cover suppliers of raw materials/components etc. to such immediate suppliers. In case the EOH is merely a trading house, the facility will be available commencing from the manufacturer to whom the order has been passed on by the Trading House.
6. EOUs/EPZ/SEZ units supplying goods to another EOU/EPZ/SEZ unit for export purposes are

also eligible for rupee pre-shipment export credit under this scheme. However, the supplier EOU/EPZ/SEZ unit will not be eligible for any post-shipment facility as the scheme does not cover the sale of goods on credit terms.

7. The scheme does not envisage any change in the total quantum of advance or period. Accordingly, the credit extended under the system will be treated as export credit from the date of advance to the sub-supplier to the date of liquidation by EOH under the inland export LC system and up to the date of liquidation of packing credit by shipment of goods by EOH. It has to be ensured that no double financing of the same leg of the transaction is involved.
8. Banks may approach the ECGC for availing suitable cover in respect of such advances.
9. The scheme does not envisage extending credit by a sub-supplier to the EOH/manufacturer and thus, the payment to sub-suppliers has to be made against the submission of documents by LC opening bank treating the payment as EPC of the EOH.

Rupee Pre-shipment Credit to Construction Contractors

- Packing credit advances to the construction contractors to meet their initial working capital requirements for execution of contracts abroad may be made based on a firm contract secured from abroad, in a separate account, on an undertaking obtained from them that the finance is required by them for incurring preliminary expenses in connection with the execution of the contract e.g., for transporting the necessary technical staff and purchase of consumable articles to execute the contract abroad, etc.
- The advances should be adjusted within 365 days from the date of advance by negotiation of bills relating to the contract or by remittances received from abroad in respect of the contract executed abroad. To the extent the outstanding in the account are not adjusted in the stipulated manner, banks may charge a normal rate of interest applicable for working capital finance.
- The exporters undertaking project export contracts including export of services may comply with the guidelines/instructions issued by the Reserve Bank of India, Foreign Exchange Department, Central Office, Mumbai from time to time.

Export of Services

Pre-shipment and post-shipment finance may be provided to exporters of all the 161 tradable services covered under the General Agreement on Trade in Services (GATS) where payment for such services is received in free foreign exchange. The financing bank should ensure that there is no double financing and the export credit is liquidated with remittances from abroad. Banks may take into account the track record of the exporter/overseas counter party while sanctioning the export credit. The statement of export receivables from such service providers may be tallied with the statement of payables received from the overseas party.

Given a large number of categories of service exports with varied nature of business as well as in the environment of progressive deregulation where the matters about micro-management are left to be de-

cided by the individual financing banks, the banks may formulate their parameters to finance the service exporters.

Exporters of services qualify for working capital export credit (pre-shipment and post-shipment) for consumables, wages, supplies, etc.

- ✔ Banks may the following: The proposal is a genuine case for the export of services.
- ✔ The item of service export is covered under Appendix 10 of HBPv1.
- ✔ The exporter is registered with the Electronic and software EPC or Services EPC or with the Federation of Indian Export Organisations, as applicable.
- ✔ There is an export contract for the export of the service.
- ✔ There is a time lag between the outlay of working capital expense and the actual receipt of payment from the service consumer or his principal abroad.
- ✔ There is a valid working capital gap i.e., service is provided first while the payment is received sometime after an invoice is raised.
- ✔ Banks should ensure that there is no double financing/excess financing.
- ✔ The export credit granted does not exceed the foreign exchange earned less the margins if any required, advance payment/credit received.
- ✔ Invoices are raised.
- ✔ Inward remittance is received in foreign exchange.
- ✔ The company will raise the invoice as per the contract. Where payment is received from the overseas party, the service exporter would utilize the funds to repay the export credit availed of from the bank.

Pre-shipment Credit to Floriculture, Grapes, and Other Agro-based Products

a) In the case of floriculture, pre-shipment credit is allowed to be extended by banks for the purchase of cut flowers, etc., and all post-harvest expenses are incurred for making shipment.

b) However, to promote the export of floriculture, grapes, and other agro-based products, banks are allowed to extend credit for working capital purposes in respect of export-related activities of all agro-based products including the purchase of fertilizers, pesticides, and other inputs for the growing of flowers, grapes, etc., provided banks are in a position to identify such activities as export-related and satisfy themselves of the export potential thereof, and that the activities are not covered by direct/indirect finance schemes of NABARD or any other agency, subject to the normal terms and conditions relating to packing credit such as period, quantum, liquidation, etc.

c) Export credit should not be extended for investments, such as import of foreign technology, equipment, land development, etc., or any other item which cannot be regarded as working capital.

Export Credit to Processors/Exporters-Agri-Export Zones

i. The Government of India has set up Agri-Export Zones in the country to promote Agri Exports. Agri- Export Oriented Units (processing) are set up in Agri- Export Zones as well as outside the zones and to promote such units, production and processing are to be integrated. The producer has to enter into contract farming with farmers and has to ensure the supply of quality seeds, pesticides, micro-nutrients, and other materials to the group of farmers from whom the exporter would be purchasing the products as raw material for the production of the final products for export. The Government, therefore, suggested that such export processing units may be provided packing credit under the extant guidelines to procure and supply inputs to the farmers so that quality inputs are available to them which in turn will ensure that only good quality crops are raised. The exporters will be able to purchase/import such inputs in bulk, which will have the advantage of economies of scale.

ii. Banks may treat the inputs supplied to farmers by exporters as raw material for export and consider sanctioning the lines of credit/export credit to processors/exporters to cover the cost of such inputs required by farmers to cultivate such crops to promote the export of agri products. The processor units would be able to effect bulk purchases of the inputs and supply the same to the farmers as per a pre-determined arrangement.

iii. Banks have to ensure that the exporters have made the required arrangements with the farmers and overseas buyers in respect of crops to be purchased and products to be exported respectively. The financing banks will also appraise the projects in Agri Export Zones and ensure that the tie-up arrangements are feasible and projects would take off within a reasonable period.

iv. They are also to monitor the end-use of funds, viz. distribution of the inputs by the exporters to the farmers for raising the crops as per arrangements made by the exporter/main processor units.

v. They have to further ensure that the final products are exported by the processors/exporters as per the terms and conditions of the sanction to liquidate the pre-shipment credit as per extant instructions.

Pre-shipment Credit in Foreign Currency (PCFC)

To make credit available to exporters at internationally competitive rates, authorized dealers of Bank Branches have been permitted to extend pre-shipment credit in foreign currency (PCFC) to exporters for domestic and imported inputs of exported goods at LIBOR/EURO/EURIBOR related rates of interest as detailed below:

a) The scheme is an additional window for providing pre-shipment credit to Indian exporters at internationally competitive rates of interest. It will apply to only cash exports. The instructions about Rupee export credit apply to export credit in foreign currency also mutatis mutandis, unless otherwise specified.

b) The exporter will have the following options to avail of export finance to avail of pre-shipment credit in rupees and then the post-shipment credit either in rupees or discounting/ rediscounting of export bills under the EBR Scheme to avail of pre-shipment credit in foreign currency and

discount/rediscounting of the export bills in foreign currency under the EBR Scheme. to avail of pre-shipment credit in rupees and then convert drawals into PCFC at the discretion of the bank.

c) ***Choice of currency:*** The facility may be extended in one of the convertible currencies viz. US Dollars, Pound Sterling, Japanese Yen, Euro, etc.

To enable the exporters to have operational flexibility, it will be for banks to extend PCFC in one convertible currency in respect of an export order invoiced in another convertible currency. For example, an exporter can avail of PCFC in US Dollars against an export order invoiced in Euro. The risk and cost of cross-currency transactions will be that of the exporter. Banks are permitted to extend PCFC for exports to ACU countries.

The applicable benefit to the exporters will accrue only after the realization of the export bills or when the resultant export bills are rediscounted on a 'without recourse' basis.

Source of Funds for Banks

a) The foreign currency balances available with the bank in Exchange Earners Foreign Currency (EEFC) Accounts, Resident Foreign Currency Accounts RFC(D), and Foreign Currency (Non-Resident) Accounts (Banks) Scheme could be utilized for financing the pre-shipment credit in foreign currency.

b) Banks are also permitted to utilize the foreign currency balances available under Escrow Accounts and Exporters Foreign Currency Accounts for the purpose, subject to ensuring that the requirements of funds by the account holders for permissible transactions are met and the limit prescribed for maintaining maximum balance in the account under the broad-based facility is not exceeded.

c) Foreign currency borrowings: In addition, banks may arrange for borrowings from abroad. Banks may negotiate lines of credit with overseas banks for grants of PCFC to exporters without the prior approval of the RBI.

Banks may avail of lines of credit from other banks in India if they are not in a position to raise loans from abroad on their own, provided the bank does not have a branch abroad. The spread between the borrowing and lending banks is left to the discretion of the banks concerned.

Banks should draw on the line of credit arranged only to the extent of loans granted by them to the exporters under the PCFC. However, where the overseas bank making available the line of credit stipulates a minimum amount for drawls which should not be very large, the small unutilized portion may be managed by the bank within its foreign exchange position and aggregate gap limit (AGL). Similarly, any pre-payment by the exporter may also be taken within the foreign exchange position and AGL limits.

d) In case the exporters have arranged for the suppliers' credit for procuring imported inputs, the PCFC facility may be extended by the banks only to finance domestic inputs for exports.

Spread

- Banks are free to determine the interest rates on export credit in foreign currency.
- EURO LIBOR / EURIBOR rates are normally available for a standard period of 1, 2, 3, 6, and 12 months. Banks may quote rates based on the standard period if PCFC is required for periods less than 6 months. However, while quoting rates for the non-standard period, banks should ensure that the rate quoted is below the next upper standard period rate.
- Banks may collect interest on PCFC at monthly intervals against the sale of a foreign currency or out of balances in EEFC accounts or out of the discounted value of the export bills if PCFC is liquidated.

Period of credit

- The PCFC will be available for a maximum period of 360 days. Any extension of the credit will be subject to the same terms and conditions as applicable for the extension of rupee packing credit.
- Further extension will be subject to the terms and conditions fixed by the bank concerned and if no export takes place within 360 days, the PCFC will be adjusted at the T.T. selling rate for the currency concerned. In such cases, banks can arrange to remit foreign exchange to repay the loan or line of credit raised abroad and interest without prior permission from RBI.
- For extension of PCFC within 180 days, banks are free to determine the interest rates on export credit in foreign currency.

Export Credit in Foreign Currency to Protect Exporters from Rupee Fluctuations

a) Banks extend export credit in Indian Rupees as well as in foreign currency, such as pre-shipment credit in foreign currency (PCFC) and post shipment credit in foreign currency (PSCFC), as per their internal lending policies within the overall regulatory framework prescribed by the Reserve Bank.

b) The export credit limits are calculated in Indian Rupees and the limit is apportioned between Rupee and foreign currency components depending upon the borrowers' requirement. While the overall export credit limits are fixed in Indian Rupees, the foreign currency component of export credit fluctuates based on the prevailing exchange rates.

c) It is observed that whenever there is a depreciation of the Indian Rupee:

   i. The un-availed foreign currency component of export credit gets reduced;

   ii. The foreign currency component of export credit already availed gets revalued at a higher value in terms of Indian Rupees resulting in the exporter being asked to reduce their exposure by part payment or where the export credit limit is not fully disbursed, the available limit for the borrower reduces, depriving exporter of funds.

d) Export finance limit is sanctioned by Indian banks, which revalue the foreign currency borrowings like PCFC and PSCFC on a periodic (ranging from daily to monthly) basis, which results in

notional excess utilization over and above the sanctioned limits in case of weakening Rupee. The Committee was of the view that denomination of facility in foreign currency would ensure that exporters are insulated from Rupee fluctuations.

e) Banks are advised that they may compute the overall export credit limits of the borrowers on an ongoing basis say monthly, based on the prevalent position of current assets, current liabilities, and exchange rates, and re-allocate limit towards export credit in foreign currency, as per the bank's policy. This may result in increasing or decreasing the Indian Rupee equivalent of the foreign currency component of export credit.

f) Alternatively, banks may denominate the foreign currency (FC) component of export credit in foreign currency only to ensure that the exporters are insulated from Rupee fluctuations. The FC component of export credit, sanctioned, disbursed and outstanding will be maintained and monitored in FC. However, for translation of FC assets in the banks' book, the ongoing exchange / FEDAI rates may be used.

Disbursement of PCFC

In case the full amount of PCFC or part thereof is utilized to finance domestic input, banks may apply an appropriate spot rate for the transaction.

As regards the minimum lots of transactions, it is left to the operational convenience of banks to stipulate the minimum lots taking into account the availability of their resources. However, while fixing the minimum lot, banks may take into account the needs of their small customers also.

Banks should take steps to streamline their procedures so that no separate sanction is needed for PCFC once the packing credit limit has been authorized and the disbursement is not delayed at the branches.

Liquidation of PCFC Account

- PCFC can be liquidated out of proceeds of export documents on their submission for discounting/ rediscounting under the EBR Scheme or by a grant of foreign currency loans (DP Bills). Subject to mutual agreement between the exporter and the banker, it can also be repaid/prepaid out of balances in EEFC A/c as also from rupee resources of the exporter to the extent exports have taken place.

- Packing credit over F.O.B. value: In certain cases, (viz. agro-based products like HPS groundnut, defatted & de-oiled cakes, tobacco, pepper, cardamom, cashew nuts, etc.) where packing credit required is more than FOB value, PCFC would be available only for the exportable portion of the produce.

- Substitution of order/commodity: Repayment/liquidation of PCFC could be with export documents relating to any other order covering the same or any other commodity exported by the exporter or amount of balance in the EEFC account. While allowing substitution of contract in this way, banks should ensure that it is commercially necessary and unavoidable. Banks should also satisfy with the valid reasons as to why PCFC extended for shipment of a particular commodity cannot be liquidated in the normal method. As far as possible, the substitution of contract should

be allowed if the exporter maintains an account with the same bank or if it has the approval of the members of the consortium if any.

Cancellation/Non-execution of Export Order

- In case of cancellation of the export order for which the PCFC was availed of by the exporter from the bank, or if the exporter is unable to execute the export order for any reason, it will be for the exporter to repay the loan together with accrued interest thereon, by purchasing foreign exchange (principal + interest) from the domestic market through the bank. In such cases, interest will be payable on the rupee equivalent of the principal amount at the rate applicable to ECNOS at the pre-shipment stage plus a penal rate of interest from the date of advance after adjustment of interest of PCFC already recovered.

- It will also be for the banks to remit the amount to the overseas bank, provided the PCFC was made available to the exporter from the line of credit obtained from that bank.

- Banks may extend PCFC to such exporters subsequently, after ensuring that the earlier cancellation of PCFC was due to genuine reasons.

Running Account Facility for all commodities

a) Banks are permitted to extend the ‘running account’ facility under the PCFC Scheme to exporters for all commodities, on the lines of the facility available under rupee credit, subject to the following conditions:

   The facility may be extended provided the need for the ‘running account’ facility has been established by the exporters to the satisfaction of the bank.

   Banks may extend the facility only to those exporters whose track record has been good.

   In all cases, where the pre-shipment credit ‘running account’ facility has been extended, the LCs or firm orders should be produced within a reasonable period.

   The PCFC will be marked off on the ‘first-in-first-out’ basis.

   PCFC can also be marked-off with proceeds of export documents against which no PCFC has been drawn by the exporter.

b) Banks should closely monitor the production of firm order or LC subsequently by exporters and also the end-use of funds. It has to be ensured that no diversion of funds is made for domestic use. In case of non-utilization of PCFC drawls for export purposes, the penal provisions stated above should be made applicable and the ‘running account’ facility should be withdrawn for the concerned exporter.

c) Banks are required to take any prepayment by the exporter under the PCFC scheme within their foreign exchange position and aggregate gap limit (AGL). With the extension of the ‘running account’ facility, mismatches are likely to occur for a longer period involving costs to the banks. Banks may charge the exporters the funding cost, if any, involved in absorbing mismatches in respect of the prepayment beyond one month period.

Forward Contracts

i. PCFC can be extended in any of the convertible currencies in respect of an export order invoiced in another convertible currency. Banks are also permitted to allow an exporter to book a forward contract based on confirmed export order before availing of PCFC and cancel the contract (for a portion of drawl used for imported inputs) at prevailing market rates on availing of PCFC.

ii. Banks are permitted to allow customers to seek cover in any permitted currency of their choice which is actively traded in the market, subject to ensuring that the customer is exposed to exchange risk in a permitted currency in the underlying transaction.

iii. While allowing forward contracts under the scheme, banks may ensure compliance with the basic foreign exchange management requires that the customer is exposed to exchange risk in the underlying transaction at different stages of the export finance.

Sharing of EPC under PCFC

i. The rupee export packing credit is allowed to be shared between an export order holder and the manufacturer of the goods to be exported. Similarly, banks may extend PCFC also to the manufacturer based on the disclaimer from the export order holder through his bank.

ii. PCFC granted to the manufacturer can be repaid by transfer of foreign currency from the export order holder by availing of PCFC or by discounting of bills. Banks should ensure that no double financing is involved in the transaction and the total period of packing credit is limited to the actual cycle of production of the exported goods.

iii. The facility may be extended where the banker or the leader of the consortium of banks is the same for both the export order holder and the manufacturer or, the banks concerned agree to such an arrangement where the bankers are different for the export order holder and manufacturer. The sharing of export benefits will be left to the mutual agreement between the export order holder and the manufacturer.

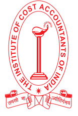
Supplies from One EOU/EPZ/SEZ Unit to another EOU/EPZ/SEZ Unit

a) PCFC may be made available to both, the supplier EOU/EPZ/ SEZ unit and the receiver EOU/ EPZ/ SEZ unit.

b) The PCFC for the supplier EOU/EPZ/SEZ unit will be for the supply of raw materials/components of goods which will be further processed and finally exported by the receiver EOU/ EPZ / SEZ unit.

c) The PCFC extended to the supplier EOU/EPZ/SEZ unit will have to be liquidated by receipt of foreign exchange from the receiver EOU/EPZ/SEZ unit, for which purpose, the receiver EOU/ EPZ/SEZ unit may avail of PCFC.

d) The stipulation regarding the liquidation of PCFC by payment in foreign exchange will be met in such cases not by negotiation of export documents but by transfer of foreign exchange from the banker of the receiver EOU/EPZ/SEZ unit to the banker of the supplier EOU/EPZ/SEZ unit. Thus,



there will not normally be any post-shipment credit in the transaction from the supplier EOU/EPZ/SEZ unit's point of view.

e) In all such cases, it has to be ensured by banks that there is no double financing for the same transaction. Needless to add, the PCFC to receiver EOU/EPZ/SEZ unit will be liquidated by discounting export bills.

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21 Work-in-Progress

Work-in-progress describes the costs of unfinished goods that remain in the manufacturing process, while work-in-process refers to materials that are turned into goods within a short period. The terms "work-in-progress" and "work-in-process" are used inter-changeably to refer to products midway through the manufacturing or assembly process.

"Work-in-process" represents partially completed goods. These goods are also referred to as goods-in-process, and for some, work-in-process refers to products that move from raw materials to finished products in a short period. An example of a "work-in-process" may include manufactured goods that normally take less than a full accounting cycle to complete.

This inventory is found on a manufacturing company's balance sheet. This account of inventory, like the work in progress, may include direct labour, materials and manufacturing overheads. A company often uses internal allocation methods to determine the estimated financial value of work in progress. For example, the company must not only assess the financial value of incomplete goods but estimate what percent complete its products are.

"Work-in-progress}" is sometimes used to refer to assets that require a considerable amount of time to complete. The underlying assumption regarding "work-in-progress" is there is a larger project framework in play that requires a heavier investment in time for the process. Although some companies use more specific types of general ledger accounts for construction projects, a large build may be considered an example of a 'work in progress'.

"Work-in-progress" is also reported on a company's balance sheet. As additional billings are incurred, the value of the work-in-progress account increases. A company may choose to determine the asset's fair market value (FMV) assessment as part of its annual financial reporting requirements.

Many companies use both terms interchangeably to describe incomplete assets. However, there are subtle differences between "work-in-process" and "work-in-progress".

Scope of Work

"Work-in-progress" often indicates repetitive steps within a manufacturing process. A standard set of machinery/equipment may be used in conjunction with bulk raw material inventories to produce a standardized product. Though these products can still be larger in size or monetary value, it is more

often associated with smaller, higher quantities of production.

On the other hand, “work-in-progress” is more representative of massive, one-time undertakings. These projects have much longer timelines and may take years to complete a single instance. Consider an example of the build-out of a custom yacht; there is only one time, a set of diverse materials, and a longer timeframe needed to complete than simpler products.

Due to its nature of repeating a process that is integrated with standardization, “work-in-process” is often used more heavily in manufacturing. It can be used in any industry where there are partially completed goods. “Work-in-progress” is often tied in construction or other industries associated with large builds. The billing scheme for these industries is referred to as progress billings (not process billings) where companies get paid based on the percentage completed of the project.

Financial Statements

Both types of accounts are found on a company’s balance sheet. However, the nature of each may be slightly different and require different accounting treatments. “Work-in-process” may refer to items of inventory with quicker turnover. Because the time span of completing and selling work-in-process assets may be short, it may be reasonable to treat “work-in-process” as a short-term asset, especially if “work-in-process” is considered to be heavily tied to raw materials and inventory.

On the other hand, “work-in-progress assets” are usually treated as long-term assets. These undertakings may take years to complete, and the financial benefits of work-in-progress projects may not be fully recognized within the next year.

Accounting Treatment

Some companies may attempt to complete all “work-in-process” items for simpler, cleaner financial statements. Though not required, the goal is to eliminate any pending products to only report completed goods. When these goods are completed, they are often transferred to inventory to later be treated as a cost of goods sold when purchased by a customer.

Asset Liquidity

A company will find it much easier to liquidate “work-in-process” items. Though these goods are incomplete and still require some work to become finalized goods, the timespan in doing so is much shorter than work-in-progress goods. In addition, the market may be more willing to buy “work-in-process goods” outright if they are standardized goods.

“Work-in-progress” items will have substantially less liquidity and the company incurring “work-in-progress costs” may find it much more difficult to liquidate the asset as it is being completed. “Work-in-progress” items (i.e., the construction of a new warehouse or specialized piece of equipment) may be very specific to a company and hold little to no value to other market participants. “Work-in-progress” items may require substantial pricing discounts to entice buyers, especially if the items are not standardized.

The capital work-in-progress (CWIP), stock-in-process (SIP) and stock of raw materials, finished goods, etc. are the three important items on the balance sheet of any entity. Considering the similarities

in CWIP & SIP and SIP and Stock the following discussion enables better understanding and unlocking the secrets hidden for an audit.

Capital Work-in-Progress

The *capital work in progress,* also known in short as CWIP, is one of the important parts of the non-current asset of an entity. CWIP includes building under construction, machinery under assembly, etc., at the time of preparation of the balance sheet. CWIP is the work that is not yet complete but the amount has already been paid. These payments and these funds which are claimed to have been paid for the said construction, which is not yet complete, or machinery or plant which is under installation is sometimes found to have been used as a route to divert or siphon the funds and thus, a cause for an audit.

Purchases of the item of assets at an inflated price especially from a related party or making payment for some assets being shown as CWIP, for which no assets have been received of economic value or even expenditure for repairs and maintenance recorded as CWIP are some of the areas of the audit. Similarly, the recording of an asset purchased as CWIP, which in effect has not been received by the entity at all, is an important aspect of an audit of CWIP.

As the name suggests that CWIP, is the work of putting plant & machinery and constructing a building that is not yet completed, the same being continued from one balance sheet date to another. Therefore, used as a tool to either inflate the same or divert the funds.

It is also relevant to know that so long as an asset is CWIP, the same is not required to be considered as fixed assets and therefore, not required to be recorded in the fixed assets register and also not required to be depreciated.

The benefit of spill-over from one balance sheet to another balance sheet which sometimes continues in several balance sheets is taken by the management, as for stakeholders, it is difficult to immediately identify any early warning sign due to such spill-over.

Therefore, the audit of CWIP requires looking into the genuineness of the same, and whether is it inflated and correctly shown.

An understanding of the CWIP and how to look at and analyse the same is important in an audit. How to decode the CWIP is explained, to find out how genuine the same is or if some issues require further investigation, or if it is used as a means/mode to divert or siphon the funds.

It is also important to understand and analyse the CWIP in audit, as CWIP forms part of the tangible net worth (TNW) of an entity. Therefore, to know the actual TNW and real position of the TNW, the CWIP requires to be looked into.

Stock-in-Process

Stock-in-process known short as SIP (also known as “work-in-progress” (WIP) is one of the important parts of the current assets of an entity. Like CWIP, WIP includes the entity’s partially finished goods waiting for completion. Since it is one of the items for calculation of the current ratio, SIP plays an important role, in any loan proposals by borrowers to the banks and/or financial institutions. Since stock

in process, is considered as part of the current assets, and the overall amount of current assets is one of the shining stars to any financial statement, its importance is shining as the sun's rays.

In every financial statement, while looking at the balance sheet, lenders investors, stakeholders, etc., whoever has an interest in the entity, always look at the amount of current assets and particularly the amount of Inventories, which forms an integral part of the current assets. Stock-in-process is one of the important items of inventories in any entity. Since stock-in-process indicates that the manufacturing process is undergoing and the raw materials are being processed or being manufactured, and the process is continuing, as the stage of finished goods or final products has not yet been reached. Therefore, a higher amount of stock in process, as compared to raw materials and finished goods is always viewed positively.

A huge inventory level of raw materials indicates that the materials have been procured but not processed and a similarly higher level of finished goods indicates that an entity has manufactured the goods but is not able to sell them. As against this, a higher level of SIP provides comfort to the lenders and investors that since it is SIP, naturally the same cannot be sold and thus, not viewed adversely or not as negatively as huge inventories of raw materials and finished goods. Therefore, the benefits of this situation are sometimes taken by entities in showing a huge inventory level of SIP.

Apart from the above, the other most important reason, for showing the huge level of inventory of SIP is that the manufacturing process of each industry is different, the manufacturing cycle being different in each industry and sometime even in the same industry, it may be different, because of management or for any reasons, it is easy to provide reasons and logic for a higher level of SIP. Such reasons are difficult for a layman to understand the same, as it is a technical subject and thus, reasons advanced by the company's management are accepted at face value.

It is also found that even in physical verification of inventories, it is easy to physically verify the raw materials and finished goods as compared to SIP, as depending upon the types of products and industry, there may be several stages of SIP, which makes it difficult to physically verify the quantity and value thereof.

It is also not possible to maintain process records of SIP, as in the case of other inventories. It is also difficult to maintain the item-wise, stage wise, product-wise, and process-wise details of the quantity and amount of every item of SIP.

Therefore, the benefit of all such situations or some of such situations is found to be taken by those entities, who want to either window dress the financial or misrepresent the facts about the good financial positions of the entity, by showing a higher level of SIP than the actual.

And that is why wherever the amount and quantity or overall value of SIP is found higher, as compared to overall inventory level, overall business volume, and/or overall sales, the detailed analysis of SIP is very important and desirable too, in audit, to find out is there anything serious or wrong in the level of SIP, as SIP normally forms part of the primary security for the working capital loan or a cash credit facility provided by the banks or financial institutions to the entity.

Similarities in CWIP and SIP

Both CWIP and SIP are undergoing items of balance sheet date. Though CWIP is part of non-current assets SIP is part of current assets. Because both have not attained the final shape and therefore, are difficult to verify as compared to finished assets.

This peculiar stage i.e., stage of under progress/process, which sometimes unnecessarily extended and after long progress and process, which keeps on progressing and progressing but never ends, and as a result, these CWIP and SIP are unable to see the light of the day!

Raw Materials and Finished Goods

Apart from stock in the process (SIP), the other inventories such as raw materials, finished goods, stores and spares, packing materials, etc., which are intended for consumption or sale in the normal course of the operating cycle, also form part of the inventory.

For an audit of an entity for the genuineness of inventories, these items of inventories are also required to be examined.

No doubt, the major concern of auditors is for SIP but the other inventories cannot be ignored, and, in some cases, it may be the other inventories that pose more seriousness, as compared to SIP.

In the case of a trading entity, the stock-in-trade i.e., the goods acquired for trading, which remained as stock at the balance sheet date, is also relevant in the audit of such trading.

Similarities in SIP and Stock

Both forms are part of inventories and both are current assets. Stock in process and stock of other inventories require to be examined by an auditor, on the same parameters, except for some additional verification concerning SIP.

Inventory Fraud

Inventory is one of the biggest assets of a manufacturing entity. Itis also one of the hardest assets to measure and track.

Thousands of transactions flow through the inventory account each year and many of these journal entries require subjective estimates, such as overhead allocations, write-offs, and valuation adjustments. In addition, many employees have direct daily access to inventory or inventory accounting records, providing an ongoing temptation to steal or cook the books.

What Makes Inventory Vulnerable to Fraud

Inventory is vulnerable to fraud because itis eventually closed out to the cost of goods sold (COGS). This is an expense account that winds up as part of retained earnings at the end of the accounting period.

The formulas for computing COGS are:

- ≈ BEGINNING INVENTORY + PURCHASES DURING THE YEAR = GOODS AVAILABLE FOR SALE
- ≈ GOODS AVAILABLE FOR SALE – ENDING INVENTORY = COGS
- ≈ These formulas make sense for retailers or distributors that don't add value to the goods they sold and, therefore, handle only finished goods. But they're oversimplified for manufacturers that process raw materials into finished goods.
- ≈ Manufacturers typically possess three types of inventories:
  - ✓ Finished goods
  - ✓ Work-in-progress (WIP)
  - ✓ Raw materials

Types of Inventory Fraud

Small manufacturers often operate like families. Owners can't fathom that a trusted "family member" would ever steal inventory. But it happens more often than thought. When faced with financial pressure and allowed to steal, an employee may rationalize the theft of inventory.

Inventory fraud may also occur within the accounting department. For example, the controller or CFO may try to overstate inventory by artificially inflating inventory counts or values, recording false entries into the general ledger, or failing to write off old, obsolete, or damaged items.

Moreover, the inventory account may become a "slush fund" for other internal fraud schemes. Inventory overstatements might be used to manage earnings or to meet financial covenants.

How to Prevent Inventory Fraud

Unearthing financial misstatements involving inventory overstatements is less straightforward than catching people who directly steal physical assets. An Auditor helps by bench marking financial statement trends, verifying source documents, and building a case that will help to find out the person involved.

WIP Inventories

WIP inventories include charges for raw materials, direct labour, and overhead. Sometimes there are additional charges when the production of components is outsourced to a third party.

In addition, manufacturers can use a variety of techniques to account for finished goods inventories under Generally Accepted Accounting Principles. These include the lower of cost or market; first-in, first-out (FIFO); and last-in, first-out (LIFO).

The more complicated a company's inventory reporting process, the more opportunities employees have to commit fraud.

Capital Work-in-Progress

The amount of CWIP is required to be shown separately on the face of the balance sheet, as part of fixed assets under non-current assets.

Inventories

The inventories are required to be classified as:

1. Raw materials
2. Work-in-progress
3. Finished goods
4. Stock-in-trade (in respect of goods acquired for trading)
5. Stores and spares
6. Loose tools
7. Others (nature to be specified).

Further, goods-in-transit is required to be disclosed under the relevant sub-head of inventories and the mode of valuation of inventories is also required to be stated.

Meaning of Inventories

As per Ind AS 2, "Inventories"– 'inventory' has been defined as assets:

- ✓ held for sale in the ordinary course of business
- ✓ in the process of production for such sale; or
- ✓ in the form of materials or supplies to be consumed in the production or the rendering of services.

Inventories Held for Sale in the Ordinary Course of Business

Inventories held for sale in the ordinary course of business are finished goods of a manufacturing entity or trading goods of trading units.

Supplies, loose tools, stores, and spares are examples of 'material or supplies to consume in the production process or the rendering of services'.

Inventories encompass goods purchased and held for resale including merchandise purchased by a retailer and 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 entity

and include materials and supplies awaiting use in the production process.

The decoding of CWIP, SIP, and Stock for audit requires the examination of several critical issues. In the following table, the important critical parameters on which CWIP, SIP, and Stock, requires to be verified for audit are given:

Sr. No.	*Verify/ Examine*	*CWIP*	*SIP*	*Stock*
1	Use	Usable in the business.	Usable as finished goods.	Raw materials are used in manufacturing and finished goods for sale.
2	Period of use	More than one year.	Immediately in finished goods.	During the operating cycle.
3	Examine the details	What constitutes CWIP	What constitutes SIP	Item-wise details of raw materials and finished goods.
4	Business of entity	Is CWIP in line with the business of the entity?	Is SIP in line with the manufacturing process?	Are the stock of inventories related to business?
5	Details of acquisition	Details of the parties to whom paid.	Details of relevant raw materials and manufacturing costs.	Details of the major suppliers of raw materials and details of manufacturing costs.
6	Internal control	Over the acquisition of items of CWIP.	Over purchases of relevant items of raw materials.	Over the sale of finished goods.
7	Verification of existence	Of CWIP items.	Of SIP items.	Of stock.
8	Verification of agreement, purchase deeds, delivery challans, etc.	To know genuineness.	To know genuineness.	To know genuineness.
9	Complete records	To establish the actual amount.	To establish the actual amount.	To establish the actual amount.
10	Verification of cut off	To know proper capitalization.	To know the proper SIP.	To know stock.
11	Rights of ownership	To find out diversion, if any.	To find out diversion, if any.	To find out diversion, if any.
12	Valuation	To know inflated CWIP.	To know inflated SIP.	To know the inflated valuation.
13	Verification of existence	To find out the siphon of funds.	To find out the siphon of funds.	To find out the siphon of funds.
14	Presentation and disclosure in financial statement	To find out any mis-statement.	To find out any mis- statement.	To find out any misstatement.
15	Purchases from a related or connected party	To find out genuineness.	To find out genuineness.	To find out genuineness.

Sr. No.	Verify/ Examine	CWIP	SIP	Stock
16	Reconciliation	To know correctness and diversion, if any.	To know correctness and diversion, if any.	To know correctness and diversion, if any.
17	Auditor's Report	Is there any qualification or discussion about CWIP?	Is there any qualification or discussion about SIP?	Is there any qualification or discussion about Stock?
18	CARO Report	–	SIP has been physically verified by the management.	All the inventories have been physically verified by the management.
19	Any disclaimer by the auditor	Any disclaimer concerning CWIP indicates early warning signs.	Any disclaimer concerning valuation and quantity indicates an early warning sign.	Any disclaimer for inventory indicates an early warning sign.

20. Most important aspect

The most important part of an audit of CWIP, SIP, and stock is to determine, for how long the same has been shown as CWIP or SIP or stock. The period of construction of building or assembling plant and machinery, if found to be substantially longer (say more than 2 years) then genuineness of the same need to be critically examined, depending upon the size of capitalization and industry. Similarly, in the case of SIP, the process of manufacturing in the terms of time is to be kept in mind while decoding the genuineness of SIP. In the case of stock also, a huge inventory level needs to be critically examined by an Auditor.

The longer and longer the period of CWIP or SIP is an area of doubt and the same requires more detailed verification in audit, to find out if is it inflated or if there are reasonable reasons for the same.

Physical verification of the inventories (which includes all inventories of raw material, SIP, finished goods, etc.) is the area always undertaken by the lenders in every cash credit facility provided by the banks in India. Such verification is carried out by the bank staff or by outside CA or Cost Accountants on behalf of banks/financial institutions.

How to Calculate the Work-in-Progress

"Work in progress" (WIP) or "work in process" is inventory that has begun the manufacturing process and is not included in raw materials inventory as it is not a complete product. "Work in progress" on a balance sheet work is shown as an asset as money has been spent on a completed product. The product has not been completed so far hence the WIP is valued lower.

WIP is the inventory of a company that is partially completed. The value of the partially completed inventory is sometimes also called goods in process on the balance sheet.

Formula for WIP

WORK-IN-PROCESS = (OPERATING INVENTORY GOODS IN PROCESS + RAW MATERIALS USED DURING THE PERIOD + DIRECT LABOR DURING THE PERIOD + FACTORY OVERHEAD FOR A PERIOD) – ENDING INVENTORY.

Example of WIP

Let us take company ABC which manufactures' widgets. Considering that it takes two weeks to make a widget. By the end of the month on the last day when the company closes its account, it is observed that there are only 10,000 widgets in its inventory. There are only 3,000 partially completed widgets. Then on the left-hand side of the balance sheet, these 3,000 partially completed widgets are recorded as work-in-progress and are considered an asset to the company.

Thus a manufacturing firm incurs costs as it transforms materials into work-in-process and later into a finished product. During the manufacturing process, the manufacturing firm consumes raw materials, labor, and factory overhead cost to create both partially completed and fully completed units of inventory. The cost of manufacturing is considered in the raw materials account, the work-in-progress account. This is also known as work-in-process or finished products account. To the inventory accounts, the inventory costs are debited till the manufacturing process is completed or the inventory is sold completely.

1. To determine the cost of beginning work-in-progress for the accounting period. During a production process, the "work-in-process" refers to raw materials inventory that has been only partially converted into a finished product. The "work-in-process" inventory undergoes additional processing to convert it into finished products.
2. Costs of the raw inventory costs are calculated for the accounting period. At the beginning of the accounting period, the cost of raw materials inventory is added to the cost of purchased materials for the period to determine the total cost of raw material inventory. Deduct the cost of raw material from this figure that is on hand at the end of the accounting period to determine the costs of materials consumed during the accounting period.
3. Labor costs for the accounting period should be calculated.
4. Factory overhead costs can be calculated for the accounting period. This includes calculations like rent, depreciation costs, taxes, and insurance.
5. During the accounting period the manufacturing cost is calculated. The raw material inventory costs, labor costs, and factory overhead costs are added together and then the calculation is done.
6. For the accounting period the cost of ending work in process is calculated. The manufacturing costs are added to the beginning of the work in process.
7. Using this formula rework and scrap or accounting errors may impact the validity of the ending work in progress. Thus, a physical work-in-progress inventory can be performed to obtain a more accurate ending work in progress.

"Work-in-progress" can be stated as the concept used to describe the flow of manufacturing costs from one area of production to the next and the balance in WIP denotes all production costs incurred for partially completed goods. Materials and labor costs are included in production costs and are used in making goods as well as allocated overhead. Along with other inventory accounts, WIP is determined by various accounting methods across different companies. Thus, investors should recognize how a company is measuring the WIP and other inventory accounts. The work-in-progress of the two

companies may not be the same or comparable. It depends on the allocations of overhead on man-hours or machine hours.

Job Order Costing

Job order costing or *job costing* is a system for assigning and accumulating manufacturing costs of an individual unit of output. The job order costing system is used when the various items produced are sufficiently different from each other and each has a significant cost. (When a company›s output consists of continuous flows of identical, low-cost units, the process costing *system* is more appropriate.)

Since there is a significant variation in the items manufactured, the job order costing system requires a separate job cost record for each item (or each job or special order). The job cost record will report each item's direct materials and direct labor that were actually used and an assigned amount of manufacturing overhead.

The job cost records also serve as the subsidiary ledger or documentation for the manufacturer›s cost of the work-in-process inventory, the finished goods inventory, and the cost of goods sold.

Examples of Job Order Costing-A few examples of the use of job order costing are:

A company that designs and produces custom-made machines and/or machine tooling

A company that constructs custom-designed buildings

A company that modifies trucks to meet customers' special needs

To conclude, the significance of inventory management to organizations is clear, but inventory audits need to be accurate and efficient for them to be effective. Inventory can change quickly, which can make monitoring difficult. Companies adopt different practices and strategies on how to best perform their inventory processes. Hence the objective of conducting a stock audit is *to ensure that the security for funds lent by the bank, are safe and valued correctly.*

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References (Bank's Guidelines / Standard Books / Websites etc.):

Note: Most of the above, was covered in various Chapters of the "Hand Book and Book Debts Audit". The instructions, formats, guidelines, periodicity of the Audit, Threshold Limit of the Working Capital Loans for Stock and Receivables Audit, Terminology, etc. will differ from Bank to Bank.

a) Refer to the 'Credit Policy Guidelines' of the Bank on Stock and Receivables Audit Instructions i.e., Limit, Period, and Coverage.

b) Refer to the Bank's Format i.e., Standard Format of 'Stock and Receivables Audit'.

c) Refer to the Stock Statements Format and Periodicity submitted by the borrowing entity and contents.

d) Refer to the Bank's instructions on Insurance (Fire, Theft, etc.) against Stocks and Receivables Insurance (Policies to be issued by General Insurance Companies), etc.

e) Refer to 'Section 20 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act)'-To know CERSAI (Central Registry of Securitisation Asset Reconstruction and Security Interest of India) Guidelines.

f) Refer Reserve Bank of India Guidelines to the Scheduled Commercial Banks on 'Working Capital / Cash Credit Loans or Advances'.

g) Refer 'Charge as per 'Section 2(16) of Companies Act, 2013' refers to the creation of interest or a right on a property or asset of a company or any of its undertakings as a security against loan provided to the company in respect of such interest.

h) Refer to Charges Under 'Sections 77 to 87 of the Companies Act, 2013', charges creation, modification, etc. for the Current Assets financed by the Banks through Working Capital Loans.

i) Refer-Gist of 'e-filing forms' under Charge Management for Stock and Receivables with ROC like (CHG-1: Creating or Modifying Charge-For other than Debentures; CHG-2: Certificate of Registration of Charge; CHG-3: Certificate of Modification of Charge; CHG-4: Intimation of the

satisfaction to the Registrar; CHG-5: Memorandum of satisfaction of Charge; CHG-6: Notice of appointment of cessation or receiver or manager; CHG-7: Register of charge; CHG-8: Application for condonation of delay shall be filed the Central Government; CHG-9: Creating or modifying the charge in (for debentures including rectification).

j) Refer to 'Credit Policy of the Company' where the Stock and Receivables Audit Conduct as per Bank Instructions.

k) Refer to the 'Inventory Management Policy' Instructions of the Company where the Stock and Receivables Audit Conduct as per Bank Instructions.

l) Refer to the 'Security Norms / Safety Norms' to preserve the various types of 'Stocks of the Company in Warehouses / Godowns' where the Stock and Receivables Audit Conduct as per Bank Instructions.

m) Refer to "Accounting Standards" for 'Stock and Account Receivables' issued by the Accounting Standards Authority.

n) Refer to "Unit Inspection Format", used by the Bank's Covered at an appropriate place in the Book.

o) Refer to "Early Warning Signals" of the Units financed by the Bank as defined by the Reserve Bank of India.

To Better Understand the Inventory Management of the Companies, refer to the Standard Books:

p) Essentials of Inventory Management, Max Muller.

q) Purchasing and Inventory Management, K.S. Menon.

r) Inventory Management with Alternative Delivery Times, Xiaoying Liang, Lijun Ma, Haifeng Wang, Houmin Yan.

s) Achieving Effective Inventory Management, Jon Schreibfeder.

t) Production & Inventory Control Handbook, Seetharama L Narasimhan, Dennis K McLavey, Peter J. Billington.

u) Basics of Warehouse and Inventory Management, Villivalam Rangachari Rangarajan.

v) Modern Warehouse Management System, President Jan Young.

To Better Understand the Receivable / Book-Debts Management of the Companies, refer to the Standard Books:

w) Essentials of Credit, Collections, and Accounts Receivable, Mary S. Schoeffer.

x) Accounts Receivable Management Best Practices, John G. Salek.

To Understand the Stock Audit & Receivables Audit of the Company's Books / Websites:

y) Stock Audit & Receivables Audit in Banks, D.P. Gupta, and R.K. Gupta.

z) https://bankingschool.co.in/

aa) https://www.rbi.org.in/

ab) https://bankingdigests.com/

ac) https://icmai.in/icmai/

ad) https://accountlearning.com/

To Understand the Product Guidelines i.e., Working Capital / Cash Credit Loans of the Bank refer to the concerned Bank websites, for example:

ae) https://www.unionbankofindia.co.in/english/home.aspx

af) https://sbi.co.in/ etc.

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Notes

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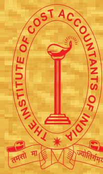

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