

# **Handbook on Stock and Book Debts Audit**



**THE INSTITUTE OF COST ACCOUNTANTS OF INDIA  
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### Foreword

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.

**(CMA Manas Kumar Thakur)**

27<sup>th</sup> June 2017

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## **PREFACE**

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

*In view of the magnitude of loans that entities obtain from banks in the form of Cash credit against hypothecation of Inventories and debtors, the importance of the physical verification of Inventories, their valuation and security aspects is of paramount importance. The auditor's role is significant in this regard as the report prepared by him is considered as authentic as well as neutral. He, therefore has to be careful and unbiased while undertaking the Inventories Audit.*

*The "Handbook on Stock and Book Debts Audit" elaborates the objective and need of Stock Audit. The stock audit procedure, contents & details of stock audit report are explained in separate chapters. Synopsis of Stock Audit of Bank Borrowers and Check List of Stock and Book Debts Audit Process are explained in detail in this handbook.*

*I would like to acknowledge the sincere efforts of CMA Dr. P. Siva Rama Prasad for preparing this Guidance Note and of Professional Development Department of the Institute.*

*My sincere thanks are due to all members of the Professional Development, Banking & Insurance Committee for their highly valuable contribution in finalization of this Guidance Note.*

*I would like to convey my special thanks to CMA Manas Kumar Thakur, President and CMA Sanjay Gupta, Vice President of the Institute for bestowing free hand to the PD, B&I Committee in its working and providing guidance and able leadership in the affairs connected with it.*

*I am quite hopeful that this Guidance Note will provide useful guidance to all the Members and enable them with the knowhow to undertake stock audit.*

June 27, 2017  
Pune

(CMA AMIT ANAND APTE)

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## **INTRODUCTION**

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

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

In order to get an assurance that the norms stated in the loan sanction form have not been disregarded, the bank appoints an external auditor, who is an independent person. The auditor undertaking such responsibility should take care that the requirements of the banks are met with and an early detection of the lapses and inconsistencies is done. The main purpose of conducting the Inventories audit in banks is to get an assurance that the security against which the loan is sanctioned represents the quality and quantity it claims to possess. With this assurance, the purpose of the Inventories audit as required by the bank is served. The examination of the securities against which the loan has been sanctioned consists of not only physical verification of the securities but also includes verification of aspects such as ownership, valuation and proper storage. The Auditor's role assumes great significance in this regard as his report is considered as veritable and neutral. He is therefore expected to be objective and unbiased while undertaking the Inventories audit.

One of the primary objectives of the banks is to lend money by way of secured loan and unsecured loan. The secured portfolio of the banking system is much more than unsecured one. In fact almost entire advance portfolio of the bank is secured. Secured loans provided by the banking system can be again classified into two sectors Term Loan and Cash Credit or working capital Loan. Bank sanctioned Term Loan against specific assets and for a fixed term and for obvious reason the same is long term in nature. In the balance sheet of an organization these loans appear as non-current liabilities (though the part of the loan maturing within one year is coming under current liability) and respective security appears under Fixed Assets or non- current Assets. The most essential and



significant portion of total Assets of an organization in general and Current Assets in particular are Stock and Receivables because they are essence of the entire business activity of the organization and provide true and fair picture of the strength of the liquidity position of the business. Banking system provides the loan to finance the working capital of a business unit by taking stock and receivables as primary security and popularly known as Cash Credit. Unlike Term Loan both the value of securities (i.e., stock and receivable) and loan varies on a daily basis, so a close monitoring from the lenders end is essential to ensure that the advance is safe and adequate security is available to recover the loan once it turns to Non Performing Asset or NPA.

The banking system monitors the working capital loan by way of taking various periodical reports from the borrowers e.g. –

Monthly basis – Monthly stock Statement to calculate the drawing power of the borrower

Quarterly basis – QIS I or FFR I to monitor the Turn over and total working capital position.

Half Yearly basis – QIS II and FFR II to monitor cash flow of the borrower.

Though the cash credit limit is sanctioned for one year and is theoretically repayable within one year but in all practical purpose it is a long term one which is renewable on yearly basis. In addition to periodical reporting banks appraise the borrower on yearly basis to renew / enhance or reduce the Working Capital Limit.

In addition to abovementioned off-site monitoring system by the bank, the banking system felt the importance of on-site inspection by an independent external agency especially after the Harshad Mehta Scam and introduced stock audit of Cash Credit accounts. The terms and conditions and frequency of stock audit vary bank to bank. But generally Banks are appointing Stock Auditor once in a year for exposure of Rs.5 Crs. or more and once in three year for exposure below Rs.5 Crs. For big tickets loan in addition to annual stock audit, Consortium of Banks may ask the monthly stock report certified by their empanelled stock auditor.

## OBJECTIVES AND NEED OF STOCK AUDIT

The main objective of conducting stock audit is to certify the correctness both in terms of quality and quantity of Inventories & Receivables positions as stated by the borrower in the monthly stock statement. The stock audit plays a pivotal role to give a warning signal for probable NPA cases to the Credit and compliance team of the bank and to take necessary corrective actions. It is also an effective tool for early detection of lapses/fraud /inconsistency if any and takes corrective actions.

The main purpose of conducting Stock Audit in Banks is enumerated below :

1. **Sanctioned Terms and Conditions:** To get an assurance that all sanctioned terms and conditions are duly adhered.
2. **Inventory System:** To have a fair view of inventory system which covers:
  - (a) Stock is owned by the borrower and has realizable value. Identification of slow moving and non-moving stock items.
  - (b) Whether stocks are preserved in good environment and ABC principle of inventory is followed and proper safe guard is maintained against burglary, fire and other probable natural calamities. Whether proper display board is maintained which reflects that stock is hypothecated to bank.
  - (c) Whether the stock is adequately insured with suitable bank clause.
  - (d) Physical stock should tally with the record maintained by the borrower on the basis of which they are preparing monthly stock statement.
3. **Receivable Management:** Whether the value and ageing of Receivables as submitted by the borrower shows the true and fair picture of the same and whether there is adequate internal control mechanism exists relating to Receivable Management.
4. **Utilization of Bank Borrowing:** To ensure the proper utilization of Bank borrowing. Whether the short term fund is utilized for long term purpose or it is diverted to any Sister Concerns/ Directors or others. Whether all transactions are routed through the cash credit Account.
5. **Drawing Power:** To check the Drawing Power calculation arrived at on the basis of statements submitted by borrower. .



## **Need for Inventories Audit**

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

An Inventories Audit is essential for the following purposes:

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

## **Scope of Inventories audit**

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

It encompasses the following aspects:

- a) Physical verification of inventories.
- b) Verification of condition of storage.



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

### **Applicability of Inventories Audit**

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

- a) Where there are over dues in term loans or other accounts, where the banks' stake is high.
- b) Where there is evidence of pressure on the borrower from the creditors.
- c) Where the inventories are stagnating.
- d) Where party is not submitting period Inventories statements regularly.
- e) Where there are grounds to suspect that the position of chargeable current assets indicated may not be correct.
- f) Where there are too many qualifying remarks about inventories and receivables in the auditors report on the balance sheet of a borrower.
- g) Where the accounts is marked as sub-standard.



- h) Suspect dealings in lending procedure, jeopardizing advances given.
- i) An errant borrower, where Inventories audit is needed to supplement actions of the branches for recovery.
- j) Any other valid reason such as mismanagement, heavy losses, lockout, strikes etc.
- k) Fulfilling the criteria fixed by the head office to get done Inventories audit.

**DEFINITIONS**

**Cash-credit facility**

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

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

- (i) **Cash Credit - Pledge:** When the possession of the goods is with the bank and drawings in the account are linked with actual movement of goods from / to the possession of the bank. The physical control of the goods is exercised by the bank by way of safe keeping of goods in a protected godown with keys of the lock held by the bank.
- (ii) **Cash Credit - Hypothecation:** When the possession of the goods remains with the borrower and a floating charge over the inventories is created in favour of the bank. The borrower has complete control over the goods and the drawings in the account are permitted on the basis of Inventories statements submitted by the borrower at stipulated periodicity.

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

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

Cash Credit facility is the loan sanctioned by the bank for working capital requirement of the borrower against primary security of paid Stock and Receivables. Unlike term loan this facility has no repayment terms. Usually it is sanctioned for one year. It is a running account. Borrower can deposit and withdraw money as and when they required subject to maximum limit of Drawing Power. Interest is



calculated on the basis of daily outstanding and debited to borrowers account on the last date of the month.

## Charge

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

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 charges so as to mean an 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 essential features of the charge are as under:

1. There should be two parties to the transaction, the creator of the charge and the charge holder.
2. The subject-matter of charge, which 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 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.

### **Charge on Assets of a Company**

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

1. **Fixed charge:** Such a charge is against a specific clearly identifiable and defined property. The property under charge is identified at the time of creation of charge. The nature and identity of the property does not change during the existence of the charge. The company can transfer the property charged only subject to that charge so that the charge holder or mortgagee must be paid first whatever is due to him before disposing off that property.



2. **Floating charge:** Such a charge is available only to companies as borrower. A Floating charge does not attach to any definite property but covers the property of a circulating and fluctuating nature such as stock-in-trade, debtors, etc. It attaches to the property charged in the varying conditions which happen to be from time to time. Such a charge remains dormant until the undertaking charge ceases to be a going concern or until the person in whose favor charge created takes steps to crystallize the floating charge. A floating charge on crystallization becomes a fixed charge.

## **Registration of charges**

### **Charge as defined in Section 100 of Transfer of Property Act, 1882**

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

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

### **Need for creating a Charge on Company Assets**

Almost all the large and small companies 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 institution or banks.

The financial institutions/banks do not lend their monies unless they are sure that their funds are safe and they would be repaid as per agreed repayment schedule along with payment of interest. In order 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 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 consent of the earlier lending institutions to the creation of second and subsequent charges on the same assets. With their consents, the charge of all the lending institutions may rank *pari passu*, i.e. on the same footing.

However, the earlier lending institution may not give its consent to the creation of second charge on the ground that the realizable 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 charge signed by the company and its charge – holder together with the instruments creating. Important points in the Act relating to charge creation:

- 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 be registered.

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

#### *Time limit for registration of a Charge*

A charge created by a company is required to be registered with the Registrar 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 for the purpose of registering or modifying the charge is 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 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 a period of 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 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 rights of any other intervening creditors of the company.

*Condonation of delay by the Central Government:* If company fails to register the charge even within this period of three hundred days, it may seek extension of time in accordance with Section 87 from the Central Government. The same has been discussed later in this chapter.

#### *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, duly signed along with 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 affected on 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 the purpose of registration of charge.

### **Certificate of Registration of Charge**

Where a charge is registered with the Registrar, Registrar 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 except that such loan becomes unsecured to such an extent in the event of liquidation of the company.

### **Acquiring property under charge and Modification 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 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.

### **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 a period of 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 of such payment on satisfaction, the Registrar shall not register the same unless the delay is condoned by the Central Government, which is later discussed in this chapter.

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 the 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 intimation to the registrar is in specified form and is signed by the holder of charge.

Power of Registrar to Make Entries of Satisfaction in absence of intimation from the company:

There may be times where a company may fail to send intimation of satisfaction of charge to the Registrar but according to section 83 of the Act, 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 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 for which a charge is already registered, it would be deemed that he has complete knowledge of charge from the date the charge is registered.

### **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 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 a period of 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 reasonable restriction as the company by its article imposes. The register of charges and the instrument of charges kept by the company shall be open for inspection-

- By any member or creditor of the company without fees;
- By any other person on payment of fee.

### **Consequences of Non-Registration of Charge**

According to Section 77 of the Companies Act, 1956, 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 unsecured creditor. The property will be treated as 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 in order 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 non-registration.

### **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 authorizing 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.

### **Object of Registration**

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

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

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

### **Consequences of Non-Filing**

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

### **Filing defective particulars**

ROC shall examine, or cause to be examined, every document received in his office if any such document is found to be defective or incomplete in any respect, the ROC shall direct the company to rectify the defect or complete and no such document shall be registered and recorded until the defect has been so rectified or the document has been completed as the case may be.

ROC is thus, under an obligation to inform the Company about the defects. However, the document shall be treated as filed on the date on which it was initially filed and not on the date it was rectified.



## **Charges with ROC**

Date of Registration with details of all charges should be thoroughly perused. The date of registration of the charge will conclusively decide the priority of creditor.

Hence proper comments on availability of security against charge created and registered should be verified and reasons for non registration of charges are reported since non registration of charge converts a **secured creditor into an unsecured creditor**.

## **Consortium lending**

This approach to lending was introduced by the RBI in 1974. Accordingly, more than one bank finances a single borrower requiring large credit limit. It

- Enables banks to spread risk of lending.
- Broke the monopoly of big banks to have large accounts.
- Enables banks to share experience and expertise.
- Introduces uniformity in approaches to lending.
- Enables banks to pool resources, and
- Checks multiple financing of the same account.

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

## **Creditors**

Creditor means an entity to whom the amount is payable for supplies of goods which is either traded or used for production or rendering services. An entity (person or institution) that extends credit by giving another entity permission to borrow money with a stipulation for repayment at a later date.

## **Debtors / Receivables**

Debtors means the amount receivable from customers for goods sold (for both manufacturing and trading unit) or services rendered (for service sector). The documentary evidence is invoices of Sales or services.

1. Maintenance of Records
2. Debtors Policy



3. Age-wise classification of total Debtors as on —/—/— (cut-off date)

4. Ageing of Major Debtors

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

A specimen of Analysis of Book Debts is as follows :

Sl. No.	Name of Debtor	0-60 Days	60-90 Days	90-180 Days*	Over 180 Days	TOTAL
1						
2						
3						
4						
5						

The above analysis of debtors constitutes 65% of total outstanding debtors if vigorous follow up for recovery can improve its liquidity and improve profitability by lowering Interest Cost of outstanding debtors.

### Drawing power

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

The value of Primary security i.e. Stock and Receivables change on a daily basis, at the time of disbursement of fresh Cash Credit Limit the bank taken the value of Security in the format of monthly stock statement and calculate the drawing power in the following method:

Type of Security	Value of Security (A)	Margin (B)	Drawing Power (C=A-B)
Paid Stock			
Receivables			
<b>Total</b>			

The Actual Drawing Power as calculated above or sanctioned limit whichever is less. Bank will not allow the borrower to draw more than actual Drawing Power/Limit. After disbursement the borrower



need to submit the Monthly stock Statement as on the last date of month within 10/15 days in the next month. If the borrower failed to submit the monthly stock statement bank must charge penal interest for the delay period and can stop the borrower to withdraw fund from Cash Credit Limit.

### **Inventories**

Inventories denotes tangible property held for sale in the ordinary course of business or in the process of production for such sale or for consumption in the production of goods or services for sale, including maintenance supplies and consumables stores and spare parts meant for replacement in the normal course. Paid Inventories refers to the Inventories which are fully paid i.e. excluding Sundry creditors.

### **Limit sanctioned**

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

### **Margin money**

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

### **Memorandum of satisfaction**

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

### **Mortgage**

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

### **Types of Mortgages**

Section 58(a) of the Transfer of Property Act 1882 deals with mortgage. Accordingly, the necessary ingredients of a mortgage are:



Transfer of interest in specific immovable property.

Transfer is for the purpose of securing the payment of money advanced or to be advanced by way of loan.

It may be existing and future debt.

It may be also for performance of an engagement, which may lead to financial liability.

### **Different types of mortgages:**

There are 6 types of mortgages. They are :

Simple Mortgage.

English Mortgage.

Equitable Mortgage or Mortgage by deposit of title deeds.

Usufructuary Mortgage.

Mortgage by Conditional Sale.

Anomalous Mortgage.

### **Simple Mortgage or Registered Mortgage**

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

### **English Mortgage**

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

### **Equitable Mortgage**

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

### **Mortgage by conditional Sale**

Where the mortgagor ostensibly sells the mortgaged property

- On condition that on default of payment of the mortgage-money on a certain date the sale shall become absolute, or



- On condition that on such payment being made the sale shall become void, or
- On condition that on such payment being made the buyer shall transfer the property to the seller.

The transaction is called a mortgage by conditional sale and the mortgagee a mortgagee by conditional sale. Provided that no such transaction shall be deemed to be a mortgage, unless the condition is embodied in the document this effects or purports to effect the sale

### **Usufructuary Mortgage**

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

### **Anomalous Mortgage**

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

### **Difference between Mortgage and Pledge**

Mortgages are dealt as per Transfer of Property Act, 1882 whereas Indian Contract Act, 1872 deals with pledge.

Pledge is the bailment of goods, as security for payment of debt, performance of promise. The creditor holds the possession of goods as security, but has no right of foreclosure; as there is no transfer of ownership. The right of enjoyment of property is not given to the pledgee.

While, transfer of possession is very important in case of pledge it is not necessarily so in case of mortgage (depending upon type of mortgage).

In mortgage there is transfer of interest, whereas in case of pledge, the pledgee has only special right of detaining the goods till repayment of loan.

Mortgagor has right of redemption and mortgagee has right of foreclosure, whereas the pledgee does not have right of foreclosure.

### **Differences between “Mortgage” and “Charge”**

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

In other words –

A “mortgage” effectuates transfer of property or an interest therein but there is no such transfer in “charge”. Every ‘mortgage’ is a ‘charge’ but every ‘charge’ is not necessarily a ‘mortgage’.



### **Non-performing assets**

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

A Non-performing asset (NPA) shall be a loan or an advance where;

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

### **Out of Order / Irregular account**

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

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

### **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.

**Paid Stock:** Paid stock means the stock against which payment is made to the supplier i.e.

$$\text{Paid Stock} = \text{Stock} - \text{Trade Creditor}$$

Inventories thus normally comprise of

- (1) Stores
- (2) Spare Parts
- (3) Loose Tools
- (4) Maintenance supplies



- (5) Raw materials including components
- (6) Work-in-Process
- (7) Finished Goods including by-products
- (8) Waste or By-products etc.

## **Pledge**

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

**Stock:** Stock is the tangible current asset of a business unit held for sale in ordinary course of business (for both manufacturing and trading unit) or in the process of production for sale or for consumption in the production of goods for sale (for manufacturing concern) or rendering services (service sector).

## **Stock statements**

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

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

**Monthly Stock Statement:** It is the statement submitted by borrower which enables bank to calculate the drawing power. It differs from Bank to Bank. A sample format of Monthly stock statement is attached herewith as **Annexure A**.

**Quarterly Information Statement (QIS-I) or Financial Follow up Report (FFR-I):** The Borrower need to submit this statement on quarterly basis i.e. June, September, December and March. This statement need to submit within 45 days from the end of the relevant quarter otherwise bank will charge penal interest. The format of this return again varies bank to bank. Format of FFR-I of XYZ Bank is attached herewith as **Annexure B**.

**Quarterly Information Statement (QIS-II) or Financial Follow up Report (FFR-II):** The Borrower need to submit this statement on half yearly basis i.e. September and March. This statement need to submit within 60 days from the end of the relevant Half Year otherwise bank will charge penal interest. The format of this return again varies bank to bank. Format of FFR-II of XYZ Bank is attached herewith as **Annexure C**.

## **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. It is essentially the extent of contribution by the borrower to finance current assets which is also known as working capital margin.

## **STOCK AUDIT PROCEDURE**

### **Responsibility of the Auditor**

The responsibility of an auditor lies towards the employing authority and the authority, which regulates the profession. In case of Inventories audit, the bank or the financial institution employs the auditor. They place reliance on the audit report and act accordingly, due to which the auditors are responsible to them. The reports issued by the auditor also cater to the needs of others including the investors, society, creditors, etc. The importance of Inventories audit is not limited to only compliance and discharge of responsibility. Inventories Audits also acts as a warning signal to those accounts, which are expected to turn into Non-performing assets (NPA). It may be possible that certain advances are potential NPAs and their timely detection may prevent them from turning into actual NPAs. The auditor should try to detect such inconsistencies and plug these loopholes so as to prevent the misuse of funds. Thus, the Inventories audit assists the bank in the process of early detection and prevention of NPAs, so that appropriate action can be taken and such instances avoided. Auditors can perform this function in view of their expertise in this area and help banks form a judgment. The Auditor thus should see to it that the purposes for which the Inventories audit is undertaken are served satisfactorily.

Special considerations while conducting Stock Audits:

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

After receiving the Allotment letter as Stock Auditor following procedures need to be followed:

- A. Obtain Detailed information from Bank related to Borrower.



- B. Analyze the information and prepare a Audit Checklist.
- C. Obtain information and documents from the Borrower.
- D. Physical Verification of Stock.
- E. Detailed scrutiny of the Borrower's accounts at the borrower's office.
- F. Discussion with the Borrower's Representative relating to Audit findings.
- G. Discussion with the Advance / Credit officer of the Bank.
- H. Preparation of the Audit Report.

**A. Obtain Detailed information from Bank related to Borrower:**

Stock Auditor should collect the following documents / information from the Bank:

1. Latest Sanction letter issued by the bank to the borrower
2. Monthly Stock Statement submitted by the borrower for last 12 months
3. QIS-I & II or FFR I & II submitted by the borrower in last one year
4. CMA Data Report submitted by the borrower as a part of fresh loan or renewal proposal.
5. Bank statement of the Borrower Account(s) for last 12 months
6. Balance outstanding in all accounts of the borrower e.g. FD, LC, BG, Bills Purchased/ Discounted at Bank etc.
7. Copy of the constitution of the Borrower entity i.e. Memorandum and Article of Association for Private Limited / Public Limited company, Partnership Deed for partnership entity
8. Particulars of Collateral Securities and related documents
9. In case of company copy of CHG-I for charge creation or modification
10. Check Pre-disbursement (e.g. Loan Agreement, Agreement with Guarantors/Co-borrowers, Demand Promissory Note, Letter of Continuity etc. and Post disbursement documents like insurance policy etc.
11. Prepare a list of adverse comments /pending compliances as pointed out in various Audit e.g. Concurrent Audit, Internal Audit, Statutory Audit etc.
12. Quarterly Due Diligence Report as per RBI norms submitted by the company if applicable.
13. Collect the contact details of Borrower from Bank.

**B. Analyze the information and Prepare a Audit Checklist:**

1. **Sanction Letter:** From the sanction letter note the sanction amount of various facilities i.e., Cash Credit / Letter of Credit (LC) / Bank Guarantee (BG), Margin on various facilities e.g., for Cash Credit, margin on stock and margin on receivables, For LC/BG margin by way of Fixed Deposit, Collateral security requirements, pre and post disbursement documents required as per sanctioned terms, any other special terms and conditions.



2. **Monthly Stock Statement:** Every bank has their own format of stock statement. But generally in every stock statement some basic points are covered i.e. Details of Stock, Debtors wise Ageing of Receivables, details of Sundry Creditors, Sale for the month, Cumulative sales up to the month, Calculation of Drawing Power etc. A sample format of these statements is given as **Annexure A**. Margin on stock and Receivables again varies from Bank to Bank and borrower to borrower. Generally margin against stock is 25% and margin against Receivables is 35% to 40%. The time limit of date of submission of monthly stock statement varies between 10 to 15 days. From the stock statement following points to be checked and noted for future action:
- (a) **Date of Submission of stock statement:** Check whether there is any delay in stock statement and note the same to check with bank (**As per Point No. G - Below mentioned Table**) whether there is any penal interest charged by the bank or not.
  - (b) **Sales figure:** Check the cumulative sales figure of the current month with the previous month's stock statement e.g. If auditor is checking the stock statement for the month of August 2016 then Check the cumulative sales figure for the month of July-2016 say it is Rs 14 Cr and current month sales as per August 16 statement is Rs 3 Cr then the accumulated sales figure upto Aug 16 should be Rs 17 Cr. If this figure is not tallied with the cumulative sales note the same as discussion point (**As per Point No. F – Below mentioned Table**). Also prepare a month wise sales trend for 12 months to check with the Accounts of the borrower as mentioned (**As per Point No. E – Below mentioned Table**) and also the seasonability of the business
  - (c) **Paid up Stock figure:** Prepare a month-wise paid up stock figure in the following format for 12 months to check with the Accounts of the borrower as mentioned in (**As per Point No. E – Below mentioned Table**) and whether the respective months Drawing Power calculation submitted by the borrower reflected the correct paid up stock figure or not and keep it a discussion point under (**As per Point No. F – Below mentioned Table**).
  - (d) **Debtor's Ageing:** Generally Bank is funding Receivables upto 60 / 90 days. Check whether Party wise Analysis is given in the stock statement or not. IF no then it is a serious fault from the Bank and negligence of the Credit officer. Then the stock Auditor has to take up as discussion point under (**As per Point No. G – Below mentioned Table**). If yes then take a note of all parties where outstanding is more than 60/90 days as the case may be for checking under (**As per Point No. E – Below mentioned Table**). Also Stock Audit should take a note of top 10 parties (sample size depends upon the list of receivables) where receivables within 60 days to check their ledger (**As per Point No. E – Below mentioned Table**).
  - (e) **Drawing Power Calculation:** Check the drawing power calculation for each month and if there is any differences note it as a discussion point under (**As per Point No. F – Below mentioned Table**). Care should be taken to exclude the outstanding creditors and applicable margin money requirement.



### A Sample Stock Audit Working Note

Particulars	Apr-16	May-16	Jun-16	Jul-16	Aug-16	Sep-16	Part of Point
Last date of Submission (A)	10-May	10-Jun	10-Jul	10-Aug	10-Sep	10-Oct	
Actual Date of Submission(B)	8-May	12-Jun	11-Jul	9-Aug	10-Sep	15-Oct	
Delay in Submission of Stock Statement (C=A-B)	-2	2	1	-1	0	5	G
Fig Rs in Cr							
Accumulated Sales upto Last month (D)	0.00	4.50	10.00	14.00	17.00	20.50	
Current Months Sales (E)	4.50	5.50	4.00	3.00	3.50	5.00	E
Accumulated Sales upto Current Month (F)	4.50	10.00	14.00	17.00	20.50	25.50	
Accumulated Sales as per Stock Statement (G)	4.50	10.00	14.00	18.00	21.00	25.50	
Difference (H=F-G)	0.00	0.00	0.00	-1.00	-0.50	0.00	F
Stock (I)	2.00	2.25	2.10	2.50	3.00	2.75	F
Sundry Creditors (J)	1.25	1.40	1.30	1.50	2.25	1.80	F
Paid up Stock (K=I-J)	0.75	0.85	0.80	1.00	0.75	0.95	E
Paid up Stock as per DP Calculation (L)	0.75	0.90	0.80	1.10	0.80	0.95	E
Difference (M=K-L)	0.00	-0.05	0.00	-0.10	-0.05	0.00	F



Calculation of Drawing Power							
Paid up Stock (K=I-J)							
Receivable within 60/90 days (N)							
Total Value of Security (O)							
Drawing Power (P)							
Drawing power as per stock statement (Q)							
Difference (R )							F

Name of Party	0-30 Days	30-60 Days	More than 60days	Total Out standing
<b>Parties having Outstanding more than 60 days bucket</b>				
A				
B				
C				
D				
E				
F				
G				
H				
<b>Total</b>				
<b>Parties having Outstanding within 60 days bucket</b>				
I				
J				
K				



L				
M				
N				
O				
P				
Q				
R				
<b>Total</b>				

3. **QIS-I or FFR I submitted by the borrower in last one year:** Format of QIS I or FFR I varies from bank to bank. Format of FFR I of State Bank of India is attached here with as **Annexure B** for easy understanding. In QIS I or FFR I following informations are available. Annual Projection of the current year, actual figure of the last year and actual of the Quarter under reporting relating to Sales, Debtors, Stock, Other Current Assets, Total Current Assets, Bank Borrowing, Sundry Creditors, other Current Liabilities, Total Current Liabilities. Auditor should check and note the figures as stated below:
- Projected Figures:** Check the projected figures given in QIS I with the CMA data Report submitted by the company. If not take a note for discussion as per **Point No. F & G mentioned in above Table.**
  - Actual Figures related to last year:** Check the actual figures of the last year with Audited Accounts and CMA data Report submitted by the company. If not take a note for discussion as per **Point No. F & G mentioned in above Table.**
  - Actual of the Quarter under Reporting:** Check these figures as a part of **Point No. E mentioned in above Table.**
  - Check figures of QIS w.r.t. Monthly Stock Statement:** Check whether the figures related to stock, Sundry Debtors, Sundry Creditors and Bank Borrowing given in QIS I is tallying with the monthly stock statement of the relevant month i.e., figures of QIS I for the Quarter ending September 2016 should tally with figures of Monthly stock Statement submitted for the month of September 2016. If the same is not tallied it should be covered under **Point No. F mentioned in above Table.**
  - Sales Figure:** Check the actual Sales figure with monthly stock statement and VAT return (if applicable). If there is any difference the same need to be covered under **Point Nos. E & F mentioned in above Table.**
  - Net working Capital:** If there is a huge change in Net working capital w.r.t. the last financial year or last quarter the same should be noted and should be covered under **Point Nos. E & F mentioned in above Table.**



- (g) **Achievement of Projection:** The auditor should report the deviation between projections and actual reported in QIS I in **Point No. H mentioned in above Table.**
4. **QIS-II or FFR II submitted by the borrower in last one year:** The format of QIS II or FFR II varies from Bank to Bank. Format of FFR II of State Bank of India is attached here with as **Annexure C** for easy understanding. Generally QIS II or FFR II having two parts. First part deals with Profitability while the second part with Cash Flow. Each report covers the figures of the last year, current year projection and actual achievement during the period under reporting. Stock Auditor need to check to ensure the followings :
- (a) **Last year's actual:** The auditors should check the figures of last year's actual with the audited balance sheet and if there is any difference the same need to be covered under **Point No. H mentioned in above Table.**
- (b) **Projected Figures of the current year:** The auditors should check the figures of I with the audited with the CMA DATA Report submitted by the borrower and if there is any difference the same need to be covered under **Point No. H mentioned in above Table.**
- (c) **Actual Achievement during the period:** The auditors should check the actual figures under **Point Nos. E, F &H mentioned in above Table.**
5. **Variation between QIS I / II with Audited Accounts:** The Stock Auditor needs to check the QIS I & II for the quarter ending March with the Audited Accounts and if there is any wide variation the same should be covered under **Point No. G mentioned in above Table.**
6. **Bank statement of the Borrower Account(s) for last 12 months:** 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 Over drawn
Apr-16						
May-16						
Jun-16						
Jul-16						
Aug-16						
Sep-16						
Oct-16						
Nov-16						
Dec-16						
Jan-17						
Feb-17						
Mar-17						



Auditor should check with the Bank as per **Point No. G** whether the overdrawing is approved by the appropriate authority and include the same along with the above table in the audit report.

7. **Bank Statement with other Banks:** If the borrower is maintaining any account with the banks other than the lender check the Bank statements properly and take notes which will be required in **Point Nos. F, G and H mentioned in above Table.**

**C. Obtain information and documents from the Borrower:** Stock Auditor should collect the following documents / information from the Bank:

1. Audited financial Statement of the last financial year.
2. Stock and Receivable statement as on the date of inspection.
3. Trial Balance or Provisional accounts as on the date of inspection.
4. Copy of insurance policies for both Primary and Collateral Security.
5. VAT/GST Return if applicable.
6. List of Bank Accounts maintained by the Borrower with other Banks (i.e. other than the lender Bank) and Bank Statement of those accounts for last 12 months.

**D. Physical Verification of Stock:** After collecting the detail information and scrutinize the same as stated in A, B & C, Stock Auditor should visit the Godown / stock yard or Factory Premises of the borrower to physically verify the stock which can be Raw Material, Stores & Spares, Work in Process and Finished Goods. The steps of Physical verification of stock is given below :

1. **Display of Board:** At the time of entering the Godown the stock Auditor should check whether Bank's name and hypothecation is properly displayed.
2. **Organization Structure of Godown:** Stock Auditor should meet the go-down in charge and note his contact details and organization structure of the Go-down i.e., number of staffs working, name and section in charges, reporting structure etc.
3. **Inventory Policy:** Stock Auditor should enquire whether there exists any stock manual, inventory policy (e.g. maintenance of average inventory, reordering level) inventory management, valuation policy of inventory etc.
4. **Physical Verification:** Physical verification should be done before starting of the operation or after ending of the normal operation of the stock yard. For continuous process industry physical verification should be done at the time when pressure of the normal operation is relatively less. The steps involved in physical verification is enumerated below:
  - (a) The stock auditor needs to take a total list of inventory along with the quantity and value.
  - (b) Physically verify the stock w.r.t. that list either entire or sample basis depending upon the volume of total stock. Though the sample depends upon the stock Auditor but he should ensure that at least 40% of the total value of stock is covered.



- (c) If there is any difference Auditor should note it for reporting purpose.
- (d) Verify the list of stock with Stock Register or excise 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		

- 5. Value of Stock:** Check the Rate & value given in the list w.r.t. the valuation policy of the borrower.

#### Valuation of Inventories

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

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

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

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

1. Find out the cost price of the Inventories
2. Determine the market value of the Inventories
3. Since different types of Inventories require different methods of valuation, ascertaining



the appropriate method of valuation and valuing it accordingly

4. Value the obsolete inventories/non-moving/scrap inventories

**Actual Cost of the Inventories:**

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

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

**Method of Valuation:**

The term, cost price is elusive since it is not well defined anywhere. The auditor has to use his discretion to decide which method of ascertaining the cost price best suits his requirement. There are various methods that can be adopted. However, the Institute of Chartered Accountants has prescribed the methods that are mandatory for the valuation of inventories, by means of the Accounting Standard-2, which deals with the valuation of inventories.

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

A brief idea of these methods is given as under:

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

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

Auditor should ascertain if there is any change in the method of valuation of inventories as it may have serious impact on the value of stock. Stock Account Report must contain specific comments and the implications of change in the valuation method on value of stocks from the lender's point of view.



### **Compliance with the sec. 145A**

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

In accordance with the method regularly employed by the assessee:

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

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

### **Market price of the Inventories**

After having arrived at the cost price of the Inventories, on the basis of the aforementioned parameters, the auditor has to find out the market price of the Inventories. As the Inventories is to be valued at cost or market price whichever is lower, it is an important step in the process of valuation. The market price may seem to be a very simple term, in the sense that it is the price of the Inventories that prevails in the market. However, in order to arrive at the market price, the purpose for which the Inventories is held is to be found out. If it is held for use then the market value is the value arrived at net of selling expenses. Similarly, if the Inventories is required to be replaced, then the cost of replacement as on the date of balance sheet should be taken as the market price. A recent purchase invoice could also be an indicator of market price of raw material while a sales invoice could indicate market price of finished goods.

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

### **Valuation of different types of Inventories:**

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

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



- (b) **Spare Parts:** It refers to the parts that form part of any Plant and Machinery. If any such spare part is consumed, they should be capitalized as part of the asset they have been used for. Spare parts should be valued at the cost price only. It is the duty of the auditor to get a list of these spare parts from the Works Manager so that he can verify their existence.
- (c) **Raw Materials:** It consists of the Inventories that is consumed in the process of manufacture. Raw material is valued at the invoice price, i.e. the cost price plus a reasonable proportion of freight, duty, etc that has been paid with regard to the Inventories. Either the actual cost or the average price can be taken as a method of valuation of raw material, depending upon the availability of data. For any diminution in the value of the raw materials, sufficient provision of the fall in the value should be made.

The raw materials should be valued at a price, which is never higher than the market price. In case of the goods, whose value appreciates with the passage of time, they are valued at a price higher than the cost price. It is the auditor's duty to see to it that they are not valued at a price that is higher than the price of the similar goods.

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

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

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

- (e) **Finished Goods:** The Finished goods are valued at the cost price. The cost price is arrived at after adding all the expenses incurred in the process of manufacture. The auditor should verify that the expenses have been appropriately apportioned.
- (f) **Goods on Consignment:** It may happen sometimes that the goods are sent on a consignment basis and they do not arrive till the date of the balance sheet. In this case, the goods should be valued at the cost price plus proportionate expenses like, freight, dock dues, etc. the auditor should insist on the consignee to verify the quantity of Inventories lying with him. Any expenses incurred during the process of sale, it should be allocated only to the goods sold and not added to the unsold Inventories. Here again the principle of conservatism should be followed, a price higher than the market price should not be taken, while provision for losses should be done. If the Inventories is valued at selling price, when sent as a consignment, it should be ascertained that the Inventories should be valued after making the adjustments, or else the Inventories will



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

(i) For Raw Material:	$\frac{\text{Actual Holding}}{\text{Annual Raw Material Consumed}} \times 365$
(ii) For Inventories in Process:	$\frac{\text{Actual Holding}}{\text{Annual Cost of Production}} \times 365$
(iii) For Finished Goods:	$\frac{\text{Actual Holding}}{\text{Annual Cost of Sales}} \times 365$
(iv) For Sundry Debtors:	$\frac{\text{Actual Outstanding Debtor's}}{\text{Annual Sales}} \times 365$
(v) For Sundry Creditors =	$\frac{\text{Actual Sundry Creditors}}{\text{Annual Purchases}} \times 365$

A comparison of holding period so arrived is considered desirable with the industry's benchmarks.

#### **Valuation of Obsolete / Dormant / Slow-moving / Excess Inventories:**

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

- Discontinuation of the product in the market
- Physical Deterioration
- Change in the design of the product
- Substitution by a better material in lieu of the existing one.

The auditor should make an effort to find out the inventories that have become obsolete due to any of the above reasons. After preparing a list of them, they should be presented to the management who can decide whether they should be disposed off or kept. Obsolete inventories should be valued at net realizable value, if any.

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



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

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

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

**Controls that should be exercised by the auditor:**

**(i) Controls with regard to the scrap, waste and spoilage:**

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

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

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



**(ii) Controls with regard to stores maintenance:**

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

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

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

The cost of Inventories includes

- Cost of purchases
- Cost of conversion comprising of cost of direct labor and
- Allocated Fixed and variable overheads.

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

- (a) He should ascertain the accounting policy adopted for valuation of stocks and consider the appropriateness as per AS-2
- (b) He should verify that the cost of Inventories does not include:
  - I. Abnormal waste material, labor or other production costs
  - II. Storage cost unless necessary in the production and manufacturing process
  - III. Administrative overheads not contributing to bringing the Inventories to the present location



IV. Selling and distribution expenses

V. Interest cost

- (c) He should check the basis for Net realizable value determination
- (d) He should ascertain that the cost of damaged and obsolete item is written off
- (e) He should check the arithmetic accuracy of stock valuation
- (f) He should check the consistency of the basis of valuation.
- (g) He should review Inventories records for identifying slow moving and obsolete items
- (h) He should review the system of overheads allocation

**6. Stock Reconciliation:** Reconcile the stock as per stock list as on date of inspection with the last stock submitted by the borrower by the following formula:-

*Stock as on date of inspection = Stock as per last stock statement + Purchase during the period - Stock issued during the period.*

**7. Slow Mon Moving and obsolete stock:** Calculate the stock Turnover Ratio of last 12 months by the following formula and calculate the average of the same:-

*Stock Turnover ratio (in days) = ((opening Stock + Closing Stock)/2) X 365 / Material Consumed during the month.*

On the basis of the average Stock turn Over Ratio the auditor should prepare the ageing report of stock. 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 in Quantity	Value of Stock

In the above sample format we have considered that average stock turnover ratio is 20 days. Slow moving items are 21-180 days bracket. Non moving items on the basis are more than 180 days. In addition to ageing Auditor need to identify the obsolete stock perishable goods or change in technology etc.

**8. Internal Control System:** The stock auditor should check the internal control system e.g.:

- (a) Process of issue of inventory items both from Stock and from different process.
- (b) Regular physical verification stock and action taken report on the same.



- (c) Treatment of difference in the accounting system.
- (d) Action taken if any on obsolete / breakage/ scrap items on a periodical basis.

**E. Detailed scrutiny of the borrower accounts at the borrower's office:** The Stock auditor needs to check following points as described in Part C:

- 1. Sales Figure:** Check the monthly Sales figure as appeared in Monthly Stock Statement with the Sales ledger maintained by Borrower. If there is any difference take explanation from the Borrower. Also if there is any difference in Sales figure between Monthly Stock Statement, QIS / FFR and VAT/GST return if applicable as covered in **PARA C2(b)** please take an explanation from the Borrower on the same. Please check whether sales figure includes sales to sister concern or related parties and note it down for reporting.
- 2. Stock Figure:** Check monthly stock figures as appeared in Monthly Stock Statement with the Accounts maintained by Borrower as covered in **PARA C2(b)** please take an explanation from the Borrower on the same.
- 3. Debtors:** Check the Debtor's balance as appeared in Monthly Stock Statement with the Accounts maintained by Borrower and take an explanation from the borrower. If the borrower is not submitting the details of ageing in monthly stock statement point out the same to Borrower and prepare an ageing on the date of inspection by checking the Debtors ledger. If the borrower is providing the ageing in Monthly Stock Statement then the stock Auditor should check the Ledger of the debtors as per the list prepared by the Stock Auditor applicable as covered in **PARA C2(e)**. To check whether Debtor includes any sister concern or related party and if yes then deduct the total outstanding amount of related party from Sundry Debtors for calculation of Drawing Power.
- 4. Sundry Creditor:** Check monthly sundry creditors figures as appeared in Monthly Stock Statement with the Accounts maintained by Borrower please take an explanation from the Borrower on the same.
- 5. Purchase Bill:** Check some purchase Bill to confirm the ownership of the stock and genuineness of sundry Creditor value.
- 6. Sales Bill:** Check some Sales Bill along with challans and excise pass if applicable to confirm the genuineness of sundry Debtor value.
- 7. Balance Confirmation from Debtors:** Stock Auditor need to collect Balance Confirmation certificate as on the date of inspection from some high value Debtors.
- 8. Figures of QIS I & II:** Stock Auditor need to check the actual figures of QIS I & II with Accounts as covered in **PARA C 3, 4 & 5**. If there is any difference that need to be pointed out to the borrower. If change in Net working capital is substantial then scrutinize the accounts to find the reason for that. Whether it is due to increase / decrease of Non Current Assets and Liabilities, fresh capital infusion etc.
- 9. Insurance Policy:** Check the insurance policy of both stock and collateral security to ensure proper Bank clause is incorporated, value of insurance policy is adequate, whether the same is expired or not etc.



Adequacy of Insurance in force

- Whether stocks at all works/ godowns including stocks lying in third party godowns are covered.
- Nature and details of risk coverage
- Verification of adequacy of insurance with stocks statements of the last 6 months since under insurance may result into proportionate claim settlement.

**10. Collateral Security:** Stock Auditor need to check whether proper collateral Securities have been taken by the Bank as per sanctioned terms and conditions and proper charge has been created or not.

**11. ROC Compliance:** Auditor needs to check whether CHG I have been properly filed within the specific time limit. Auditor need to check various Annual compliance relating to MCA e.g. Form AOC-4, Form MGT 7 etc. Auditor should also check whether Audited Balance Sheet submitted to bank tallies with that submitted to ROC. Auditor need to check Board Minutes Book and AGM Minutes Book with special attention whether Board Resolutions submitted to Bank is duly recorded in the minute's book.

**12. Calculation of Drawing Power :-**On the basis of aforesaid Checking Stock Auditor need to calculate the actual Drawing Power of the borrower for last 6 months (at least for the last month) and on the date of inspection and report it in the Stock Audit Report.

**13. Utilization of Bank Limit :-**If the borrower maintain a current account either with the lending bank or with any other bank, the stock auditor need to know the reason of the maintaining such account and check the transaction of the Current Account(s) to know whether any part of the collection of the receivables is diverted to any other purposes.

**14. Borrowing from the Other Banks:** One of the common sanction condition of Cash Credit limits is that the Borrower cannot take any type of loan (including term loan) from other bank without the consent of lender Bank. Stock Auditor need to check whether the Borrower has taken any loan from other Bank and if so then whether proper approval has been obtained from the lending Bank.

**15. Bank Reconciliation Statement:-**Check the Bank Reconciliation statement of Cash Credit Accounts and all Other Current Accounts.

**F. Discussion with the Borrower's representative relating to Audit findings:**

Various issues mentioned in Sl. No. E are to be discussed in detail either with borrower or borrower's representative and get the clarifications from them to give a qualitative stock and debtors audit report to the Bank.

**G. Discussion with the Advance / Credit Officer of the Bank:** - As a good practice before submission of the Stock Audit Report the stock Auditor should discuss the findings with concerned credit / Advance officer of the Branch. The discussion points can be classified in the following broad groups:



## 1. Compliance of Sanctioned Terms and Conditions:

- (a) **Renewal cum enhancement letter:** No fresh renewal letter of the existing limit is issued by the branch, instead of that approval note of the higher authority ( Regional office / Zonal Office or Head Office) is just forwarded to the borrower
- (b) **Defective Pre Disbursement Documents:** There are some errors in the pre disbursement documents **as mentioned in Para A 10.**
- (c) **Non Compliance of Audit findings:** Comments on the pending compliances as mentioned by Concurrent Auditor / Internal Auditor or Stock Auditor has not been complied with.
- (d) **Collateral Security:** Proper collateral security as per sanctioned letter is not taken e.g.
  - ✓ Sale deed is not taken only Registered Sales Agreement had been taken.
  - ✓ Sales Deed taken but the Registered Sales Agreement had not been taken so there may be a possibility of double funding against same security.
  - ✓ Value of the collateral security is in adequate.
  - ✓ Legal vetting Report, valuation Report are not with the branch custody.
  - ✓ The original document has not been kept in fire proof cabinet.
- (e) **Fresh Stock Statement:** Fresh stock statement has not been taken before releasing the documents.
- (f) **Due Diligence Report:** In case of multiple banking due diligence report is not taken from the borrower. Annexure II has not been exchanged with the existing bankers.
- (g) **Post Disbursement Documents:** Fresh insurance policy of the enhanced limit has not been taken. For fresh limit insurance policy is not taken or Bank clause is not incorporated. Policy value is inadequate to cover the risk. ROC charge has not been created or modified.

## 2. Various Returns:

- (a) **Delay in submission of Stock Statement / QIS:** Stock Statement or QIS returns not submitted within specified time period. But no/inadequate penal interest has been charged by the bank.
- (b) **Stock Statement:** Following probable irregularities might be observed during the course of audit and pointed out during discussion:
  - (i) Stock Statement submitted by the borrower either not in prescribed format of the bank or the details are inadequate e.g. the ageing of debtors is not given.
  - (ii) The figures of Inventory, Receivables, Sundry Creditors and Sales given in the stock are not tallied with the accounts of the borrower.
  - (iii) Stock is overvalued. Stock in transit and advance given to supplier has been considered as stock.



- (iv) Stock includes non-moving and obsolete Stock.
- (v) Sundry Debtors includes receivables more than 60 / 90 days and also includes due from Sister Concern or related parties.
- (vi) Sundry Creditors is undervalued.

All the above points affect the Drawing Power Calculation and resulting actual drawing power is much less than the claimed one.

**(c) QIS / FFR:**

- I. Figures of QIS I/FFR-I** The figures related to Sales, Receivables, Sundry Creditors, Bank Borrowing are not tallied with Monthly stock statement submitted by the borrower and the same was not pointed out by the Bank officer.
- II. Last year's Actual & Current year's estimation** as provided in QIS I / FFR I are not tallied with Audited Balance Sheet and CMA DATA Report.
- III. Figures in QIS I / FFR-I** particularly related to Other Current Assets & Other Current Liabilities is not tallied with the accounts maintained by the Borrower.
- IV. Change in Working Capital:** The working capital is decreased in the last Quarter w.r.t the last year is due to payment of long term loan or investment in Fixed Asset.
- V. Difference between Annual Accounts and QIS I/ FFR I for the fourth Quarter:** The figures of QIS I or FFRI (Current Asset & Current Liabilities) for the fourth Quarter ending on 31.03.2016 differs hugely with the Audited Accounts for the financial year 2015-16. After receiving the Audited Balance Sheet the Bank officer has not checked the QIS I / FFR I and pointed out the same.

**(d) QIS II & FFR II:** Please refer format of QIS II & FFR II

- (i) **Last year's Actual & Current years estimation** related to Profit & Loss Account and Balance Sheet as provided in QIS II & FFR II is not tallied with Audited Balance Sheet and CMA DATA report submitted by the Borrower. Also figures corresponding 6 months ended 30.09.2015 as provided in FFR II for Sept 2016 is not tallied with the FFR II submitted by the borrower 1 year back.
- (ii) **Growth & Achievement:** The auditor should discuss the growth of the company in the current with respect to previous year and also achievement of Annual projection.

**3. Findings of Godown visit of the Borrower:** The auditor should discuss any adverse findings relating to the followings:

- (a) Display board
- (b) Inventory System
- (c) Difference in Stock taking as mentioned in Part D 4.



- (d) Slow moving & non moving stock.
- (e) Insurance Policy on Stock
- (f) Safety arrangement of Stock
- (g) Stock Reconciliation
- (h) Valuation of Stock
- (i) Direct access to Godown

**4. Findings of office Visit of the Borrower:** The auditor should discuss any adverse findings relating to the followings:

- (a) Accounting System
- (b) Bank Limit utilization and diversion of fund
- (c) Over utilization and proper approval
- (d) Debtors Ageing and Debtor turnover ratio
- (e) Obsolete/ other Current Assets
- (f) Collection of receivables vis-a-vis turn over in the accounts
- (g) Drawing Power
- (h) Fund Flow and Ratio analysis.
- (i) ROC Charges
- (j) Any other findings.
- (k) Change in valuation method and its impact
- (l) Comparison with industry benchmark

**H. Preparation of Audit Report:**-Except some Banks there is no standard format of Stock Audit Report and the same varies from bank to bank. The contents of the standard Stock Audit Report will be discussed in the Next Part. As a good practice at the starting of the Audit Report there should be an Executive Summary which reflects major adverse findings. It will help the higher officials of the bank (Zonal Manager / Regional Manager etc. At the time of preparation of Audit Report, Stock Auditor need to keep the following things in mind:

1. Report should not be biased. It should be objective and fair.
2. All the figures and comments mentioned in the Audit Report should be backed by supporting material.
3. Explanation of the Borrower during the discussion should be incorporated with every adverse finding.
4. Discussion and comments of the Credit officer should be incorporated suitably.

## UNIT-V

### CONTENTS OF STOCK AUDIT REPORT

As a good practice at the starting of the Audit Report there should be following two parts:

- A. Executive Summary:** Executive Summary which reflects major adverse findings. It will help the higher officials of the bank (Zonal Manager / Regional Manager Etc.) to have an impression about the borrower without going through the detail audit report.

**Borrower's Profile:**

1.	Name of Concern		
2.	Constitution		
3.	a) Registered Office Address		
	b) Corporate Office Address		
	c) Works/ Factory & Godowns' Address		
4.	Name of Directors	a)	
		b)	
		c)	
		d)	
5.	Nature of activities and Products Manufactured		
6.	Date of Incorporation		
7.	Dealings with Bank (which has appointed us)		Since .....
8.	Other Banks and facilities being enjoyed	a)	Bank of India
		b)	Oriental Bank of Commerce
9.	Name & Address of Statutory Auditors		M/s ABC & Co. Cost Accountants/Chartered Accountants ..... ..... .....
10.	Name of the Branch Officials contacted/ discussed		



11.	Borrower's Representative, contacted/ discussed	
12.	Duration of Audit	From            To No. of days visited/deployed :
13.	Value date of stocks	DD/MM/YY

**Shareholding Pattern:**

Shareholding pattern as per last audited accounts be reviewed with terms and conditions of sanction letter if any regarding sale/ transfer/ mortgage of shares by Promoters/ promoter company/ associate concern and any deviation should be reported. The shareholding pattern can be verified through the Annual Return of the Company filed with Registrar of Companies.

The shareholding pattern may be reported as follows:

Sl. No.	Name of Shareholder	No. of Shares	Paid up Value	%age holding
A	Directors and their Family Members			
B	Promoter Company (ies)			
C	Associate Concerns & Group Companies			
D	Institutional Investments			
E	NRI Investments			
F	Friends and Relatives			
G	Others (Public)/Employees			

**B. Non Compliance of Various Audit Findings:** This part of the report should reflect the non compliance of various finding of Concurrent Auditor, Internal Auditor, Statutory Auditor, previous stock Auditor etc. From this part higher manager can 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. Go down condition



2. Stock Verification & 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 concern
  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 vs. Actual Achievement of the last financial year**
- I. Bank Limit Utilization**
- J. Fund Flow Statement**
- K. Ratio Analysis – More particularly the holding period of all current assets including debtors and also the availability of credit from suppliers.**

## UNIT-VI

### DETAILS OF STOCK AUDIT REPORT

#### A. General Information

1. **Details of Bank & Branch:** Name & 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 & Line of Business
  - (e) Details of Partners, Promoters share holders and their % of share of Profit or % of share holding
  - (f) Contact Details: E Mail, Phone No., Fax No etc.
  - (g) Borrowers Address – Both Registered Office, Godown, Factory etc.
  - (h) Ownership 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 % Book Debts Upto 60 days
2	LC/BG		LC:15%, BG:20%	As per Circular	
3	Bills Purchased/ Discounted Facility				
	<b>Total</b>				



#### 4. Current position

<b>Cash Credit</b>		
Sanction Limit :	Rs. / Lacs	
Drawing Power advice by Borrower as on the date of Stock Statement	Rs. / Lacs	(Copy of Stock Statement Dated is attached here with as <b>Annexure</b> )
Drawing Power as calculated by Branch	Rs. / Lacs	
Outstanding as on last date of the Previous month	Rs. / Lacs	
Outstanding as on date of Inspection	Rs. / Lacs	
Bank Guarantee		
Sanction Limit :	Rs. / Lacs	
Utilized Amount as on last date of the Previous month	Rs. / Lacs	
Outstanding as on date of Inspection	Rs. / Lacs	
Fixed Deposits as on last date of the Previous month	Rs. / Lacs	
Fixed Deposits as on date of Inspection	Rs. / Lacs	

#### 5. Details of Unit Visit:

	<b>Name of Person</b>	<b>Venue</b>	<b>Designation</b>	<b>Contact No.</b>
<b>Name of Persons Contacted</b>		Office	Accountant	
		Godown-Dhulagarh	Godown In-charge	
		Godown-Shalimar	Godown In-charge	

#### B. Comments on Unit Visit

##### 1. Go down condition:

- Whether the Bank's Name plates with hypothecation clause is properly and visibly displayed
- Whether proper security management is there



- (c) Sufficient fire extinguisher is there as a safety measure
- (d) Whether proper arrangement is there for water logging to save the inventory
- (e) Whether the godown is directly accessible.
- (f) Whether goods are distinguished and demarcated vis-à-vis the goods of associates in the same premises.

2. **Stock Verification & Monitoring:** Verify the list of stock with Stock Register or excise 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 stock list as on date of inspection with the last stock submitted by the borrower:

Sl. No.	Stock Item	Quantification	Balance as per last Stock Statement	Purchase	Issue	Balance as on date of Inspection



**4. Capacity Utilization:**

(a) **For manufacturing company: Installed Capacity: Kg.**

Month	Actual Production	% of Utilization	Previous Year's fig	Growth
Apr-16				
May-16				
Jun-16				
Jul-16				
Aug-16				
Sep-16				
Oct-16				
Nov-16				
Dec-16				
Jan-17				
Feb-17				
Mar-17				

(b) **For Trading Concern:**

Month	Purchase			Sales		
	CY	PY	Growth	CY	PY	Growth
Apr-16						
May-16						
Jun-16						
Jul-16						
Aug-16						
Sep-16						
Oct-16						
Nov-16						
Dec-16						
Jan-17						
Feb-17						
Mar-17						

Note: "CY"- Current Year; "PY" – Previous Year



5. **Method of Valuation of Stock:** Check the Rate & 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 in Quantity	Value of Stock

7. **Value of Stock as on date of inspection:** Calculate the value of stock on the basis of 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			Asset 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 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	Bal 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 on the basis of Balance Sheet and calculate the exposure and report the same:

Sl. No.	Name of Related party	Sales upto 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 per point No 1 above and deduct the exposure on related party as per point no 3.
5. **Receivable Management:** Check the high value Debtors and credit limit provided to them. If the outstanding exceeds the limits what action Borrower has taken need 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-16						
May-16						
Jun-16						
Jul-16						
Aug-16						
Sep-16						
Oct-16						
Nov-16						
Dec-16						
Jan-17						
Feb-17						
Mar-17						

6. **Routing of Sales Proceeds:** Check whether all the collection from receivables is deposited in the cash credit account. If some amount is deposited to other current account then enquire the reason for such routing. Also following will help for some conclusions:

Month	Sales	Average Utilization of CC	Sales / Av Utilization	Credit in Bank Statement	Collection	Difference
Apr-16						
May-16						
Jun-16						
Jul-16						
Aug-16						
Sep-16						



Oct-16						
Nov-16						
Dec-16						
Jan-17						
Feb-17						
Mar-17						

7. **Deed of Assignment:** Book Debts are assigned to Bank and Deed of Assignment should be registered with the Debtors to ensure direct payment into Cash Credit Account towards realization of Book Debts.

8. **Checking of Sales Bill:** Check some Bills and report if there is any discrepancy found.

E. **Sundry Creditor:** Check the sundry Creditors w.r.t purchase bills and ask borrower relating credit period allowed by the individual Creditor. If payment is not made within the specified periods enquire the reason behind it. Prepare ageing analysis of creditors and report the same in 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 on a monthly basis 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-16						
May-16						
Jun-16						
Jul-16						
Aug-16						
Sep-16						
Oct-16						
Nov-16						
Dec-16						
Jan-17						
Feb-17						
Mar-17						

**F. RATIOS****Stock Turnover Ratio:**

To be calculated as per Audited Accounts:

Particulars	2010-11	2011-12	2012-13
Cost of Goods sold			
Opening Stocks			
Closing Stocks			
Average Stocks			
Stock Turnover Ratio			

If STR is increasing every year that means efficiency is improving and if it is decreasing that may mean more non/slow moving stocks or unusable stocks.

Similarly Sales to closing stocks should be worked out:

Particulars	2013-14	2014-15	2015-16
Sales			
Average Monthly Sales			
Closing Stock			
Closing Stock/ No. of months sale			

The closing stock to sale ratio is to be analyzed considering general trends in the industry and to indicate non saleable closing stocks or higher inventory which should be critically commented.

**Debtors Turnover Ratio (DTR):**

To be worked out as per last Audited Accounts:

Particulars	2013-14	2014-15	2015-16
Sales			
Opening Debtors			
Closing Debtors			
Average Debtors			
Debtors Turnover Ratio			

Lower DTR indicates undue long credit being allowed to customers – Comment on the trend keeping market forces in mind.

**Sales to Debtors Ratio as per last Audited Accounts:**

Particulars	2013-14	2014-15	2015-16
Sales			
Average Monthly Sales			
Closing Debtors			
Debtors in No. of months sale (X)			

This (X) should be analyzed with the terms of sanction of Book Debts/ Bill Discounting limits and excess period should be properly analyzed in calculating Drawing Power.

**G. Statutory Compliances:**

1. Check whether Sales Tax/ VAT /CST, Central Excise, Customs duty/GST paid or not.
2. Check whether relevant returns are files or not.
3. Check whether TDS / TCS returns are regularly paid or not.
4. Check whether TDS/TCS returns are filed or not.
5. Check whether any material penalty or fine is levied for non compliance of any law or regulation or delay of statutory dues.
6. Check whether Income Tax Return, ROC Return are submitted in time.

**H. Calculation of Drawing Power:** Recalculate the drawing power of the last month and as on the date of inspection in the following format with reasons.

Particulars	DP calculated by Borrower	DP Calculated by Auditor	Difference
Value of stocks (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 Co.			
Less: Customer which have an outstanding more than 90 days			



Actual Debtors			
Less: Stipulated Margin			
D.P on Book Debts (B)			
Aggregate DP(A+B)			

**I. Projection vs. Actual Achievement of the last financial year:** Prepare a variation statement for both Profit & Loss Account and Balance Sheet on the basis of 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 Years estimation, Achievement up to the date of inspection and % of achievement.

**J. Bank Limit Utilization:** 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 Over drawn
Apr-16						
May-16						
Jun-16						
Jul-16						
Aug-16						
Sep-16						
Oct-16						
Nov-16						
Dec-16						
Jan-17						
Feb-17						
Mar-17						

Also stock auditor should mention whether proper approval is there for overdrawing.

**K. Fund Flow Statement:** Stock Auditor should prepare a fund flow statement for the last 2 years and current period and make appropriate comments.



Particulars	Rs. in Lakhs.		
	2014-15	2015-16	2016-17
<b>Cash Flow from Operating Activities</b>			
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			
<b>Cash Flow from Investing Activities</b>			
Purchase of fixed assets/Capital work-in-progress and Intangibles			
Sale of fixed assets			
Investment in subsidiaries			



Investment in associates			
Investment in 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			
<b>Cash Flow from Financing Activities</b>			
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			
<b>Net increase/(decrease) in cash and cash equivalents</b>			
<b>Cash and Cash Equivalents as at the beginning of the year</b>			
<b>Cash and Cash Equivalents as at the end of the year</b>			



L. **Ratio Analysis:** Stock Auditor should prepare a ratio analysis for the last 2 years and current period and make appropriate comments.

Sl. No.	Particulars	2014-15	2015-16	2016-17
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	Raw material Input Output ratio			

**Stock Audit of Bank Borrowers  
(Synopsis)**

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 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 Professionals at frequent time intervals to conduct stock audit specifically where the exposure exceeds the predetermined threshold limit (generally over Rs. 100 Lacs).

**Appointment of Stock Auditors and Period of Audit**

The appointment of stock auditors is generally made by the regional or Zonal Offices in case of nationalized banks.

While in case of co-op banks sometimes concurrent auditors only are asked to conduct stock audit of select borrowers of the branch.

Terms of appointment are prescribed by such offices which sometimes involves conducting of stock audit as one time exercise only while in others it may be a contract for two half yearly visits during a particular financial year, of which first visit to be conducted before September and second visit before March.

The stock audit involves audit of latest stock and debtors' information of the borrower and the report should give the position of stock and debtors ideally on the date of visit.

Further it will also make examination of past data submitted by the borrower to the bank and appearing in the books of accounts of the borrower, to check reliability of information submitted by the borrower.

**Objectives of Stock Audit**

The banker appointing the Professionals for conducting stock audit has main objective of ascertaining whether the security (borrower's stock and debtors) against which finance has been made is safe and is valued correctly.



The various purposes expected to be achieved through stock audit may be summarized as follows: –

- To ensure proper preservation / storage and handling of stock. To identify whether there exist any obsolete stock & if yes, whether it has been segregated & 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)
- To ascertain whether physical stock tally with the stock statement submitted to the banker
- To ascertain whether hypothecated stock is realizable.
- To confirm that stock is owned by the borrower and finance is made against 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.

### **Steps Involved in Stock Audit**

Stock audit is necessarily required to be conducted at the borrowers place for obvious reasons. But before visiting the borrower, understanding the entity, its banking operations and financial affairs is must.

It is advisable to visit the respective branch where the borrower is having the account so as 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 Inspectors, Concurrent Auditors etc) to have a brief understanding about the borrower and its financial affairs.

- **Visit to Borrower's Unit**

Banks generally have the system of maintaining two folders (in 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 other folder contains 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 with reference to terms of Sanction helps stock auditor to gain insight about the borrower' affairs and conduct of the account.

- **Visit to 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 audit questionnaire at the time of visit so that no important point / area is missed out.



Visit to borrower involves verification of stock and debtors, inquiry about MIS and internal control, future projections and financial plans of the borrower and analysis of past results and bank operations.

Although audit is related to stock and debtors only, understanding of overall financial scenario and inquiry as to sister concerns & their businesses may also help the stock auditor to finalize the report in a better manner.

- **Preparation of Audit Report and discussion about audit findings**

After conclusion of visits, stock audit report in the prescribed format, if available is to be prepared.

In the absence of format, questionnaire prepared can itself also act as a report format.

At the end of the questionnaire or in the covering letter itself (where auditor has to report in bank specified format) summary of major adverse findings (or points for future action) must be submitted by the auditor.

Before submission of audit report, discussion about audit findings with the monitoring branch as well as borrower may be a good practice which may bring further clarity in reporting.

#### **Format for Stock Audit:**

Format for stock audit report may vary from bank to bank.

Some banks have customized stock audit report formats while others may hint only the important areas to be reported by stock auditors.

Irrespective of the formats, it is good to have questionnaire to be prepared by stock auditor covering following important areas of stock audit –

- Compliance with terms and conditions of sanction.
- Timely & adequate submission of stock statements & other important financial information.
- Account operations – overdrawing, credit summation and cash withdrawals.
- Drawing power calculations by banks and by the auditors & discrepancies, if any along with the reasons/justification.
- Physical maintenance and storage of stock and adequacy of facilities at the borrowers place.
- Systems / procedures implemented by borrower to identify the slow and non-moving stock items.
- Borrower's Management information system, its adequacy & Internal controls to safeguard stock.
- Method of valuation of stock, time interval for valuation and adequacy & sufficiency of procedures thereof.
- Insurance of stock.



- Verification of Debtors.
- Distinguishing and demarcating stock vis-à-vis the stock of other unit functioning in the same premises.

The list of common irregularities / observations given below will give the better idea about preparation of stock audit questionnaire.

### **Common Irregularities / Observations in Stock Audit**

The Common Irregularities that may be observed by the CMA Firm during Stock Audit can be summarized as follows:

#### **Observations about statement submission & Scrutiny:**

- Stock Book Debts statements not submitted / not submitted in time.
- Inadequate details viz. rate, quantity and amount of different type 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) considered for drawing power.
- Drawing power not correctly calculated.
- Latest visit report by branch official not on record.
- Trade Creditors not shown and/or not deducted from the value of Total Stock to arrive at paid Stock.

#### **Observations about account operations:**

- Operations in the accounts not scrutinized with reference to 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 not routed through account.
- Account not operated actively.
- Cash withdrawal during current period is abnormal.
- Frequent overdrawing in the account.
- Balance over drawing power although within Sanctioned Limit.



**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.

**Observations about verification of stock and creditors:**

- Stock book not maintained/ not updated.
- Obsolete stock not excluded from stock figures submitted to bank.
- Deteriorating stock turnover ratio.
- Stock figures submitted at the year end and as per Financial Statement not matching.
- Confirmation for inventory with 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 verification of Sundry Debtors:**

- Existence of long pending debtors.
- Long pending debtors shown as below 90 days debts to 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 into higher DP than calculated by bank.
- Stock debtors as per statements submitted and as per books not matching.
- Registration of Deed of Assignment of Book Debts with the Debtors to ensure direct payment to Bank.

**General Observations:**

- Diversion of funds and inter account transfers are not properly monitored.
- Borrower having operations with other bank for which permission of lender not obtained.



- Bank name plate not displayed

### **Findings of Stock Audit and its Uses**

Stock audit by External Professional is one of the important tools of credit monitoring for the bank. Apart from ensuring 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 DP register, scrutiny of statements, review of accounts and compliance of audit findings.

Stock audit also has the utility for the borrower. Comments about insurance inadequacies, wrong product description and locations stated in the policies, if rectified timely may save the borrower from avoidable future losses.

Statutory Audit where there is thrust only on the compliance under respective statute, the Stock Audit is a knowledge value addition exercise for both – bankers as well as borrowers.

### **Terms and Conditions of Stock Audit (Banks)**

1. Reconciliation of the stock statements submitted to Bank by the Company with their accounting records.
2. Physical Verification of Stocks, excluding obsolete/damaged/defective goods, covering 100% of high value items, 50% to 75% of medium value items and 10-20% of low value items.
3. Valuation of Inventory at the cost price or market price whichever is lower indicates both the cost and market price with comments on weighted average purchase price of main raw material.
4. Condition and location of storage, godown – whether open or covered, owned or rented. Verifying items in transit/lying with third parties/ on consignment basis/ with processing houses/ customers warehouses.
5. Age, quality, holding levels and method of valuation of different items of Inventory. Also Comparison with the Audited Balance Sheet as on 31<sup>st</sup> March ...
6. Inventory management and control policies, method of procurement, maintenance of records of issue and receipt of stock. Sourcing of Raw Material and credit available. Proportion of Cash and credit sale and average period of credit. Extent of purchases made from the sister/ allied concerns and its genuineness.
7. Age-wise and value-wise verification and evaluation of Receivables/ debtors. Reasons for non-payment of long standing debts, if any.
8. Verification and evaluation of Sundry Creditors relating to stocks and other creditors.
9. Verification & Correctness of registration/ modification of Bank's charge with ROC.



10. Sufficiency and currency of Insurance policies and risk covered.
11. General attitude of Promoters/ staff for safety of stock and recoveries of receivables.
12. Comments on overdue statutory liabilities, demand/ supply and markets of products.
13. Examination of Shareholding Patterns etc.
14. Registration of Deed of Assignment of Books Debts with the Debtors in favour of Bank.

### Methodology of Stock Audit

As required by the terms of reference of letter of the Bank, the following methodology is adopted by us for carrying stock audit:

1. Discussion held with Mr. \_\_\_\_\_, Relationship Manager of \_\_\_\_\_ Bank, \_\_\_\_\_ (Branch).
2. Required documents and information were obtained from the Bank.
3. Visit of factory from \_\_\_\_\_ to \_\_\_\_\_.
4. Detailed discussion held with the concerned officers and necessary documents and information was obtained.
5. Last Physical verification of the stocks of the company was carried out on \_\_\_\_\_.
6. Verification of books of accounts, excise records, stores and other records to check the information provided to the Bank.

### Brief Profile of the Associate Concerns

1. Name of the Concern :
2. Constitution :
3. Activity :
4. Bankers :
5. Conduct of Account : Standard/ Sub. Standard/ Doubtful
6. Limits enjoyed :
  - a) C.C. (Hyp.)
  - b) C.C. (B.D.)
  - c) WCTL
  - d) LC/ FLC
  - e) Bills Purchased/Discounted by Bank
  - f) Term Loan
7. Investments in :
- Group Concerns :
  - a) Investment in \_\_\_\_\_



8. Remarks
- b) Investment in \_\_\_\_\_
- : The Company has leased out \_\_\_\_\_ sq. ft. of Factory building to \_\_\_\_\_ (associate concern) on monthly rentals of Rs. \_\_\_\_\_ with the permission of the Bank.

### Observations of Stock Audit

1. Physical Verification
2. Records Maintained
3. Basis of Valuation of Stocks (Net of Cenvat)
4. Valuation of Stocks as on (cut-off date) and Last Audited Balance Sheet.
5. ABC Analysis of Stocks
6. Calculation of Drawing Power
7. Verification of Stock Statements
8. Inventory Norms
9. Existence of slow moving/ Non-moving Inventory
10. Inventory Management and Control Policy

### Statutory Dues

Since dues to the Government are first charge on Assets of the Borrower, outstanding statutory dues beyond the due date may be reduced from the value of Current Assets to ascertain DP.

### General comments on notes of Auditors / Management

Previous 2 years audited accounts may be perused and Auditor's / Management notes should be thoroughly scrutinized. Any Comment/ note resulting into contingent liability/ outstanding statutory dues under litigation/ non fulfillment of commitment should be reviewed and commented upon.

## DOCUMENT-2

# STOCK AND BOOK DEBTS AUDIT PROCESS (CHECK LIST)

### **Audit Planning**

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

- (1) The nature of the accounting and internal control systems used regarding Inventories.
- (2) Inherent, control and detection risks, and materiality related to Inventories.
- (3) Whether adequate procedures are established and proper instructions issued for physical Inventories counting.
- (4) The timing of the count.
- (5) The locations at which Inventories 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) At the borrower's plant.
- (3) In transit.
- (4) On Consignment.
- (5) In a public warehouse.
- (6) For processing.

### **Substantive Procedures**

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

#### **Before making visit to party**

- (1) Obtain the Name, Address, Telephone No., and Fax No of the party



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

#### **At the Borrower's Office**

1. Check whether the party has maintained the Inventories register
2. Check whether other books of account have been maintained by the party i.e. cashbook, bank passbook, purchase book, sales book, debtors ledger & creditor ledger etc.
3. Check all statutory dues have been paid
4. Check whether prescribed particulars of charges as detailed in S125(4) along with the instrument by which the charge is created has been filed with the Registrar for registration within 30 days after the date of its Creation
5. Check the sales and purchase invoices
6. Bank nameplate stating "Hypothecated to Name of Bank/ Financial Institution" should be affixed on the wall in Inventories premise e.g. "Hypothecated to Corporation Bank".
7. If there is damaged Inventories, then it should not be taken into account for calculation of drawing power.
8. Inventories must be in sufficient quantity to cover the advance given by the bank.
9. Inventories should be kept in proper condition.
10. Inventories must be kept in the premises, which should be free from water leakages, fire, & other hazards etc. so that damage to Inventories does not Occur



11. Fire-fighting equipment must be available in Inventories premises and it should be regularly checked to preserve its utility.
12. Specify the name of the person who has attended the auditor.
13. Whether the godown has direct access.

**Documents to be obtained from the borrower-Copies of following should be obtained from party:**

- (1) The auditor should obtain a written representation from management concerning:
  - (a) The completeness of information provided regarding the Inventories; and
  - (b) Assurance with regard to adherence to laid down procedures for physical Inventories count.
- (2) Insurance premium receipt with respect to the insurance policy
- (3) Bank/ Financial Institutions original sanction letter and the latest review note
- (4) Balance Sheet & Profit & Loss Account of the borrower for last 3 years
- (5) Inventories Statement & Book Debts Statement as on the last day of the Quarter and for the year and preceding 3 months before the date of inspection
- (6) Copy of Memorandum of association, Articles of association along with form No. 32 & 18, partnerships deed, Trust deed & its byelaws as may be applicable
- (7) 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 there on.
- (3) Examine the layout of the godown where inventories are stored
- (4) If the godown is rented, inspect the rent receipt and ensure that it is in the name of the borrower. Also ensure that the rent is not in arrears. If the godown is in ownership, verify the ownership agreement and ensure that it is in the name of the borrower
- (5) Ensure that there is no other gate or entrance to the godown and if it is there, it is properly locked from inside
- (6) Ensure that the godown is located at the address given to the bank and as mentioned in the insurance policy and other documents
- (7) Ensure that the ventilators are covered by grills
- (8) Ensure that no hazardous material is stored nearby the godown. If so, it should be specifically mentioned in the insurance policy



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

### **Procedure for verification of Hypothecated Inventories**

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

Verify the actual inventories in the godown physically with that declared in the Inventories statement.

- (1) Verify that the record keeping is proper and that there are no indications of dishonest or inefficient management.
- (2) Verify that there are adequate internal control systems commensurate with the size of the concern
- (3) The auditor should review management's instructions regarding:
  - (a) The 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.
- (4) The auditor should also consider cut-off procedures including details of the movement of Inventories just prior to, during and after the count to ensure that such movements are appropriately included and/or excluded, as applicable from such Inventories. For example,
  - (a) Goods purchased but not received are included in the inventories;
  - (b) Goods sold but not dispatched are excluded from the inventories.



- (5) Verify whether consistent and accepted accounting principles are adopted for valuation of Inventories
- (6) Evaluation of the security measures for prevention of theft and pilferage
- (7) Costing system in operation to ensure the value of the system in use
- (8) Go through the "Purchase register", "Sales register", "Goods received note", and "Goods returned note" and verify with the invoices. If these registers are not prepared, then examine the books, which serve as a record of the things made as in these registers
- (9) If there is any difference between the physical verification of the inventories and the records, the same should be jotted down
- (10) In case the inventories are lying with processors, verify whether the branch has obtained a letter of no-lien from the processors
- (11) Scrutinize at least 20 % of the total raw material and 85 % of the total finished goods and semi-finished goods lying in the godown
  - (a) Prepare the age-wise list of the inventories in the following manner:
  - (b) more than 12 Months Old
  - (c) more than 6 Months Old and Less than 12 Months Old more than 3 Months Old and Less than 6 Months Old
  - (d) more than 1 Month Old and Less than 3 Months Old less than 1 Month Old
- (12) Bifurcate the inventories into paid and unpaid and ensure that only paid inventories are taken for the purpose of calculation of drawing power
- (13) In case of unpaid Inventories, the Bank/Financial Institution should not provide any assistance or credit facility to that extent
- (14) Check whether the Insurance policies cover the following risks:
  - (a) Fire
  - (b) Marine
  - (c) Other Natural Calamities
  - (d) Theft
- (15) The inventories hypothecated should be well within the norms as suggested by the Tandon / Chore committee. If the borrower is keeping excess Inventories than the prescribed norms, the borrowers should give a time-bound program to reduce the level of Inventories
- (16) A written declaration from the borrower about his existing credit facilities with other banks, if any, and an undertaking that the inventories will not be hypothecated to any other banks without the prior consent of the bank is taken on record
- (17) Also verification of the Production register should be done



- (18) Details of the Inventories as regards to quantity, quality, life, date of purchase and price must be verified
- (19) Check whether goods require any specialized preservation, and if so, then proper arrangement should be made for facilitating such storage
- (20) Check the method, which has been employed for ascertaining the final value of closing Inventories
- (21) Check whether borrower follows the method consistently or not
- (22) Verify the movement of Inventories
- (23) Check the work in progress and its basis of valuation and percentage of completion.

### **Procedure for verification of Hypothecated book debts**

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

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

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

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



involving large amount from a few parties. If so, examine whether limits for individual debtors have been fixed and whether the limits are adhered to

- (10) Compare the statement of Book Debts with the Debtors ledger to ascertain the genuineness of the debt, aging of debt, & cases of non-realization of long outstanding debts.
- (11) All realizations are duly deposited in the account and the borrower furnishes realization statement of book debts.
- (12) The drawing power is revised from time to time on the basis of statements and the required margin is maintained in the account.

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

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

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

### **Confirmations**

Where significant stocks of the entity are held by third parties, the auditor should examine that the third parties are entitled to hold the stocks of the entity. The auditor should also directly obtain from the third parties written confirmation of the stocks held. Arrangements should be made with the entity for sending requests for confirmation to such third parties. In the process of audit, external evidence is considered to be more reliable than internal evidence. Therefore, confirmation of Accounts Receivables, which are hypothecated for the purpose of loans from financial institutions or bank, is a generally practiced auditing procedure to obtain such evidence. This establishes reliably the existence and the value of the debts as is reflected in the accounts.

The entire process is as follows:

- (1) Select the parties for obtaining confirmation.
- (2) Design the confirmation request.
- (3) Communicate the confirmation request to the third party.
- (4) Obtain response from the third party.
- (5) Evaluate the information provided by the third party and scrutinize the same for reliability.
  - The date of request of confirmation is also very important.
  - The date may be as follows:



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

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

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

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

### **Calculation of drawing power**

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

### **Verification of Insurance coverage**

- (1) Check whether the Inventories hypothecated is adequately insured
- (2) Check whether the policy is in force



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

### **Documents to be taken as Working Papers**

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

- (1) Auditor's report on Inventories for the previous three years, if available.
- (2) Bank statements of the last 3 months.
- (3) A statement showing previous year's Opening Inventories, Purchases, Sales, Work in progress and Finished Goods.
- (4) Details of Installed capacity, licensed capacity and Actual production with documentary evidence.
- (5) Copies of sales invoices for last 12 months, taking on an average at least 3 entries per month and checking the process of collection.
- (6) Copies of purchase invoices for last 12 months, taking on an average at least 3 entries per month and checking the process of collection.
- (7) A certified copy of the constitution of entity represented by either the Partnership Deed or the Memorandum and Articles of Association or the Trust deed for Trust, etc.
- (8) In case of a company, the following copies (i) a copy of form No.18 along with filing fees receipt for registered office address (ii) A copy of form no 32 along with filing fees receipt for directors. (iii)A copy of form No. 8 & 13 along with filing fees receipt & charge registration certificate (iv) a copy of Form No.8 & 17 along with filing fees receipt & certificate for registration of charge and balance sheet.
- (9) The statement of Profit and Loss account for the last 3 years.
- (10) Month-wise Inventories statement of the last one year.
- (11) Month-wise book debt statement of the last one year.
- (12) In case of a manufacturing concern, a brief summary of the manufacturing process
- (13) A list of books and records maintained for the purpose of Inventories, debtors and security.
- (14) An organization chart giving an overview of the organizations' hierarchy, along with their respective responsibility.
- (15) A flowchart depicting the movement of raw materials, work in progress and finished goods.
- (16) The credit policy as is employed by the company.



- (17) A detailed statement of debtors showing the date of the bill and age-wise classification of debtors.
- (18) An Inventories statement as on the date of physical verification along with date of purchase with the detailed breakup of its components.
- (19) A copy of agreement of ownership / Lease agreement / Rent agreement for office / Factory / Godown.
- (20) A list of sundry creditors with date of bill for goods purchased on date of physical verification.
- (21) A certified copy of the Insurance policy in force.
- (22) A certified copy of loan sanction letter.
- (23) Comprehensive management representation letter.
- (24) A certified copy of Excise return (RT-12), Sales tax return and Income tax return of the previous year.
- (25) Copy of registration certificate under Shops and Establishment Act, Register of Firms, Pollution control Board, Food and Drugs Approval Authority – other laws as applicable.
- (26) A note specifying the accounting policies that are employed.
- (27) A detailed note on accounting system for purchases, sales and inventories.

The auditor should verify the documents that are available with the bank branch and satisfy him about the adequacy of such documents. As far as possible the auditor should not, call for these documents if they are insufficient since the borrower may be hesitant to divulge his trade documents to a third party. Instead the banks should be asked to call for these documents.

## Reporting

- (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 summaries
- (3) It should include the date, time, location of visit and the name of the officials conducting the audit and the official of the entity present at the 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 make a reference 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.

**Indian Bank's Association Letter on  
Calculation of Drawing Power**

**Indian Banks' Association**

**CORPORATE & INTERNATIONAL BANKING**

No. C&I/Circular/2014-15/689

September 29, 2014

To

**The Chief Executives of All Member Banks**

Dear Sirs/Madam,

**Calculation of Drawing Power in consortium accounts including CDR/bilaterally restructured accounts**

The Managing Committee (MC) considered a reference received from Reserve Bank of India (RBI) on issues relating to calculation and allocation of Drawing Power in respect of accounts under Consortium and CDR Restructuring, The reference contained a representation from a Member Bank in this regard and RBI suggested that these issues are procedural and may be examined and addressed, suitably by IBA.

2. The Committee noted that the banks follow RBI's approved MPBF methodology for arriving at the working capital requirement of their borrowers. The method of calculation of Drawing Power and its allocation under the Consortium Accounts presently followed by the Member Bank is in accordance with the MPBF system of working capital assessment. As regards the allocation of Drawing Power in Consortium Arrangement or a CDR Arrangement, the discipline envisaged in these arrangements demands that the Drawing Power allocation made by the Consortium Leader / Monitoring Institution is binding on the members in the Consortium and CDR lending system.

3. As regards the Member Bank's reference on the security cover of accounts under CDR in bilateral restructuring mechanism, the Committee decided that the instructions contained in para 16.1, 1. of the CDR Master Circular of 2012, relating to security coverage by way of realizable value of security, both primary and collateral, should be diligently followed by the lenders. RBI Master Circular dated 1st July 2014 on "Prudential Norms on Income Recognition Asset Classification and Provisioning



pertaining to Advances”, has mandated that the classification of an asset is to be made on the record of recovery. It was pointed out that the accounts, which come for restructuring generally display weakness in availability of adequate drawing power. The asset should not be classified as NPA, merely on account of some deficiency, which is temporary in nature, such as non-availability of adequate drawing power based on the stock statement, balance outstanding exceeding the limit temporarily, non-submission of stock statements and non-renewal of limits on due date etc. In the matter of classification of accounts, with such deficiencies, banks may follow the laid down guidelines. The Committee desired that these guidelines may be reiterated to the member banks in terms of RBI’s reference.

4. The detailed guidelines in this regard are contained in the Annexure. A copy of this circular is being forwarded to the RBI for their information.

Yours faithfully,

(Senior Advisor)  
Sangeet Shukla

**Annexure to IBA Circular No. C&I/Circular/2014-15/689 dated September 29,2014**

1. The DP in case of consortium accounts would be calculated and allocated based on the method approved by RBI under the MPBF methodology as under -

Total Value of Stocks (Closing balance of stocks, their value as per market rates or cost price, whichever is lower)	A
Less : Excess of Sundry Creditors (Stocks)	B
Excess of Other Sundry Creditors Over the level assumed at the time of assessment	C
Net Value of Stock	$D=A-B-C$
Add: Eligible Trade Debtors including advance for stocks and expenses as envisaged at the time of assessment.	E
Less: Outstanding under Bills discounted	BD
Net Value of Debtors	$F=E-BD$
Total eligible Current Assets	$G=D+F$
Less: Stipulated Margin	H
Drawing Power	$G-H$



The allocation between the consortium members shall be done by the consortium leader pro-rata to the exposure assumed by these banks under consortium. The DP allocation advised to the consortium members will be binding on them for conduct of borrower's account. This may also apply to the facilities under the Multiple Banking Arrangements.

2. In case of the standalone credit facilities, it is advisable that the member banks adhere to the above methodology for the sake of uniformity and consistency so as to reduce confusion in operation staff and auditors alike.

3. As regards the status of restructured account and accounts referred to the CDR mechanism, the instructions issued by CDR Cell, vide Para 16.1(i) of CDR Master Circular 2012, should uniformly apply, which are produced as under-

**Fully secured:** When the amounts due to a bank (present value of principal and interest receivable as per restructured loan terms) are fully covered by the value of security, duly charged in its favour in respect of those dues, the bank's dues are considered to be fully secured. While assessing the realisable value of security, primary as well as collateral securities would be reckoned, provided such securities are tangible securities and are not in intangible form like guarantee etc., of the promoter/others. However, for this purpose the bank guarantees, State Government Guarantees and Central Government Guarantees will be treated on par with tangible security.

As regard these accounts, the impact of stock audit should be ignored if the account is fully secured as indicated above by total security, i.e. Primary and Collateral and is otherwise adhering to the terms of restructuring under the restructuring or CDR terms.

4. The classification of an asset as NPA should be based on the record of recovery. Account should not be classified as NPA, merely due to existing of some deficiency which are temporary in nature such as non-availability of adequate drawing power based on latest available stock statement, balance outstanding exceeding the limit temporarily.

## **SYNOPSIS OF INVENTORY AUDIT**

### **Why is it important?**

#### **Easiest Assets to Manipulate**

- Misstatement affect reported profit: misstatement of inventory balances has a direct effect on reported profit.
- Inventories identification: some inventories can be very difficult for an auditor to identify stock of gas reserve.
- Need an **expert** to estimate the quantity- ISA 620" using the work of an expert.

1. Inventories difficult to establish: the quantities of inventory held at a specific given moment may be difficult to establish. It may not be possible to cease inventory movements during the inventory count and **cut off** may be hard to establish with precision.

2. Valuation: difficult for certain products e.g. antique-no active markets, hospital which is working 24/24 hours.

3. Inventory losses: from pilferage, wastage, obsolescence, damage, dormant stock.

4. Inventories may be intangible: some very significant work in progress balances may be **intangible** in nature.

#### **Risks associated with Inventory**

1. Inadequate or inappropriate inventory held: to meet the demands of sales and production e.g. stock out
2. High inventory levels resulting in poor cash flow and financial loss.
3. Inaccurate or incomplete record of inventory movements resulting in lack of awareness of the actual inventory position and difficulties in meeting customer needs.
4. Lack of security over inventory resulting in loss, theft or misappropriation.
5. Obsolete inventory held or incorrectly supplied to customers, resulting in financial loss and damage to reputation.



## Physical Inventory Counts

The 2 methods of carrying out inventory counts are:

- 1 **Periodical:** made at or close to the year end.
- 2 **Perpetual:** counting on a **continuous** basis over the whole year.

Each item is physically inspected at **least once a year**, and more frequently in the case of items liable to loss.

**Adequate records** are kept up to date.

The **records are amended and signed as a result of physical inspection** and that there are appropriate reports and **investigation procedures for discrepancies**.

## Organization of Counting-Client Procedures

It is the responsibility of management to count inventory.

1. Permanent organization of the stores:
2. Location and records of goods: goods are kept in bins or on racks, with complete description of each item stated in the bin cards.(in and out)
3. Goods are protected against deterioration.
4. Restriction of access to stores: to avoid misappropriation.
5. Goods held for third parties, and slow moving, obsolete inventories, etc are identified and separated.
6. Stores area should be tidy.

## Instructions for Counting

1. Comprehensive stocktaking instructions are laid down for the undertaking of the stock take. Management should implement the following controls when carrying out an inventory count:
2. All stocktaking staff must be fully familiar with stock to enable them to identify damaged or sub standard goods.
3. Areas of responsibilities.
4. A responsible officer must be responsible for the issue and collection of all stock sheets.
5. Stock sheets should be sequentially numbered.
6. All stock sheets must be signed by the stock taker.
7. Any changes on the stock sheets must be initialed by stock taker.
8. No stock movement during the stock take, keep a special bay for dispatch/receipts during stock take.
9. Staff should record the condition of the items in stock.



10. Staff should count the stock in a systematic way.
11. The stock take must be supervised by senior official within the organization.
12. Assistance of internal auditor.
13. Those staff involved in the stock take must not be responsible for the day to day custody of the items.
14. Proper procedures for reconciliation of the physical stock take with the stock records.

## **The Auditor and the Inventory Count**

### **Auditor's Attendance at Counting**

**ISA 501: 'When inventory is material to the financial statements, the auditor should obtain sufficient appropriate audit evidence regarding its existence and condition by the attendance at physical inventory counting unless impracticable.'**

Attendance enables the auditor to:

- Inspect inventory.
- Observe compliance to proper stock count procedures in order to provide evidence as to the reliability of the stock count exercise.

Where the count is not attended on the date planned due to unforeseen circumstances the auditor should take or observe some physical counts on an alternative date if possible.

**Note: It is client responsibility to carry out the stock count where the auditor can perform test counts on sample basis.**

### **Auditors Responsibilities and Duties for a Stock Count**

#### **(1) Before the count: Planning**

1. *Review and planning*: Review prior year's working papers, familiarize themselves with the nature volume and location of inventories, consider the controlling and recording procedures over inventory and the timing of the count.
2. *Problem identification and reliance*: identify problem areas in relation to the system of internal control and decide whether reliance can be placed on internal auditors.
3. *Risk and materiality*: assess inherent, control and detection risks and establish materiality.
4. *Inventory held by third parties*: arrange third party confirmation of inventories held by third parties- depending on *materiality*, the auditors should also consider the integrity and independence of the third party and whether it is necessary to arrange for other auditors to observe the count or whether it is sufficient to obtain another auditor's report on the adequacy of the third party's systems or merely to inspect relevant documentation held at client place.



5. *Expert assistance*: if the nature of the inventories is specialized then the auditor will need to arrange expert help.
6. *Counting instructions*: examine the client's counting instructions: if found to be inadequate, the matter should be discussed with the client with a view to improving them prior to the inventory count.

## 2) During the Counting

When the auditor attends stock take, he will carry out the following:

- Observation that the controls within the stocktaking instructions are being adhered to.
  - Stock is counted systematically by client's staff.
  - Ensure that there is no movement of stock to be counted by the stock count teams.
  - If stock is recorded by weight, weight a sample.
1. If stock is in sealed boxes, the auditor must open a sample of boxes to confirm the quantity in each box.
  2. Inspection of goods to make notes of damaged or obsolete stock.
  3. The gathering of cut off details such as goods received notes and delivery notes numbers to be followed up after stock take
  4. Ensure exclusion of third party stock.

## 3) After the Counting

There are 3 objectives after stock take:

### Existence

1. Follow up all test count.
2. Ensure exclusion of third party stock.
3. Ensure exclusion of damaged or obsolete stock.
4. Ensure all stock sheets have been accounted for.
5. Perform cut off tests.
6. Investigate any significant differences between the physical stock take and stock record.

### Valuation

Analytical review

*Cut off procedures*

Cut off highlights the fact that the balance sheet date divides two accounting periods, and the purpose of the correct cut off procedures is to ensure the correct allocation of all transaction to the period to which they relate.



### **Cut off tests- stocktake at year end.**

#### **Sales cut off**

1. Select sales invoices before the yearend ensuring that the number sequence was complete.
2. Match these sales invoices to the corresponding dispatch notes before the year end.
3. If a sales invoice has been issued but no dispatch not has been raised, the stock must be excluded from the stock take and treated as third party stock.
4. Accordingly, the sales account and debtor's ledger must be updated as well as the stock record.
5. Similarly a sample of dispatch notes should be matched to corresponding sales invoices and the sales record to detect cases of understatement.
6. The above tests will be repeated for sales just after the year end.

#### **Purchases cut off**

1. Select a sample of GRN and ensure completeness of population by checking sequential numbering.
2. Ensure that the GRN can be matched with an invoice and that the purchase ledger and purchases account has been updated. If not, a provision for accrual should be made.
3. Ensure that the stock record has been updated accordingly.
4. Similarly the purchase invoices will be matched with GRN to detect cases where goods have not yet been received.
5. The above tests will be repeated for goods received after the year end to ensure that they have not been included in the year end stock take and that the corresponding invoice has been included in the following year results.

### **Cut off tests- stock take before year end (Two cut off dates)**

If the stock take is to be performed before the year end, the auditor will have to perform two separate sets of cut off tests.

1. Ensuring physical cut off to the stock records.
2. Check purchase accruals and debtors to be performed at the year end.

#### **Purchases cut off**

1. Select a sample of sequentially numbered GRN before the stock take date and ensure a like entry has been made in the stock records.
2. Select some sequentially numbered GRN after the stock take to ensure that these deliveries were not entered into the stock records until after the stock take date.



### **Sales cut off**

1. Select a sample of sequentially numbered DN before the stock take date and ensure that a corresponding entry had been made in the stock records.
2. Similarly, the test will be repeated for dispatches after the stock date.

### **Inventory valuation procedures**

#### **Raw materials and consumables**

1. Ascertain what elements of cost are included e.g. carriage in, duties. Etc
2. If standard costs are used, enquire into basis of standards, how these compare with actual costs and how variances are treated.
3. Test check cost prices used with purchase invoices received in the month(s) prior to counting.
4. Follow up valuation of all damaged or obsolete inventories noted during observance of physical counting with a view to establishing a net realizable value.

#### **Work in progress**

1. Ascertain how the various stages of process are measured and if estimates are made, on what basis they are made.
2. Ascertain what elements of cost are included. If overheads are included, ascertain the basis on which they are included and review this basis with the available costing and financial information.
3. Ensure that any material costs exclude any abnormal wastage factors.

#### **Finished goods and goods for resale**

1. Enquire into what costs are included, how these have been established and ensure that the overhead included is based on normal costs and is reasonable in relation to the information disclosed by the draft FS.
2. Test check prices on inventory lists with official sales price list, bearing in mind any trade discounts which are normally granted off the list prices.
3. Ensure that inventories are valued at net realizable value if this is less than cost. For any such items, also check back and see if the relevant partly processed inventories and raw materials have also been written down.
4. Follow up any items which is obsolete, damaged, slow moving ascertain the possible realizable value of such items.
5. Follow up any inventories which at time of observance of physical counting were noted as being damaged or obsolete.

## DOCUMENT-5

# EMPANELMENT OF STOCK AUDITORS / VALUERS GUIDELINES

1. **State Bank of India invites application for Stock Auditors / Valuers**, those having their place of business in the State of Delhi, Uttarakhand, Rajasthan and the following districts of Uttar Pradesh and Haryana may send their offers:

**AGRA, ALIGARH, ETAH, FIROZABAD, HATHRAS, MAINPURI, MATHURA, BAGHPAT, BULANDSHAHR, GAUTAM BUDH NAGAR, GHAZIABAD, MEERUT, MUZAFFARNAGAR, SAHARNPUR, ROORKEE, GURGAON, SONPAT, FARIDABAD, MEWAT, PALWAL may apply as per the following:**

### **A. Stock Auditors**

- The Auditors should be from companies/firms of Chartered/Cost Accountants with **at least 3 years of experience**. Those companies/firms who have personnel with engineering background to assist in conducting the Stock Audit will be given preference.
- Those who are already empanelled with us/other banks/FIs and having good track record of handling the assignments will be given preference.
- Experience/competency in handling stock audit, adherence to the specified time frame, reasonableness of the charges and locational advantage will be taken into consideration.

### **B. Valuers of Collateral Security**

- The valuers should be from companies/firms of engineers with at least 3 years of experience
- Members of the Institution of Valuers will be preferred.
- Those already empanelled with the Bank/other banks/FIs//LIC/GIC will be given preference.
- Experience, competence in handling such work, reasonableness of the charges and locational advantage will be taken into consideration.
- Registration with the Wealth Tax.

**2. THOSE ALREADY ON THE PANEL OF OUR BANK AND ALSO THOSE WHO HAVE SUBMITTED THEIR APPLICATIONS IN THE PAST FOR SUCH EMPANELMENT NEED TO APPLY DE NOVO.**



3. Bank reserves the right not to empanel any of the companies/firms etc. without assigning any reasons.

**4. The parties / firms de-empanelled by our Bank or any other Bank / Financial Institutions will not be considered for empanelment with our Bank.**

5. The panel will be reviewed at yearly intervals & bank reserves the right to depanel any of the company/firm in between on observance of unsatisfactory performance/report.

**6. Bio-data form placed as Annexures A & B respectively for Stock Auditors & Valuers be submitted duly completed in all respect, which must reach at undernoted address on or before 16th July, 2014.**

**Deputy General Manager & CCO,  
CCO Sectt, 9<sup>th</sup> floor,  
Local Head Office,  
New Delhi - 110001  
Contact No- 011-23407265**



(On Firm's Letterhead)

**BIODATA FOR EMPANELMENT AS STOCK AUDITORS**

Photo

Photo

Photo

No.

Date

**State Bank of India,  
CCO Department,  
New Delhi LHO.**

We hereby apply for empanelment as **Stock Auditors** and furnish hereunder the requisite bio-data/ information/ documents.

1	Name of the Firm / Company	
2	Constitution	
3.	Date Established	
3.	Registered/Communication Address of the Firm/ Company	
4.	Contact phone/ mobile Nos.	
5.	PAN No/ TIN No.	
6.	Nature of Present Activity of the Firm/ Company & since when	
7.	Revenue & Net Profit during the last 3 years	
8.	Names, Educational' Professional Qualification, Income. Phone No. & Addresses of Prop/ Partners/ Directors	
	Particulars of Registration/ Affiliation with the Institute of CA/ Architects/ Valuers/ Engineers, IT/ Wealth Tax Authorities (CBDT), RBI, any other Organization, as CA/ Architect/ Valuer/ Auditor/ Stock auditor/ NBFC/ Auctioneer/ Mgt Consultants.	
9.	Details of Present Set-up/ Infrastructure Available to deal with stock audit work	



10.	Particulars of empanelment with other banks/ financial institutions	
11.	Past Experience in audit/ stock audit (with names of clients, nature of tasks handled and results achieved).	
12.	Furnish details if the firm has been depanelled by any bank/ organization in the past	

*Note* : Please attach self-attested photographs and photocopies of proofs relating to :

- (a) Photographs of the prop/ all partners/ all directors.
- (b) Identity & addresses of the firm and the prop/ all partners/ all directors.
- (c) Partnership deed/ memo & articles of association of Company
- (d) Qualifications & experience of the prop/ partners/ directors
- (e) PAN/TIN Card
- (f) I.T. Returns (last 3 years)
- (g) Empanelment with other banks/ institutions.
- (h) Registration/ Affiliation with the Institute of CA/ Architects/ Valuers Engineers, IT/ Wealth Tax Authorities (CBDT), RBI, any other Organization, as CA/ Architect/ Valuer/ / Engineers/ Auditor/ Stock auditor/ NBFC/ Auctioneer/ Mgt Consultants

We solemnly declare that the information furnished above is complete and entirely true, and nothing has been concealed. We affirm that terms & conditions of State Bank of India relating to empanelment of Stock Auditors are acceptable to us.

*For & On Behalf of Firm :*

(Signatures)  
Name & Designation

(Signatures)  
Name & Designation

(Signatures)  
Name & Designation

(Signatures)  
Name & Designation

(Signatures)  
Name & Designation

(Signatures)  
Name & Designation

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(On Firm's Letterhead)

**BIODATA FOR EMPANELMENT AS VALUERS**

(Only those persons who are registered as valuers under Wealth Tax Act 1957. For a partnership firm, all the partners should be registered valuers.)

Photo

Photo

Photo

No.

Date

**State Bank of India,  
CCO Department,  
New Delhi LHO.**

**We hereby apply for empanelment as VALUERS of Assets and furnish hereunder the requisite biodata/ information/ documents.**

1	Name of the Valuers	
2	Name of Business Finn / Company & Constitution	
3.	Date Established	
3	Registered/ Communication Address of the Valuers, Firm/ Company	
4	Contact phone/ mobile Nos.	
5	PAN No/TIN No.	
6	Nature of Present Activity of the Finn/ Company & since when	
7.	Revenue & Net Profit during the last 3years	
8	Names, Educational/ Professional Qualification. Income. Phone No. & Addresses of Prop/ Partners Directors	
	Particulars of Registration/ Affiliation with Wealth Tax Authorities (CBDT), Institute of Valuers/ CA/ Architects/ Engineers, RBI. any other Organization, as Valuer/ Engineer/Architect/ NBFC/ Auctioneer/ Mgt Consultants.	



9	Details of Present Set-up/ Infrastructure Available to deal with Valuation work	
10	Particulars of empanelment with other banks/ financial institutions	
11	Past Experience in Valuation And Property Management (with names of clients, nature of tasks handled and results achieved).	
12	Furnish details if the Valuer/ firm has been depanelled by any bank/ organization in the past	

*Note:* Please attach self-attested photographs and photocopies of proofs relating to:

- (a) Photographs of the Valuers/ prop/ all partners (For a partnership all partners should be duly registered with Wealth Tax Act)
- (b) Identity & addresses of the firm and the prop/ all partners / directors.
- (c) Partnership deed/ memo & articles of association of Company
- (d) Qualifications & experience of the Valuers/ prop/ partners/ directors
- (e) PAN/TIN Card
- (f) I.T. Returns (last 3 years)
- (g) Empanelment with other banks/ institutions.
- (h) Registration/ Affiliation with Wealth Tax Authorities (CBDT), Institute of Valuers/ CA/ Architects/ Engineers, RBI, any other Organization, as Valuer/ Engineer/ Architect/ NBFC/ Auctioneer/ Mgt Consultants.

We solemnly declare that the information furnished above is complete and entirely true, and nothing has been concealed. We affirm that terms & conditions of State Bank of India relating to empanelment of VALUERS of Assets are acceptable to us.

*For & On Behalf of Firm :*

(Signatures)  
Name & Designation

(Signatures)  
Name & Designation

(Signatures)  
Name & Designation

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Name & Designation

(Signatures)  
Name & Designation

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## ANNEXURES

### ANNEXURE-A

<b>STATEMENT OF STOCK AND BOOK DEBTS AS ON _____</b>
------------------------------------------------------

Name of the Company/Unit: \_\_\_\_\_

**Part A: INVENTORIES**

(Rs. in thousands)

Dues from	Opening stock			Stocks in			Stocks Out			Closing stock		
	Quantity	Unit Rate	Value	Quantity	Unit Rate	Value	Quantity	Unit Rate	Value	Quantity	Unit Rate	Value
<b>I- Raw Materials</b> 'A' items* (specify whether imported or indigenous)  1. 2. ... Others												
<b>II- Stock-in-Process</b>												
<b>III- Finished Goods - 'A' items*</b>  1.												



2. ... Others												
<b>IV- Stores</b> - 'A' Items*												
1.												
2.												
... Others												
<b>V- Spares</b> - 'A' Items*												
1.												
2.												
... Others												

**Part B: BOOK DEBTS**

(Rs. in thousands)

**1. Age analysis of book debts considered good (including bills discounted but excluding deferred receivables)**

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								
<b>Total</b>								



## 2. Only where drawings are permitted directly against book debts

(List of major debtors, i.e., covering at least 60% of total book debts mentioned above)

Name of the debtor	Outstandings up to 3 months		Outstandings more than 3 months	
	Number	Amount	Number	Amount

### Part C : OTHER INFORMATION

	Projected for Current Accounting Year	Up to end of the Last Month	During the Month under Report
Sales			
Production			
Consumption of raw materials			
Consumption of Stores			
Sundry Creditors	Year End:	<b>XXXX</b>	At the end of the month:

#### Notes:

1. 'A' items should cover at least 60% of the value of stocks 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 quantity, value and names of such processors, etc., along with appropriate certificates from such parties, to the effect that they (i) have received such materials from the borrower for processing, etc., (ii) hold the goods in trust for the bank; and (iii) 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 stocks more than a year old and included hereinabove should be shown separately.
4. Particulars of tailor-made / custom-built products, which are found defective / rejected by the designated buyer should be shown separately.
5. Valuation of stocks, etc., should be on the same basis as adopted for the statutory balance sheet and should be applied on a consistent basis. 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 total stocks of a borrower, a summary of the total stocks inclusive of stocks shown in this statement should be submitted along with this statement classified into raw materials, stocks-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.*

**Certificates:**

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 stocks 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 stocks 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 stocks lying with outside processors included hereinabove and charged to the Bank, the company are in possession of 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 stocks and assets shown as being in transit and charged to the Bank, the company are in possession of 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 company have complied with all the requirements of ..... (e.g. Cotton Textiles Control Order 1965) and carried out all the instructions issued by the ..... (e.g. the Textile Commissioner) pursuant to the powers vested in him under the same order;
- (h) The above noted stocks and assets (excepting those which are not subject to fire hazards) are fully insured against fire and ..... risks as per 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;
- (i) The particulars of stocks of assets and all the other information furnished hereinabove have been taken from and are in agreement with the company's books of accounts maintained in the normal course of business and or other books and records maintained in accordance with statutory or other requirements.



**Summary of Stock & Book Debts position as per the stock statement dated \_ \_ \_ \_ \_**

(Rs. in thousands)

Valuation done at the lowest of cost, market or controlled rates	Items	Value of Stocks	Margin		Advance Value (3-4)	Sub-limit, if any	Drawing Power
			Amount	%			
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						
	<b>Total of (i) to (vi)</b>						



**ANNEXURE B**

**(Format of QIS-I or FFR-I)**

Based on information furnished by the customers (Part I to be filled in by the Customer)

**(Part I to be filled by the Customer)**

Report for the \_\_\_\_\_ (I / II/ III/ IV) Quarter ended)

Period covered by the Report: 3/6/9/12 Months

**Name of the Borrower:** \_\_\_\_\_

**A. Performance during the year:**

(Rs. in Crs.)

Activity	Annual Plan (Current Year)	Actuals for the quarter ended	Actuals, cumulative up to quarter ended —'—'—	Percentage of achievement
(i) Production ( <i>Quantity</i> )				
(ii) Purchases				
(iii) Gross Sales				
(iv) Net sales ( <i>Rs. in Crs.</i> )				
(a) Domestic				
(b) Exports				

**B. Status of Working Capital Funds:**

(Rs. in Crs.)

Particulars	At the end of last year (31.3. __ ) (1)	At the quarter ending ( / / ) (2)	Change during the current year {(2)-(1)} (+) or (-)	Estimates at the end of Current Year (31.3. )
a. Inventory				
b. Receivables less than six months				
c. Other CA				
<b>d. Total CA (a+b+c)</b>				



e. Bank Borrowings for WC				
f. Sundry Creditors				
g. TL installments repayable in 12 months including FCCB.				
h. Other CL				
i. Total CL (e+f+g)				
j. NWC (d - h)				
k. Current Ratio (d/h)				

**A. Other information:**

Sl. No.	Situation	Customer response
1	i) Is there cash loss?ii) If cash loss is there during the quarter, plan for funding it?iii)If EBIDTA is inadequate to service interest and repayments, furnish comments on source of funds to service interest and installment including bringing funds to meet the shortfall.	
2	If investments / loans and advances to associates has increased during the quarter/ upto the quarter, reasons there for and whether Bank's approval is available for additional investments.	
3	Whether capex and funding are as per projected lines. If not, elaborate.	
4	Whether there is Overdue statutory payments like excise duty, EPFO and other taxes. If so, quantify them.	
5	Whether there are material changes in a) Sales b) Profit c) Current assets and current liabilities d) raw material prices, e) power, f) labor, etc. affecting the business?	
6	Any foreign exchange loss, material change in Other Income and Other expenses.	
7	Is there any salary or other dues pending to the employees as on date?	



8	Details of current accounts opened with other banks. Provide details like : i) Name of the Bank ii) Bank Address with Code Number iii) Account Number	
9	Any new borrowings availed during the quarter? Provide details like : i) Name of the Bank / FI ii) Address with Code Number iii) Nature of facility iv) Loan amount v) Security offered	
Place :		<b>Signature of the Authorized Officials of the company</b>
Date:		

<b>Part II For Office Use</b>			
<b>A. Levels of inventory, receivables and sundry creditors.</b>			
	<i>(In number of days)</i>		
	At the end of last year (31.3.—)	At the quarter ended ( — /— /— )	Estimates at the end of current year (31.3. — )
Inventory			
Receivables			
Sundry creditors			
In Section A, levels in days should be computed for each column as follows:			
For Inventory : (Value x 365)/ Net Sales			
For Receivables : (Value x 365)/ Gross Sales			
For Sundry Creditors : (Value x 365)/ Purchases			
<i>(For the above, sales and purchases for part of the year are to be annualized)</i>			



<b>B. Remarks</b>		
1	Is the performance in regard to production and sale up to the quarter end under report is in line with the current year estimates.	
2	Are changes in Net Working Capital and Current Ratio in consonance With the changes expected during the current year?	
3	Is change in the level of bank borrowing in tandem with the changes in the value of inventory and receivables? In case the change in the bank borrowing is due to increase/ decrease in the sundry creditors or other current liabilities, examine whether the position reported is acceptable.	
4	Is there is any significant change in the pattern of individual sources of finance for current assets and if so, whether it is acceptable.	
5	The levels of inventory, receivables and sundry creditors on the date of the report as compared with the year-end estimates are also to be examined.	
6	<b>Brief Comments on:</b>	
	i) Conduct of account since last Quarter review (Irregularity in CC & Other accounts.	
	ii) Devolvement of LCs	
	iii) Invocation of Bank Guarantees	
	iv) Overdues in other banks / FIs	
	v) Non-routing of sale proceeds	
7	Any other adverse feature observed	
	<b>Customer Support Officer/ Credit Analyst</b>	



<b>Remarks</b>	
	(If the published data / remarks by CSO/CA call for Corrective Action Plan, please indicate the proposed course of action including any discussions with customer).
	<b>Relationship Manager</b>
<b>Remarks</b>	
	(Escalation to higher authority , if required, to be commented)
	<b>Branch Head / DGM / GM</b>

**ANNEXURE C**

<b>(Format of QIS-II or FFR-II)</b>				
<b>FINANCIAL FOLLOW-UP REPORT (FFR II)</b>				
<b>BASED ON INFORMATION FURNISHED BY THE CUSTOMERS</b>				
<b>(Part I to be filled in by the customer)</b>				
<b>PART-A</b>				
Name of the borrower : _____				
<b>Half-Yearly Operating Statement</b>				(Rs. in Crs.)
	Half year ended _____. 20__ (Actuals)	Corresponding 6 months ended _____ in the previous year	Last year (Actuals)	Current year (Estimates)
1. Gross Sales				
a) Domestic				
b. Exports				
2. Less Excise duty				
3. Net sales (1-2)				
<b>4. Cost of goods sold</b>				
(a) Raw materials consumption				
(b) Other spares				
(c) Power & fuel				
(d) Direct labour (factory wages & salaries)				
<b>(e) Other manufacturing expenses :</b>				
i) Depreciation				
ii) other manufacturing expenses				
(f) Sub-total (4(a) to 4(e))				



<b>Add</b> : Opening stocks-in-process & finished goods				
<b>Deduct</b> : Closing stocks-in-process & finished goods				
Total Cost of goods sold				
5.Selling, general & administrative expenses				
6. Interest				
7.Sub-total (4+5+6)				
8.Operating Profit/ Loss (3-7)				
9.Other non-operating income/ expenses - Net (+/-)				
10. Profit before tax/ Loss (8+9)				
11. Tax				
12. Profit After Tax				
<b>Place :</b>	<b>Signature of the Authorised Officials of the Company</b>			
<b>Date:</b>				

**PART – B**

B. Half Yearly Statement of Assets and Liabilities:

**Statement of Assets and Liabilities:**

Rs. in Crs.

Particulars	As at the Current Half Year Ended	As at Corresponding 6 months ended — in the Previous Year	As at Previous Year ended	Current Year Estimates	
<b>EQUITIES AND LIABILITIES</b>					
Share Holders' Funds					
a) Share Capital					
b) Reserves and Surplus					
c) Money received against Share warrants					
<b>Subtotal of Share holders fund</b>					
Share application money pending allotment					
Non-Current Liabilities					
a) Long term borrowings - TL (installments > 12 months)					
b) Deffered Tax Liabilities					
c) Other Long term Liabilities					
d) Long Term Provision					
<b>Sub total Non- Current Liabilities</b>					
Current Liabilities					
a) Short term borrowings					
b) Trade Payables					
c) TL installments repayable in 12 months including FCCB.					



d) Other Current liabilities					
e) Short Term Provision					
<b>Sub-total Current Liabilities</b>					
<b>TOTAL EQUITIES AND LIABILITIES</b>					
<b>ASSETS</b>					
<b>Non-Current Assets</b>					
a) Fixed Assets					
b) Non-current investments					
c) Long term loans and advances					
d) Trade Receivables (more than 6 months)					
d) Other non-current assets					
<b>Sub total Non Current Assets</b>					
<b>Current assets</b>					
a) Current Investments					
b) Inventories					
c) Trade Receivables (less than 6 months)					
d) Cash & Bank balance					
e) Short term loans and advances					
f) Other Current assets					
<b>Sub-total Current Assets</b>					
<b>TOTAL ASSETS</b>					



**Part II**  
**For Office Use**

<b>Half Yearly Operating Statement</b>					
<b>Name of the Borrower</b> _____					
<b>Limits Sanctioned</b>					
<b>Date of last sanction</b>					
<b>CRA Rating</b>	<b>ECR Rating</b>				
<b>IRA Status</b>					
					<b>Rs. in cr.)</b>
Particulars	Actuals Half year ended _____. 20__	Percentage achievement vis-a-vis estimates	Actuals at the end of same half year last year	Last Year (Actual)	Current Year Estimates
<b>A. Net Sales</b>					
B.					
i) Other income					
ii) other expenses					
C. EPS					
1. PAT					
2. TAX					
3. Interest/ Financial charge					
4. Depreciation / Amortization					
5. EBIDTA					
6. Cash Accruals					
7. Interest Coverage ratio					
8. Profitability					



**Part II**  
**For Office Use**

Half yearly Funds Flow Statement				
( From LLMS)				
<b>Name of the Borrower</b> _____				
<b>Limits Sanctioned</b>				
<b>Date of last sanction</b>				
<b>CRA Rating</b>	<b>ECR Rating</b>			
<b>IRA Status</b>				
(Rs. in Cr.)				
<b>Particulars</b>	<b>Half year ended (Actuals)</b>	<b>Corresponding 6 months ended _____ in the previous year</b>	<b>Last year (Actuals) (Data if available)</b>	<b>Current year (Estimates)</b>
<b>1. SOURCES</b>				
a) Increase in Capital and reserves				
b) Increase in term liabilities				
c) Depreciation				
d) Decrease in				
i) Fixed assets				
ii) Other non-current assets				
e) Others				
f) TOTAL (1(a) to 1(e))				
<b>2. USES</b>				
a) Decrease in Capital and Reserves				
b) Decrease in term liabilities (incl. public deposits)				
c) Increase in :				
i) Fixed assets				
ii) ICDs placed				
iii) Investments in				



associates/ subsidiaries				
iv) Other non-current assets				
d) Others				
e) TOTAL (2(a) to 2(d))				
3. Long term surplus (+) / deficit (-) (1(f) – 2(e))				
4. Changes in current assets Increase (+)/ Decrease (-)				
5. Changes in Current Liabilities Increase (+)/ Decrease (-)				
<b>6 Net surplus (+) / Deficit (-)</b>				

**Remarks**

Sl. No.	Particulars	Comments
1	Whether the results, namely, the profit, profitability are in line with the estimates.	
2	Brief comments on Interest coverage ratio and capability of the unit to repay term loan installments falling due in the quarter.	
3	i) If there is Long term deficit, has the unit incurred cash loss or is there diversion of short term funds to long term purpose? ii) In case of Cash Loss , indicate source of funding. iii) In case of diversion, the steps taken to rectify.	
4	If there is any variation especially in items like ICDs, investments in subsidiaries –please comment about its impact on the liquidity, gearing of the company	

**Customer Support Officer/ Credit Analyst****Remarks**

(If the published data / remarks by CSO/CA call for Corrective Action Plan, please indicate the proposed course of action including any discussions with customer).

**Relationship Manager**

Remarks:

(Escalation to higher authority, if required, to be commented)

**Branch Head / DGM / GM**



**ANNEXURE D**

**STOCK AUDIT REPORT SPECIMEN  
(CONFIDENTIAL)**

**Report of Factual Findings in Connection with Agreed Upon Procedures Assignment Related To Stock Audit of M/s \_\_\_\_\_ Account with [Name of Bank], [Name of Branch].**

To,

[Branch Address]

[Branch Address]

[Branch Address]

[Branch Address]

Dear Sir,

We have performed the procedures agreed with you and enumerated below with respect to the Stock Audit of \_\_\_\_\_ for the period \_\_\_\_\_.\_\_\_\_\_ to 31.01.20XX set forth in the accompanying schedules (Stock Audit Report).

**Our engagement was undertaken in accordance with the Standard on Related Services (SRS) 4400 “Engagement to Perform Agreed upon Procedures regarding Financial Information”. The procedures were performed solely to assist you in evaluating the validity of the Stocks and Book Debts summarized as follows:**

1. We obtained and checked the Stock Records and accounts receivables (Debtors) as at \_\_\_\_\_.\_\_\_\_\_ prepared by \_\_\_\_\_ and we compared the same with the general ledger account.
2. We compared the Stock Statements submitted to [Name of Bank], [Name of Branch] as at 31.01.2016 with the related particulars with the books of accounts maintained by the borrower.
3. We compared the stock statements with the physical verification of stock carried out by us at Factory / Godown Premises at
  - Address:
  - Address:
  - Address:
  - Address:

The deviations of items of stock were reconciled with purchases and consumptions, records for the period 31.01.20XX till date of our physical verification in case of Raw Material and with the Sales Records in case of Finished Goods.



We report our findings below :

(a) The stock statements and the physical stock as on 31.01.2016 were matching.

that the amount of stock and book debts as shown in stock statement as on 31.01.2016 to be correct as per books of account produced before us and our subsequent physical verification of the same.

Our detailed observations are attached in the **STOCK AUDIT REPORT** and annexure, if any, to the said report given along with this report.

**We have carried out physical verification of stock on selective basis.**

**Had we performed additional procedures or had we performed an audit or review of the financial statements in accordance with the generally accepted auditing standards in India, other matters might have come to our attention that would have been reported to you.**

**Our report is solely for the purpose set forth in the first paragraph of this report and for your information and is not to be used for any other purpose or to be distributed to any other parties. This report relates only to the accounts and an item specified above and does not extend to any financial statements of \_\_\_\_\_ taken as a whole.**

**We have discussed the draft stock audit report with the [designation of officer] of [Name of Bank], [Name of Branch] along with the representative of Borrower on \_\_\_\_\_.\_\_\_\_.2016.**

**For [Name of Cost Accountant Firm]**

**[Name of Partner]**

**Partner**

**Membership No.**

**Firm Registration No.**

Place:

Date: \_\_\_\_\_.\_\_\_\_.20XX



**Executive Summary**

<b>Sl. No.</b>	<b>Particulars of Stock Audit</b>	<b>Shortcomings observed by the Auditors, if any</b>
1.	Physical verification of stocks as shown in Stock Statement/ reconciliation with stock register/subsidiary books/extent of paid for stocks / obsolete stock / credit enjoyed etc.	
2.	100% verification of high value inventory of major inputs.	
3.	Method and basis of valuation of stocks and receivables / comment on actual position vis-a-vis data submitted to Bank/ if overvalued, quantification of the same.	
4.	Proper categorisation and valuation of stocks/ comments on inventory and receivables norms accepted at the time of sanction and the actual position.	
5.	Comprehensive details of quantity and value of chargeable stocks as on any particular day during stock audit.	
6.	Scrutiny of records for arriving at accurate position of sales achieved and Receivables outstanding / verification of at least 75% of outstanding debts within acceptable age and 100% outstanding debts beyond acceptable age/ comments on quality of receivables and their realisability, follow up of overdues, credit policy of the borrower, average credit allowed on sales etc. / specific comments on bad debts and possible losses.	
7.	Scrutiny of QIS and fund flow statements with the books of accounts to verify veracity of information provided to Bank vis-a-vis actual.	
8.	Understatement of credit enjoyed on purchases, if any, and the extent of such understatement.	
9.	Comment on borrower's internal procedures regarding physical verification of inventory / frequency thereof, procedure for accounting rejected goods, etc.	
10.	Comment on inventory management and control policies followed by the borrower	
11.	Comments on arrears of statutory dues and obligations, if any	
12.	Comments on Notes of Auditors and any other qualifying	



	remarks contained in the last Balance Sheet of the borrowers/ comment on change in Accounting Policies, if any and its impact on the profitability / value of security charged to bank.	
13.	Comments on general conditions of storage, plant condition, plant lay out, plant maintenance, testing and inspection, quality control, etc.	
14.	Comments on adequacy of insurance for primary as well as collateral security	
15.	Comments on transactions/dealings with sister/associate/group companies	
16.	Comments on system for movement of goods sent for processing.	
17.	Comments on movement of finished goods to various distribution centres.	
18.	Comments on sales return / rejections in respect of finished goods.	
19.	Specific comments on diversion of funds, if any, observed. If no diversion noticed, it should be stated specifically.	
20.	Any other finding during the course of Stock Audit, having adverse impact in the account.	
21.	Net impact of observations on the value of security charged/ on the Drawing Power	

**STOCK AUDIT REPORT**

DATE OF VISIT AT BRANCH	
AT OFFICE	
AT UNIT	
DATE OF SUBMISSION OF REPORT	

Name of the Account	
Constitution	
Name of the Branch	
Name of the CMA firm	
Name of the person who inspected the account	
Name of the person from the branch who accompanies CMA	
Name of the person/s contacted at borrowers site:	

<b>ADDRESS:</b>	
Office	
Warehouse / Godown	
Factory	
Nature of activity	

Date of last renewal		Regular/shortIf short review, give the validity period of limit	
Banking Arrangement		Name of the other bank	



**POSITION OF ACCOUNT AS ON 31.01.2017**

**[Rs. In Lacs]**

Nature of facility	Limit sanctioned	O/s as on 31.01.2016
<i>Fund Based Limits:-</i>		
A. CC Hypothecation of Book Debts (upto 90 days)		
i. EPC		
ii. FBP/FBN		
B. Maximum (i +ii)		
I. Total WCFBL (A+B)		
II. Non Reducible – Overdraft against property		
III. Term Loan		
Total Fund Based limit (I+II+III)		

<i>Non Fund Based Limits</i>		
i. L/C Import DA 180 days		
ii. L/C Import DP		
A. Maximum (i+ii)		
B. BG (inland)		
Total Non Fund Based (A+B)		
Aggregate Limits (FB +NBF)		

**Details of Primary & Collateral Security:**

**[Rs. In Lacs.]**

Type of security	Particulars	Total Value
<b>Primary:</b>		
<b>Collateral:</b>		
Collateral		
<b>Total</b>		



Sl. No.	Particulars	Observations / Remarks
i)	The minimum period that should be covered by our stock audit, should be from 01.04.2016 or from the date of Last Stock Audit whichever is later to till date of Stock Audit is being carried out. However, if the circumstances so warrant or the account is being placed under stock audit for the first time, a longer period say of 1.5 to 2 years should be covered.	
ii)	Physical verification of stocks as shown in the stock statements submitted to the bank shall be carried out. The latest stock statement to be tallied with stock register and also other subsidiary books to verify the correct position of stocks, extent of paid stocks, stagnant / obsolete stocks, credit period available, etc.	
iii)	Physical verification shall be conducted on the basis of ABC analysis which will bring out the components that account for major inputs. Such high value inputs shall be verified on a cent percent basis and not by random verification method.	
iv)	Stock Audit shall bring out the method and basis of valuation of stocks and comment on the actual position vis-à-vis the data submitted to Bank.	
v)	A proper categorization and valuation of raw materials, work in process, finished goods and stores and spares shall be made. Comments shall also be given on the inventory and receivable norms accepted while assessing working capital requirement and the actual position maintained by the borrower.	
vi)	The Stock auditors shall work out comprehensive details of the quantity and value of chargeable stocks as of any particular day during the course of the audit.	
vii)	The auditors shall scrutinize Sales Register, Debtors Ledger, Bills / Invoices, Delivery Challans, Excise Records, Sales Tax Payments, etc. for getting an accurate position of Sales and Book Debts. Stock auditors shall verify at least 75% of outstanding debts upto the period accepted for assessment of working capital limits and 100% verification must be made in respect of items not realized within the accepted period. The report shall, inter alia, contain comments on quality of receivables and their realisability. Follow up action regarding over dues, the credit policy of the company, average credit period allowed, advances given to suppliers, etc. Special	



	mention must be made if there are any probable losses on account of bad debts particularly in respect of associate / sister concerns and of old debtors carried forward in the books, the realisability of which is doubtful.	
viii)	Stock auditors shall scrutinize the QIS and fund flow statements with the books of accounts to determine the veracity of information provided to the Bank vis-à-vis the actual position. The report shall contain item-wise detailed comments on the correctness or variations pertaining to these statements.	
ix)	The stock auditors shall look into and comment on the borrowers internal procedures regarding physical verification of inventories and the frequency thereof, procedure of accounting in respect of rejected goods, maintenance of stocks and product records etc.	
x)	Inventory management is crucial for continued profitability of any unit and it is, therefore, vital that this is optimized and inventory carrying costs kept to the bare minimum. The auditors shall bring out the inventory management and control policies of the concerned corporate and comment upon policies being followed.	
xi)	The stock auditors shall also examine/ comment as to whether statutory liabilities and obligations have been met and that there are no arrears in payment of these dues.	Example: Yes, timely compliance of VAT, CST and Income Tax is made by the borrower.
xii)	Stock audit report shall invariably comment on the notes of auditors and any other qualifying remarks contained in the last balance sheet of the company.	
xiii)	The stock auditors shall also comment upon the general storage conditions, plant layout, plant maintenance, testing and inspection, quality control etc.	
xiv)	Specific comments shall be made if any diversion of funds is observed. If no diversion of funds is observed, it should be stated so.	
xv)	To look and comment on the system adopted by the company for <ul style="list-style-type: none"> <li>i) Policy of Procurement.</li> <li>ii) Movement of Stocks from Stores.</li> <li>iii) Bin Card System if adopted for management of Stock.</li> </ul>	



xvi)	To comment on sales returns/rejected stocks of finished goods ascertaining the reasons there for and also the measures being adopted by the co. for disposal of such rejected stocks.	
xvii)	To comment on the adequacy of insurance cover for the stocks, adequacy of coverage for all locations of storage, comment on coverage of risks based on the nature of goods etc.	
xviii)	To comment on the movement of goods sent for processing, if any, and the adequacy of control system to ensure the return of the goods duly processed.	
xix)	To comment on the movement of finished goods to various distribution centres and the system adopted for controlling the finished goods lying in the distribution centres which are included in the stock statement.	
xx)	In case part of the procurement of raw materials from sister/ associated company, then to comment on the reasonableness of the purchase consideration vis-a-vis market related policies.	

**For [Name of the Firm]**

**[Name of Partner]**

**Partner**

**Membership No.**

**Firm Registration No.**

Place :

Date : \_\_\_\_, \_\_\_\_, 20XX