UNIT 4: AUDIT OF STOCK AND DEBTORS / UNIT INSPECTION (AUDIT OF BORROWAL ACCOUNTS)

1. OVERVIEW

Review, Monitoring and Supervision of advances of all borrowal accounts include Unit Inspection inter alia consisting of audit of stock and debtors. This audit is carried out either by Concurrent Auditors or by empanelled external auditors. The scope of audit, the percentage verification as well as format of reporting are prescribed by the Banks.

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<th>PURPOSES OF UNIT INSPECTION:</th>
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<td>(i) To have independent verification of working of borrowal unit.</td>
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<td>(ii) To confirm correctness of statements and information furnished to the bank vis-à-vis the books of accounts and other records of the borrower.</td>
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<td>(iii) To ensure end use of funds as per terms of sanctions.</td>
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<td>(iv) To make sure that the stock exists, is marketable, is properly insured and is a paid stock.</td>
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<td>(v) To verify whether the book debts are current and are recoverable.</td>
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2. AUDIT PROCESS FOR UNIT INSPECTION

2.1. Preparation for Inspection –

1. List the locations to be visited, such as – Bank’s branch where borrower has account, borrower’s office, factory, godowns, sales offices from where invoicing is done, Job workers location where goods are sent by the borrower etc.

2. Verify documents with the bank – such as – promissory note, sanction letter, mortgage deed, visit reports, insurance, stock & debtors statement, Quarterly Information Statement submitted by the borrower, etc. and list defects.

3. List primary and secondary securities mortgaged/hypothecated to the bank.

4. Know projections to estimate the levels of stock and debtors at the time of Inspection.

5. Verify last 12 months stock statements to identify slow movings stock, seasonal trends in levels and knowing break-up of percentages of Raw Material, Work In Progress, and Finished goods to total stock for stocks at different locations.

6. Identify major debtors balances.
7. Make intelligent scrutiny of cash credit account to reveal diversion of funds, off balance sheet items serviced to other lenders by the borrower such as instalment of leased finance obtained, payment to parties unrelated to business indicating investment outside business, frequent overdrawing, frequent bouncing of cheques, repeated against effects, repeated requests for adhoc limits etc.

8. Refer last inspection reports to note the defects already found and responses thereto by the borrower.

9. Arrange to refer books of account of the borrower including excise record.

10. Understand process to know, how work in progress is valued.

11. Arrange for physical verification of stock at all locations.

12. Take current list of debtors and creditors including advances received and paid.

2.2 Information to be collected from Branch

1. Borrowing arrangements – under sole/multiple/consortium finance with share of the bank.

2. Information of the borrower. Such as –
   (i) Constitution
   (ii) Nature of Stock
   (iii) Nature of Activity

3. Information about all advances (Term Loans, C.C., OD, Bill Discounting, Guarantees, LCs) – Sanction limit, value of security, drawing power, outstanding balance and extent of irregularity.

4. Last renewal/review date.

5. Sanction limit valid up to the date.

6. Documentation of the borrower for all loan accounts.

7. Charge creation – For first charge and second charge.

8. Last available Balance confirmation.

9. Particulars of Insurance cover for all Fixed and Current assets.

10. Debit and Credit summation for one year.

11. Interest application – rate, calculations and frequency.

12. Regularity of repayment of Term Loans.

13. Rate of recurrence of Cash transaction with average amount.
14. Excess drawings – Number of times overdrawn, Average time taken for regularization, excess neither adjusted nor confirmed by higher authorities.

15. Non Compliance of terms and Conditions of sanctions, if any

16. Information by the borrower of –
   (a) Recent Stock/book debt Statements
   (b) Drawing power calculation
   (c) Regularity of submission of quarterly/monthly statements
   (d) Last Audited Statements

17. Overdue bills, bank guarantees and LCs.

18. Devolvement of LCs with the reason for devolvement and method of adjustment.


20. Expired guarantees not reversed.

21. Reports on Inspection either by branch, or by concurrent auditors, or by Bank’s Internal Inspection Team and Compliance by the borrower on the requirements and observations of the Inspectors.

2.3 Information to be collected at the time of visit to borrower

<table>
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<th>About Godown</th>
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<tr>
<td>i. Whether access to godown is restricted</td>
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<td>ii. Whether Security arrangements at godown are satisfactory</td>
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<th>About Stock</th>
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<tr>
<td>i. General Storage condition of stock at godown</td>
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<td>ii. Stock at the time of Inspection with reconciliation of stocks in books =</td>
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<tr>
<td>iii. Physical Stock + Stock given on Job Work - Stock received for job work - Unpaid Stock</td>
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<tr>
<td>iv. ABC categorization of stock</td>
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<tr>
<td>v. Method of stock valuation and statutory auditor’s comments thereon.</td>
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<th>About Manufacturing &amp; related stock records</th>
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<td>i. Production details – such as – Licensed capacity, installed capacity and capacity utilization of each plant.</td>
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<td>ii. Tallying of stock with balances in Excise Register</td>
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<tr>
<td>iii.</td>
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<td>iv.</td>
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### About Book Debts

| i.  | Book-debt value = Book debts balance as per books of accounts - debts not ranking for DP - doubtful debts – debts not pertaining to line of business - margin |
| ii. | Party wise / Age wise break-up of book debt |
| iii. | Book debts reported to bank v/s correct balance as accounting package including correctness of ageing |
| iv.  | Average realization time of book debts |

### Drawing Power Calculations & other information about Stocks

| i.  | Drawing power calculations = Value of Stock + Value of Debtors - Unpaid Stock – Stock under LC – Stock under Bills - Stock under packing credit - Obsolete/non-saleable stock - Unrelated stock/old stock - margin |
| ii. | Stock belonging to sister concerns |
| iii. | Stock holding as a percentage of sales |
| iv.  | Abnormal increase /decrease in stock levels with reasons |

### Other Information

Details of temporary closure of unit due to lock out/strike or labour unrest.

#### 3. FINDINGS OF INSPECTION

### About Stock

| i.  | Address of Godown or even the borrower not matching as per documents with bank. |
| ii. | Stocks identified as non-moving, or slow moving or non saleable included in statement to the bank. |
| iii. | Stock valuation not done properly, e.g. Valuation done at selling price, interest included in cost, administrative or selling overheads included in cost, etc. |
| iv.  | Safety of material not ensured. |
v. Arrangements of stock not appropriate making it difficult to count the same, making it impossible to use on FIFO basis, making it prone to damages.

vi. Excess stock found.

vii. Billing to sister concerns not supported by stock movement.

viii. Physical stock and book stock showing material differences.

ix. Stock in pledge old and non-saleable

Debtors

i. Ageing of debtors indicating long outstanding debit balances or irrecoverable balances.

ii. Advance receipt not deducted from debtors balances.

iii. Written-off debtors reported to bank as good and recoverable.

iv. Debtors requested to pay directly to the creditors thereby avoiding the margin required to adjust the default in term loans.

v. List of invoices raised in 90 days given to bank instead of outstanding balances of debtors.

Creditors

i. Suppliers name on the bills and on the stock packing do not tally thereby indicating either stock does not belong to the borrower or the bills are fake.

ii. Level of actual creditors substantially higher than as reported to bank.

iii. Debit balances/Advances to creditors shown as debtors.

Others

- Drawing power not properly calculated.

- All sales receipts are not deposited in bank Account.

- Bank accounts opened with other banks without permission of the lending bank.

- Multiple financing availed without permission of the lending bank.

- Change in constitution not informed to the bank, e.g. Retirement of Key Management personnel, without appropriate replacement, affecting business, not intimated to bank for the fear of cancellation of limit.

- Insurance company not informed about temporary change in location thereby running a risk of rejection of claim in case of damage to stock.
Transactions with related parties not genuine, e.g. Accommodation bills raised against invoices having no underlying stock movement.

Name plate of the bank not displayed inside the godown, thereby carrying a risk of hypothecation of same stock to other lender.

Activity partially or fully discontinued and/or premises given on rent not informed to bank.

Laboratory tests of materials indicate lower potency/non usable stock.

Excessive stock holding noticed in certain items, which is not supported by business plan.

Substantial increase in cash sales but not deposited in bank account.

Some of the assets not insured

Defects found in last inspection still persisting.

4. REPORT

(i) Report will have to be given in the format prescribed by the bank.

(ii) Any negative findings should be discussed with the borrower and also with the bank officials before writing the report.

(iii) Any difficulty in carrying out the inspection needs to be informed to the bank well in time.

(iv) Inspection should be carried out within reasonable time of appointment and report should be submitted immediately thereafter in order to help the bank act on the observations expeditiously.