Audit of Cash Credit Loans.

During my Articleship period, I was fortunate enough to do the Concurrent Audit of Main branch of a Public Sector Bank in Coimbatore. And the knowledge which I gained during the audit is invaluable.

In this article, I am going to write about how to audit Cash Credit loans or Working Capital loans. This article is **not an exhaustive coverage** of all the items to be checked in Cash credit loans, but only the important aspects .

1. **Working Capital / Cash Credit loans :**

   Working Capital loans (Cash Credit) are usually borrowed by Companies, Partnership Firms and even Sole proprietors for their **working capital requirements**. The following are the list of things that can be checked in a detailed manner in case of Cash credit loans.

   - **Loan Sanction agreement / Sanction ticket.**

     This document will contain the details of cash credit loan which is given by the bank to the borrower. All the terms and conditions which needs to be followed by the borrower, and incase of violation of any of the terms and conditions, what are the consequences to be faced by the borrower (eg : penalty) will be mentioned in the loan sanction document. All of us read the sanction document , but I feel that we do not give appropriate attention to all the small details given in the Sanction Document.

     Tip: Understanding what is given in the Sanction letter is important, during my audit, I once noticed a small clause written at the end of the letter that "Incase of the failure of the borrower to give the Audited Financial Statements of the Company/Firm within December end, Penal Interest will be charged at 2% P.A of the limit sanctioned". Many a times, during the audit of December/January month, we fail to see this and there are chances of **Revenue leakage** to banks and it is the duty of the Concurrent Auditor to note the same and report in the Concurrent Audit

Report. The amount may be huge, if we consider all the accounts who have not submitted their Audited Financial Statements.

- **<u>Interest rates:</u>**

  Interest rates are based on Marginal costs of funds based lending rates (MCLR). Working capital loans are given for a maximum period of 12 months(Subject to extension) and after that they are renewed . And each period when they are renewed, the interest rate will be based on the **then MCLR** (Plus certain percentage, which differs from banks to banks).

  <u>Tip</u>: In most of the banking software, Interest rates have to be manually entered by the bank staff, so there is a possibility of doing a mistake at the point of entry. Based on the number of Cash credit accounts available with the bank, test check can be done on a monthly basis (usually for 2-3 accounts). All the accounts which are opened or renewed during the month can also be checked for Interest rate differences. During the audit, I have even found revenue leakages upto 25000 in a single account due to the **Interest rate mismatch as per sanction letter and what is debited in the account of the borrower.**

- **<u>Security:</u>**

  Cash credit loans will be given on the basis of Current assets (Stock and debtors). They are the primary security for these types of loans. However we sometimes do not give adequate importance to **Collateral Security**. Memorandum of Title deeds, Encumbrance Certificate needs to be checked.

  <u>Tip:</u> We should make sure that the **latest Encumbrance certificate** is available in the file of the borrower. **Insurance** should have been taken for the primary and collateral security. **Under Insurance** or items whose Insurance have **expired** needs to be reported in the Concurrent Audit Report. **Insurance Register** needs to be maintained by the Banks, either in soft copy or hard copy, if not maintained the same can be reported in the Concurrent Audit Report.

- **Stock statements:**

  Since the cash Credits are given based on Current Assets (Debtors and stock), the bank wants to know the position of the stock and debtors every month. The borrower has to submit the Stock Statements to the Bank every month. Based on the stock statements given by the borrower, drawing power needs to be calculated**.**

  Tip: Sometimes few Companies **overstate** the Debtors and Stock in the Stock statements so that their Drawing power is not affected. Cross verification can be done by looking at the Closing stock and Debtors in the Audited Financial Statements for the year ended 31/03 to have an idea of whether the company is manipulating the figures or not. If the Company is a **listed company Interim Financial Statements** can also be checked. And to my surprise in one or two accounts of the borrowers had overstated the Debtors for the month of March to a great extent which I was able to discover only after the receipt of the Audited Financial Statements in the month of August. If this is the case, the Concurrent Auditor **can exercise more caution** during the scrutiny of that particular account.

- **Drawing Power:**

  The drawing power is the maximum amount that can be drawn by the borrower for a particular month.

  Tip: Most of the times, we do not check if the borrower has drawn in excess of the drawing power. We just calculate for reporting purposes, If the borrower has withdrawn above the Drawing power (Subject to overall limit), the same has to be considered, as it is a serious irregularity which shows the weakness of the borrower.

- **Continuous monitoring:**

  Every debit and credit needs to be monitored in **each account**, it should be ensured that the funds are not utilized for the personal purpose of the Directors or the Partners.

  Tip: Since, Cash credit loans are mainly given for meeting the Working Capital requirements, Sales and Purchases should be routed through this account only, During the scrutiny of one of the major borrowers in the Bank, I came to know that Sales and Raw material purchases were not routed through this account, instead they were using the Cash Credit account for Purchase of Fixed Assets ,which is a serious irregularity and should be reported in the Concurrent Audit Report.

- **Commitment Charges:**

  Commitment charges will be charged by the bank for the **unutilized minimum limit.** Since this has to be manually charged by the banker in the banking software, they tend to miss it. **Revenue leakage** can be found in this part.

- **Valuation Report:**

  Valuation report has to be **updated every 3 years** for Collateral Security. If the latest Valuation report is not available in the file of the borrower, the same has to be reported in the Concurrent Audit Report.

  Tip: In most of the software used by the Banks, there is an option in the Borrower's profile to enter the date of the Valuation Report, if the same is filled at the time of grant of CC, reports can be generated from the Report section which will be helpful every month.

- **Unit Inspection Charges:**

  It is the duty of the bankers to visit the Unit of the borrower to see whether the office/factory is infact situated in the address which is mentioned by the borrower. (Concurrent Auditor may also accompany the unit visit)

Unit Inspection charges should be debited from the account of the borrower, which needs to be done manually and hence there is a possibility of missing the same. It is a **Revenue Leakage** for banks. Such Revenue leakage has to be reported in the Concurrent Audit Report.

Tip: Unit Inspection charges depend from Borrower to borrower (based on the limit), the details of which will be available in the Loan sanction document or any circular available with the Bank.

After Unit Inspection is done by the bankers a Form needs to be filled (name depends from Bank to Bank) which can be read by the Concurrent Auditor to find out the deficiencies that are encountered during the Physical visit (For eg; I found out that a Company had not obtained Pollution Control Certificate, though it was mandatory for the Company to obtain the same due to the nature of the business which it was into)

The most important part of Unit Inspection is, the **Name of the Bank** should be displayed in the place of the borrower that the stock is hypothecated with the bank and it is a primary security of their loan.

Unit Inspection Register(Can be either in hard copy or soft copy) should be maintained by the Bankers if the same is not maintained, should be reported in the Concurrent Audit Report.

- **CIBIL and CERSAI :**

  CIBIL should be generated at the time of grant of the loan and at the time of **renewal**. After 01-10-2018, CERSAI KYC should also be maintained, so we should check if the Bankers are maintaining the same for all the borrowers.

- **Debit Confirmation:**

  Debit Confirmation should be obtained for all the CC accounts quarterly. It is nothing but a statement which has to be sent by the Bank to the borrower to verify that the same balance also exists in the books of the borrower as that of the bank.

Tip: As per my observation in the concurrent audit , due to the busy schedule of the Bankers, they do not send the Debit confirmation or they send it very late after the end of the Quarter, we cannot take it in a light manner. During the security of one of the Debit Confirmations, I was shocked to see that a different balance was stated in the Debit Confirmation (Which is sent by the bank to the borrower and later filled and sent by the borrower to the Bank) and it took a lot of time to resolve the differences.

The above are few of the important aspects that can be checked during the audit of Cash Credit loans, there are other aspects as well.

Thank you!

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