

STOCK STATEMENT/END USE VERIFICATION- AN EYE OPENER

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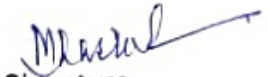
Cover Page of Abstract and Case Study

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CERTIFICATE OF ORIGINALITY

This is to certify, that the Case Study and the Facilitation Note submitted by us are an outcome of our independent and original work. We have duly acknowledged all the sources from which the ideas and extracts have been taken. The project is free from any plagiarism and has not been submitted elsewhere for publication / presentation.

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Case Study
Stock Statement/End use verification - An Eye Opener

Executive Summary:-

The study report based on the cases occurred in bank which leads loss , non-compliance and other issues. It will deal the modus operandi of the borrower who were enjoyed the credit facilities from bank and ultimately result in fraud/ loss/NPA. The study shows that stock statements/end use of funds are the most effective parameters to detect the un towards incidents like turning account in NPA, Fraud & loss.

Assumptions:-

The case study is related to assets side which requires different parameters for sanctions loans & advances. We assume that all the parameters related to pre sanctions have been followed . This study doesn't put emphasis on processes of sanctions and approvals. It restricts itself to study the importance of stock statements & end use verification which is post sanctioned process. Also it doesn't include Non-fund based facility. Further this study is not related to collaterals it is only related to primary security.

Introductions:-

Bank is dealing in various facets of financial requirements of which the core facet is to finance loans & advances . The genesis of banking is finance and we use to perform these activities to earn income and profit. In banking we are dealing with man as well as money which is most sophisticated things on the earth. We don't know the intention of the man who are getting money from the bank although we have certain parameters on the basis of which we finance them. Ultimately the money is being used by the individual so when we finance we need to see the individual behind the project. Once it is identified banks are ready to finance. The projects are the outcome of the man behind the project. If the borrower is good then the project outcome will certainly be in right directions. But simultaneously the borrower is also an individual identity it has its own dreams and expectations which he wanted to fulfil. Sometimes they diverted from the core business and put more importance to their own wishes which leads diversions or misutilisations of fund for which they applied or taken finance from bank.

This individual wish leads to non- creation of stocks or in other way diversion of fund. They not utilize the fund for the purpose for which they obtained finance and end use of the fund is not ascertained.

Since there is no any device by which we can watch the customer's day to day operations so it is very difficult to ascertain that our money is being utilized for the given purposes. We have certain tools by which we can monitor the activity of the customer/business. Credit monitoring deptt of the bank is issuing detailed guidelines in this regards.

This study paper is limited to one of the tools of monitoring i.e. Stock statements/End use Verifications.

Case Evaluation:-

To discuss the importance of stock statements /End use verification we have gone through the six cases related to bank and turned bad/NPA.

- i) M/s ABC Stores (Gold palace)
- ii) M/s XYZ Jems & Jewellery
- iii) M/S XYZ singh & Company
- iv) Shree PQR Singh
- v) Shree TUV Singh Gill
- vi) M/s STV Textiles Mills Ltd

Case-i) M/s ABC Stores

It is registered partnership firm having registered office at Chennai. It was dealing in Sale of Gold, Silver & diamond ornaments, trading of textiles & readymade garments, footwears , cosmetics, packing, branding . Bank sanctioned TL-Rs 150 Cr & OCC-90 cr on 26.09.2017. The account was classified NPA on 07.07.2019.

After NPA account was assigned for **Forensic Audit** of the accounts to external agency. The observations were as below-

- a) Huge variation in property value purchased by firm. Overvaluation leads possible diversion of fund
- b) Non- utilization of OCC and no evidence of margin money infused by firm
- c) Directly credit in the current account and no evidence of purchase of inventory.
- d) Anomaly in valuation of stock reported to the bank. Due to overvaluation firm portrayed higher sales profit and shows high drawing power.
- e) The fund has been diverted in purchase of long term assets by utilizing short term funds.
- f) Funds credited in to related parties.

Reasons for slippage :- Firm couldn't achieve the sales as per projections due to which there was shortfall in cash flow to meet term loan repayment . The firm also stated that the funds were diverted to capital expenditure which results in liquidity crisis.

Outcome/ analysis- As per the forensic audit as well as the reasons for slippage it shows that there was **diversion of the fund**. The diversion of short term funds to long term use will be possible only when we have not verified the end use or obtained stock statements regularly. It is obvious the when first time disbursement made then we have to verify the use of the fund and it will certainly result in to stock creation. If the stocks are not being created it indicates that i) **the margin has not been properly infused** & ii) the money has **been used for some other purposes** also. It is perceived that whether in OCC or TL one go disbursement not possible in case of business enterprises because limit is based on projections for the whole year and it is only @ 25% means customer will debit the account partly and then purchased stocks and converted in to say 90 days .In case of TL there is disbursement schedules.

The **crux** is that when we disburse money immediately we have to be sure that it is being utilized for the said purposes and stock should be verified.

Learning points- Till the full disbursement we should obtained stock statement daily/weekly basis then monthly basis.

Case ii- M/s XYZ Jems & Jewellery

It was a Pvt Ltd company incorporated in 22.11.2006 for trading & manufacturing of gold & diamond studded jewellery items. The OCC limit was Rs 30.00 cr & sanctioned on 19.12.2017. The account become NPA on 27.08.2019.

After NPA account was assigned for **Forensic Audit** of the accounts to external agency. The observations were as below:-

- a) Inflated sales figure to increase the turnover for availing higher working capital finance.
- b) The sales & purchase to some parties are **only book entry** not a genuine transaction.
- c) **Routing of funds to some bogus suppliers** /customers. The transaction of receipt or payments in respect of sales or purchased of traded goods have same pattern.
- d) **Huge payments to related parties**
- e) Investment in related parties
- f) Disposing inventories without accounting and siphoned off these funds outside banking channels.

RBIA Report-

- a) End use verification certificate not held in file
- b) Insurance expired
- c) Non compliance of sanctioned terms & conditions
- d) 19.07.2019 the value of stock decreased sharply from 54.58 cr to 16.60 Cr

Outcome/ analysis- After perusing the above contents it is clear that customers intention was to get overvalued finance by showing inflated prices. In case of jewellery items the value of stocks can be verified by weight & prices. Overvaluations can be done by showing higher price or showing more weights. It can be verified by only original bills & vouchers, GST, VAT etc. We concentrate more on transactional analysis basis i.e. whether the transactions are routed through our accounts or not. In this case customer candidly made transactions in the account by mere book entry. There was no genuine transactions means no stocks created . all transactions/investments they made to related parties. End use not verified at the time of disbursement . If our officials monitored the stocks properly then fraud may be avoided.

Insurance indicates interesting things about the business health. At least once in a year a third party is evaluating the stocks and then analyses the premium. If the customer is not willing to go for insurance it is an indicator for stress in the business of depletion of stocks. Customer is not interested to pay the insurance because he is in winding up position. Sometimes we do insurance without visiting stocks and debiting the customer account. At the time of insurance we should invariably visit to unit and properly assess the stock position.

Learning point- Books entry/ transaction through accounts should be verified with proper unit visit and physical stocks available with them. Buyers and sellers list should be with us to verify the genuineness of transactions and to avoid related party transactions.

Case iii) M/S XYZ singh & Company

It is a partnership firm established on 01.04.2004 having registered office at Gomati nagar Lucknow. It was engaged in constructions business. The firm was enjoying credit facility of Rs 3.25 Cr & 0.75 Cr as OCC & BG respectively. The facility was sanctioned on 28.09.2017. The account become NPA on 28.11.2019.

Internal Investigation report-

- a) Sales projections were unrealistic
- b) List of work orders not obtained

RBIA report-

- a) Unrealistic Projections
- b) Disbursements made to individuals and mostly in cash.
- c) Exposure to other banks not taken in calculation of limits
- d) Insurance value was low

Outcome/ analysis- Although initially we have mentioned that this paper is not related to pre sanction processes. But here we discuss reason behind is activity of the customer. The activity is of construction where there are maximum chances of manipulations. The finance should be based on not on MPBF method but on Cash budget method. The verification of work orders are of utmost importance. Mostly in case of constructions business cash plays an important role but also it is very difficult for bankers to verify the end use.

In case of construction business **stock audit plays important** role. Auditors put remarks that book records are not available with the customer so it is difficult to ascertain the value. Stock audit is yearly process hence it is responsibility of the BM that they should invariably obtain the stock statements on time & verify it with physical records.

Here Insurance shows that customer has no stock and he has diverted the money.

Learning points- In case of construction business ascertaining the end use of the fund is somehow difficult by bank officials. It should be verify by the claim made by the borrower with the govt agency or the tenderer who floated the tender. Originality /verifications of the bills are very important.

Case-IV-Shree PQR Singh

A housing loan of Rs 10.00 lacs was sanctioned to Sri Raju Singh by bank on 22.01.2014. The account became NPA on 25.09.2019. The proposed flat no 89 was not in existence and there was no approved lay out plan. After NPA it was revealed that there was no such flat in the complex. The borrower has submitted the deed to the branch in collusion with builder so that matter will not disclose.

Investigation report-

- a) No approved layout plan
- b) Non-existence of flat number
- c) Collusion with builder
- d) Branch has failed to visit to the property proposed to be purchased before & after the sanction of the loan

Outcome/ analysis- The fraud may be avoided if there was proper end use verification done by the branch. In case of housing loan we disbursed the loan in phase wise and keep the track record of construction by taking photographs. At the time of first disbursement if branch has visited or verified the credential about the flat then it can be avoided.

It is classic case of non verification of end use.

Learning points- Borrower may have two lay out plans one is for taking finance & other is for constructions. Branch should verify the RERA no. online and also the details of the lay out plan. At the time of visit bank officials should go with approved plan to verify the construction status and also the status of flat.

Case V: Shree TUV Singh Gill

Mr Nirmal singh Gill has sanctioned commercial vehicle loan of Rs 11.00 lac by Link Road branch on 28.11.2017. Account classified NPA on 22.07.2018.

Investigation report-

- a) Borrower didn't submit RC copy
- b) No end use verification done by branch
- c) Connivance of borrower with car dealer
- d) Vehicle was hypothecated to other financial institute

Outcome/ analysis- In case of car finance the disbursement should made directly to the car dealer. It is observed that in most fraud cases the connivance of dealer is observed. Sometimes the borrower produce the receipt of margin money issued by dealer. In those cases branches should visit personally to dealers and verify the genuineness of receipt issued by them. In the above case the branch should visit the dealers shop while handing over the key to borrower and keep photographs. Further branch should issue letter to dealer to submit the original invoice directly to them and invariably mark hypothecation of the bank.

It is suggested that branch should visit the residence of the borrower for final verification of next day and try to take temporary RC copy in the name of borrower.

In this it is clear that branch has not verified the end use of the fund.

Case VI: M/s STV Textiles Mills Ltd

It is a public limited company registered at sector 9 Ghandigarh. The company initially sanctioned CC of Rs 6.60 cr on 30.08.2007. On 12.09.2009 the account was reviewed and limit was restricted to Rs 2.75 cr. On 29.12.2016 account was classified NPA.

Investigation report-

- a) Willful defaulter
- b) Diversion of fund
- c) Malafied intention related to property

Outcome/ analysis- In this case when the limit was restricted to rs 2.75 cr , the branch should take precautionary measures to save the fund. The decrease in the limit shows that business is in shrinking phase. Total sales in 2014 was Rs 3.89 cr out of which Rs 3.40 cr transactions have been with M/s Ishan Retail Ltd having common directors. It reveals that the fund was diverted and the stocks were on the books not in physical form.

Mostly where only book entry like transactions found we merely found any stocks. In this case also the stocks have not been verified and no end use verification certificates found in the file.

Conclusions

Bank's core business is to finance the business enterprises and also to cater the personal needs of the borrower. Proposed borrower visit our branches with purpose and then we offer facility according to their needs. Facilities depends upon the requirements , projections, margins etc. Means when we provide credit to borrower the needs, requirements should be fulfilled by creating wealth & assets. It is the responsibility of the borrower as well as banker to take care of created wealth & assets. In most of the cases borrowers stake in finance is limited to 20% to 25% and bankers stake is from 75% to 80% . as our stakes are more so our responsibilities are also more. We can't be available round the clock to monitor the assets but we have some tools by which we can infer some ideas about the business. Stock statements/End use verification is the most effective tools which not only make the assets earning but also to avoid any fraud initially.

We can be confident about our assets if we follow the proper verification of the assets and their use. Sometimes we found that the machineries are there but no proper utilization. Due to non-utilisation of machinery our funds blocked.

Therefore , it is pertinent to mention here that Stock statements/End use verification are the eye opener of the business.