



भारतीय रिज़र्व बैंक

RESERVE BANK OF INDIA

www.rbi.org.in

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January 14, 2011

The Chairman /Chief Executives Officer
All Scheduled Commercial Banks (excluding RRBs)

Dear Sir,

End Use of Funds - Monitoring

The Reserve Bank, as a part of ongoing supervision, had undertaken an assessment of the practices in vogue at certain banks for ensuring the end use of funds. The review revealed that the expected level of due diligence had not been exercised in some cases facilitating diversion of funds by the borrowers. The shortcomings, amongst others, included, crediting of term loan disbursements to the current/cash credit accounts of borrowers and utilisation thereof for day-to-day operations, as also, **exclusive** reliance on Chartered Accountants' certification both in regard to infusion of promoters' contribution and deployment of banks' funds.

2. In the context of the above, it is advised that the efficacy of the existing machinery in your bank for post-sanction supervision and follow-up of advances may please be evaluated and made robust, wherever considered necessary.

Illustratively, the systems and procedures may broadly include the following:

- (i) meaningful scrutiny of the periodical progress reports and operating/financial statements of the borrowers;
- (ii) regular visits to the assisted units and inspection of securities charged/hypothecated to the banks;
- (iii) periodical scrutiny of the books of accounts of the borrowers;
- (iv) introduction of stock audits depending upon the extent of exposure;

- (v) obtention of certificates from the borrowers that the funds have been utilised for the purposes approved and in case of incorrect certification, initiation of prompt action as may be warranted, which may include withdrawal of the facilities sanctioned and legal recourse as well. In case a specific certification regarding diversion/siphoning of funds is desired from the auditors of the borrowers, a separate mandate may be awarded to them and appropriate covenants incorporated in the loan agreements; and
- (vi) examination of all aspects of diversion of funds during internal audit/ inspection of the branches and at the time of periodical reviews.

3. As would be appreciated, effective monitoring of the end use of funds lent is of critical importance in safeguarding a bank's interest. Further, this would also act as a deterrent for borrowers to misuse the credit facilities sanctioned, and in the process, help build a healthy credit culture in the Indian banking system.

4. Please acknowledge receipt.

Yours faithfully,

s/d.

(Dr.N. Krishnamohan)
Chief General Manager-In-Charge