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10,526 ▼ -18.75

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PNB scam raises questions over safety systems of banks

 BY [SALONI SHUKLA](#) & [SACHIN DAVE](#), ET BUREAU | UPDATED: FEB 16, 2018, 08.37 AM IST

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The biggest corporate fraud in Indian history at [Punjab National Bank](#) exposes the poor auditing standards at Indian firms as the irregularities were allowed to perpetuate for nearly seven years before getting detected accidentally.

What is shocking is that branches are not only just audited by one team of auditors, but there are concurrent auditors. If something is missed by two teams for years, it raises questions about the quality of such auditing.

“Any business activity undertaken by the bank is audited not only by the internal audit team of the bank, but also the concurrent auditors auditing a single branch, it is shocking that such an incident went unnoticed by not only auditors, but also the senior bank staff as well,” said a banker who did not wish to be named. “Audits look at the companies approved to do business, the bills that are funded, letters of credit issued, short-term funding tools etc.”

State-run Punjab National Bank was hit by a Rs 11,300 crore corporate scandal with its staff conniving with jewellers [Nirav Modi](#) and [Mehul Choksi](#) of [Gitanjali Gems](#).

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The bank issues letters of undertaking since 2011 to various banks, which funded the diamond merchants.

These LoU were getting rolled over as soon as they expired, but came to light only when the officer handling the account all these years retired recently.



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These kinds of activities should have been caught by the auditors quickly as there is concurrent audit too. But for [PNB](#), it claimed that its internal core banking system and the international messaging system operated by SWIFT were not integrated, which, it believe, led to this fraud.

Industry experts point out that there were mainly two issues as far as statutory auditors are concerned in the case. As per the standard practice prevalent among most PSU banks, several auditors across cities are appointed. These auditors don't have visibility of all the transactions with a particular business and have access to data pertaining to one branch. Also, for most of these auditors PSU banks are the biggest and in many cases sole consumers.

This leads to a situation where auditors may not be really independent, say industry experts.

“In this case, there was a systematic failure of all the institutions involved including the bank and regulators, and it would be unfair to merely point fingers at the auditors.

That said auditors must be of size and scale commensurate with clients' operations. Banks need to be more assertive in appointment of auditors of clients as well as their independent directors,” said Suresh Surana, of RSM India.

Some of the auditors of the bank, according to its annual report, are Chhajed & Doshi, R Devendra Kumar & Associates, Hem Sandeep & Co Suri & Co SPMG & Co. Its auditors in 2011-12 were V K Verma & Co Mookherjee Biswas & Pathak Amit Ray & Co Sarda & Pareek Borkar & Muzumdar G S Madhava Rao & Co None of them could be independently reached for their comments.

PSU banks' system of appointing auditors has remained archaic.

While a private sector bank would have one or two auditors, the number runs into hundreds for state-run lenders. Recently, a PSU bank saved over Rs 35 crore by just reducing its concurrent auditors from 1,400 to just 30. Even the Big 4 firms charge anywhere between Rs 1.5 crore to Rs 5 crore to audit top Indian firms. "When we were handling over 1,400 auditors, the quality was bad; we were unable to use the audit reports.

Now, people actually have time to go through the reports, because we now have consolidated reports. So, we now have 14 reports instead of reading hundreds of reports," the banker said.

Audit experts say that while valuations are subjective some qualifications in the audit report must have been added more so because prices of diamonds and gold are easily available and auditors can actually go and check if the inventory is merely on paper or it's actually with the company. Apart from this there could be issues where the auditors did not raise red flags.

"In the gems and jewellery business, unlike say in a steel business, red flags should have been raised when inventory kept increasing. Also no valuation of the inventory was ever conducted, which is not that difficult," he said.

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