Why auditors needs to first put their house in order

BY SALONI SHUKLA & SACHIN DAVE, ET BUREAU | JUL 18, 2018, 08.09 AM IST

About a year ago, Prime Minister Narendra Modi had told the world that the signature of a chartered accountant on financial statements was, perhaps, more powerful than even one of his own.

"Just like doctors don't want people to be ill to get more business, chartered accountants, too, need to safeguard the society's economic health. Your signature is more powerful than the PM's, and the government also believes the accounts signed by you," Modi had said.

The CA community, however, may not have woken up to the value of the initials they put on financial statements. Last year has been more of a challenge for the community's reputation, with banking frauds, asset quality divergences and mid-term auditor resignations dominating the headlines.

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The downfall began, perhaps, in the divergences. In its annual audit, the central bank found that lenders were under-reporting bad loans and asked them to disclose these divergences if more than 15% difference was found in their assessments.

And then came the great revelation. SBI, which accounts for more than a fifth of India's banking assets, admitted to a divergence of Rs 23,239 crore in bad loans for FY17. Yes Bank reported a divergence of Rs 6,355 crore for FY17, while it was Rs 4,177 crore for FY16. Axis Bank reported a divergence of Rs 5,633 crore for FY17, which was Rs 9,480 crore for FY16.

The largest private sector lender, ICICI Bank, had reported a divergence of Rs 5,104 crore in FY16. "As far as auditors and banks are concerned, I believe it's not that something has been done intentionally," says Rajnish Kumar, chairman, SBI.

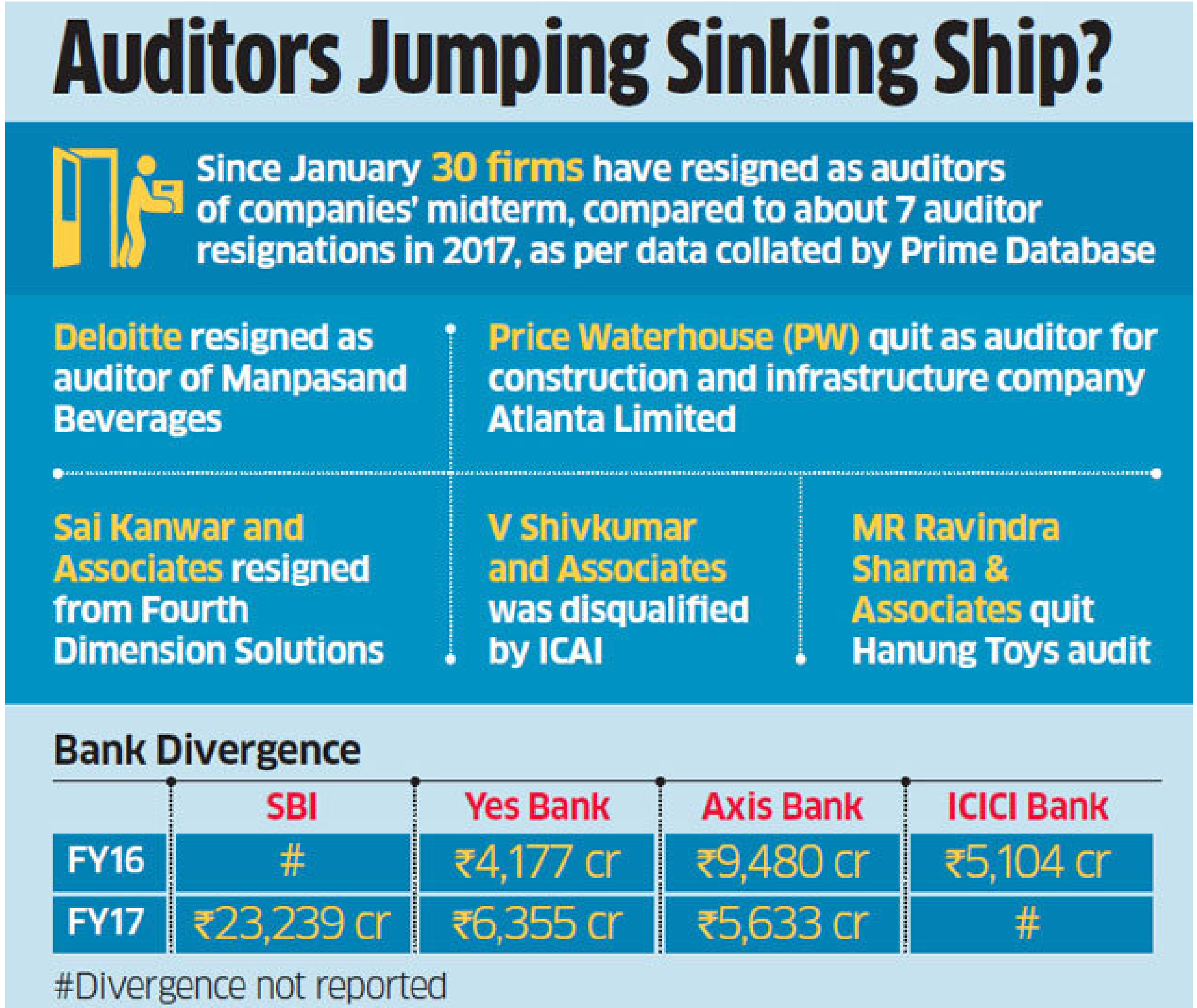
“There cannot be a situation where there will be 100% agreement on everything. You may have rules but still judgmental factors in credit, asset recognition come in. The approach is that as soon as the asset is stretched, banks have to recognise the problem.”

Recently, the banking regulator said that it is putting in place a framework to take action against statutory auditors of scheduled commercial banks, should lapses be found in the audit process.

“This crackdown was expected after the huge asset quality review exercises and divergences … I think the RBI is ensuring a total clean-up of the system,” said Karthik Srinivasan, group head, financial sector ratings, ICRA. “This will result in auditors being more cautious and also help in stress recognition sooner rather than later.”

MULTIPLE AUDITOR RESIGNATIONS

Scores of auditors quitting assignments mid-term reflect the malaise in the corporate world, but auditors haven’t covered themselves in glory either. Since January this year, more than 30 CA firms have resigned as auditors mid-term, compared to about 7 premature resignations in 2017, as per data collated by Prime Database.



In the past few weeks, Deloitte resigned as the auditor of Manpasand Beverages after the company failed to share key data, and PwC quit as auditor for construction and infrastructure company Atlanta Limited.

Sai Kanwar and Associates resigned from Fourth Dimension Solutions; V Shivkumar and Associates was disqualified by ICAI; and MR Ravindra Sharma & Associates quit Hanung Toys audit due to “pre-occupation in other assignments”. Even in Sri Adhikari Brothers case, the auditors said they didn’t want to continue due to preoccupation. Astonishingly, the governmentowned banks have numerous audits: concurrent audit, internal audit, statutory audit and then one by the Reserve Bank. And let’s throw CAG also in the mix.

Staterun banks also conduct credit audit, risk-based internal audit, revenue audit, information systems audit, snap audit, segment audit, compliance audit, legal audit, FEMA audit, management audit, foreign office audit and audit of outsourced services … One would question how the RS 13,000-crore Nirav Modi scam went undetected with this kind of scrutiny!

PSU bank auditors, in the aggregate, are paid much more than those minding private sector banks. According to shareholder advisory firm IiAS, PNB paid its auditors Rs 67 crore for FY17, State Bank of India a whopping `216 crore, while HDFC Bank, the lodestone for managing risk, spends just Rs 21.8 crore! Perhaps it is time regulators revisited the basis of empanelling audit firms.

"HDFC Bank or Kotak Bank are audited significantly more differently than audits in PSU banks; it is high time the RBI takes a hard look at it," says Amit Tandon, MD, IiAS. "This whole nexus which has developed between the bankers and auditors, you need to cut that cord at some stage. It's good that auditors are put on notice but RBI also needs to focus on the underlying issue."

THE BLAME GAME

Insiders point out that the banks should be the first to take the blame, as they were busy throwing good money after bad business. "Take Bhushan Steel or Jyoti Structures or any other company; the bankers were indulging in rotational lending. So when the music stopped, a few were left with hot potatoes. Basically, all the offpaper NPAs became on-paper NPAs," said a senior partner with an audit firm.

People in the audit industry say that they were merely following the RBI regulations that defined when a loan can be classified as an NPA. "In many cases, banks were so aggressive that they were lending even when the company had stopped operations and that was all over the media. Take ABG Shipyard for instance. Why were the banks' lending even after 2014?" asked a partner with one of the top audit firms.

But some say auditors could have looked harder and gone beyond the details presented to them by bankers.

"There is undoubtedly a heightened expectation from the bankers and other stakeholders from the auditors," said Suresh Surana, founder of RSM Astute Consulting Group. "The auditors need to go beyond the documentary evidence and standard audit procedures for classifying an NPA, impairment of assets, and diversion of funds. The entity need not be viable or solvent just because loans taken by a company are paid within a stipulated time."

Insiders also say that the new accounting standards may have played a spoilsport. India has changed its accounting standards from

GAAP to Ind-AS, which is on a par with International Financial Reporting Standards (IFRS), from April 1, 2016.

The new accounting standards put the onus on the auditor to go beyond the documentary evidence and look into the business operations of a company. “Auditors may have been comfortable with the rules being complied with, but the existing rules do not consider all the factors causing higher provisioning.

Going forward with IND-AS, the provisioning would not just be rule-based but would also take into account a lot of details regarding a business to safeguard the way accounting is followed,” said Yogesh Sharma, partner, MSKA & Associates, part of the BDO India network.

In many cases, banks were lending to some of the companies with the knowledge that the loans were stressed. Auditors remarks in many cases went unnoticed. “Take the example of Bhushan Steel with a debt of Rs 40,000 crore. For such a company to even have a chance to pay back the loan, annual turnover at 15% operational margins has to be Rs 4 lakh crore.

But even basic logic just went out of the window and banks together kept dishing out loans to such companies even when their annual turnover was half of the total debt,” a top auditor said. A PwC may have been punished by the regulator in the Satyam Computer fraud, but that may just be the tip of the iceberg.