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RBI wants audit firm partners under lens to stay off banks

BY SUGATA GHOSH, ET BUREAU | UPDATED: JUL 18, 2019, 12.52 PM IST

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Mumbai: Audit firm partners who are in the midst of any disciplinary proceedings will be barred from signing the balance sheet of any bank or even engage in the audit process. This is the latest directive to banks from the Reserve Bank of India (RBI) which over the last one year has placed significant responsibility on statutory auditors of commercial banks.

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Thus, even chartered accountant firms which face no ban either from the RBI or the court could be forced to pull out some of their senior partners from playing a role in any bank audit.

"Even if one thinks such advice from the regulator carries an element of regulatory paranoia, it could well be part of an exercise to ensure that bank numbers do not throw up nasty surprises.. but, we don't know how much all this would achieve," a person familiar with the matter told ET.

Amid divergence in asset quality of banks — resulting in higher provisioning numbers, shock waves to investors, and bad press — the central bank has put in place a system to exchange notes with auditors every quarter. In the course of such meetings, RBI officials share their observations on provisioning and other issues which, if necessary, may be incorporated by the auditor in the financial results for the next quarter. "Auditors also use the opportunity to take guidance from the regulator," said a senior chartered accountant.

However, the outcome is that banks are inundated with queries from auditors while they go through the books. "The problem is there is a difference between inspection and audit. The two cannot be equated. Audit is largely based on management declarations. If an auditor carries out an inspection, then every audit would come across like a forensic audit. As a result, some of the auditors are treading on areas without understanding the context," said a bank compliance head.

On one hand, auditors have been pulled up by central investigative agencies — with a few having their assets frozen — on the other hand, the RBI has instructed bank auditors to certify a string of matters such as 'priority sector lending', calculation of banks' marginal cost of funds based lending rate (MCLR), process and controls, income recognition and asset classification, and even cyber security — a subject that several auditors may be clueless about.

"There are issues that need to be resolved. For instance, differences are cropping up between banks and auditors over subjects like priority sector which banks have to report to the RBI on a regular basis. On cyber security, auditors have already expressed their limitations," said a banker.

However, one of the main regulatory concerns and the reason why the load on auditors have gone up relates to asset classification. And the RBI's recent communiqué on auditors to banks comes at a time when in the course of an interrogation a senior auditor told an investigative agency that in several cases it was unclear whether the RBI would view 'evergreening' of loans as an "acceptable business practice" or a "fraud". Evergreening is an old trick to hide defaults and losses by giving new loans to delinquent borrowers.

According to some, auditors, particularly of financial institutions, may be entering into an unchartered territory. "Till recently, a bank auditor could clearly define their role and defend itself when someone pointed fingers at it. But with the RBI widening their role, it would be far more difficult for auditors to distance themselves if there are lapses on the part of banks," said another person.

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