Swaminathan J: Shared vision, shared responsibilities - advancing assurance in banking supervision

Speech by Mr Swaminathan J, Deputy Governor of the Reserve Bank of India, at the Conference of Statutory Auditors and Chief Financial Officers of Commercial Banks and All India Financial Institutions (AIFIs), Mumbai, 9 July 2024.

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Shri Ajay Bhushan Prasad Pandey, Chairperson, National Financial Reporting Authority; Shri M R Rao, Deputy Governor Reserve Bank of India; Executive Directors from Reserve Bank of India; CA Ranjeet Agarwal, President Institute of Chartered Accountants of India; Auditors and Chief Financial Officers from the Banks and All India Financial Institutions; my colleagues from the Reserve Bank of India; Ladies and Gentlemen. Good morning.

It is indeed an honour to address this distinguished gathering of Auditors and Chief Financial Officers – one of the key pillars of financial integrity and governance in our banking system. Today's conference is a first of its kind in terms of the target audience but is part of a series of engagements that the Reserve Bank has been having with its regulated entities, underlining the critical importance of governance and assurance functions.

The theme of the conference today, Shared Vision and Shared Responsibilities, is reflective of the synergies between the roles of auditors and bank supervisors, which are both critical to the health and stability of our financial system. Together, we share a vision and responsibility for advancing assurance and banking supervision.

Role of CFO and expectations

Today, we have CFOs of banks and All India Financial Institutions amongst us. Having served as a CFO myself of a bank, I deeply understand the immense responsibilities this role entails. All I can wish for you is that may your audits be clean, your numbers accurate, and your coffee always strong!

As CFOs, you are tasked with ensuring the accuracy, completeness, and integrity of the bank's financial statements and reports. Further you need to do all of this while meeting strict statutory and regulatory deadlines. Although there is a Chief Risk Officer dedicated to risk management, the CFO's contribution in this area is crucial, particularly in managing capital adequacy, maturity mismatches and liquidity. CFOs also play a pivotal role in strategic planning, budgeting and investor relations – in short, shaping the financial future of their institutions. In fact, in today's dynamic financial landscape, the role of the CFO is not just about numbers but also about leading the institution towards sustainable growth and resilience. From personal experience, I can say the job would not be as interesting if it was only about numbers!

Given these extensive functions, CFOs are deeply intertwined with the bank's daily operations and possess a profound understanding of their institution's strengths and weaknesses far better than any other heads of business or other vertical heads within the organisation. This intimate knowledge places CFOs in a unique position of responsibility. It is this position which has a visibility of the entire bank and its key levers of financial strength in one place, probably next only to the CEO. It is, therefore, their duty to familiarise auditors and supervisors with the nuances of the bank's operations, particularly new auditors and first-time members of supervisory teams. By providing a comprehensive overview and context, CFOs can help these teams gain a clearer understanding of the bank's internal environment, challenges, and strategic objectives. This not only facilitates more effective audits and supervision but also fosters a collaborative relationship aimed at enhancing the bank's overall performance and regulatory compliance.

Integral to this collaboration is the need for CFOs to maintain open and honest communication channels with auditors and bank supervisors. It is imperative to eschew the notion of hiding, withholding, or providing incomplete information to these teams. Transparency is key; by sharing comprehensive and accurate data, CFOs not only facilitate a smoother audit and supervision process but also reinforce the bank's commitment to integrity and compliance. This collaboration builds trust, ensures regulatory adherence, and ultimately contributes to the financial stability and reputation of the institution.

It is equally true internally as well. The CFOs must protect the integrity of the financial reporting by guarding against any misadventure or intelligent interpretation of regulations or accounting standards. I would urge the CFOs to have an eye for detail and an honest and transparent communication with the MD & CEO and the rest of the top management. You should also keep alive the channel of escalation to the Chair of the Audit Committee of the Board (ACB), if a higher level of guidance is needed in any matter.

CFOs should conduct thorough root cause analyses of any deficiencies observed during audits or supervisory reviews. Rather than implementing short-term fixes, understanding and addressing the underlying causes of these issues ensures that compliance is sustained over the long term. This approach helps prevent the recurrence of problems and strengthens the overall governance and control environment of the bank.

One area that has come into sharper focus in the last couple of years is the control and management of internal accounts. We found certain banks having lakhs of such accounts with apparently no valid reason. Some of these accounts were also used as a conduit for certain fraudulent transactions and ever-greening of loan accounts. Internal accounts are high risk in nature on account of its potential for misuse. I therefore request the CFOs to have them rationalised completely, bring them down to the essential minimum and exercise greater control through periodical reconciliation and a proper reporting to ACB.

I would also urge CFOs to invest in technology and data analytics which would empower them to provide more accurate and real-time financial insights. This not only aids in strategic decision-making but also enhances the ability to respond swiftly to any issues identified during audits or supervisory reviews.

Role of Auditors and Expectations

The primary responsibility for preparing accurate financial statements rests with the management of banks, with Chief Financial Officers playing a pivotal role. However, the role of auditors is equally critical. All stakeholders, including regulators, investors, and most importantly, depositors, rely on the assurance provided by auditors that financial statements reflect a true and fair view of the bank's position and performance, free of material misstatements. This role becomes even more crucial in the banking sector, where trust is paramount.

All of you would be familiar with the three lines of defence model. The first line of defence is Line management, followed by Compliance and Risk Management with the third line being Internal Audit. Together they constitute the internal defence mechanism in a bank. But the fourth and most critical line of assurance for a Regulator is the bank's Statutory Auditors.

Recognising the significant role auditors play, the Reserve Bank of India (RBI) has undertaken several initiatives to enhance the effectiveness of the auditing process. These include structured meeting mechanisms between supervisory teams and auditors, introducing exception reporting, streamlining processes for the appointment of auditors, and other measures designed to safeguard the independence of auditors. To facilitate better understanding, RBI has also put in place a system of sharing with the Institute of Chartered Accountants of India, the typical reasons for divergence between audited positions and RBI observations. Further, auditors have been given greater discretion to determine business coverage factoring in bank specific business and financial risks.

In this context, I would like to highlight five key expectations from auditors to help ensure robust financial oversight and regulatory compliance.

Firstly, auditors must apply due rigor in their audit processes to mitigate any potential for divergence, under-provisioning, or non-compliance with statutory and regulatory requirements. Further, a critical aspect of the auditor's role is the careful evaluation of internal financial controls over financial reporting. By maintaining meticulous standards and adherence to regulatory guidelines as well as auditing standards, auditors can minimise the need for supervisors to intervene.

Secondly, as regulatory frameworks and accounting standards increasingly shift towards principles-based approaches, the role of auditors' judgment becomes increasingly critical. In executing their responsibilities, auditors must exercise prudent judgment, prioritising substance over form. This implies that auditors must go beyond mere technical compliance. Instead, they should discern the intent of the regulations and assess its application in practice so as to enhance the credibility of audit outcomes.

Thirdly, auditors can play a significant role in identifying and promptly reporting incipient vulnerabilities to both the bank management and the RBI. As you would be aware, a system of exception reporting has been implemented which requires reporting to RBI as soon as an issue of concern is observed. Early detection of risks such as operational inefficiencies, liquidity concerns, or evolving irregular market trends enables proactive management strategies and mitigation measures. This not only safeguards the bank's interests but also reinforces systemic resilience and enhances overall financial stability.

Fourthly, auditors should deploy competent staff equipped with the necessary training, skills, and experience, particularly in critical areas such as information technology (IT) and cyber security. In today's digital age, where cyber threats are increasingly sophisticated, auditors with specialized expertise are essential to assess and mitigate IT risks effectively. By ensuring audit teams are well-versed in emerging technologies and security protocols, auditors can contribute significantly to safeguarding sensitive financial data and maintaining robust cybersecurity frameworks.

Finally, and most importantly, upholding the highest standards of integrity, auditors must ensure there are no conflicts of interest that could compromise the objectivity and independence of their audits. Transparency and impartiality are of the utmost importance in fostering trust among stakeholders, including regulators, investors, and the public. Auditors must adhere strictly to professional ethics and guidelines to uphold their credibility and preserve the integrity of audit outcomes.

Conclusion

In closing, I would like to mention that today the banking sector is at a decadal high in terms of all financial parameters that we monitor, and the sector is well poised to support the growth of Indian economy. But we have a shared responsibility to ensure that the same is sustainable over the years. Therefore, today's conference underscores the indispensable partnership between the auditors, CFOs and financial sector regulators in safeguarding the integrity and stability of our financial institutions. Together, we must uphold the highest standards of transparency, diligence, and professionalism to foster trust among stakeholders and ensure the continued resilience of our banking system.

Keeping in tune with the theme of today's conference, all of us-auditors, CFOs, and supervisors-should continue fostering collaboration and communication so that we move towards a future where our banking sector not only meets but exceeds expectations, setting new standards of excellence in governance and integrity.

With this I thank you for your participation at today's conference. We look forward to listening from you at the interactive sessions scheduled later in the day.