

Role and Responsibility of Audit Committees

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Factors why role of AC and RC relatively more important for banks

- Deals in large volume of cash and cash substitutes
- Large volume of transactions
- Large geographic spread of operations
- Variety of exposures which can escalate very fast
- Complex financial products where risk is difficult to identify and measure

Factors which differentiate a bank (Contd.)

- Highly dependent on the use of technology
- High degree of value judgements and management estimates in preparation of financial statements
- Increasing outsourcing of processes

Role of the Board

- **Overseeing Strategy**
 - Understand and agree long-term objectives
 - Support and discuss alternative options
 - Agree with management and monitor long-term performance indicators
- **Ensuring Effective Risk Management**
- **Monitor Performance**
- **Ensure Succession Planning**

Role of the Board (contd)

- Monitor Corporate Social Responsibilities
- Ensure Regulatory Compliance
- Ensure Effective Communication with Stakeholders

Role of the Audit Committee according to BIS

- Financial reporting , including disclosures
- Internal Control
- Internal Audit
- Statutory or external auditor
- Remedial Actions

RBI on role of Audit Committee

- Direction and oversee the total audit function
- Compliance with RBI regulations
- Review of internal audit and inspection
- Compliance with audit and inspection reports
- Review of accounting policies and financial statements
- Remedial action and ensuring ethical conduct and accountability

Malegam on role of Audit Committee

- Oversight on financial reporting system
- Ensuring adequacy of Internal Control System
- Bridge between Board and Internal and External Auditors
- Monitor Risk Management Process
- Monitor “Whistle Blowing”

AC –STAFF FUNCTION NOT LINE FUNCTION-
should not take on Management role

No overlap with Risk Committee- but AC provides feedback to RC and Board

- RC sets the framework and process – it approves the limits, the rules and the risk measurement tools and models
- AC monitors the process to see if working –if the policies and processes set are complied with and provide feedback to RC to review the framework

STAFF FUNCTION NOT LINE FUNCTION

Oversight on financial reporting

- Review of all financial information being disclosed and put in public domain
- Under provisioning –for restructured assets , for NPAs, non SLR investments and liabilities such as pensions, MTM losses on derivatives
- Expenses not accounted for fully or properly

Bridge between Board and auditor

- Standing and reporting lines for Head of Internal Audit Function
- Strength and competence of audit function-
dumping ground? Rotation?
- Coverage – Audit Plan – predictability and flexibility
- Concurrent Audit –damage control

Interaction between AC and external auditors

- Discuss scope especially scope limitations
- Discuss extent of interaction with branch auditors
- Discuss major adjustments arisen out of audit to assess quality of accounting
- Discuss major areas of management estimation
- Discuss LFAR
- Discuss RBI AFI report and compliance
- Encourage suggestions for improvement

RBI Inspection based on CAMELS

- **C** capital - litmus test –unknown unquantifiable underestimated risks that are not provided for risks
- **A** asset quality -movement in NPAs-write offs and recoveries –ratings migration –NPA composition –loan provisioning as % of NIM
- **M** management
- **E** earnings – NIM,ROA, ROE, CASA
- **L** Liquidity –concentration of deposits, dependence on wholesale markets
- **S** Systems

Divergence between RBI report and bank's report

- Important to discuss with statutory auditor
- Objective reasons and subjective reasons – where divergence beyond certain level , discussion between RBI and SA
- Action against auditor by RBI , by management ?

Compliance with risk management system, processes and limits

- Increase return by taking risk – easiest in finance
- AC to understand nature of major risks
- Risks such as non-compliance of laws and regulations and other such risks
- Risk Management systems – overarching principles (i) identify and prioritise risk (ii) measurement of risk and limits (iii) separation of those who take risk and those who control it (iv) strong risk management culture from the top

Whistle blower policy

- Tool to detect fraud
- Identify an independent authority to whom whistle can be blown (senior within bank such as Head of IA or external adviser)
- Ensure confidentiality – any fear of being disclosed will create fears of victimisation
- Penalties for misuse to be strong deterrent for frivolous reports
- Awareness within bank