Stricter audit norms on the cards

Govt plans to revise the Company Auditors Regulation Order 2016 to expand scope of audits and improve scrutiny

RUCHIKA CHITRAVANSHI
New Delhi, 8 December

Auditors might soon have to provide a detailed report on usage of borrowed funds, comment on critical financial ratios, and flag any factors that affect the going concern nature of the companies under audit, as the government plans to expand the scope of audits and improve scrutiny of financials, a senior official said.

The Ministry of Corporate Affairs is planning to revise the Company Auditors Regulation Order (CARO) 2016, announcing several additions to the rulebook for auditors early next year.

"The subject involves multiple jurisdictions. We should be able to introduce the revised order by January after consulting other regulators," the official said.

The requirement to audit the usage of borrowed funds was dropped in 2016 from CARO due to lack of clarity. The government, through the revised CARO, wants auditors to provide a "fund to fund" audit to ascertain how money given as loans by one company to the other such as its own subsidiaries or related parties is being utilised.

"The idea is to restrict the transfer of such funds as the funds are being given to a company, which was not eligible to get a loan on its own…Also such transfers are made at a much lower interest rates. All this affects the financial health of a company," said Pavan Vijay, founder of Corporate Professionals.

The move will also keep in check the practice where a company borrows funds for working capital but uses it for a different purpose since such loans are easily available, experts said.

Auditors are also likely to be asked to comment on critical financial ratios such as debt to equity. Experts said, to make an informed comment on the matter, a detailed format would have to be introduced, which would throw better light on the company's debt situation. "Companies currently provide a total loan figure instead of a bank wise break-up which can be misleading and lead to under-reporting of company's total debt exposure," an industry expert said.

With increasing expectations from auditors to highlight frauds, he said this could bring more clarity as these figures are conclusive evidence and would leave little scope for manipulation of books.

Also, with rising instances of company insolvency and bankruptcy coming to light, government is likely to ask auditors to comment on anything that might affect the going concern nature of the company in their reports.

"As auditors we would like to provide exhaustive information…A mere opinion on the financial statements may not meet the requirements of all stakeholders. Extended reporting through CARO could address that need," a senior executive of an audit company said.

The ministry is in consultation with regulators such as Sebi, Reserve Bank of India, Pension Fund Regulatory and Development Authority, Institute of Chartered Accountants of India to finalise the revisions to CARO.

The proposed changes, according to experts, will bridge the expectation gap that exists between auditors and those who use their reports, including bankers.

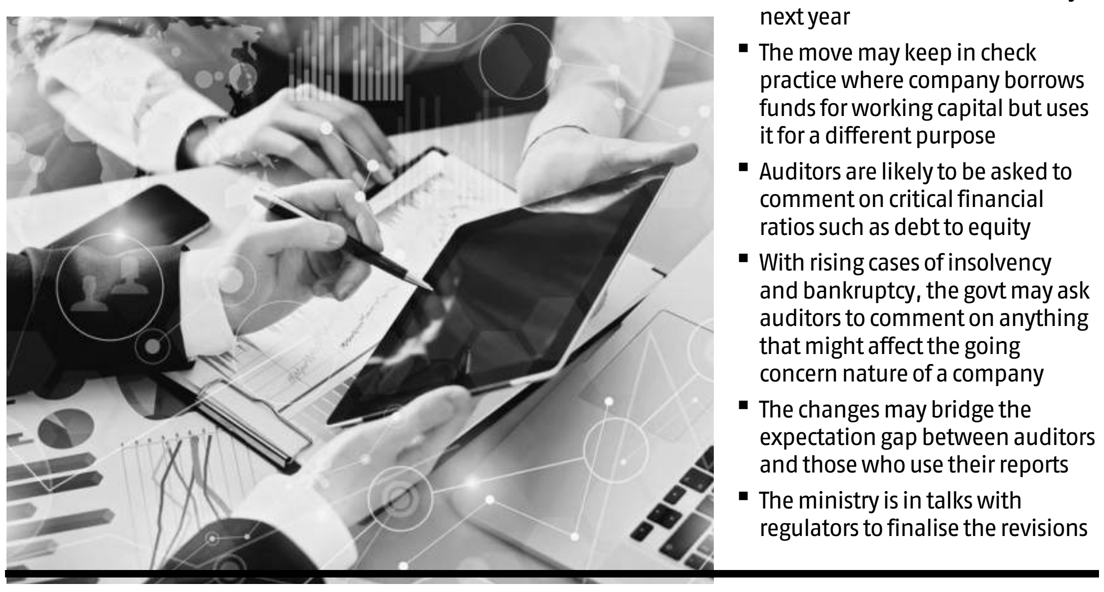
The revisions will also put greater onus on companies to provide detailed information to auditors. This has been one of the major reasons for a spate of resignations of auditors who want to de-risk themselves from companies whose accounting practices may be questionable.

"While this is true, once it is clearly stated what an auditor has to comment on, he will have to qualify any such hurdles in the scope limitation of audit… The purpose is to provide auditors assertion of specific points on state of compliances," a senior auditor said.

While auditors are not responsible for every compliance, it has been their defence that they have stuck to the objectives of the audit, he said.

Will all the extra work hike the audit fees? "It should, although the audit fees are not very high now. Most audit companies use auditing as a stepping stone to provide a whole host of other services to their clients which is where they make money," said a senior industry executive.

WHAT WILL CHANGE



- MCA plans to announce additions to the rulebook for auditors early next year
- The move may keep in check practice where company borrows funds for working capital but uses it for a different purpose
- Auditors are likely to be asked to comment on critical financial ratios such as debt to equity
- With rising cases of insolvency and bankruptcy, the govt may ask auditors to comment on anything that might affect the going concern nature of a company
- The changes may bridge the expectation gap between auditors and those who use their reports
- The ministry is in talks with regulators to finalise the revisions

MPC note shows export stagnation a long-term trend

EXIM MATTERS

T N C RAJAGOPALAN

The Reserve Bank of India (RBI) has significantly cut its economic growth forecast for the current and next financial year. Apparently, its concern to rein in inflation rate has prevailed while deciding not to cut the repo rates, at least for now.

On the external sector, the Monetary Policy Committee (MPC) noted that since its meeting in October 2019, global economic activity has remained subdued, though some signs of resilience are becoming visible. Growth has shown signs of picking up in some advanced economies (AEs) and emerging market economies (EMEs).

The Monetary Policy Committee noted that since its meeting in October, global economic activity has remained subdued

Crude oil prices have moved in a narrow range in both directions, reflecting the constantly changing sentiments relating to the progress of the US-China trade talks. Inflation has generally remained benign in major AEs and EMEs in Q3 of 2019. Global financial markets were buoyed in October by risk-on sentiment stemming from renewed optimism on a trade truce between the US and China and possibility of a Brexit deal. However, selling pressure took hold in the second half of November on renewed fears of US-China trade talks getting stalled on the Hong Kong standoff. While the US dollar weakened against other major currencies, EME currencies have been trading with an appreciating bias, said the RBI governor in the fifth bi-monthly monetary policy statement.

The statement also acknowledged that that exports contracted in September-October 2019, reflecting the persisting weakness in global trade, but non-oil export growth returned to positive territory in October after a gap of two months. Imports contracted faster than exports and as a result, the trade deficit narrowed in September-October 2019. This part of the statement seemed to gloss over the fact that export stagnation is a long-term trend and import contraction has more to do with slowdown in the domestic economy.

Elsewhere, the statement does say that manufacturing firms expect weak demand conditions and reduced input price pressures, but they also expect muted output prices reflecting further weakening of pricing power.

On the financing side, the RBI paints a rosier picture reporting an increase in net foreign direct investment, net foreign portfolio investment, net disbursals of external commercial borrowings, and foreign exchange reserves.

This means the non-merchandise foreign exchange inflows are keeping rupee at the present overvalued levels, affecting the export growth. The RBI has now allowed users to undertake over-the-counter (OTC) currency derivative transactions up to $10 million, without the need to evidence underlying exposure. Banks shall be provided with the discretion, in exceptional circumstances, to pass on net gains on hedge transactions booked on anticipated exposures.

International Financial Service Centre Banking Units (IBUs) will be allowed to open foreign currency current accounts of their corporate borrowers, subject to the provisions of FEMA 1999 and to accept fixed deposits in foreign currency of tenor less than one year from non-bank entities with a view to facilitating ease of operations.

The RBI says in line with the slowdown in the economy, goods and services tax (GST) collections so far have fallen below budgeted targets and a similar scenario with regard to direct taxes and customs duty collections cannot be ruled out. In the meantime, the lower tax collections have started delaying the disbursal of refund claims of exporters and compensation for the states for shortfall in their revenues.

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'Investors convinced with our transformation story'

On its 100th year, CSB Bank, formerly called Catholic Syrian Bank, went public and its ₹410-crore initial public offering (IPO) was subscribed 86.89 times. **C V R RAJENDRAN**, managing director and chief executive officer, who was instrumental in getting the ₹1,200-crore investment from Fairfax about two years back, tells **T E Narasimhan** how the bank plans to position itself against non-banking financial companies (NBFCs). Edited Excerpts:

"WE ARE PLANNING TO BECOME A NEW-GENERATION BANK THAT WILL WORK MORE ON THE NBFC SPACE, AS FAR AS LENDING IS CONCERNED. MICROFINANCE, MSME, TWO-WHEELERS, AND USED TRUCKS ARE SOME OF THE AREAS WHERE THE YIELDS ARE BETTER"

What are the factors that attracted investors, which led to the stellar performance of IPO?

Investors are convinced with our transformation story and journey towards a new private sector model. It is a work in progress, but they are happy about the progress. Growth in gold loan and advances in the past three years, even without capital, also impressed them. The bank has expanded the advance portfolio but reduced risk-weighted assets and grew the portfolio. Investors liked that change in the composition.

Q&A

CSB's network and the granular deposit base are other factors. Non-performing assets (NPAs) are much less than the industry itself. Industry level is around 0.36 per cent NPA in the gold loan, and CSB's is less than 0.10 per cent and credit losses are very limited. Yield is also better compared to the industry. Our positioning as a competition to the NBFCs and not as a competition to the bigger banks also impressed the investors.

What are the challenges?

Scaling up (the business), which we have to prove to the market. We are working on it. We have our ability to maintain NPAs at the current level and PCR at the current level of 80 per cent. It will improve over a period of time, but with the portfolio growing, it may be a challenge. We need to prove our ability to reduce the cost to income ratio to below 50, which is down from 103 to 71 now.

How are you planning to scale up?

For every ₹1,700 crore of growth (₹1,000 crore of deposit and ₹700 crore of advances), we may get ₹30 crore more profit. CSB got about ₹1,208 crore capital from Fairfax and about ₹25 crore from the issue. With this capital, and the same composition of 33 per cent of gold loan and remaining risk weighted assets, we can double the balance sheet without need for further additional capital.

What is your target?

We had anticipated growth of not less than 25 per cent. Since we are celebrating the bank's 100th year, we are looking at whether we can grow at a higher level to prove to the world our ability to grow.

On a full year you have registered a loss last year.

Last year, we reported a one-off loss, an additional provisioning of ₹98 crore, and another ₹100 crore, because of employee provisions. We already have posted a ₹44-crore net profit for the first half of the financial year. Our operating profit was around ₹104 crore.

How do you position CSB?

We are planning to become a new-generation bank that will work more on NBFC space, as far as the lending is concerned. Micro finance, MSME, two-wheelers, and used trucks are some of the areas where the yields are better.

What are your other targets?

We were able to reduce the cost of deposit from 7.8 per cent to 5.9 per cent, yield on advance is around 10.6 per cent on our advances. Net interest margin rose to 3.4 per cent from 1.7 per cent in three years. But the industry best is about or more than 4 per cent. Our effort should be to reach industry benchmarks. How fast you can do it is the challenge.

Are you expanding branches?

We have written to the Reserve Bank of India, and started working on expanding branches. About 200 branches will be coming in next 18 months.

India's real GDP growth to come below 5%: IHS Markit

PRESS TRUST OF INDIA
New Delhi, 8 December

India's real GDP growth in 2019-20 fiscal is expected to be slightly below 5 per cent as the impact of stimulus measures will take time to filter through to the economy, IHS Markit has said.

The latest GDP data for July-September quarter showed a significant further moderation in the pace of growth to 4.5 per cent, the weakest in six years with a key contributory factor being a slump in manufacturing output. This compared with the 5 per cent growth rate registered in the previous quarter and 7 per cent rate recorded a year ago in September quarter of 2018. For the first half of 2019-20 fiscal, GDP growth slowed to a pace of 4.8 per cent compared to the 7.5 per cent a year back.

"Financial sector fragilities continue to weigh on India's economic momentum, with the high level of non-performing loans on the balance sheets of the public sector banks, constraining their new lending," IHS said in a report.

Furthermore, there are also risks from potential contagion effects from troubled non-bank financial companies (NBFCs) to the balance sheets of some commercial banks, which could further weigh on the overall pace of credit expansion. In response to the growth slowdown, the Reserve Bank of India has eased policy rates significantly during 2019, with a series of rate cuts since February.

STATSGURU

Ball in the fiscal court

THE RESERVE BANK OF INDIA'S (RBI's) Monetary Policy Committee (MPC) decided to keep the policy repo rate unchanged in its December 2019 meeting, surprising the market. The MPC underlined the rising consumer price inflation as one of the reasons. In October, food prices rose as fast as 10.5 per cent in cities and by 6.4 per cent in rural areas (Chart 1).

While financial markets were hoping for a rate cut, the MPC signalled that it intends to wait until effective transmission happens. The real lending rate — deflated using headline inflation — has reduced by nearly 3 percentage points in less than a year (Chart 2), during the rate cut cycle.

More so, a central bank's survey highlighted that consumers are perceiving the current situation on jobs and incomes as the worst since 2012 (Chart 3). In fact, the perception of income has turned negative for the first time this year.

The slowdown is affecting government's revenues as well. Gross tax revenue of the central government is rising at a slower than desired pace. (Chart 4).

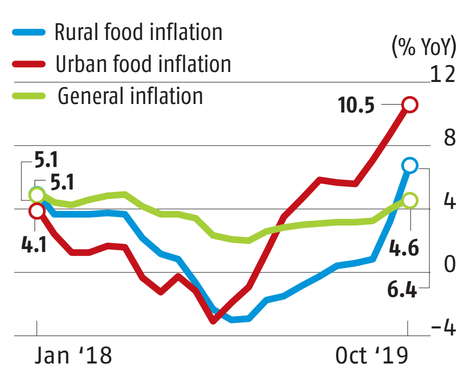
Though the Union government is on a fiscal glide path, it has missed its own targets in the last few years (Chart 5). If it decides to give a fiscal boost to counter the slowdown, it could come in the form of increased spending on either employment, or income-oriented schemes, or on capex (Chart 6).

If that happens, the impact would depend on the strength of the fiscal expansion. For example, expanding the fiscal deficit to as high as 4 per cent of the gross domestic product would give the government an additional ₹1.17 trillion (Chart 7), though it would impact borrowings.

ABHISHEK WAGHMARE

1: RISING FOOD PRICES A CAUSE FOR THE PAUSE

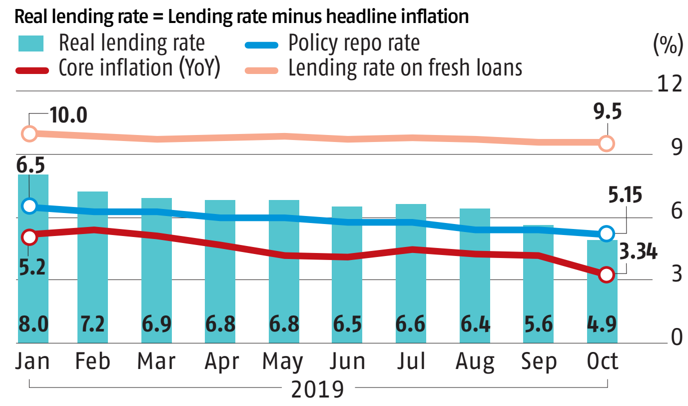
Consumer inflation



Source: RBI

2: REAL COST OF BORROWING RISES

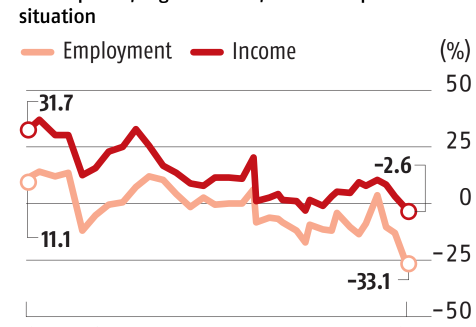
Real lending rate = Lending rate minus headline inflation



Note: Core CPI which is likely to have further declined in November and December, has been taken as unchanged up to date, due to unavailability of data. Lending rate is the weighted average across all SCBs
Source: RBI, CRISIL

3: CONSUMERS SEE JOB SCENE PRECARIOUS AND INCOMES UNDER THREAT

Net response, Higher the NR, better the perceived situation



Source: RBI Consumer Confidence Surveys

INDIA'S FISCAL SCENARIO

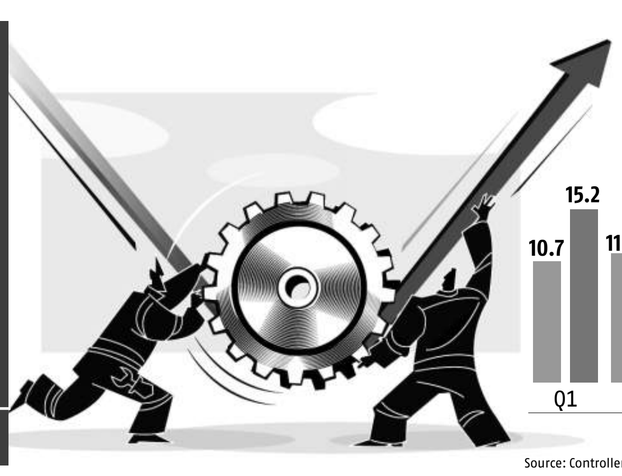
₹205 trillion India's nominal GDP*

₹7.04 trillion Fiscal deficit**

3.43 FD as % of GDP

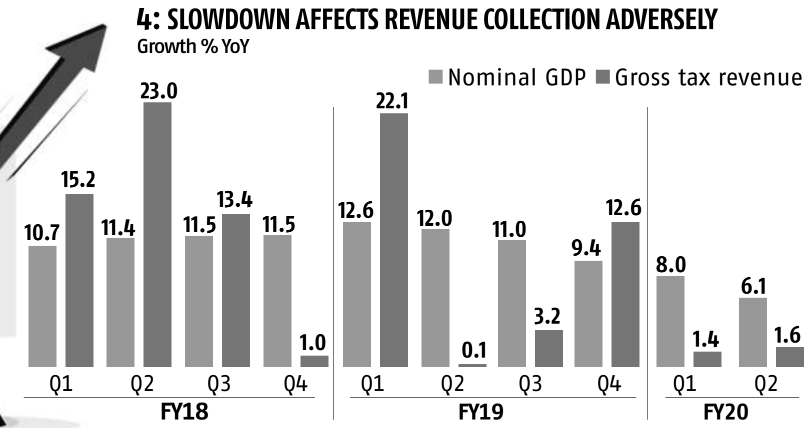
₹20,500 crore 0.1% of GDP

*Assuming nominal growth at 8 per cent for FY20;
** Budget estimate



4: SLOWDOWN AFFECTS REVENUE COLLECTION ADVERSELY

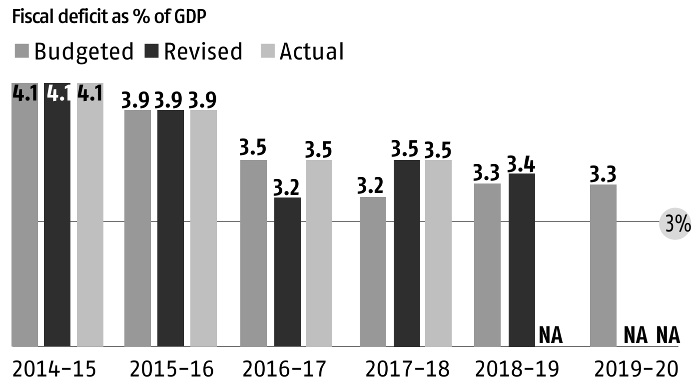
Growth % YoY



Source: Controller General of Accounts, National Statistics Office

5: FISCAL GLIDE PATH

Fiscal deficit as % of GDP



Source: OpenbudgetsIndia, Union government

6: INCOME-ORIENTED AND INVESTMENT-ORIENTED FISCAL EXPANSION

Income-oriented schemes	₹ crore
Scheme	Allocation
Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA)	60,000
Pradhan Mantri Kisan Samman Nidhi (PM-KISAN)	75,000

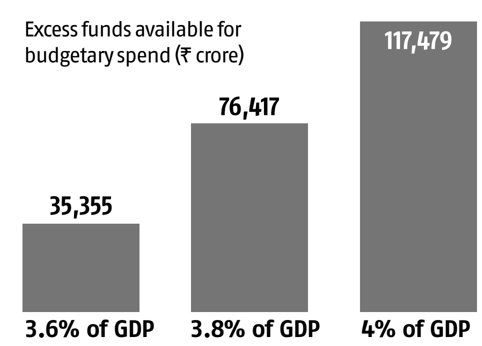
Capex-oriented spending

Allocation

Roads	Railways
₹68,062 crore	₹65,763 crore

Source: Union Budget

7: IF FISCAL EXPANSION HAPPENS…



Source: Union Budget, NSO

StatsGuru is a weekly feature. Every Monday, *Business Standard* guides you through the numbers you need to know to make sense of the headlines

Compiled by BS Research Bureau