Financial Crisis in the Banking Sector of Bangladesh and Auditors' Silence

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Abstract

The banking sector, an important component of the financial system, has been in a catastrophic situation in recent years. Most of the state-owned banks and some private banks have been operating beyond the regulations and deemed as to be a 'risky' zone. External corporate auditors as trust engendering engines are supposed to protect the trust and confidence of the investors and users of banks. Analysis of some distressed state-owned and private banks, has revealed that most of the banks have received 'Unqualified' audit opinion within the period of financial difficulties as well as immediately prior to the public declaration of financial difficulties of the banks. But the market doesn't seem to be assured by just the title 'Unqualified' audit opinions as these financial institutions either collapsed or had to be bailed out within a short period of receiving Unqualified audit opinions. With the public trust and confidence shaken it raises valid questions regarding the auditors' roles, independence, values, quality, and knowledge.

Keywords: Unqualified Audit Report, External Corporate auditors, Auditor's Silence, Auditor Switches.

1. Introduction

The banking sector is known as the heart of an economic system which develops and mobilizes resources for productive investments in a country. In Bangladesh, financial system is mainly dominated by banks. But in recent years, this sector is in crisis in terms of trust and confidence of the public as shocks hit the sector drastically from time to time. The loan scam of state-owned banks such as Sonali Bank Ltd, Hallmark group and many other incidents of private commercial banks in recent time hit hard on the trust and confidence of people. In this scenario the external auditors, as a neutral third party, can play a major role to increase the trust of stakeholders in this sector. This study has found that most of the auditors of the well-known audit firms in Bangladesh remain silent about these crises in the banking sector by providing unqualified audit reports.

According to Power (1999), External Audit is considered as a trust engendering technology that persuades the stakeholders that capitalist corporations and management are not corrupt and the audited companies and their directors are made accountable. In an uncertain world, there is the expectation that assurance of the auditors might produce comfort by reassuring the stakeholders that the technology "provides an external and objective check on the way in which the financial statements have been prepared and presented, and it is an essential part of the checks and balances required … Audits are a reassurance to all who have a financial interest in companies" (Committee on the Financial Aspects of Corporate Governance, 1992, p. 36). Accountants, as auditors, are trusted by the public that auditors' expertise enables them to mediate uncertainty and construct independent, objective, true and fair accounts of corporate affairs (O'Connor, 1987).

Recent crisis and challenges along with interference by the government are making the banking sector of Bangladesh vulnerable. And this situation raises a question regarding the role of the auditors in particular, why this situation was not reported in the auditors' report and subsequently the quality of services provided by them?

2. Objectives of the study

- To evaluate the roles of corporate auditors in the distressed state-owned and commercial banks in Bangladesh.
- To find out what is the effect on these Banks when they receive 'Unqualified' audit opinion within the time of financial difficulties and also immediately prior to the public declaration of financial difficulties of the banks.

Capital deficit banks, Sonali Bank, Janata Bank, Rupali Bank, NRBC Bank, BASIC Bank, and Farmers Bank (bdnews24.com, 2018) are chosen for this study.

The rest of the paper is structured like as follows: data collection and research methodology, literature review, financial crisis and general scenario of the banks in Bangladesh, auditor's silence, analysis of the audited financial statements of prescribed banks, auditors' switches and conclusion.

3. Data collection and Research Methodology

Secondary data was used to finalize the objectives of this study. Data for the study were collected from two sources. Firstly, from the annual reports of the selected banks. Secondly from the different indirect sources like newspaper, article, magazines, blog, etc. This paper has also observed and examined the literature on auditors' roles in the financial institutions at the time of financial difficulties of the institutions in Bangladesh and other countries.

A detail analysis was conducted based on the auditors' opinions in the annual reports of the banks and information on financial crises of banks provided in different sources for example: newspaper, websites and various reports.

4. Literature review

Unexpected activities by banks can create a crisis in the banking sector which subsequently hinders the economy of the country and a loss in public trust and confidence. Along with this the unexpected opinions by the auditors, increases the tension in the suspicious minds of the investors, depositors, and other stakeholders of the banks (Prem Sikka, 2009).

The auditors' responsibility is to add credibility to the financial statements by providing reasonable assurance to users and indirectly to control the activities of the management. However, during the recent financial crisis the 'Unqualified' audit opinions provided by some major audit firms questioned this responsibility of the auditors, as just after receiving the opinions these banks asked for government's support (UK House of Commons Treasury Committee, 2008). According to the US Senate Committee on Foreign Relations (1992), such audit opinions and auditors' silence "caused substantial injury to innocent depositors and customers". Some authors think that there is a dependency of the audit firms on the financial institutions for their income and this fee dependency impairs the capacity and independence of auditors (Powers Jr. et al., 2002; United States Bankruptcy Court for the District Delaware, 2008). The low fee structure affects quality of audit services and ethics of the auditors (Sobhan and Werner 2003, p. 62). According to Hanlon (1994), audit staffs pamper the clients' interest at the expense of the social interests.

5. Financial crisis and general scenario of the Banks in Bangladesh

The reason behind the recent financial challenges faced by the financial system of Bangladesh in the form of financial crisis of Banks, shocked the whole economy of the country. At the time while it is very difficult to measure the social cost of this financial crisis, government provided significant amounts of public money to financially distressed commercial banks to recover their situation. Massive amounts of bad debt which subsequently triggered the liquidity crisis in the banks, are considered to be the main reason for this problem. To save these banks, the government had injected Tk. 102.72 billion into state banks as recapitalization facility from FY2005-06 to FY2016-17(Islam, 2018).

A series of severe loan scams of large amounts in the state-owned banks is causing the capital deficit problem in the banking sector of Bangladesh. Among the loan scams of state-owned banks, the Hallmark scam of **Sonali Bank** is most renowned. According to an expert in this field, “The defaulter did not have the amount of collateral needed to show against the loan sanctioned. In reality, there has not been any disbursement of the loan rather it was a complete theft which led the defaulted loan to nearly 50%”. According to Bangladesh Bank investigation of Sonali bank branch, the Ruposhi Bangla Hotel loaned Tk. 3,547 crores on fake documents to Hallmark and five other companies (Islam, 2017). According to the journal of “The New York Times” (2017), heading under “Bangladesh’s other Banking Scam” mentioned that Sonali Bank gave out illegal loans of $454 million out of which $344 million to Hallmark group.

During the fiscal year 2016-2017, **BASIC Bank** received the highest amount of recapitalization from the government, Tk. 3,390 crores followed by recapitalization of Sonali Bank amounting Tk. 3,003 crores. There was a misappropriation of Tk.7.85 crores in a loan scam involving officials, Managing Director and Chairman (banglanews24.com, 2017). According to BB report, up to December 2008 BASIC bank disbursed total loan amounting Tk. 2,700 crores which was raised up to Tk. 9,373 crores till March 2013. Among the disbursed loans of Tk. 6,673 crores in the last six years, Tk.4,500 crores was given in breach of the rules and regulations (Alo, 2017).According to an inspection of BB in 2013, the four branches of BASIC bank breached the rules in approving loans of around Tk. 4,500 crores between December 2009 and November 2012 and Tk. 4,500 crores driven out from the Bank in between 2009 and 2012 during the tenure of Sheikh Abdul Hye Bachchu as the Chairman of the bank’s board of directors(Dhaka Tribune, 2018).

Some privately-owned commercial banks also suffer from severe capital in adequacy problem. **Farmers Bank** is one of those. This troubled Bank took the interbank short-term loans from Sonali, Agrani, Janata and NRB Global Banks between November 22 and December 5 of the year 2017, but failed to repay the loans. There is no other option for the troubled bank to pay off the loans of four banks with its securities, treasury bonds, and bills. It had a requirement to maintain 19% percent of its depositors’ money in the form of SLR (Statutory Liquidity Requirement) and CRR (Cash Reserve Ratio) with the BB to protect the interest of the depositors. However, in reality the bank has no SLR now. And the failure to keep required CRR and SLR, led to a penalty of Tk. 18.49 crore (Prothom Alo, 2018). This ‘risky' bank had created a ‘systematic risk' for the entire economic sector in Bangladesh by taking high-interest rates' loans from depositors and other banks while it's unable to pay back the loans (Uddin, 2018). In the calendar of 2017, Farmers Bank has made a net loss of Tk 530 million. Its balance sheet shows that the deposit worth Tk 46.73 billion available at year-end whereas the bank’s aggregate loan disbursement to clients are amounting to Tk 51.30 billion, exceeding the deposit amount. It submitted an unaudited annual report to the BB that reflects the crisis of the Farmers Bank. And the bank was unable to recover outstanding loans so most of the depositors could not withdraw cash whenever they needed (Prothom Alo, 2017).

From Bangladesh Bank investigation of **NRBC Bank**, it found that there were massive irregularities in operating and sanctioning of loans by the board of directors. Not only compromising the general rules and regulations in sanctioning loans, the bank went as far as to falsifying the signatures of the directors to give loans amounting Tk. 701 crore. Violating the single borrower exposure limit, the bank gave Tk. 301 crore loan to a borrower who later took bank’s shares worth Tk. 43.71 crore. All of these activities are a violation of norms of the banking sector. Without taking any collateral securities, the bank disbursed Tk 32.92 crore to Thermax Group. From which the group used Tk. 30 crore to repay the previous loans of the group to Standard Chartered Bank and it didn't provide any collateral securities to NBRC against the loan (The Daily Star, 2017). The corporate branch of the bank also disbursed a credit limit of Tk. 226 crore without taking any collateral securities to Anowar

Ispat Ltd, Abdul Monem Ltd, Rangs Motors and Nitol Motors (Pvt) Ltd(Newagebd, 2017). Such breach of rules and regulations subsequently put the bank in uncertain conditions.

Janata Bank disbursed loan Tk. 5504 crores to AnonTex Group, not following proper process of disbursing loan to AnonTex whereas it failed to pay back its previous loans. Besides, the loan to AnonTex Group is above 25% of the state-owned bank's capital base, which is a direct violation of the Bank Company Act 1991(The Daily Star, 2018). Janata Bank's corporate branch disbursed loans to this troubled client from 2010 to 2015. And over the last six years, the group was reportedly lobbying to reschedule loans (The New Nation, 2018).

It was evidenced from Bangladesh Bank report that **Rupali Bank** violated the single borrower exposure limit by sanctioning loan to Virgo Pharmaceuticals amounting Tk. 114.98 crore and to an associate company of Virgo Pharmaceuticals, Virgo Media Limited amounting Tk. 144.74 crore. Surprisingly the information about the large loan of these two companies did not report to the central bank by Rupali Bank (Dhaka Tribune, 2018).The board of the bank also approved many more loans violating the credit limit rules and regulations of the bank (Dhaka Tribune, 2018).

6. Findings and Analysis:

Auditors silence

To be informed about the risks, liabilities and economic exposure of the banks, the stakeholders generally depend on the published financial statements which have been highly problematic (Stiglitz, 2003). For instance, sometimes management of the financial institutions misuse the accounting rules to manipulate and inflate the value of the assets and liabilities of the organizations (Prem Sikka, 2009). Accountants, as auditors are recognized as they have passed "muster" and special attention has focused on auditors because of the belief that "a green light from an auditor means that a company's accounting practices have passed muster" (New York Times, 2008).

From the last decade the banking sector of Bangladesh has been suffering from severe crisis. Loan scams, insufficient liquidity, frequent need to recapitalization, etc. have become the common features of this sector while their financial statements are showing that they are doing very well. This situation has given rise to a question in the minds of the stake holders as to whether the assurance providers are providing reasonable assurance or they are silent? The following table shows the auditors' opinions ¬for the above mentioned six banks before, during and after the financial crises, which will help to find the answer for the question.

Bank Name	Year End	Auditor	Year of Audit	Audit opinion	Audit fee (TK)	Net Income (Loss) (TK)	% of Net Income
Basic Bank	31 Dec 2013	1. ACNABIN 2. Aziz Halim Khair Choudhury	30 April 2014	Qualified	9,20,000	(531,533,329)	-0.0017
	31 Dec, 2014	ACNABIN	27 April, 2015	Adverse	9,74,500	(1,100,160,173)	-0.00089
	31 Dec, 2015	ACNABIN	11 April, 2016	Adverse	9,20,000	(3,140,361,573)	-0.00029
	31 Dec, 2016	S. F. Ahmed & Co.	18 April, 2017	Qualified	9,20,000	(14,930,401,001)	-.000062
	31 Dec, 2017	S. F. Ahmed & Co.	30 April, 2018	Qualified	9,20,000	(6,843,689,621)	-0.00013
NRBC BANK	31 Dec, 2013	1. A. Wahab& Co. 2. K. M. Hasan& Co.	27 Feb, 2014	Unqualified	2,00,000	22,028,397	0.0091
	31 Dec, 2014	1. A.Wahab& Co. 2. K. M. Hasan& Co.	07 Feb, 2015	Unqualified	2,50,000	78,496,000	0.0032
	31 Dec, 2015	1. A. Wahab& Co. 2. K. M. Hasan& Co.	07 Mar, 2016	Unqualified	3,11,500	560,075,565	0.00056
	31 Dec, 2016	1. Hoque Bhattacharjee Das & Co. 2. ACNABIN	26 Feb, 2017	Unqualified	3,04,750	869,031,969	0.00035
	31 Dec, 2017	ACNABIN	25 Mar, 2018	Unqualified	4,02,500	442,923,095	0.00091

JANATA BANK	31 Dec, 2013	1. S. F. Ahmed & Co. 2. G Kibria& Co.	27 Feb, 2014	Unqualified	3,985,070	9,608,380,745	0.00042
	31 Dec, 2014	1. S. F. Ahmed & Co. 2. G Kibria& Co.	25 Mar, 2015	Unqualified	6,695,204	3,831,095,800	0.0018
	31 Dec, 2015	1. S. F. Ahmed & Co. 2. G Kibria& Co.	28 Feb, 2016	Unqualified	7,807,932	4,685,327,592	0.0017
	31 Dec, 2016	1.Aziz Halim Khair Choudhury 2.Syful Shamsul Alam & Co	30 Apr, 2017	Unqualified	9,658,346	2,608,226,157	0.0037
RUPALI BANK	31 Dec, 2013	1. M. J. ABEDIN & CO. 2. HUSSAIN FARHAD & CO.	30 Apr, 2014	Unqualified	1,746,500	451,973,271	0.0040
	31 Dec, 2014	1. M. J. ABEDIN & CO. 2. HUSSAIN FARHAD & CO.	05 May, 2015	Unqualified	1,553,250	490,907,467	0.0032
	31 Dec, 2015	1. M. J. ABEDIN & CO. 2. HUSSAIN FARHAD &CO.	29 May, 2016	Unqualified	1,557,500	236,445,055	0.0069
	31 Dec, 2016	1.A Wahab& Co. 2. Mahfel Huq & Co.	27 Apr, 2017	Unqualified	2,745,000	(1,211,700,389)	-0.0023
Sonali Bank	31 Dec 2013	1. AHMED &AKHTAR 2. Aziz Halim Khair Choudhury	28 April, 2014	Unqualified (emphasizing of matter)	2,725,368	3,446,803,502	0.00079
	31 Dec 2014	1. AHMED &AKHTAR 2. Aziz Halim Khair Choudhury	30 March 2015	Unqualified	2,910,016	5,979,339,561	0.00049
	31 Dec 2015	1.AHMED & AKHTAR 2.Aziz Halim Khair Choudhury	28 April 2016	Unqualified	2, 685,445	548,423,887	0.0049
	31 Dec 2016	1. S. F. Ahmed & Co. 2. Howladar Yunus & Co.	27 April 2017	Unqualified	3,21 8,603	1,493,265,927	0.0022
	31 Dec 2017	1. S. F. Ahmed & Co. 2. Howladar Yunus & Co.	30, April 2018	Unqualified	3,334,834	7,161,158,032	0.00050
The Farmers Bank	31 Dec 2013	HodaVasi Chowdhury & Co	31 Mar 2014	Unqualified	300,000	38,183,802	0.0079

Note: *There are inadequate data related to The Farmers Bank Limited's other annual reports those are publicly available.*

Source: *Audited financial statements of the banks*

From the table, it is evident that distressed banks received unqualified audit opinions except for BASIC bank during the time of financial difficulties and also immediately prior to the public declaration of financial difficulties of the banks.

The state-owned Sonali Bank received "true and fair view" or unqualified audit opinion in the income year 2013, 2014, 2015, 2016 & 2017, though the loan scams of Hallmark Group started from 2010 to 2012. According to the investigation of Bangladesh Bank, the Ruposhi Bangla Hotel branch of Sonali Bank loaned Tk. 3,547 crore on fake documents to Hallmark and five other companies (Dhaka Tribune, 2017). Until 30th September 2017 capital deficit of Sonali bank was Tk. 31.4 billion. The government has recapitalized the bank in these prescribed years(Bdnews24.com, 2018). Thus, there might be a question regarding the independent auditors' opinion of "true and fair view" within the year of financial difficulties of the bank and also immediately prior to the public declaration of financial difficulties of the banks as 'Unqualified'. The audit procedures of 2013, 2014, 2015, 2016 and 2017 consolidated and separate financial statements.

State-owned Janata Bank also received 'Unqualified' audit opinion on the financial statements in the income year 2013, 2014, 2015 & 2016. There was a loan amounting to Tk. 5,504 crore to a single group which is above 25% of the bank's capital base which was disbursed from the year 2010 to 2015 (The New Nation, 2018). The capital deficit of the bank until 30 September 2017 was12.73 billion. Thus, while the bank exceeded the single borrower exposure credit limit and breached the rules, how it can receive the 'Unqualified' audit opinion raises some questions (The Daily Star, 2018).

State-owned bank, Rupali Bank also has a record of irregularities in disbursing loans and exceeding the single credit exposure limit. Until 30 September 2017, total deficit of the bank was TK 6.9 billion (Dhaka Tribune, 2017). Surprisingly in these volatile situations the bank received "Unqualified" opinions from auditors'. NRBC bank received 'Unqualified' audit opinion from the income year 2013 to 2017 from the audit firm A. Wahab & Co., K. M. Hasan & Co., and ACNABIN. From the scenario of the financial crisis of the bank, it is found that there were massive irregularities in operating and sanctioning loans by the board of directors (The New Agebd, 2017).

BASIC Bank is the only bank which received modified audit opinion from the audit firms ACNABIN & Aziz Halim Khair Choudhury in the income year 2013, 2014 & 2015 respectively. An adverse opinion of independent auditors indicates that financial statements are so materially misstated or misleading that the bank does not present the financial statement fairly and there is an absence of conformity of the operations and cash flows of the bank with GAAP. As a basis of adverse opinion in the year 2015, the independent auditors showed the bank had a shortfall of provision for classified loans and advances. From the Audited Financial Statements of BASIC Bank 2015, it is seen that the bank's total loans and advances were TK. 12880.70 crore as on 31 Dec. 2015 which included classified loans and advances of 3610.65 crore on said date. Due to this, the bank was required to maintain a provision of 1762.16 against these loans and advances but it had only 177.32 crore provision. The report also shows that there were many shortfalls of provision for Blocked Assets reported previously in 2014. There was a capital deficit of TK 25.23 billion until 30 September 2017 as per Financial Statements of BASIC Bank, December 2017. Again, it has received 'Qualified' audit opinion from S. F. Ahmed & Co. and the BASIC bank receives this 'Qualified' opinion after switching of the audit firm in 2016. And in all of these income years, there are huge 'Net Loss' of the bank.

The newly-established bank, The Farmers Bank is at its notorious financial crisis in recent time and the bank is not listed in the stock exchange of Bangladesh. The Audit report of the bank is available only for 31st December, 2013 and after that, any audited report on the financial statements of the bank was not available publicly. For 31st December 2013, the audit firm Hoda Vasi Chowdhury & Co had given 'Unqualified' audit opinion. The bank's capital deficit is TK 747.7 million until 30 September 2017 (Dhaka Tribune, 2017). In the calendar of 2017, Farmers Bank has made a net loss of Tk. 530 million. Its balance sheet shows that the deposit worth Tk. 46.73 billion available at year-end whereas the bank's aggregate loan disbursement to clients are amounting to Tk. 51.30 billion, exceeding the deposit amount. It submitted an unaudited annual report to the BB that reflects the crisis of the Farmers Bank. And the bank was unable to recover outstanding loans so most of the depositors could not withdraw cash whenever they needed (Prothom Alo, 2018). But there are inadequate data related to The Farmers Bank Limited annual reports.

External audit adds credibility to financial statements, as claimed by many traditionalists (Prem Sikka, 2009). The current situation of the banking services of Bangladesh hit the confidence of the entire population. From the analysis of financial crisis in the banking sector and the "Unqualified" audit opinions by major auditing firms, it shows there is absence of reasonable assurance in the banking sector. Here, the distressed banks in the table have received 'Unqualified' audit opinion within the year of their financial crisis and also immediately prior to the public declaration of financial difficulties of the banks. This situation inevitably raises the old-age question about the auditors' independence and also audit quality. Thus, it can be said that audit evidence is not available to the general public and there is an indication of impairment of auditors' independence and overall, little is known about how the auditors add credibility to the accounts of financial statements. The scenario of auditors' silence and the financial difficulties of the banks indicate rather how the exploration of confidence is eroded and persuaded significant others to ignore auditor assurances and also the advancement of the career of the auditors and fee dependency can create a conflict of interests (Prem Sikka, 2009).

Auditors' switches

Auditing firms received considerable income as shown in the table that may be significant to issue audit opinions. The value of the audit begs the question of the politics of audit opinion. As audit firms are capitalized enterprises, they depend upon the companies and the directors for their income. Fee dependency of the auditors has the capacity to silence auditors (Powers Jr. et al., 2002; United States Bankruptcy Court for the District Delaware, 2008). As capitalized enterprises, the audit firms may take into account that an adverse audit opinion may lead to dismissal. Based on the evidence of the higher frequency of switches after a qualified opinion than after a clean opinion, auditors are not independent here and auditors' independence is consistent with this evidence. Auditors' future payoffs depend on the issued audit opinion on the financial statements. Issued audit opinion of today may influence the firm's decision to switch/retain the auditor. Therefore, the auditors' concern to take a decision of whether to issue a clean or qualified opinion balances the expected costs of litigation against costs of losing a client (Creswell, 2008). From the annual report of Rupali Bank, it is found that on 31 Dec 2016, the year-end financial statements of Rupali Bank have received an "Unqualified" audit opinion. But after switching of the audit firm from yearend 2015 to year end 2016, the audit fee for the auditors of 2016 was almost double than audit fee of 2015 auditors', though there is a huge net loss at Dec 31, 2016.Thus, this questions the issued audit opinion and auditors' independence.

7. Conclusion

As an important component of Bangladesh's financial systems, the banking sector has become notorious in the recent years' financial crisis and irregularities of the banks. The confidence and trust of the investors and users are eroded by the several massive hits from the specified banks. Banks facing financial difficulties are at same time receiving "Unqualified" opinion, has fueled suspicion in the minds of stakeholders about the auditors' lack of claimed expertise to render an independent and objective account of corporate affairs. It is unexpected to get a verified 'unqualified' report from the auditors when the banks are in such distressed situations. Interestingly within a short period of receiving unqualified audit opinions, these banks either collapsed or had to be bailed out. Thus, shaking the confidence of the market and raising valid questions about the roles, values, and independence of the auditors

The recent financial scam in the banking sector can be seen as an eye-opening incident to all those associated with the banking sector as well as the other sectors. To improve the performance of this sector, appropriate measures should be undertaken by the different regulatory authorities and policy makers to expose and remove inherent weaknesses. Strengthening the governance practices of banks along with proper investigation and punishment of involved persons with irregularities, could improve the situation.

However, this study fails to identify the justification behind the audit opinions provided by them. The future researches can be done taking in depth interviews of the auditors to identify the basis behind these opinions.

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