Lenders uneasy with term caps for external auditors

Move by regulator is motivated by concern that unethical auditors could get into deals with their clients, affecting their independence

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Banks and accounting firms have reacted sharply to the Central Bank of Kenya's proposal to introduce three-year term limits for external auditors.

A survey by *Smart Company* reveals that the local banking industry is facing a familiarity threat due to the long tenures of auditors — some spanning over two decades— that some lenders' are enjoying.

For example, audit firm Ernst & Young, trading as EY, has been the external auditor of Equity Bank since the lender acquired a commercial banking licence in 2004, according to data from annual reports.

EY has also acted as auditors of Co-operative Bank for more than a decade, dating back to 2003 when the lender had not listed on the Nairobi bourse.

KPMG, the current auditor at I&M Bank, has been handling the mid-sized lender for the last 20 years.

Ecobank's auditors have been PricewaterhouseCoopers (PwC) since the Togo-based financier entered the Kenyan market in mid-2008 when it acquired the loss-making East African Building Society.

PwC also continues as external auditor at the local unit of Nigerian lender United Bank for Africa ever since it set up shop in Kenya in 2009.

Stanbic Bank warned that the proposal may cause concerns in the industry. The lender said it has been audited by KPMG and PwC in the last two decades, and only rotates partners in charge every five years.

"There are benefits and unintended consequences of having term limits for banks' external audits. Any regulation should achieve a balance of the two," Stanbic said in a statement.

"The choice of auditors is co-ordinated across different geographies to ensure efficiencies in the audit process."

KCB, Equity, CBA, Barclays, StanChart, Co-op Bank, National Bank, Family, Sidian, GT Bank, Spire, Jamii Bora, Credit Bank, and Bank of Africa, refused to comment.

"This is definitely real in Kenya and is a threat. It leads auditors to be complacent and assume certain things without sufficient and appropriate checking," said Mr Dipesh Shah, a partner at audit firm Grant Thornton.

"There is risk that unethical auditors could get involved in various deals with their banking clients and this would definitely affect their independence and impact the way the audit is carried out," said Mr Shah in an interview.

Mr Deepak Dave, a risk management expert, said he supports rotation of auditors to enhance corporate governance, as well as empowering boards to enforce and investigate audit findings.

"Every three to four years auditors must rotate; and the firm providing audit should not work on consulting, IT or corporate advisory during the term as auditor at a bank," said Mr Dave of Riverside Capital.

But in a rejoinder, PwC Kenya said it is opposed to term limits for banks' auditors, and called on CBK to find 'a better way' of addressing the matter.

AUDIT QUERIES

Where it all went wrong

Deloitte served as external auditors at distressed Chase Bank for more than 20 years, and had always given the mid-sized lender a clean bill of health.

PKF Kenya audited Imperial Bank for ages and was induced with a $5 million (Sh500 million) low-interest loan to turn a blind eye to a Sh34 billion fraud scheme at the collapsed lender, according to court papers.

"There remains no evidence that mandatory audit firm rotation will increase auditor independence or reduce over-familiarity nor will it enhance audit quality," said Mr Peter Ngahu, a partner at PwC in charge of assurance practice.

"A number of countries have experimented with mandatory firm rotation and rejected it," said Mr Ngahu.

At Middle East Bank, chief executive Dhiren Rana said PwC has been auditing the firm 'for many years' and said he couldn't highlight any rotations.

"I reckon PwC have been our auditors for many years. I will check if there was a change," he said. Mr Rana added: "Engaging partners and entire audit team has been rotated every three years."

The other big four accounting firms namely EY, Deloitte, and KPMG – which dominate the auditing of banks in Kenya – also declined to respond to our queries.

CBK governor Patrick Njoroge in July told MPs that the regulator was mulling over introducing mandatory auditor term limits. The lawmakers were concerned about the long tenures of auditors in the cases of collapsed banks.

Best practices

"The international best practices is actually for rotating qualified auditors. So we cannot have an auditor, according to best practices, for more than three years," said Dr Njoroge.

"So it is really to deal with this issue so that you have a new fresh pair of eyes to look at the issue and there is no (sort of) let's say complacency that develops. So we will think about this...we will think about this."

I&M Bank said despite the long tenure of KPMG at the bank, 'partners have rotated regularly.'

Basel-based Bank for International Settlements – owned by central banks across the globe – has also warned regulators about the threat of having one auditor for a very long time.

"Where the audit firm has been the external auditor of the bank for many years, there may be a risk that there is a familiarity or self-interest threat to the external auditor's objectivity and independence in its audit of the bank."