Hauling Deloitte & KPMG over coals may singe India Inc

With only few quality audit firms, scaled-down presence of Big Four could hit cos, stump foreign investors.

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MUMBAI: With the spectre of punitive action hanging over Deloitte Haskins & Sells and BSR & Co, a member firm of the KPMG network, in the IL&FS case, any scaled-down presence of the Big Four auditors in India may pose a problem for top companies and confound global investors.

The Deloitte and KPMG groups audit more than 250 companies that make up about 40% of the market capitalisation of listed Indian companies. In case of a ban on them, like the one imposed on PwC, there aren't enough quality audit firms that companies can seek in their place.

The 'concentration risk' that the Big Four pose to the global markets is now suddenly a clear and present danger in India, too. Outside of big six — EY, Deloitte, KPMG, PwC, Grant Thornton and BDO — there are less than 25 Indian firms with more than 20 partners.

The regulators face a dilemma because the big firms have practically become too big to fail, something their Indian rivals have pointed out for long. The problem is compounded because when an emerging market like India wants to attract more global investments, the Big Four play a role in providing comfort to investors.

'Whole System Needs Revamp'

Even after rotation of auditors mandated by the Companies Act, 2013, the Big Four still managed to snag a big share of listed company audits.

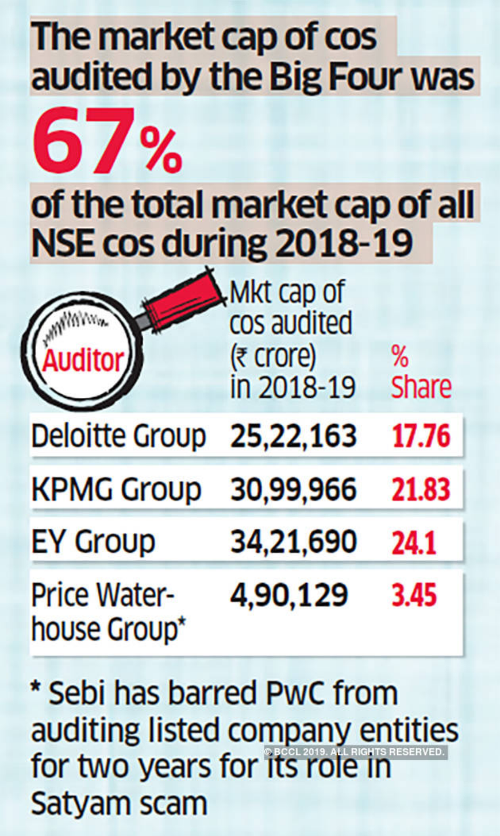
"The Big Four dominated with the market capitalisation of the companies audited by them being 67% of the total market capitalisation of all companies listed at NSE during 2018-19," said Pranav Haldea, MD of Prime Database Group.

ET reported on Wednesday that the government-appointed board of Infrastructure Leasing & Financial Services (IL&FS) had proposed punitive action against the two audit firms for failing to issue warnings about shortcomings while auditing the books of IL&FS Financial Services.

With the National Financial Reporting Authority, Institute of Chartered Accountants of India and Serious Fraud Investigation Office probing the role of the audit firms in IL&FS-related cases, their other clients are getting confusing signals.

"We need to get away from the guilty-until-proven-innocent thinking. The need of the hour is to empower one regulator to quickly finish the investigation and then let the law take its course," said Vishesh Chandiok, CEO of Grant Thornton.

Deloitte, KPMG and EY didn't respond to ET's questionnaire.



Indian audit firms have tried unsuccessfully to fight the growing dominance of the bigger firms and had even proposed joint audits as a solution.

"India is suffering huge systemic risks," said Raghu Aiyar, CEO of KS Aiyar & Co, India's oldest audit firm.

According to Aiyar, the top 20 Indian audit firms had written to the prime minister in July 2016 to highlight the "impending crisis like situation in the profession" from the conduct and concentration of the multinational audit firms in India.

He alleged that despite positive directions by the PM's office through mechanisms such as the joint audit committee and the committee of experts, the regulators opposed them, taking the situation backwards and further supporting the multinationals.

"What had been warned by Indian audit firms has now come to pass," said Aiyar.

BIGGER PROBLEM

Even so, auditors say they are being singled out and they are only part of a bigger problem that needs to be fixed.

"Each government arm is looking through a limited lens without understanding the issues in entirety. The whole system needs a revamp: ratings agencies, independent directors, regulators, audit firms," said an ex-ICAI president. "For auditors, the dilemma now will be to sign off an account and practically kill the company's ability to stay afloat or stay back, give honest qualifications and help the management turn around things. People don't understand that the responsibility for financial statement presentation lies with the company's management — we just provide an independent opinion."

"Serious reforms are needed in terms of how governance structures are implemented in the company. The government needs to lay down the order of priority for responsibility of various stakeholders. Audit willy-nilly becomes a soft target among internal and external stakeholders," said an ex-Andersen partner.

Some experts said the Big Four need to reorient their culture.

"The focus should be on excellence, not revenue and cross-sales," said Girish Vanvari, founder of Transaction Square, a business advisory firm.

The Securities and Exchange Board of India barred PwC from auditing listed companies for two years in January 2018 in an unprecedented move 10 years after the Satyam scandal.

Globally, audits firms are reprimanded, fined or stopped from taking on new audits, but Sebi changed the game by barring PwC from auditing listed clients for two years.

Experts said clients were punished along with the firm for no fault.

"Globally, the best regulators investigate whether it's a one-off transgression or a systemic fault and then they punish audit firms accordingly. Indian regulators are still evolving," said the ex-ICAI president.

Recently, the UK's Competitions and Markets Authority studied the oligopolistic structure of the audit market and the inherent conflict of interest between the audit and non-audit businesses of the firms. It suggested mandatory joint audits with non-Big Four firms because the current structure was skewed in favour of the Big Four and restricted choice.