Sector under scrutiny, Big 4 ease revenue targets for audit partners

As the role of auditors comes under increased scrutiny in India, some of the biggest firms in the business, including EY, PwC, Deloitte and KPMG, are either removing or relaxing revenue targets for their audit partners.

In the past few months, some of the audit firms have either told their partners that they would not have any revenue targets, or have delinked their pay packets from the revenue they would help generate.

According to the earlier arrangement, an audit partner — normally leading a team of about 10-12 professionals — would be given a revenue target. In return, the partner would get anywhere between 20% and 35% of the revenue as compensation.

“When audit rotation happened, partners were expected to go out and win big accounts. In some cases, the auditor’s compensation also depended on how much business he or she helped generate for other verticals,” said a senior audit partner with one of the major firms.

Industry trackers say that caution has set in after the Securities and Exchange Board of India (Sebi) and the Reserve Bank of India (RBI) came down heavily on auditors in cases of financial fraud. The auditor’s role was questioned in several cases and Sebi banned a network firm of PwC for two years from auditing listed firms.

The removal of revenue targets also comes at a time when several firms are resigning as auditors of companies. Since January, about 40 firms have resigned mid-term, compared with about 7 auditor resignations in 2017, data collated by Prime Database Group showed.

To replace work that was lost in audit rotation, many aggressive audit partners had accepted assignments of some of the companies without much due diligence. “A year since the audit rotation, the skeletons are tumbling out. The firms realise that revenue targets for audit partners could backfire as the most important thing about auditing is perception,” said a senior audit partner with one of the bigger firms.

An audit partner recently discovered, in one of the assignments, that promoters were siphoning off money. “The promoters had exaggerated the cost of some of the investments done by them in the past few years. We resigned as the auditors as Rs 2 crore (charged as audit fees) is not worth the risk,” said the partner, who resigned from a BSE-listed company recently.

Removing revenue targets for partners and their teams in auditing could mean no pressure to retain a client in case of detection of a corporate governance breach. Revenue per partner in these firms ranges from Rs 5 crore to Rs 15 crore, of which about a third goes directly to the partner.

“While we did not have direct revenue targets for audit partners, their compensation depended on how much business they generated for our advisory or tax teams,” said the India head of one of the firms.

In India, the big four operate through separately-owned subsidiaries for auditing as foreign firms cannot be the auditor. Corporate governance issues are not limited to the big four, though.

A well-known Indian firm, that was auditing a Mumbai-based real estate company, is under investigation for its role in a loan fraud. Insiders point out that the client was brought on board around the time of audit rotation when some of the bigger companies were choosing foreign firm affiliates over the Indian firm.

Some of the firms are now appraising partners merely on the quality of their audits and also for the work they bring for other service lines.Their compensation would be decided by that, too.

“The most critical goal for our audit partners is audit quality, and this will continue to be a key priority going forward. Attracting and retaining highquality talent and adoption of technology in audit are other areas of focus for our audit partners. With the audit rotation activity behind us, our audit partners are fully geared to delivering high-quality audits to our clients,” said Jamil Khatri, head of Audit, BSR & Co, an affiliate of KPMG India.

“Our top priority has always been the delivery of the highest quality audits to promote trust and confidence in financial reporting. Quality is an important aspect of how we evaluate our partners and people,” said a spokesperson for SR Batliboi & Co, an EY India affiliate firm.

(Economic Times)