'Make in India' in auditing

The time has come for the industry to support Indian firms

A research report by IIM-A gives us reason to be proud of Indian audit firms. The report (a 'first to examine' this issue) on whether multinational audit firms' (MAF) fee premiums are related to superior audit quality, concludes that such an opinion about the audit by MAF is only a 'market perception'. It observes that the higher audit fees do not necessarily result in any difference in the quality of reported earnings with Indian audit firms (IAF); and also that the only potential driver of fee premium is the need to 'signal' superior quality of reported information.

On an average, the IIM-A report says, fees of MAF is double, to 2.8 times, of fees of the IAF. Interestingly, the larger the auditee, the more the MAF are seen to extract from the client (after adjusting for size), though there is no additional risk. The following are the 'perceived' benefits cited, based on research in the West, one or two decades prior to the present report (unrelated to the quality of reported earnings): viewing discretionary accruals more credibly, reputation of the MAF, lower cost of equity capital, lower levels of IPO under-pricing, and higher earnings response coefficients. It is a well-known fact that IAFs of stature have held the flag of ICAI flying high since Independence. There is really no reason these benefits cannot come from IAF, as was the case in the past.

The IIM-A report goes on to state that two particular causes of audit fee premiums in the West have been eliminated in the Indian context: quality needs (non-existent in India); and insurance needs (users claiming damages from auditors).

So, one is forced to ask: what is the secret of the IAF, that they can provide excellent performance without the funding, surrogate branding, systems, or the double/triple fees that MAF enjoy? This: high-quality auditing, one emanating from multi-dimensional-experts, who give valued grass-root support, immense personal partner-level attention to assurance, value the loyalty of deeper professional relationships, security (inside information is not put into global knowledge management systems), and client friendliness (IAF do not try to have overbearing control). These are indeed open secrets and are conspicuous by absence in MAF.

The IAF have been marginalised with top 20 revenues under ₹200 crore, while reliable estimates of MAF audit revenues are in excess of ₹5,000 crore. Recent admissions from MAF partners indicate that the threat from the MAF has only increased with ongoing Audit Firm Rotation. We have proxy advisory firms asking to vote against IAF, though a weak and polarised audit profession is against the national interest. Audit concentration is a concern and creates systemic risks and has become an existential threat to IAF, which have taken this matter to the prime minister. MAF have still to answer for the violations of law of land contained in the ICAI Reports of 2003 and 2011, with which they tilted the 'level playing field'.



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The Gurumurthy 2001 Report rather prophetically warned of all this. MAF created a monopoly over the last two decades by this perception of superior audit quality in the Indian audit market, now diagnosed by the IIM-A Report. A myth has been decisively broken by this report. Put simply, it is quite obvious; how can flashy branding possibly substitute individually rooted virtues, such as integrity, independence, and competence? More scams have originated globally from MAF, while the IAF of stature have held the flag of ICAI high for decades. Audit being a quasi-judicial function is individually driven, and is a noble profession. Branding in auditing is a mirage. The value of 'Make in India' in auditing cannot be overstated. A strong base in India will help towards creating global IAF: China has now banned the MAF and supports its top 50 with this vision. The timely arrival of this eminent report from IIM-A researchers paves the way for companies to return to widely engaging Indian auditors. And audit firm rotation provides us this opportunity.

Backed by the findings of this enlightened IIM-A report, Indian industry, PE/VC, institutional investors, lead advisors, start-ups, will not have any hesitation, as in the past, to support 'Make in India' in auditing. Even the lay, surely note that credibility of IAF in areas like discretionary accruals. The big firms can be used for consulting, which they are good at, even as Indian MNCs and MNCs in India – as also their promoters and audit committees – duly re-examine the policy of auditor selection in this light. Additionally, is not 'Make in India' one of the large responsibilities cast on all of us by our prime minister? As part of this turning tide, while Indian shareholders confidently appoint IAF, this genuine service comes with the advantage of a raft of other positives, without paying more for less. It is good to have research support for something we have always intuitively known. ◆