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The Comeback of Consulting

It's once more a huge business for Big Four auditors, thanks partly to Sarbanes-Oxley rules

Four years ago, the partners at Deloitte & Touche did something radical: They kept the firm in one piece. It was the only one of the Big Four accounting firms that hadn't already dumped its lucrative consulting arm. And pressure for the split was high inside and outside the firm--including from the Securities & Exchange Commission. The idea was to insulate the bookkeepers from accusations that big advisory fees would taint their audits. At Enron, Arthur Andersen had earned $25 million in auditing fees and $27 million for consulting the year prior to the company's spectacular collapse. That heightened concerns that auditors were going easy on big consulting clients. But Deloitte's plan for a management-led buyout of its consulting division fell through. Borrowing costs skyrocketed in the wake of Andersen's closure, while revenue sank as cautious audit clients canceled nonaudit contracts. So on Mar. 31, 2003, with little alternative, the firm scrapped the idea.

Sometimes it's best to be lucky. In the years since the aborted breakup, Deloitte's consulting business has taken off. Consultants have more than made up for lost business from audit clients by selling to the large universe of public companies the firm doesn't audit--about 75% of them. Private equity firms and the companies they manage are customers, too. Strong demand for advice on Sarbanes-Oxley compliance, risk, forensic investigations, and outsourcing has helped fuel demand. So has the mergers-and-acquisition boom.

Today, consulting is Deloitte's second-largest business in the U.S., a $3 billion segment that accounted for more than a third of the U.S. firm's 2006 revenue, second to auditing. Worldwide, consulting is an even bigger business for Deloitte, totaling $8.9 billion, or 45% of its $20 billion in global revenue, according to Kennedy Information in Peterborough, N.H. "In a strange kind of way we're very fortunate," says Barry Salzberg, CEO of Deloitte & Touche USA. "By serendipity we ended up with a strategy that is unique."

DANGER ZONE

Or maybe not unique. It hasn't taken long for the other audit firms to do the math and quickly rebuild their own consulting arms. Worldwide, KPMG last year sold $5.3 billion worth of consulting services, a 12% jump from the year before. PricewaterhouseCoopers took in $3.7 billion, up 20%, and Ernst & Young rang up $2.4 billion, a 2% increase. **"It's a huge growth industry and a big-margin business," says Clark R. Beecher, a professional-services executive search consultant at Houston-based Magellan International. Beecher estimates that demand for consultants who do the work the Big Four specialize in is now 15 times the supply. "It's the old mentality again: you sell everything you can."**

But that's exactly what got the firms in trouble last time, critics say. The resurgence of consulting has some worried it could distract audit firms from a proper focus on that core part of their business. "The real issue that's going to be posed is: Have you learned your lesson, or is this going to turn out badly again?" says Tom Rodenhauser, vice-president of Kennedy Information's consulting division.

Ensuring that auditors don't overstep the bounds of what's allowed is the responsibility of each company's audit committee. But Lynn E. Turner, former chief accountant at the SEC, says those committees are not always as attuned to independence issues as they might be. He cites recent examples, which are not public information, where a company's audit firm was partly paid for nonaudit work on a contingent-fee basis. Any such fees are a no-no for audit firms under U.S. regulatory rules, but the audit committees hadn't caught it.

Given what happened at Enron, WorldCom, Adelphia, Tyco, and elsewhere, it's ironic that the very dangers those meltdowns highlighted are what's driving much of the demand for Big Four nonaudit services today.

Mark Goodburn, head of KPMG's advisory business, says forensic investigations and anti-money-laundering probes are some of the services that have made his practice grow to 30% of the firm's U.S. revenue. "The risk awareness has been changed forever," says Goodburn.

M&A deals that used to be done on the CEO's handshake now take months of financial due diligence. Once-permissive credit markets are finally demanding tough financial reviews of debt, which adds to the need for the accounting firms' number-crunching prowess. And high turnover among chief financial officers, traditionally audit firms' key corporate contacts, has combined with increasing responsibility in that role to create a group of customers with a bigger appetite for advice than ever.

At Deloitte, partners say consultants are now far more intertwined with the rest of the business, starting with their wallets. The SEC outlawed the practice of paying auditors based on nonaudit work. So Deloitte has one big pool of profit that auditors, tax experts, and consultants all share. How much of a share any one person gets depends on their record as managers, the size and value of their clients, and their expertise. Audit partners can still refer business to their consulting counterparts, but they benefit only in a broad sense, not directly. "Teaming became our mantra," says Salzberg.

Deloitte is certainly cross-selling vigorously these days. One example: a large project the firm did for test and measurement company Agilent Technologies in 2005 and 2006. Agilent, then a $7 billion hodgepodge of businesses Hewlett-Packard Co. had spun off, wanted to split up. It eventually sold its semiconductor business to private equity firm Kohlberg Kravis Roberts (KKR) and spun off another business, Verigy Ltd. Deloitte was the main adviser on all three deals and put a team of 200 people on the assignment. Auditors advised on how to set up the initial-public-offering financials, consultants helped design the proper supply chain for a smaller Verigy, and tax strategists worked to lower the tax bill for the remaining Agilent business. In the course of the work, Deloitte encountered just one independence issue. The firm had been running some of the systems KKR was buying, and since Deloitte audits the private equity giant, it had to offload those duties before the deal closed. Other than that, says Agilent CFO Adrian Dillon, there was "never an issue." Other big consulting clients include biotech giant Genzyme Corp. insurer Aetna Inc., and the Homeland Security Dept.

SYSTEM CHECKS

To manage potential conflicts, Deloitte has a firm-wide training program for all professionals. And everyone has to attest each year, around the time of their birthday, that they have not provided forbidden services. The firm has changed its accounting system as well. It won't allow someone to start a project at all without first certifying that the lead partner at that company has O.K.'d it. The lead partner is pivotal because he or she knows all the business the firm is doing with the client and is in the best position to flag potential issues. Additionally, Deloitte has created a team that randomly audits its own engagements to ensure compliance. Thanks to Sarbanes-Oxley, the services with the clearest potential for conflict have been outlawed. To make it easier for auditors to insulate themselves from business pressures, Deloitte no longer calculates the individual profitability of its audits or consulting services.

It's not easy to know for certain how well these systems are working. The Public Company Accounting Oversight Board (PCAOB), created by the Sarbanes-Oxley Act to monitor audit quality, does check whether auditors are providing any of the 10 prohibited services. But the PCAOB does not publicly disclose its findings. At Deloitte, issues raised by the board have been easily addressed, Salzberg says, and the firm has yet to lose a single client over an independence issue. To the contrary, its list of clients only seems to be growing longer.

By Nanette Byrnes