



Private Equity: KPMG's Forensic service offerings


Advisory



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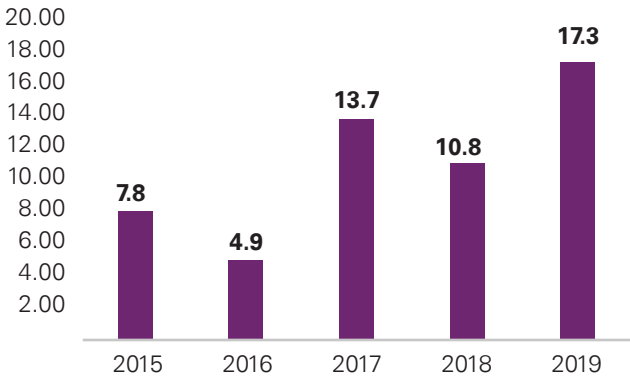
Private equity and corporate acquisitions/investments have witnessed a phenomenal growth in the last decade, and are now being considered as one of the primary sources of funding in India. KPMG in India's Forensic team can provide assistance to Private Equity and other M&A investors (Investors) looking to invest in Indian entities from the pre-transaction stage to the exit mechanism stage, thereby helping reduce the risk of financial or reputation loss.

KPMG in India's Forensic services helps clients protect their business from fraud, misconduct and non-compliance, which, in turn, helps reduce reputational risks and commercial losses. We do this by providing independent, proactive and responsive services through our investigative, accounting and technology capabilities. Our team comprises more than 1000 plus professionals, with each one bringing in not only rich and extensive experience, but also competitive and specific skill sets.



Trends of PE investments in India


Amount in USD billion



Source: Private equity investments hit 10-year high in 2019, Refinitiv, Ganesh Sivaraman, January 7, 2020

Key risks while investing in India

- Siphoning of funds by promoters of the investee company
- Utilisation of funds for purposes other than investment
- Misrepresentation of financial statements for better valuations
- Non-compliances to various Indian statutes such as IP and copyright violations, anti-competitive behavior, Companies Act and others.



'Corruption' accounted for 62 per cent of the misconduct cases in the south Asian region.



Source: 2018 Report to the Nations. Copyright 2018 by the Association of Certified Fraud Examiners, Inc.

USD 850,000 was the global average value of loss on account of fraud and misconduct perpetrated by senior management.



Common fraud and misconduct risks for a private equity investment:

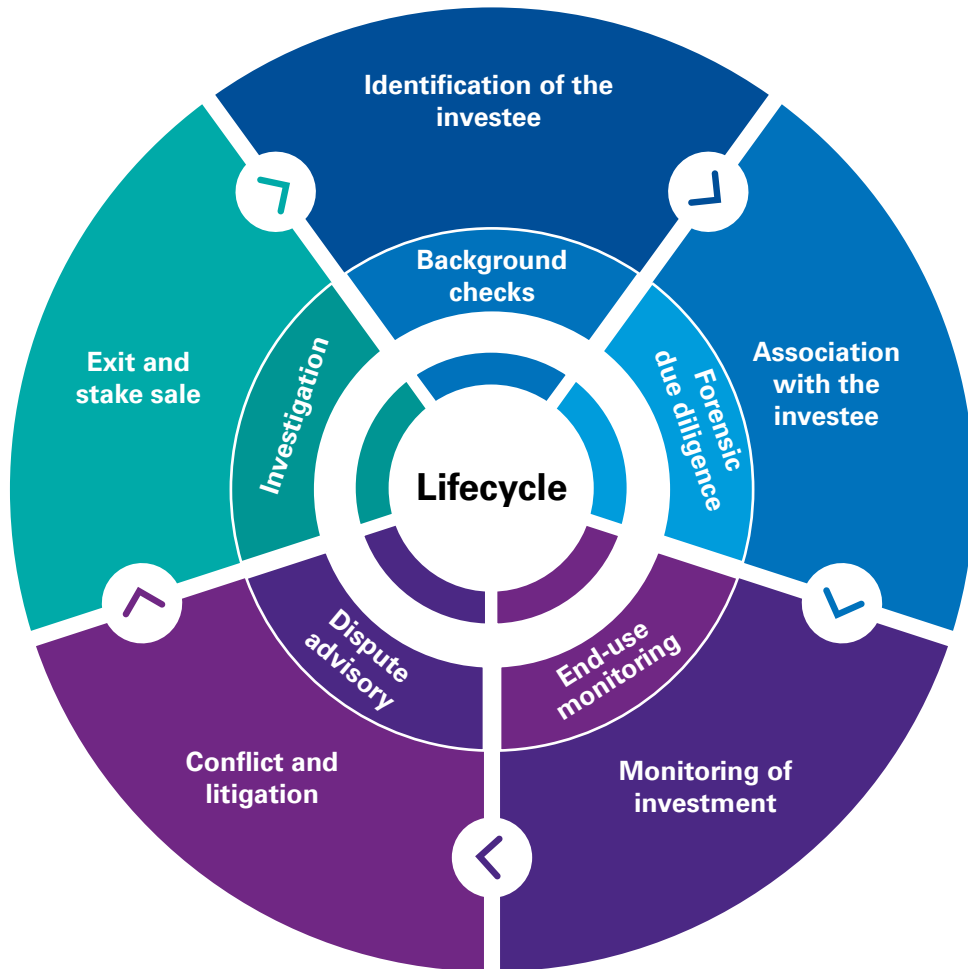
Associating with people with tainted backgrounds	Misrepresentation of financial statements	Bribery and corruption	Diversion and misappropriation	Non-compliance
<ul style="list-style-type: none"> • Litigation matters against the company and/or its promoters • Regulatory investigations against the company and/or its promoters • Tax evasion cases against the company and/or its promoters • Management involved in any criminal offences. 	<ul style="list-style-type: none"> • Inflated revenues to demonstrate better prospects of the company • Undisclosed liabilities on account of arbitration/ dispute matters or tax assessments • Non-existent assets or assets accounted at non-depreciated values in the financial statements. 	<ul style="list-style-type: none"> • Winning and retaining contracts through inappropriate means • Nature of industry and frequency of interactions with government officials • Use of intermediaries and third-Party consultants as liaisons. 	<ul style="list-style-type: none"> • Procurement from undisclosed related parties/ favoured vendors at prices higher than the market prices • Utilisation of funds for personal benefits such as real estate, vehicles, mobile phones, personal holidays and others • Payouts to non-existent employees and/ or disbursement of excess salaries for round tripping of cash. 	<ul style="list-style-type: none"> • Infringement of local and international copyright/patent guidelines • Impact on market dynamics and compliance to local competition regulations • Risk to data privacy and security in line with global and local data protection regulations.



KPMG is seeing an upward trend in inquiries from PE firms, especially for forensic analysis of financial results, background checks of the management of the Investee Company and investigation into cases of diversion of funds.

Additionally, we have experienced an increase in number of inquiries from PE firms for periodic auditing and monitoring of portfolio company activities.

The illustration below provides a glimpse of the key forensic offerings mapped to the investment lifecycle.



Our key offerings include:

1. Identification and association



Pre-investment forensic due diligence

Investing in a company without assessing the ethical standards of promoters and/or knowing its factual financial health may lead to regulatory, financial and reputational problems for PE firms.

Our compliance and investigation team can assist PE firms in identifying probable risk factors, which might impact their businesses negatively. We can also help them make better decisions.

We help gather detailed insights into the backgrounds of the local management or promoters of Investee Company from market sources.

Taking a step further, our team assists PE firms perform detailed forensic reviews of transactions of Investee Company.

US FCPA and UK Bribery Act due diligence

Major challenges for PE firms during pre-investment due diligence is to check whether Investee Company complies with U.S. Foreign Corrupt Practices Act (FCPA) and/or the UK Bribery Act (UKBA) provisions.

Another challenge for PE firms is the threat of 'successor's liability', as investee companies might inherit legal issues, and become liable for acts/violations committed in the past. This makes it essential for companies to conduct a due diligence to determine any possible violations.

We help clients conduct FCPA/UKBA due diligence on Investee Companies and third parties to ensure there are no hidden risk factors.

2. Monitoring



Implementation of an ethics framework for investee companies

A large number of PE firms are investing in start-ups or companies that are in the initial phase of operation. The corporate governance of such companies might not be as strong as those of large established corporates.

We help PE firms implement an ethics framework in investee companies, which consists of robust policies and procedures on aspects of whistle-blower mechanism, risk mitigation, incidence response plan, anti-fraud plan, code of conduct and anti-bribery policy.

Investment/End use monitoring

Post investment, PE firms are concerned about the utilization of funds by Investee Company. PE firms may want to ascertain whether the operations of business are conducted in accordance with the shareholder agreement and in a legally/ethically correct manner.

We help PE firms by monitoring the utilization of investment funds to identify potential issues of siphoning or misappropriation.

Fraud risk management

Organizations often fail to recognize the risk due to fraud and misconduct until they themselves become victims. This further gets complicated for PE firms that don't have visibility over the functioning of investee companies.

Our approach to fraud risk management helps PE firms assess their investee companies for potential fraud, and advise them in mitigating associated risks. Our team helps clients understand fraud risks, evaluate existing preventive mechanisms, train staff and develop effective anti-fraud policy.

Intellectual property and contract compliance services

Organizations rely on multiple partnerships to create, market, distribute and/or sell their products and solutions. These partnerships, if not continuously monitored, can result in possible violations of IP rights/contractual obligations and impact costs.

We help PE firms analyze key business relationships of investee companies to identify any compliance-related gaps or instances of under reporting, and offer suitable recommendations for course correction.

Our services include royalty compliance reviews, license compliance reviews, contract/agreement compliance reviews and reseller and distributor reviews.

Data breach forensics

We help clients respond to data breaches by identifying the source, potential motives and the perpetrator.

In a preventive mode, we conduct assessments to help understand and remediate key data leakage points in IT infrastructure and processes, and implement controls for the future.

3. Conflict and litigation



Dispute, litigation and arbitration assistance

After a fraud has been discovered and investigated, the case might proceed to either prosecution or civil litigation or both. There are many factors that can affect this result, such as the amount of the financial loss, the strength of evidence and prosecutorial discretion.

We help PE firms in various stages of an arbitration or litigation with Investee Company. Such cases frequently require forensic examination of evidence and analysis of facts to ascertain the modus operandi deployed by the promoters/senior management.

Our team can assist in data preservation, factual analysis of documents/information, presenting of the facts in a relevant manner to the court/tribunal and acting as an expert witness.

4. Exit and sale of stakes



Fraud and misconduct investigation

A robust system of anti-fraud controls can act as a powerful deterrent to fraud, as well as become a prevention and detection mechanism. However, many companies fail to adopt anti-fraud controls, which could impact the growth and reputation of the company.

Our team can conduct fact finding reviews on behalf of PE firms to help identify instances of any misconduct or impropriety (including misrepresentation in financial statements) by the promoters/senior management/employees of the investee company.

Our team has experience in some of the large financial fraud investigations across industry verticals, and has assisted organizations in solving a range of fraud and misconduct situations. The investigation outcome can then be evaluated by legal experts so as to mitigate risks around litigation and reputation.

While these are our standard services, we leverage our extensive skills and experience to customize our offerings to suit clients' specific needs.



Our select credentials

A multinational PE firm was considering investing in a large promoter-driven infrastructure company in India. KPMG in India was appointed to conduct a pre-acquisition forensic due diligence on the investee company.

Issues identified

Our investigations revealed:

- Investee management maintained a parallel book of accounts. Revenues as per the correct book of accounts were substantially less than what was shown to the PE firm
- Non arms-length transactions with undisclosed related parties
- Bribes paid to government officials to obtain necessary approvals and licenses.

The PE firm walked away from the proposed deal based on our findings.

A large PE fund was concerned about diminishing profit margins after their investment in a chain of hospitals in India. KPMG in India was appointed to conduct a review of financial statements in an attempt to understand the reasons for diminishing returns.

Issues identified

KPMG identified the following malpractices by the investee company:

- Large scale procurement from related parties at non arms-length pricing
- Cash collections were not recorded in the book of accounts leading to lower revenue booking.

Basis the observations, the PE firm renegotiated their terms and conditions with the investee company, as well as recovered the losses suffered.

KPMG in India was appointed by an international governing body to verify the utilization of their funds invested in an infrastructure company in India.

Issues identified

KPMG in India reported the following issues:

- Financial misreporting and diversion of funds by inflating the expenses and accounting of non-existing assets
- Promoters diverted the funds and brought partial funds back as their share of investment
- Related party transactions not at arm's length
- Diversion of business to the company operated by the promoter's in-laws.

The investor filed a case against the investee company and withdrew their investment.

KPMG in India was appointed by a global PE firm to conduct a pre-acquisition assessment of compliance to FCPA.

Issues identified

KPMG in India reviewed the policies and procedures and checked whether the transactions in compliance with FCPA provisions. The firm identified gaps such as:

- Bribes were paid to government officials through intermediaries
- Employees were not aware of the FCPA provisions and the prohibitions on giving gifts to government officials
- Adequate clauses were not included in the vendor agreements.

The client was able to evaluate risks and counter measures for the proposed transaction.

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