Price waterhouse coopers (pwc) audit scandal and fraud

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Introduction

The Sarbanes-Oxley Act (SOX) is an Act that came into force on the 5 th of July 2002 in the United States. The law was created in order to fix the flaws that were prevalent in the auditing of public owned companies (Hoitash, Hoitash & Bedard, 2008). The Sarbanes-Oxley Act (SOX) created a body to oversee and regulate auditing through the Public Company Accounting Oversight Board (PCAOB). The body enlists auditors to enforce laws against theft and fraud by corporate officers. The scandal that hit Price Waterhouse Coopers (PWC) which is a renowned audit firm across the globe was first discovered in the month of January 2009. Analysts have indicated that this was one of the mega scandals involving the audit of companies in the history of India (The Economist, 2009). The company CEO disclosed the fraud when he indicated that for quite some time, he had been inflating the company's financial sheets to show profits amounting to approximately 1 billion dollars. This study gives a comprehensive look at this scandal the failures of Price Waterhouse Coopers (PWC) in their audit of the company.

Requirements of SOX that have reduced corporate fraudulent activity

The requirements of Sarbanes-Oxley Act (SOX) have reduced the intensity at which corporate fraudulent activities occur. This has been made possible by the various requirements that are available in the Act. Under section 103 of the Act, through the creation of the Public Company Accounting Oversight Board (PCAOB), certain internal control measures were introduced (Romano, 2004). It states that by rule any audit firm is required to consider standards

established by one or more professional bodies and it bears the sole responsibility of making amendments to such standards. In so doing, each registered public accounting firm shall prepare and maintain for a period not less than 7 years audit paper works and any other information that they may have that relates to audit reports (Hoitash, Hoitash & Bedard, 2008). Secondly, they should provide a concurring partner review concerning audit reports. Thirdly they should describe in each audit report, the scope of the auditor's testing of the internal control structures and procedures as is required by the issuer under section 404 (b).

Section 201 to 209 is dedicated to the analyses of auditors. Section 201 (h), talks about the ability of a company to engage in non-audit functions. In this case, such an external audit firm is required to first acquire an approval from the audit committee of an issuer according to subsection (i), such a law is very prohibitive to some extent an audit company cannot engage in some fishy kind of business (Hoitash, Hoitash & Bedard, 2008). The extent to which an external auditor could effectively provide their services was limited by Section 203 subsection (j) which subjects a company to an Audit Partner Rotation which makes it illegal for a public firm to provide audit services to an issuer if the lead partner or the auditor in charge of reviewing the audit had performed audit services for that particular issuer in each of the previous 5 fiscal years for that particular issuer (Romano, 2004). This requirement, impacted companies negatively in that they could not entrust their audits on one particular company. This meant that they had to seek new auditors from time to time.

The auditors were also impacted negatively in that they could not have their own customers who relied on their particular services this means that an audit firm has to continuously seek new markets for its services (Hoitash, Hoitash & Bedard, 2008). This was geared at reducing the instances of fraud. Auditor independence under section 208 was severely contravened under this section; it was illegal for an audit form to issue an audit report with respect to an issuer if the firm engages in any activity that the issuer may have prohibited (Romano, 2004). Some of the prohibitions were rigorous under section 10A of the Securities Exchange act of 1934 thus the scope of work that these auditors could do was highly reduced. Through these provisions, the Sarbanes-Oxley Act (SOX) has been able to curb fraudulent activities in companies and thus all market players are more assured of financial security and are assured of safe business practises.

PWC audit of Satyam Computer Services Limited

The Satyam Computer Services fraud came to light in January 2009. This was the biggest ever fraud known in the history of India. The scam was brought to light by the company’s CEO Mr. Raju who admitted that he had fraudulently manipulated the company’s financial statements for several years to show inflated profits and non-existent assets that totalled to $1 billion (Leahy, 2009). It is believed that Price Waterhouse Coopers (PWC) played a role in enabling the fraud to take place. To start with, Raju admitted that he had manipulated accounts thus is enough reason to show that auditor in the firm were not keen. The auditors in the firm instead of using an independent testing mechanism used Satyam’s investigative tools and thus they compromised on laid down rules on reporting standards (The

Economist, 2009). The auditors had also observed deficiency in the Information Systems and the risk to fraud. However, they chose to keep quiet over the issue and did not report these concerns to shareholders. VSP Gupta the global head of internal audit during investigations admitted that the coverage and resources of internal audit was also not commensurate to the size of the business.

Assessment of Price Waterhouse Coopers (PWC) performance

Price Waterhouse Coopers (PWC) were not keen on checking the invoices neither did they have keen interest on analysing the company’s debtors which the CEO had overstated by 23 percept according to the SFIO report on the fraud (The Economist, 2009). The auditors did not independently verify cash and bank balances. If the auditors were keen on their job, they would for example check the cash in hand so as to ensure it was actually existent and also whether money in the company’s bank account had been invested properly.

In serious auditing, there is usually the need to physically verify the assets owned by the company rather than merely relying on books of accounts prepared by the company (The Economist, 2009). There is also enough evidence of sort to show that the auditors had prior knowledge of the fraud. This is because in the financial year 2007-2008, PWC received a fee of 4. 3 core which is almost twice what they charged this is enough evidence to show that they were being lured to give the company a clean bill of health (The Economist, 2009). Thus the auditors were not independent and their decisions had already been influenced.

Price Waterhouse Coopers (PWC) audit and control structures

PWC heavily relied on internal control structures to carry out the audit for example the auditors rather than use an independent testing mechanism used Satyam’s investigative tools (Leahy, 2009). This shows that the auditors were not keen in their work and thus they used an already established mechanism in the company rather than building their own computer aided testing tool that would have ensured that they had sealed all the loop holes that were created by the company and thus they would have used their independent tool to carry out the audit efficiently.

In any case, any company whether they have an intention of committing a fraud or not, would not have an efficient audit tool since they would fear that it would work against them thus it would be in their best interests to seal such loop holes. The auditors also saw loop holes in the Information Systems but overlooked such issues since they believed that the company had reliable internal control which was not the case (Niazi & Ali, 2015). This is enough evidence that PWC relied heavily on the company’s internal control structures.

The audit committee of any company is to ensure transparency in the business operations. In this case, it means that financial statements and financial disclosures provide the correct and appropriate information and a credible picture. Also internal control systems need to be in place to ensure fraud cases do not go unnoticed. PWC did not check the internal control structures present in the company yet it heavily relied on it.

The audit firm was not keen on looking at the transactions of the company and thus only looked at the books of accounts of the company without themselves taking an initiative of looking at them and thus assumed what the book accounts read was the actual state of affairs in the company (Niazi & Ali, 2015). This is well evidenced by that the audit firm did not carry out a physical analysis for a large sum of money that added up to Rs. 5040 crore thus the auditors played an active role in penetrating fraud by giving the company a clean bill of health yet the audit reports had been doctored and contained cooked values. Thus the auditors should have been responsible and taken their job seriously and would have physically examined the company's accounts of assets and liabilities.

The firm should have sort to know the actual money that the company had at hand and also checked with the company's banker to ensure the amount of money in the company's account was the actual value that had they had stated and also they would have analysed how the money that had been spent had been used (Leahy, 2009). If for example an asset had been acquired using the money such an asset would have to be seen and valuation done on it to ensure that prices had not been inflated. In this way I believe the auditors failed the shareholders who relied on these auditors' reports.

Price Waterhouse Coopers (PWC) exercise of due care

PWC did not meet its responsibility of due care. According to the Sarbanes Oxley Act (SOX), directors are prohibited from having any direct involvement in the company's operations. However the auditor's in this case were not

keen and thus most of the directors ended up being participating in the operations of the company this was a case of carelessness on the part of the auditors since they would have noticed this red flag and would have advised the company and its stakeholders appropriately (Leahy, 2009).

The auditors also betrayed the boards trust by authenticating financial reports without taking up the responsibility of ensuring that those reports were a true documentation of what the company's accounts read. They highly relied on the book of accounts provided to them by the company and did not take an initiative of investigating whether these reports were truthful (Niazi & Ali, 2015). The auditors used the company's audit tools rather than coming up with their own tool this was another let down since an audit firm should not depend on the internal controls of any company since they may have loopholes but such companies should come up with their own audit tools which are not subject to manipulation by outside forces (Niazi & Ali, 2015).

The improvements needed to external auditing firms and the accounting profession

External auditing firms need to adopt operation standards whereby they need to maintain high discipline and degrees of ethics. In this case, the audit firms should maintain independence when carrying out audits (Niazi & Ali, 2015). Such auditors should not allow internal influence to outline their operational road map rather they should shape the sequence of operations to ensure operations are based on openness and integrity. An External Auditor should also come up with an appropriate auditing tool based on the

company on which it is carrying the audit. Such a tool should be tailor made for each company and should always be checked from time to time to ensure that there are no intrusions to the system (Niazi & Ali, 2015).

They should also do away with the notion of believing what the internal auditors tell them and what the book of accounts contain rather it is upon them to do their own independent audit and their results compared to those the company has provided and discrepancies addressed thereafter (Leahy, 2009). Also provisions of SOX need to be given more power and bigger penalties for non-compliance introduced so that a provision like, that a single auditing firm cannot work in the same company year in and year out is obeyed so that discrepancies with an audit firm can be realised by another auditing firm that audits the company.

Conclusion

In summary, it is important to point out that audit firms have the mandate to ensure that they report details on their client’s financial status in a transparent and open manner. This way, most of the issues that are encountered later when the flaws are detected can be avoided. Price Waterhouse Coopers (PWC) did not pay the due diligence in their audit of Satyam. The firm heavily relied on information from individual auditors at the company rather than the available control structures. This was a major failure on their part. It is important that the provisions of the Sarbanes-Oxley Act (SOX) are fully put into force so as to ensure that proper reporting and disclosure of the audit reports is prevalent in all public owned companies.

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