

# A study on PWC – Audit Failure Legal Implications

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## ABSTRACT

The world is experiencing both an economic and an ethical crisis as a result of corporate fraud, accounting scandals, poor management, bribery, and other ethical lapses. Corporate accounting fraud seems to be a serious issue that is growing in both frequency and severity, as seen by Enron, WorldCom, and Satyam. Thus, according to research, an increasing number of frauds have undermined the validity of financial reports, resulted in significant financial losses, and eroded investors' faith in the value and dependability of financial statements. Due to the increase of white-collar crime, stringent fines, severe penalties, and effective law enforcement are required. Due to their larger size and more internal auditing experience, reputable auditors are expected to provide SEC registrants with audits of a higher calibre. Going-concern audit reports are more likely to be produced by offices with bigger staff sizes, and clients in these offices tend to behave less aggressively in terms of earnings management. Given that the Big 4 firms have more reputational capital to lose and since the failed audit was performed by a non-US Big 4 auditor, it may be predicted that they will increase the quality of their audits when the failed audit is revealed. Company scandals, particularly in the US, have led to worldwide changes in corporate governance, accounting methods, and disclosure requirements. The Sarbanes-Oxley Act, 2002, was passed as a result of the corporate governance reform process being launched in response to the Enron scandal in 2001 and a number of other crises involving significant US firms during that time. , According to a recent study, PWC-audit India's quality was inferior to both other Big 4 (OB4) and Indian auditors before the 2009 discovery. In this essay, we look at the reasons why Satyam Computer Services Ltd.'s failed audit has revealed and as well as potential solutions that may be implemented to prevent future frauds of similar nature. India also requires corporate governance reforms and must restructure corporate governance by making stringent legislative adjustments. Even while they cannot completely forbid it, corporate governance systems can at least be used as a tool to identify unethical behavior by senior management before it is too late.

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## INTRODUCTION

India is currently the sixth-largest economy in the world, ahead of France, and the IMF projects that it will expand to become the fifth-largest economy, ahead of the United Kingdom, by the end of this year 2019 and the third-largest economy, ahead of Germany and Japan, by 2030. Additionally, it is anticipated that India would become a more significant source and destination for direct and indirect foreign investment, making Indian audit quality a possible topic of interest for US regulators, investors, and scholars. Despite having a common law system and having laws and procedures that appear to be excellent on paper, India's enforcement is frequently lax, and historically, shareholder activism has been either nonexistent or very limited.

The Securities and Exchange Commission was founded by the US Securities and Exchange Act of 1934. (SEC). The SEC was given the power to control auditors and establish accounting standards in addition to other duties . In the accounting industry, audit failure is a major problem. The majority of failures happened at the start of the twenty-first century. When auditors wrongly assume that a company's financial statements are accurate even though they contain fraud or errors, an audit failure results. Before the problem of audit failure was identified and investigated, it was blamed on the auditors' poor behaviour while considering generally accepted accounting principles (GAAP),

There is a lengthy history of research on audit quality and audit reports. As everyone is aware, the foundation of the audit market is audit quality because a high-quality audit can increase stakeholder confidence. However, the public's confidence in audit reports has decreased as a result of some auditing scandals. Therefore, we are trying to better understand the

reasons behind these audit failures and how we can raise the caliber of future audits. The goal of this study is to undertake a thorough literature evaluation of the scholarly work on audit failure.

Increasing your knowledge can also help you fight negative effects, like restoring auditing's credibility. Three main categories make up our review: a proxy measure of failure of audit, b audit failure causes, and c audit failure impacts. We observe that proxies are frequently used in the literature to detect audit failure. Material misreporting, auditor communication, financial reporting quality, and perceptions are four factors used to classify audit outcomes. Our research reveals that there are two main causes of auditing failures. Economic fluctuations are one of the factors that put managers under tremendous peer and financial pressure to perform. The other is having a rule-checking attitude. Following GAAP requirements can enable some reports to be correct at the rule-level but conceal the real picture because financial reporting is governed by rules rather than principles. In addition, we observe three crucial signs of a failed audit: Code violations, severe inaccuracies in the most recent set of audited financial accounts, and failing to issue a GCO prior to a business failure.. We discover that client market value is decreased by audit failures, as is the auditors' capacity to keep clients. Additionally, there is evidence to support the claims that increased responsibility reduces audit failure and increases auditor effectiveness by increasing audit fees and effort.

These are some of the ways that our study adds to the body of literature. In order to give a thorough evaluation of the literature on audit failure, we first examine published works. We conclude by summarizing the research's findings and making recommendations for additional study. The rest of this essay is structured as follows. To provide readers a complete picture, we briefly introduce a few well-known auditing failure scenarios (**we also discussed in detail case of Indian IT company Satyam**). We discuss the reasons for failure of audit and also we discuss the consequences of audit failure, makes recommendations for additional study.

## BACKGROUND

The Sarbanes-Oxley Act, which was an attempt by the U.S. legislature to impose ethical behaviour and reduce the occurrence of new reporting issues, was a direct result of audit failure cases, which are crucial to this topic because of their influence. Enron and WorldCom make up the first case, and Kanebo and ChuoAoyama make up the second. the controversy involving the Indian IT company Pwc Satyam, the third one.

Enron -Arthur Andersen: As a relatively small energy firm with its headquarters in Texas, Enron grew during the one of the biggest American conglomerates by the 1990s with a variety of energy trading and utility operations around the world. It was one among the most profitable American companies, with a market value of \$70 billion. Enron, however, shocked the market in October 2001 when it revealed an accounting shift that resulted in approx. \$620 million third-quarter loss and a \$1.2 billion decrease in its claimed net value. Over the following weeks, radical methods of controlling earnings, such as a sophisticated off-balance sheet system that masked substantial liabilities and losses, came to light more and more.. Furthermore, the company's revenue and liabilities were valued incorrectly. Although these issues existed, Enron's auditor, Arthur Andersen, did not mention them in their audit report. .. It was also made known that Andersen actively and significantly contributed to the creation of the ground-breaking earnings management system that Enron used. Andersen earned more money in the year 2000 from selling consulting services to Enron (\$27 million) than it did from auditing the company's financial records (\$25 million). This drew wide criticism and charged with conflict of interest For an additional fee, it also offered tax services and the outsourcing of some internal audit work .If Andersen had provided more capable and reliable audit procedures, Enron might not have filed for bankruptcy in less than two months with unpaid liabilities reaching \$55 billion.

WorldCom,-If Anderson's audit failures at Enron had led non-experts to question the dependability of expert systems, the subsequent accounting fraud claims at WorldCom in June 2002 would have exacerbated public alarm and fostered widespread scepticism. WorldCom eclipsed Enron's previous bankruptcy record, which had been established less than eight months before, on July 21, 2002. This latest bankruptcy surpassed all others after Andersen looked into the company and discovered that WorldCom had improperly capitalised \$3.85 billion in revenue expenses as capital expenditures—a practice some have termed as history's largest accounting fraud.

Aoyama and Kanebo Another incident, similar in scope and social impact to the Enron crisis, took place in Japan. One of Japan's biggest producers of clothing and cosmetics was Kanebo. In Japan, ChuoAoyama was a well-known auditing firm. It performed audits for numerous well-known businesses, including Sony and Toyota. ChuoAoyama was a member of the worldwide network of PricewaterhouseCoopers. This accounting scam involves a record-breaking amount of money totaling 215 billion yen over the course of five fiscal years (FYs) that ended in March 2004. The fraud's main goal was to keep Kanebo out of bankruptcy because of its high liabilities, which in FY 1998 totaled over 250 billion yen.

The Kanebo investigation demonstrates that the company's former management had engaged in accounting fraud. The business also admitted that their financial statement was incorrect. Due to its substantial obligations, it inflated earnings by around 200 billion yen. In the end, the government detained appropriate individuals and imposed punishment, and ChuoAoyama's statutory auditing service was suspended for several months even though the company itself was not charged with a crime. The stock prices of ChuoAoyama's clients and, to a lesser extent, those of the other Big 4 auditors' clients were both significantly impacted by the news of the poor audit quality.

### **Satyam case**

Satyam is India's fourth-largest IT business. The CEO of the business, Ramlinga Raju, scammed investors of around \$2 billion. B. Ramalinga Raju established Satyam in 1987 in Hyderabad, India, with less than 20 employees. The company, which specialises in information technology, business services, and computer software, is a leading provider of outsourcing in India. Satyam achieved success right away. Deere and Co. became Satyam Computer Services Limited's first Fortune 500 client after it was established as a public limited company in 1991.

It quickly ascended to become a leading global consulting and IT services firm with operations in 55 countries before competition caught up with it. It was ranked as India's fourth-largest software exporter, behind Infosys, TCS, and Wipro. A number of subsidiary companies were also founded as a result, including Satyam Renaissance, Satyam Info way, Satyam Spark Solutions, and Satyam Enterprise Solutions. Satyam Info way (Sify), which became the first Indian internet company to be listed on the NASDAQ,

Nearly 50,000 people worked for Satyam at the peak of its business,, and operated in 67 nations. India's increasing success was illustrated by Satyam. For its innovation, leadership, and corporate responsibility, Satyam has received various honours. Mr. Raju received the Entrepreneur of the Year honour from Ernst & Young in 2007. For being a model of corporate accountability and governance in India, Satyam received honors from MZ Consult on April 14, 2008. The "Worldwide Peacock Award" for outstanding corporate accountability on a global scale was given to Satyam by the World Council for Corporate Governance in September 2008.

### **PROBLEM BEGIN**

On December 16, 2008, Satyam's chairman, Mr. Ramalinga Raju, announced that he is going to bid \$1.6 billion for, Maytas Infrastructure Ltd. and Maytas Properties Ltd., claiming he wished to make good use of the available funds for the benefit of investors. Incidentally both these entities are promoted and owned by Raju's family. He had to backtrack within 12 hours after receiving a negative response from investors and the market. Concerns concerning Satyam's corporate governance caused share prices to drop by 55%. In an unexpected decision, the World Bank announced on December 23, 2008, that Satyam had been banned from doing business with the Bank for eight years for supplying Bank workers with "improper incentives," and that it had also been charged with data theft and bribing the staff.

The price of shares dropped by further 14%, reaching their lowest level in more than four years. The lone independent director since 1991 has resigned, according to US professor Mangalam Srinivasan. The father of the Pentium and a former employee of Intel, Vinod K. Dham, as well as M. Rammohan Rao and Krishna Palepu, both distinguished independent directors, also announced their resignations on December 28. Then, on January 7, 2009, B. Ramalinga Raju announced his admission of perpetrating a financial crime totaling more than Rs. 7800 crore and announced his resignation as chairman of Satyam. He said in his letter that he was making one more effort to "fill fake assets with real ones" by making an offer to buy Maytas' companies.

In his letter, he acknowledged that it was similar to riding a tiger without understanding how to exit without getting devoured. The central government took over the firm when the two brothers, B Ramalinga Raju and B Rama Raju, who were promoters, were detained by the police. The Raju brothers were accused of criminal conspiracy, criminal fraud, and criminal forgery in accordance with the Indian Penal Code. The Central Government appointed three individuals to the board of Satyam, including C Achuthan, a former SEBI member, Deepak Parekh, the chairman of HDFC, and Kiran Karnik, a former Nasscom chairman and IT expert.. The Institute for Chartered Accountants (ICAIformer)'s president, TN Manoharan, and three more directors were appointed by the Central Government to the Board. A week after B Ramalinga Raju, the founder of Satyam, made his scandalous admission, Satyam's auditors Price Waterhouse finally acknowledged that their audit report was flawed because it was based on inaccurate financial figures that Satyam's management had submitted. On January 22, 2009, Srinivas Vadlamani, CFO of Satyam, acknowledged that he had extrapolated the number of employees by 10,000. He acknowledged to law enforcement officers questioning him that this allowed him to take around Rs 20 crore per month from the related and fictitious salary accounts.

## HOW THE FRAUD WAS UNCOVERED?

Responsible Parties: - The managing director, Mr. Raju, was the main fraudster, while the CFO and the company's global head of internal audit were also involved. Satyam's auditors and the board of directors also bear some of the culpability because they were unable to detect the fraud. Last but not least, the ownership structure of Indian corporations had an impact on the Satyam disaster. Mr. Raju claimed that he overstated assets on Satyam's balance sheet by \$1.47 billion. The corporation made a false statement that it had around \$1.04 billion in cash and bank loans. Satyam also underreported liabilities on its balance sheet.

Over the course of several years, Satyam inflated earnings almost every quarter to satisfy analyst expectations. To further the deception, Mr. Raju produced many bank statements. In order to artificially inflate the balance sheet with unreal balances, Mr. Raju fabricated the bank accounts. By claiming interest income from the fictitious bank accounts, he inflated the income statement. Mr. Raju also said that during the previous few years, he created 6,000 phony salary accounts and stole the money after the business deposited it. In order to inflate revenue, the company's worldwide head of internal audit invented fictitious client identities and produced fictitious invoices in their names. Additionally, the worldwide head of internal audit faked board decisions and got loans for the business unlawfully.

Furthermore, it appeared that the money the company acquired through American Depository Receipts ("ADRs") in the United States of America was never reflected on the balance sheets. Mr. Raju initially asserted that he did not shift any money to personal accounts and that the company was not as successful as it had purported to be. But after more probing, Mr. Raju acknowledged that, starting in 2004, he had been moving substantial quantities of money to other companies he owned.

### Auditors Role

From June 2000 until the scam was discovered, Satyam's financial records were examined by international auditing company Price Waterhouse Coopers ("PWC"). PWC received strong criticism from several pundits for failing to catch the fraud. Under Indian law, PWC was accountable for the figures and signed Satyam's financial accounts. Evidence exists to support the idea that the auditors did not independently verify with the banks where Satyam allegedly had deposits. The deception also lasted for a number of years and involved the manipulation of both balance sheets and income statements. Satyam simply created fictitious sources whenever it needed additional money to meet analyst estimates without the auditors ever noticing the deception. The fact that Satyam paid PWC double what other companies would have asked for the audit raises doubts about whether PWC was involved in the scam.

Furthermore, Merrill Lynch identified the fraud as part of its due diligence in about 10 days, although PWC audited the company for approximately 9 years and failed to find it. The Satyam audit committee neglected to address a whistleblower's allegations. The independent director Krishna Palepu allegedly received an anonymous email on December 18, 2008, two days after the Satyam board decided to buy two group companies, Maytas Infra Ltd. and Maytas Properties Ltd., according to the findings of SFIO. The scam was made clear by that email. Palepu forwarded the email to the audit committee chairman M. Rammohan Rao, who then forwarded it to Price Waterhouse partner S. Gopalkrishnan for investigating further and he promised to provide a comprehensive response in a projected presentation before the Audit Committee on December 29. The new date for the meeting was scheduled for January 10. As required by Indian listing regulations, the Board consisted of five independent members. In 2008, Satyam stated in its regulatory filings with the SEC that it did not have a financial specialist on its board of directors. Later, concerns about the Board of Directors' lack of impartiality became apparent. There were several well-known businesspeople on the Board, which may have lessened the amount of scrutiny Satyam received.

On December 16, 2008, the Board approved Satyam's acquisition of real estate companies in which Mr. Raju owned a sizeable stake, drawing early criticism. After shareholders revolted against the deal, the Board revoked its approval. Within two days following the cancellation of the deal, Vinod Dham, Rammohan Rao, and Krishna Palepu all resigned from the board. Investors believed that the Board was not closely watching Satyam because of the bungled deal. The Board should have also picked up on a few of the same red flags that the auditor, PWC, missed. The Board of Directors should have been concerned as well because Mr. Raju substantially cut his Satyam shares over the three years prior to disclosing the financial figures, going from 15.67% to 2.3%.

### SATYAM TIMELINE

- **December 16, 2008:** Raju, the CEO of Satyam, announces plans to acquire Maytas Infra and Maytas Properties, two companies owned by his sons. At this time, Satyam is the fourth largest IT company in India with clients worldwide.

- **December 17, 2008:** Satyam's stock falls by a third in reaction to this announcement.
- **December 23, 2008:** World Bank bars Satyam from doing business with it.
- **December 26, 2008:** One independent director quits the Satyam board.
- **December 29, 2008:** Three more directors quit the Satyam board.
- **January 2, 2009:** Promoters' stake falls from 8.64% to 5.13% as institutions with whom the stake was pledged dump the shares.
- **January 6, 2009:** Promoters' stake falls to 3.6%.
- **January 9, 2009:** Raju, the CEO of Satyam, resigns, admitting inflating company profits.
- **January 11, 2009:** The Indian government steps into the Satyam outsourcing scandal and installs three people to a new board in a bid to salvage the firm. The board is comprised of:
  - Deepak S Parekh (Executive Chairman of HDFC),
  - C. Achuthan (Director at the National Stock Exchange, and former member of SEBI),
  - Kiran Karnik (Former President of NASSCOM).
- **January 12, 2009:** The new board at Satyam holds a press conference, looking at ways to raise funds for the company and keep it afloat during the crisis. One method discussed is asking Triple A-rated clients to make advance payments for services.
- **January 14, 2009:** Deloitte and KPMG appointed as new joint auditors for Satyam.
- **January 21, 2009:** Raju confesses to diverting funds from Satyam.
- **January 24, 2009:** Two audit partners of PwC who were in charge of Satyam's audit are arrested.

### DIFFERENT FRAUD-RELATED FACTORS

#### A variety of things contributed to the Satyam fraud.

Despite having access to detailed data and models, professional investors, and reputed directors who were proficient in respective domain, SEBI, retail investors, and the external auditor, were unable to spot the fraud.

#### The following is a list of factors that contributed to the fraud:

- **Greed; ambitious business growth; deceptive reporting tactics;** a focus on share price that is excessive; executive incentives; and stock market expectations. Accounting principles:
- **False accounts ESOP for the prepared; risky transactions that fail;** Internal and external audit failures; aggressiveness of investors, rating agencies, commercial banks, and investors; vulnerability of independent directors and audit committees; and The whistleblowing policy is ineffectual.

### CONCLUSION

The Satyam scam has taken authorities and the government by surprise. dashed the hopes of many investor types, and raised concerns about India's corporate governance standards as well as the accounting procedures of statutory auditors. From the aforementioned corporate devastation, severe corporate governance issues result. Numerous other similar corporate collapses in the USA, UK, and Europe had many of these governance issues as well. In response to the business failures, these nations took a strong position for codes and standards of corporate governance. The scope of the fraud serves as a startling eye opener, even to casual observers of the Satyam debacle. Scams and frauds involving corporations that target naive investors have become commonplace in India, occurring almost annually.

But as several astute corporate analysts have noted, the Satyam scandal had an impact that was unprecedented in India's corporate history as well as the entire world. Despite the fact that the board was run by professional managers, internal auditors, independent directors and market regulator SEBI, careless and irresponsible fraudsters have been active within the company for a very long time. the fact that it was , the Corporate Law Commission, the Department of Corporate Affairs, and the legal system only underscore how highly the fraudsters value all these organizations and institutions.. One widespread misconception is that most Indian businesspeople, especially those who are first in their generation, don't really understand the differences between a proprietary operation and a public limited corporation in terms of their rights and privileges and the corresponding obligations and accountability.

We are not claiming that the Indian corporate sector has more thieves than anywhere else.,but rather that this country's entire system makes it easier for them to prosper rather than harder for them to carry on their criminal activities. Company scandals, particularly in the US, have led to worldwide changes in corporate governance, accounting methods, and disclosure requirements. The Sarbanes-Oxley Act, 2002, was passed as a result of the corporate governance reform process



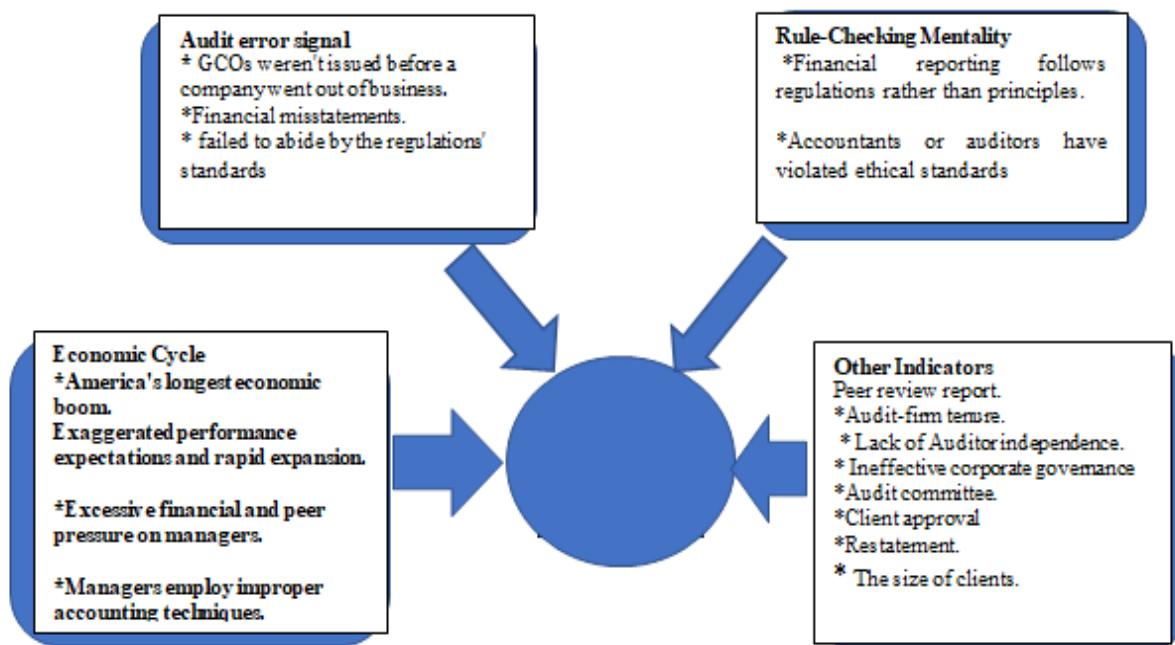
being launched in response to the Enron scandal in 2001 and a number of other crises involving significant US firms during that time. By eliminating corporate crimes and promoting transparency and disclosures, the Oxley Act's primary goal is to restore investor confidence. India also needs corporate governance reforms of a similar nature. India needs to overhaul corporate governance by enacting strict legislative changes. Corporate governance systems can at least serve as a way of discovering unethical behaviour by senior management before it is too late, even though they cannot totally prohibit it. A remedy for rotten apples does not exist., but at least the disease can be removed before it spreads and infects the entire basket. Effective governance is actually all about this. The corporate governance structure must be followed both literally and figuratively. Strong fines and punishment are required due to the rising prevalence of white collar crimes. Small distortions created by some unethical leaders have serious repercussions. Hopefully, raising people's awareness of the serious consequences of seemingly small lies will prevent some from falling into this trap.

The deception committed by the founder of Satyam in 2009 is evidence that human greed, ambition, the desire for fame, money, power and honor have a profound influence on behavior. Unlike Enron, which went bankrupt due to the 'agency problem', Satyam went bankrupt due to the "tunnel effect". The Satyam Scandal emphasizes the significance of corporate governance and securities regulations in emerging markets. In fact, the Satyam fraud prompted the Indian government to tighten corporate governance standards in order to stop the occurrence of similar frauds in the future. Major financial reporting frauds must therefore be studied in order to draw lessons from them and develop measures to use going forward.

### Causes of Audit Failure

Audit failure occurs when an auditor deviates from the applicable professional standards in such a way that the opinion contained in his or her audit report is false.

We will discuss earlier studies that looked into what contributes to audit failure. We divide these variables into two categories. Researchers have categorically classified the first set of factors as those that lead to audit failure, while the second set of factors includes indicators that are related to the chance of an audit failing



### Economic cycle

According to one theory, a key contributing cause to audit failure is the economic cycle. In America's history, the longest economic boom came to an end in 2001. As the boom set in, high performance standards and rapid growth rates put managers under intense group and financial pressure to rapidly increase market share and revenue. Then, business observers started to believe that such a rapid rate of expansion was typical. Once when the boom was over, many managers failed to live up to expectations, thus some tried to fix by employing questionable accounting practices or fictitious transactions, their dismal performance. Therefore, the auditing profession is always bitterly affected following a boom-bust economic cycle. On the other hand, some studies show how auditors perform between 2007 and 2009, when the macroeconomic environment is in a recession. To evaluate the auditors' performance, they compute measures for audit fee pressure. The baseline norms are established using audit fees from 2008, a year without a recession. They come to the conclusion that auditors are influenced by customers' fees.

Additionally, there is a correlation between fee pressure and the concurrent decline in audit quality. As a result of the widespread discovery of corporate fraud during that time, the market as a whole frequently doubts the veracity of issued unqualified audit conclusions.

### **Rule-Checking Mentality**

Another element that contributes to audit failure is the rule-checking mindset (Ball, 2009). A rule-checking mindset was popular in the accounting industry between 2001 and 2002. According to this viewpoint, financial reporting is governed by rules rather than principles, and compliance with rule-based GAAP is adequate. Enron's financial reports technically complied with GAAP, but they mislead investors by failing to appropriately reflect the economic substance of the transactions. Accounting professionals should adhere to the content over form principle, which holds that when more pertinent information can be provided to the reader of financial statements, legal and procedural considerations should be disregarded. As a result, an audit will still fail if accountants or auditors violated a principle, even though the reports will make sense from a rule-level perspective.

### **3 Signs of a Failing Audit**

We note that audit failures have three metrics:

Misjudgment by GCO, material misstatements in its most recent audited financial statements, and violations of the Code.

#### **GCO's Inaccurate Judgment**

A GCO's inaccurate assessment is the first sign that an audit failed. For a GCO's inaccurate conclusions, there are two main types of reporting misclassifications. If a GCO is issued by an auditor and the client does not subsequently fail. A GCO is not issued by the auditor, and the customer subsequently collapses (Carson, 2013). The auditor evaluates whether the going concern assumptions used in preparing the financial statements are reasonable and whether there is significant doubt about the customer's ability to continue as a going concern after the date of the auditor's report. must be determined. This evaluation will take at least one year. Even if the going concern assumption is appropriate for the preparation of the financial statements, the auditor must issue a permanent opinion to the GCO to fully disclose the material questions in the financial statements of the report. If management has failed to adequately disclose the uncertainty, the auditor may provide a qualified opinion or qualification, as appropriate, noting in its opinion that there are serious concerns about its ability to continue as a going concern. I will say. Given the above conditions, if he fails to issue a GCO before the company goes bankrupt, it can be considered a failed audit (Francis, 2011). The most common term for this is Type II disability. For example, Mutchler and Williams (1990) found that after first receiving his GCO from the Big 8 companies the following year, 1985, he had less than 10% of the manufacturing companies that went bankrupt the following year. This type I error also risks audit failure.

#### **Financial Misstatement**

The second symptom of an audit failure is financial misrepresentation. The danger of major misstatements must be identified and assessed regardless of whether the statement was made fraudulently or accidentally. To ascertain whether material misstatements occur, sufficient, high-quality audit evidence is required. Obtaining reasonable assurance that the financial statements are accurate and free of serious misstatements is another goal of an audit. Therefore, errors in the most recent audited financial accounts indicate that the audit was unsuccessful. Instead, this area's research by Hennes et al (2014) shows a link between restatement and its effects. They find that, although it happens more frequently to non-Big 4 corporations than to Big 4, severe restatements almost invariably result in the dismissal of external auditors. They find that, although it happens more frequently to non-Big 4 corporations than to Big 4, severe restatements almost invariably result in the dismissal of external auditors. The market nevertheless reacts favourably even though restatements raise switching costs and rotation frequency. Firms tend to restore their financial reputation while replacing auditors. The possibility of an audit failing can be decreased in this way. Similar arguments are made by Mande and Son (2013) and Hennes et al (2014). In order to improve audit quality and cut down on losses from shock markets, companies who have restated their financial statements are frequently pressured by the capital market to fire their current auditors. Restatement rates and auditor turnover rates are found to be positively correlated. They also point out that the stock market views the transfer in auditors as a good indicator for earlier companies who have restated their financial statements.

#### **Failing to adhere to the regulations established by the authorities**

Failure to follow regulations set forth by authorities is the third symptom of audit failure. Five fundamental principles are outlined in the regulations that authorities have released, and they also establish the minimum professional conduct requirements that must be met by all CAs. The guiding principles include professionalism, competence, objectivity, and honesty. The code contains information on every facet of the moral and professional

conduct required of members. Every CA is required to follow by the code and to be able to provide proof that their behaviour and actions are in line with it. In the event that CAs violate the code, which is considered an audit failure, regulators will take enforcement action.

### **The size of customer and auditor offices**

Another concern is if the size of the audit customer or the audit firm affects the standard of the audit reports. Auditors may be tempted to give up their independence and produce favourable findings in an effort to retain dependable clients as a result of the eco-dependence that large clients engender. Larger clients are more likely to receive going concern audit reports, claim Reynolds and Francis (2000). They argue that because larger clients pose a greater potential danger to the audit process and as a result could cause audit companies and their personnel to suffer greater reputational harm, auditors report more cautiously for them. Empirical studies have linked the dependence on audit/non-audit fees in the U.S. and Australia, two nations.

### **Audit committee**

Another element that contributes to failed audits is the audit committee. Protecting external auditors from termination after the release of a critical report is one of the key responsibilities of audit committees. Directors can nevertheless have a big impact on the audit opinion even though audit committees are made up of impartial board members of the company being audited. According to Carcello and Neal (2000), there is a decreased chance of receiving a going concern report when there are more associated directors on an audit committee. As a result, auditors are more likely to submit inaccurate reports that cause an audit to fail. They claim that when linked directors controlled an audit committee, management could not only persuade the auditor to issue an audit report. It also means that stronger audit committees are better able to safeguard auditors against dismissal following the release of a going concern report since they are more impartial, educated about governance, and hold less stock interests. It seems logical to assume that increasing the audit committee's independence, knowledge, and standing will lower the likelihood of audit failure.

### **Unreliable auditor independence**

Lack of auditor independence is another factor that may cause an audit to fail. While tracking and evaluating corporate activities is getting more and more challenging, the audit industry looks to be under tremendous competitive pressure to cut audit prices. There is also concern that market pressure may make auditor independence less strong. Accountants may be compelled to alter their opinions in unrelated circumstances in the war for clients in order to help the client and improve the financial health of a firm rather than risk losing the business.

### **Customer acceptance**

Before accepting to enter in to contract to audit, audit partners must decide whether to accept a client. According to reports, investment audit organisations work to reduce risks by eliminating riskier clients from their portfolios and adding new clients who are less risky than current recurring clients while adding new clients or renewing existing ones., according to Johnstone and Bedard (2004). However, there is no concrete evidence that links audit failure to client acceptance. Client acceptance is not connected to audit failure, claim Casterella, Jensen, and Knechel (2009)

### **Observation**

**Audit firms were solely subject to peer review for self-regulation for nearly 25 years.** Concerns regarding the efficacy of self-regulation have nonetheless been rekindled by the rise in well-known financial reporting failures at the beginning of the twenty-first century. A direct response to this issue was the Sarbanes-Oxley Act of 2002 (SOX). Public Company Accounting Oversight Board was introduced by SOX in place of self-regulation to ensure high-quality auditing reports (PCAOB). However, recent analysis of audit-firm supervision after the PCAOB started performing inspections does not support the notion that external monitoring has a positive impact on auditing (Lennox & Pittman, 2010b). They emphasise that audit customers do not believe that PCAOB oversight has greatly improved audit quality or served as a signaling tool.

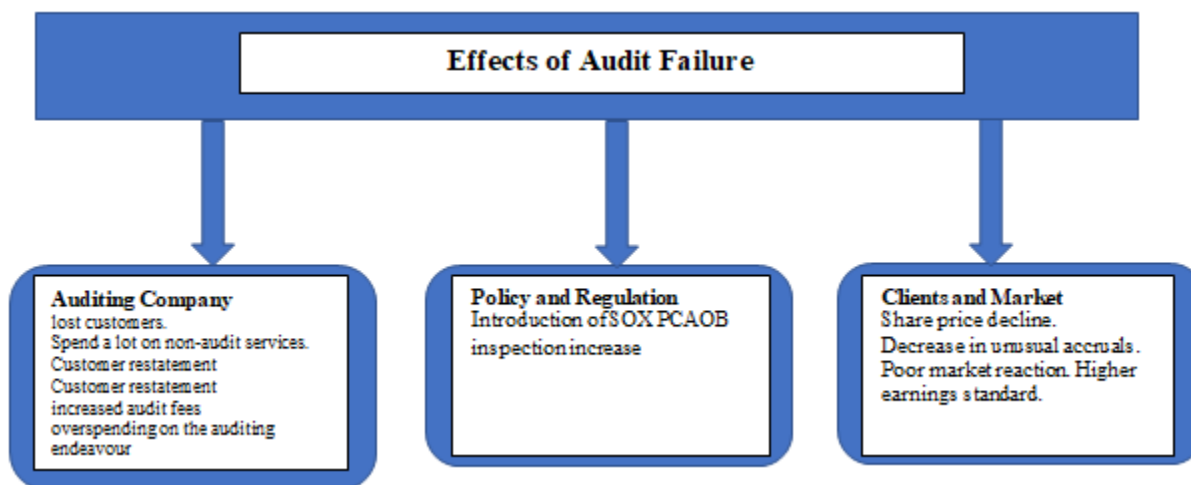
### **Corporate Governance**

Corporate governance is crucial in every sector. Corporate governance is the term used to describe a set of guidelines and rewards used to direct and regulate business management. As a result, good corporate governance boosts a company's revenue and overall value to shareholders. However, poor corporate governance can lead to fraud because of lax oversight. Additionally, there is a connection between weak corporate governance and accounting errors or fraud. The danger of an audit failing rises, according to Fuentes & Porcuna's (2019) research, when there is a greater likelihood of financial problems, the auditor is more amenable to upward earnings management, and the audit report is signed by a single auditor.



### Effects of an ineffective audit on the auditing firm

We talk about the effects of audit failure. This section is developed in three stages. The repercussions of an audit failure on the auditing company are covered in the first section. The impact of audit failure on policy and legislation is covered in the second section. The third section explores how audit failure affects customers and the market.



Failure of an audit has a bad impact for auditing businesses. We categorise the effects on auditing businesses into two categories based on prior research. The first is how it will affect the standing of an auditing business. The contagion effect is the second.

Research on the contagion effect and subpar audits is done by Francis and Michasin (2012). When evaluating audit failure, they consider downward restatements and the contagion impact. An occurrence that is unfavorable for one company can have a detrimental ripple impact on other businesses. Audit firms are included in this occurrence, according to their findings. A client restatement by an audit company increases the likelihood that another one may occur within the next few (up to five) years. On the other side, large organisations and those with extensive audit competence can mitigate this effect. According to our research, audit failure lowers value of the customer and the auditor's capacity to retain clients. There is more evidence that rising audit fees are a result of greater penalty for audit failure.

### The Effect of Audit Failure on Clients and the Market

By guaranteeing the accuracy of financial data and addressing any potential agency conflicts that may occur between business owners and external shareholders, Fan and Wong (2005) show that Big 4 audit companies provide a critical monitoring function in emerging economies. The auditors' reputation for client independence can be inferred from the quality of their audits, despite the fact that it cannot be seen. PwC India's reputation was probably harmed by the arrest of two of its partners in connection with the Satyam affair. The risk of financial statement falsification that would have overstated corporate assets and revenues was likely revised upward by outside shareholders of other Big 4 audit clients (i.e., clients other than Satyam).. This would cause market participants to lower their estimates of the future projected revenues of other PwC clients, which would support the idea that their equities saw abnormally negative returns following the arrest date. This supports the theory that, in comparison to other Big 4 client firms, PwC India's non-Satyam clients show greater negative anomalous returns following the arrest event period.

### PwC's Information Technology (IT) clients.

When the non-compete agreements pertaining to the sale of its consulting practise to IBM came to an end in October 2007, PwC promoted technology firms like Satyam as a strategic partner for systems integration engagements and a suggested choice for IT outsourcing due to the lucrative nature of the contracts. As a result of PwC's advice services, connections to IT service providers that serve as its technical resources, and audit clients, there may be possible conflicts of interest. This suggests that the agency costs are likely higher in the information technology industry, increasing the demand for audit services in this area of the economy, especially from PwC's audit clients..

### Predictions about auditor switch.

DeAngelo (1981) asserts that if PwC clients were "unhappy," they would "penalise" their auditors for allegedly breaking their obligation to provide the high level of confidence outlined in their audit contract.. This assumption may or may not be true. The reputational damage suffered by PwC as a result of the detention of its partners who were involved in the audit of

Satyam may have contributed to this notion. A client's motive to disengage the current auditor who she suspects of delivering an audit product of poorer quality must be weighed against the estimated cost of switching auditors. For instance, when several client companies need to hire new auditors, the expense of finding and engaging a new audit company comes into play. In addition, when the current auditor is moved and a new one is hired, there is a cost associated with losing the firm-specific audit experience (DeAngelo 1981). We think that PwC clients are more likely to switch auditors as a result of the arrest incident in.

#### **Forecasts regarding Audit Fee reductions**

Clients are compelled to switch auditors, as was previously mentioned, when their current auditors suffer a significant loss in reputation. The "tarnished" auditors, on the other hand, have an incentive to retain their clients by offering audit price reductions to them as a reward for doing business with them. This may be similar to instances where an auditor first "low-balled" clients on audit fees. DeAngelo was the one who first suggested that auditors might be persuaded to give cheaper initial audit engagement expenses in exchange for a contract (1981). In the context of Australian audit fees during the initial engagement, Francis (1984) gave evidence of low-balling. We presume the PwC office in India will employ underhanded strategies in order to avoid losing too much market share, we expect that PwC's Indian affiliate would reduce audit costs.

### **CONCLUSION**

Failure in an audit might result in significant costs for an audit firm. Impaired auditor reputation eventually makes it more difficult for the audit business to gain new clients or keep current ones (Wilson and Grmlund [1990]). Private companies that want to raise capital through an IPO tend to work with reputable auditors to reassure potential investors that the financial statements were prepared in compliance with GAAP. If the reputation of the audit business deteriorates, employees will look for work elsewhere. Prior to the Enron incident, fines and the expense of failed audits had been relatively low. The majority of the time, when an accounting firm settled a lawsuit, the settlement agreements were written in such a way that the auditing firm made no admissions. When an auditing firm settled a legal dispute, the settlements were typically written in such a way that the auditing firm made no admissions. In this article, we look at the expense of audit failure and the damage to PwC image that resulted from it in relation to various Enron saga dates. The information made public on these occasions paints a negative picture of PwC auditing practises and possibly of its reputation as well. We discover that PwC other clients saw a statistically unfavourable market reaction when they came to know the hand in glove relation with the organization which suggests that investors discounted the quality of the audits conducted by PwC. Whether the decline in reputation observed for PwC may spill over to other audit firms is yet to be determined, but clearly others are already worried.

### **SUGGESTED AREAS FOR FURTHER RESEARCH**

When the causes and effects of failure of audit were explored in the literature, numerous significant elements were determined to be pertinent.. Some studies claim that the economic cycle or the rule-checking mindset are the main reasons why audits fail. The literature also briefly discusses additional aspects of audit failure. Studies have concentrated on the consequences of failure of audit including how it impacts the auditing industry. how it affects the law and regulations, and how it affects consumers and markets. However, there are other important concerns that this literature review must address.

#### **Industry expertise**

The connection between audit failure and skill in the auditing sector has to be further investigated. When auditors initially contact a new company to be audited, they sometimes do not understand its distinct business activities, which makes it difficult to ensure the quality and efficiency of the audit. Unfortunately, there hasn't been much research done in this area. Future research should therefore be done in this area.

#### **Defects of professional ethics**

The demand for auditors has grown in response to the growth in corporations and businesses. In the auditing sector, this causes inconsistent professional ethics. Some CAs do not understand that they have economic responsibilities beyond generating revenue Others fail to adhere to the principle of independence with absolute rigour, while some of them accept the arguments put out by corporate management. They also lack the professional care necessary for audit work. The failure of an audit is clearly caused by a CA's lack of fundamental professional ethics. More evidence about this aspect may be found in future studies.

#### **Audit object and scope**

As the scope and audit object grow, so do the risk and likelihood of an audit failing. The accounting object approach gets more challenging as economic units continue to expand. The growth of the knowledge economy and information networks

has a particular impact on this, as well as the emergence of cognitively demanding industries similar to online and simulation businesses. The development of the types of entities being inspected as well as the corresponding audit material have both been made possible by the growth of virtual entities. Examples include audits of human resources, nonfinancial statement information, corporate mergers, and international businesses. Auditing has become more difficult and now has a higher risk of failing due to various expansions of the audit content.

### **Concluding Remark**

The effects of an audit failure are also covered in this review.. There are three key factors: 1) The auditing company will be impacted by a failed audit. 2) The spread of contagion. 3) The effect on the reputation of the auditing firm. We draw the conclusion that audit failure harms the reputation of the auditing firm with regard to the consequences on the reputation of the auditing company..

In terms of the contagion effect, a company's audit failure will hurt other businesses. Second, audit failure has an impact on policy and legislation. The government's response to audit failures serves as an example of how debates can result in changes to the law and public policy. Third, clients and the market are also impacted by audit failure. We can deduce from the PwC-Satyam case that an audit failure affects the audit firm's other clients. A distinct viewpoint is offered by research that highlights the difficulties in estimating the reputation effect using an event study with confounding variables. We conclude from our investigation that it is critical to understand audit failure. We must first comprehend the causes of audit failure in order to identify the proper fixes. It can also aid in the effort to counteract its consequences, such as reestablishing trust in auditing. If we fully comprehend this subject, we may also offer our own suggestions and remarks. But it's crucial to keep in mind that a literature review also serves as a comprehensive defence of the prior study, not just a summary of what is currently known about the subject. However, this assessment might not be stern enough.

### **INTRODUCTION OF THE COMPANY**



Under the PwC brand, PricewaterhouseCoopers is a global network of professional services companies that operate as partnerships. It is considered as one of the "Big Four" accounting firms, together with Deloitte, EY, and KPMG, and it has the second-largest professional services network in the world. In 1998, Coopers & Lybrand and Price Waterhouse amalgamated to form the business that exists today.

PwC's conducts business globally, with 36% of the total taking place in Europe and 44% in the Americas. PwC firms employ 284,000 individuals across 157 countries and 742 locations. The Americas had 26% of the workforce, Asia had 26%, Western Europe had 32%, and the Middle East and Africa had 5%. Global revenues for the corporation in FY 2019 totaled \$42.4 billion, of which \$14.4 billion from its Advisory practise, \$17.4 billion came from its Assurance profession, and \$10.7 billion from its Tax and Legal practice

PwC had 295,371 employees worldwide as of June 30, 2021. The regions with the highest employment rates include Western Europe, Asia, and the Americas. In addition to asset management, capital projects, and capital expenditures, PricewaterhouseCoopers (PwC) now provides services and expertise across 22 different industry sectors, including aerospace and defense, entertainment and media, government/public services, healthcare, pharmaceuticals, and life sciences. Even whistleblowing and anti-corruption services are provided by PwC. Despite the fact that these multinational accounting companies frequently market their services as "integrity warriors" whose goal is to uphold financial integrity and "good governance," their own financial practices.

Employees by....

as on 2020

Region		Practice		Level	
Region	Number of Employees	Practice area	Number of Employees	Staff type	Number of Employees
Americas	73,601	Assurance	116,890	Partners	11,897
Asia Pacific	98,876	Advisory	81,369	Directors	19,447
Europe, Middle East, and Africa	122,894	Tax	55,286	Managers	69,195
<b>Total</b>	<b>295,371</b>	Internal firm services	41,826	Associates	180,114
		<b>Total</b>	<b>295,371</b>	Interns and trainees	14,718
				<b>Total</b>	<b>295,371</b>

The following list of revenue according to regions

Region	Revenue (2018)
Americas	\$17.454 billion
Asia	\$5.675 billion
Australasia and Pacific	\$1.810 billion
Central and Eastern Europe	\$918 million
Western Europe	\$13.864 billion
Middle East and Africa	\$1.559 billion

#### In-line services

The two service lines that make up PwC are as follows: Security (41%). -Advisory (33%) - Actuarial and Insurance Management Solutions (AIMS) and a section of "Human Resource Services" are two PwC actuarial consultancy businesses that offer advisory services (HRS). The five main industries that actuarial covers are investments, pensions, life insurance, non-life insurance, health insurance, and non-life insurance. While AIMS manages investments and life and non-life insurance, HRS primarily focuses on pensions and group health. Additionally, PwC has expanded into advertising and digital media. International tax planning is 25% of tax.

#### PwC can bring data analysis to many different fields.

- Approximate size of the drone market: A 2016 PwC report predicted that by 2020, the drone market would be worth close to \$127 billion, with Poland setting the standard for regulations governing their commercial use.
- The G7 will be replaced by the E7, a group of seven emerging economies, by the year 2050, according to PwC. The other six emerging nations are China, Russia, India, Mexico, Indonesia, Turkey, and Brazil. • PwC evaluates a nation's risk premium, which is crucial when examining an entity's worth.
- The business examines pay equity, or the difference in salaries between men and women. In its Women in Work Index report published in early 2017, PwC discovered that the UK's gender wage gap might not be closed for another 24 years, or until 2041.
- • The Low Carbon Economy Index, which tracks how much the G20 nations are lowering their carbon emissions, is published by PwC.
- • PwC Portugal is engaged in a lengthy study project called The Economy of the Sea. The project HELM includes it. which was launched in 2006 with the objective of creating a comprehensive plan for successful and sustainable marine operations. It collects data from industries that rely on the sea as well as from nations that use it, and it also examines best practises from throughout the globe. Total Impact Measurement and Management (TIMM) is a methodology created by PwC to help businesses conduct impact assessments that will enable them to value all of their operations, goods, and services.

In addition to asset management, capital projects, and capital expenditures, PricewaterhouseCoopers (PwC) now provides services and expertise across 22 different industry sectors, including aerospace and defence, entertainment and media, government/public services, healthcare, pharmaceuticals, and life sciences. Even whistleblowing and anti-corruption services are provided by PwC. Despite the fact that these multinational accounting companies frequently market their services as "integrity warriors" whose goal is to uphold financial integrity and "good governance," their own financial procedures are anything from best practises.

### Recognition

PwC received a **Top Rating from Gartner in 2010** for Financial Consulting. PwC Brazil was placed **first in the audit category** on the list of **Brazil's Most Admired Companies** published by Carta Capital magazine in **2012**.

The **Malcolm Baldrige National Quality Award** was given to PwC's **Public Sector practice in 2014**. The business was named the **"Most Inclusive Employer of the Year" in 2015** by the **European Diversity Awards**.

PwC has consistently received all **five stars** on the **Business in the Community (BITC) Corporate Responsibility Index**, and in **2016**, it once more did so with a **score of 99%**. Only four professional services firms, including PwC, took this action.

One of the **top four places to work in advertising and media in 2016** was **PwC Digital Services Experience Center**, according to **Advertising Age**.

The **"Audit Innovation of the Year"** award was given to PwC by the **International Accounting Bulletin in 2016**.

The **Institute of Singapore Chartered Accountants' Best Practice Award** was presented to **PwC Singapore in 2016**.

According to **Brand Finance's annual index**, PwC was the **strongest business-to-business brand in 2016** and one of the **top 10 most powerful brands globally**.

In **DiversityInc's 2016 list of the Top 12 Companies for Global Diversity**, PwC came in **third place**.

**PwC India** won the **2016 Global Spotlight Award for Growth Strategies** from the **Association of Management Consulting Firms**.

For the **thirteenth year running**, PwC topped a survey of newly hired graduates to determine **The Times' list of the top 100 graduate employers for 2016**.

PwC received the **Market Leader Australia** title from the **Australian Financial Review Client Choice Awards in 2016 and 2017**.

PwC was included among the **500 most valuable brands in the world** by **Brand Finance in 2017**.

PwC is now ranked:

- **#5 on Forbes' list of the largest private companies in America**
- **#68 on their list of the most valuable brands in the world**

PwC US has been listed among **Fortune's 100 Best Companies to Work For** in the US for **16 years** as of **2020**.

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