Offshoring Audit Work in India Needs Improvement

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Absract: According to PwC Middle East, "An audit is the examination of the financial report of an organisation - as presented in the annual report - by someone independent of that organisation. The financial report includes a balance sheet, an income statement, a statement of changes in equity, a cash flow statement, and notes comprising a summary of significant accounting policies and other explanatory notes."(1) Audit can be of 2 types: Internal Auditing and External Auditing. Internal auditing is a department within the organization that provides independent assurance on the effectiveness of risk management, control and governance processes in an organization. External auditing is an independent examination done qualified auditors external to the organization of the financial statements prepared by the organization. Doing an audit has 3 key advantages. It helps achieve business objectives. Business processes that helps achieve business objectives needs right business process and IT controls to ensure its effectiveness in achieving the right output. An audit department is necessary in preventing debilitating misstatements in a company's records and financial reports. Any accounting irregularities and frauds can be detected by regularly monitoring the internal controls. Hence, auditing plays a crucial role in any organization ensuring that business is functioning as expected and business objectives are achieved.

***Keyword:** Accounting standards, Audit's status , Offshoring*

Introduction

Audit's status and where is it going "U.S. practice evolved since the late 19th century towards a process of collecting evidence as to assets and liabilities or what is frequently referred to as a balance sheet audit. As a result of extensive misleading financial reporting that contributed to the stock market crash of 1929.

The U.S. Securities Acts of 1933 and 1934 created the Securities and Exchange Commission (SEC), which regulated the major stock exchanges in the United States. These legislations greatly influenced auditing around the world.

"In the 1970s, a change in audit approach was observed from "verifying transaction in the books" to "relying on system". Such a change was due to the increase in the number of transactions which resulted from the continued growth in size and complexity of companies, where it was unlikely for auditors to play the role of verifying transactions. As a result, auditors in this period had placed much higher reliance on companies' internal control in their audit procedures. When internal control of the company was effective, auditors reduced the level of detailed substance testing.

In the early 1980 there was a readjustment in auditors' approaches where the assessment of internal control systems was found to be an expensive process and so auditors began to cut back their systems work and make greater use of analytical procedures. An extension of this was the development during the mid-1980s of risk-based auditing. Risk-based auditing is an audit approach where an auditor will focus on those areas which are more likely to contain errors.

"The early 2000s saw various accounting scandals like WorldCom, Enron, Tyco, etc. In response to the Enron fall Sarbanes-Oxley Act 2002, was passed, which brought various accountability provisions for both management and auditors. The Sarbanes-Oxley extended the duties of auditor to audit the adequacy of internal controls over financial reporting.

"Although the overall audit objectives in the present period remained the same, i.e. lending credibility to the financial statement, critical changes have been made to the audit practice as a result of the extensive reform in various countries.

"The accountancy profession, and the role of audit, have responded to an increasing pace of change in our society, economy and capital markets. The global economy is changing at an accelerating pace with new technology challenging traditional business models and an increasing concentration of economic power and wealth in the hands of very large corporations. Alongside this, the nature of value has evolved into a more multi-dimensional concept, including intangibles, societal and environmental factors as well as the traditional financial resources. And the audit firms themselves have been the subject of consolidation, meaning that in most markets globally 80 percent of the audits are conducted by the Big Four firms.

"Technological advancements give us tools to continue to improve the efficiency and effectiveness of audits in an increasingly complex business environment, but there is still a need for the professional evaluation, judgment and skepticism that auditors bring to the task.

The changes to the financial statement audit will be shaped by four factors: technology, methodology, standards and skills.

Technology

In our connected world, historical reporting is less relevant than real-time reporting. With the onset of the cloud, automation and data analytics, we are already moving down the path toward greater timeliness in financial reporting. The final stage — continuous monitoring and assurance — will benefit the public but require innovation to succeed.

Methodology

The increasing use of audit data analytics can transform financial statement audits and will be a key element of the transformative, data-driven audit methodology that will underpin a new, dynamic audit solution.

Standards

The Auditing Standards Board has recently prioritized certain standard-setting projects, with an eye toward technology and evolving practice, starting with the standard on audit evidence. Following on this work, the ASB will address auditing estimates, risk assessment, data analytics, quality control and professional skepticism. Without changes to the standards, innovative audit methodologies will be difficult to develop and execute.

New skills

As practice continues to evolve, auditors will increasingly need to draw on a broader range of skill sets, from information technology to data science to analytics. The demand for new assurance service lines, such as SOC for cybersecurity, will require expanded competencies.

Auditing in India

The Institute of Chartered Accountants of India (ICAI) is the governing body for audits in India, and is the premier professional accounting body in India. Only a member of ICAI can become an auditor. ICAI has set up an Auditing and Assurance Standard Board (AASB) to review auditing practices and procedures in India, and to develop a set of Auditing and Assurance Standards (which have since been renamed the Auditing, Review and Other Standards). These standards are designed with a view to bring out the best possible outcomes while also expressing an accurate view of the company's financial statements. All auditors in India must comply with these standards while performing an audit.

The provision of the cooling period is one of the major areas of concern that is addressed by the SOX Act. Section 206 of the SOX Act specifies that an accounting firm cannot perform an audit of a company "[i]f a chief executive officer, controller, chief financial officer, chief accounting officer, or any person serving in an equivalent position for the issuer, was employed by that registered independent public accounting firm and participated in any capacity in the audit of that issuer during the 1-year period preceding the date of the initiation of the audit." The SEC, while framing its Rule on "Conflicts of Interest Resulting from Employment Relationships" for implementing these provisions of the SOX Act, expanded the coverage of the cooling-off period from the four specified key officers named in the Act to any person in a "financial reporting oversight role." However, recognising the over-reaching nature of the laws, it narrowed down the application of the cooling period to only the lead partner, the concurring partner, and any other member of the audit engagement team body who provided ten or more hours of audit, review. and attestation services (SEC Rule 208-2).

There are some notable differences between the SEC Rule and the recommendations of the NCC Report. Under the NCC recommendations, the cooling-off period applies to not only the audit partners but also to all the members of the audit engagement team. In contrast, the SEC Rule is applicable only to the lead partner, the concurring partner, and to those members rendering ten or more hours of audit services (the assumption being that some minimum amount of participation is required for a member to have significant interaction with the management during the audit process). Secondly, under the NCC recommendation, the cooling-off period is applicable irrespective of the employment position that the former audit firm member takes up in the audit client, and is not restricted to positions with financial reporting and oversight roles as it is under the SEC Rule. Thirdly, the NCC recommendations apply not only to the members of the audit firm taking up positions in the audit client but also to the employees of the audit client taking up positions in the audit firm. Finally, the cooling-off period under the NCC is two years, while it is one year under the SEC Rule.

The first two recommendations of the NCC are perhaps too broad in their applicability and can be narrowed down to some extent. The major criterion in determining the applicability of the law should be the ability and the incentive of the members of the audit firm and the audit client to influence the effectiveness of the audit process. However, unlike the SEC Rule, the NCC recommendations that require the cooling-off period to also apply to employees of the audit client while joining the audit firm is a well thought-out move that recognises the reverse influence that former employees of the audit client can exercise when they are part of the audit engagement team. In this case as well, the scope of the recommendation can be narrowed down by making the law applicable only to the key officers of the audit client who are joining key positions in the audit firm. Thus, the ideal rule would be one that provides for a cooling period before the lead, concurring, or any significant member of the audit engagement team takes up a financial reporting oversight role in the audit client or before a person in a financial reporting oversight role in the audit client becomes a lead, concurring, or a significant member of the audit firm. The terms "significant audit member" could be defined based on the nature and duration of services of the audit member. The extent of the cooling period could be decided based on the norms and practices in other countries

Accounting Standards

For financial statements to have a true and fair view, it is essential that the statements are prepared in accordance with India's accounting standards. However, India's accounting standards are different from worldwide accepted International Accounting Standards (IAS) and International Financial Reports Standards (IFRS).

There are numerous subtleties between current Indian accounting standards and IAS/IFRS norms. As IFRS are accepted worldwide, it thus becomes difficult to make comparisons between Indian companies and their foreign counterparts. To overcome such difficulties, the new Indian Accounting Standards (Ind AS) have been prescribed and comply with IFRS. These standards were originally supposed to be applicable from April 1, 2011, but they are yet to be fully implemented. The new date of implementation of Ind AS is yet to be finalized, however general adherence to them is still recommended.

Offshoring challenges between Audit in India and USA

"Auditing of U.S. corporations' financial books, a vital underpinning of investor confidence, increasingly relies on work carried out in India, where there is no clear system of oversight.

U.S. audit regulators do not conduct regular physical inspections of offshore centers in India where U.S. audit work is performed, Indian accounting officials and employees of large audit firms told Reuters.

The U.S. arms of the Big Four audit firms - Deloitte Touche Tohmatsu Ltd, KPMG, PricewaterhouseCoopers and Ernst & Young Global Ltd - said that work handled by Indian employees is routine and systematically sent back for review to the United States.

But some audit firms are layering on more complex tasks in the offshore centers and Indian workers are rising to senior positions in the auditing ranks, said Big Four firm employees and others in the accounting industry in India.

Given the failures of U.S. auditors so alarmingly displayed in recent accounting problems - for instance, February's $2 million penalty against Ernst & Young over its past Medicis Pharmaceutical Corp audits - some experts said having more Indian auditors on the job may result in better audits.

Yet concern is growing that no coherent regulatory system exists to closely police the work in India, to gauge its quality, and to take action if problems should develop.

Crunching the Numbers

Auditing is labor-intensive. In offshore centers scattered from Mumbai to Bangalore, swarms of entry-level workers review piles of documents and cross-check numbers on balance sheets.

In India, many rookie accountants consider $10,000 a generous annual salary; their U.S. peers earn five times that.

Attracted by wage savings and Indians' command of English, the U.S. arms of the Big Four have opened offices or joint ventures in India and hired thousands of local workers to do a range of tasks, including tax, consulting and audit work.

PCAOB Chairman James Doty said offshoring helps large firms be efficient. He added: "We have to watch, to be alert for, when efficiency becomes an enemy of quality.

The firms said that their offshored audit work meets the same quality standards as work done in the United States.

Tough Sell for Some

There was some pushback in the United States within firms to some of this offshoring.

Communication was another concern. "It is tough to supervise on a remote basis," said Carmichael, the former PCAOB chief auditor.

No Pact with India

No country hosts more U.S. auditing work than India. No audit failures have been traced to offshore work there, and audit work done in India is routinely sent back to the United States where the PCAOB can review it. But there is no formal agreement on offshoring with India, which allows the PCAOB unfettered access to inspect audit firms.

The PCAOB's Indian counterpart, the Institute of Chartered Accountants of India, has no oversight of the Indian offshore centers doing audit work on U.S. companies' books.

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