

# Annual Transparency Report for Audit Firms- Will it make a difference?



**Dr. Ambrish Gupta**  
Former  
Sr. Professor-Finance &  
Accounting Area  
FORE School of  
Management

## Background

National Financial Reporting Authority (NFRA) issued an 'Invitation for Comments' (IFC) to Statutory Auditors of the NFRA Regulated Public Interest Entities (PIEs) on the subject of 'Publication of Annual Transparency Reports (ATR) by Auditors/Audit Firms' on 16<sup>th</sup> January, 2023. Rule 8(2) of the NFRA Rules 2018 empowers it to require an auditor to report on its governance practices and internal processes designed to:

- Promote audit quality,
- Protect its reputation and
- Reduce risks including risk of failure of the auditor

And may take such action on the report as may be necessary.

In accordance with Rule 8(2), NFRA considered it appropriate to prescribe publication of **Annual Transparency Report (ATR)** containing certain critical information about the auditor's:

- Operational activities,
- Management, governance and ownership structures, and
- Policies and procedures necessary to deliver high-quality audits etc.

This requirement of an ATR is stated to be implemented in a gradual manner across the audit profession engaged in the audit of PIEs falling within the purview of NFRA, starting with the auditors/audit firms performing audit of top 1000 listed companies (by market capitalisation) from the financial year ending 31 March 2023.

## Contents of ATR

Annexure to the IFC specifies the contents of the ATR:

### A. Description of the Statutory Auditor's

1. Legal Structure
2. Ownership
3. Management Structure
4. Governance Structure

### B. Details about the Network, if the Statutory Auditor is a member of any Network in India or Overseas

1. Description of the legal, operating structure and domicile of the Network
2. Whether the Network is subject to registration with

and oversight of any professional accountancy body or independent regulator, in India or overseas.

3. Nature of the activities and services rendered by the Network
4. Name, Domicile and legal and operating structure of the other Members of the Network operating in India and overseas and nature of their activities
5. Total Income of the Network and the source of this income.

### C. Details about the Working Alliances, Collaborations, Licensing Arrangements, Knowledge/Resource Sharing Arrangements, if any, of the Statutory Auditor with any third party or organisation, in India or International

1. Name and Domicile of the entity with whom the Statutory Auditor has any Working Alliances, Collaborations, Licensing Arrangements, Knowledge/Resource Sharing Arrangements
2. Nature and Details of the Alliances, Collaborations and other Arrangements.

### D. Details and Descriptions of the Statutory Auditor's Policy and Procedures in respect of the following areas. (Qualitative Commentary in this section should be supplemented by quantitative metrics)

1. Overall Internal Quality Control System
2. Monitoring and Ensuring Compliance with the Independence requirements for Independent Auditors
3. Acceptance and Continuation of Audit Clients
4. Audit Quality Control Mechanisms and Structures and its operating effectiveness
5. Brief description of Audit Methodology
6. Continuing Professional and Technical Education for all professional staff
7. Remuneration and Compensation of its Partners and Senior Staff
8. Transaction Pricing for Rendering Services to or Receiving Services among members of its network entities.
9. Date of the most recent internal review of its quality control mechanisms including compliance with Independence Requirements, results of this review and remedial actions to address the weaknesses and non-compliances, identified if any
10. Date of the most recent review of quality control system review by the NFRA.

### E. Name and identification number of the entities that are within the purview of NFRA and are audited by the Statutory Auditor and/or other members of its network, alliances and/or collaborations in India.

### F. Information about the total revenue of the Statutory Auditor and its network firms

## Focus Area

The requirements set out in para A, B, C, E and F are technical and administrative in nature. The real focus area is para D. It is through the reporting on para D items that quality of internal governance and audit quality mechanism prevalent in the audit firm could be gauged. It is however to be noted that reporting requirement has been left to the discretion of the audit firm. To make the ATR more effective individual detailed check –points should be specified so that a more concrete information network could be placed in force. The audit firms should be required to furnish pre-specified pointed information under each head of para D to improve the efficacy of the ATR. It should thus be standardised, say, on the lines of corporate governance report (CGR).

## Purpose: Auditing the Auditor

The IFC states, “Regulators have been prescribing obligations for PIEs to provide high-quality comprehensive financial and non-financial information commensurate with the nature, size and complexity of their operations to the various stakeholders. The role and responsibilities of the independent auditors of such entities have also evolved significantly with focus on the need to build commensurate professional and operating capabilities within the auditing profession. Audit professionals have been augmenting their capabilities and resources including building a network or alliances of firms, domestically and globally, developing in-house multi-disciplinary professionals or professional units, delivering variety of non-audit services, increasing use of digital audit tools and techniques, separating management and governance structures and so on”.

How transparently they have been doing this? To understand that an ATR by the auditors themselves is also required. It seems that requirement of ATR is akin to corporate governance report which the auditors audit and report upon. They have now to disclose their own CGR. It will be a good idea to get one audit firm’s ATR audited by another.

## International Scenario

As per the IFC, Regulators and Oversight Authorities in some overseas jurisdictions require audit firms carrying out audit of PIEs to prepare and publish information in the form of Transparency Reports on annual basis. Accordingly, the audit firms in those jurisdictions have been publishing the Transparency Reports. The IFC has given references of ‘Rule 13 of REGULATION (EU) No 537/2014 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 16 April 2014 (EU Audit Regulation 2014) and Section 322 of Corporations Act 2001, Australia and Schedule 7A of Corporations Regulations 2001, Australia to support its statement.

## PWC Transparency Report, 31<sup>st</sup> October 2022

The IFC has provided references to transparency reports of a few international auditing firms. One such is that of PWC (<https://www.pwc.com.pk/en/assets/document/Transparency%20Report%202022.pdf>). The PWC report claims, “The quality of our work is at the heart of the PwC network and we invest significant and increasing resources in the continuous enhancement of quality

across our network. This includes having a strong quality infrastructure supported by the right people, underlying tools and technology at both the network level and within our firm, and a continuous programme of innovation and investment in our technology. The PwC Network’s **Global Assurance Quality (GAQ) organisation** aims to support member firms in promoting, enabling, and continuously improving Assurance quality through effective policies, tools, guidance and systems used to further promote and monitor quality and to build an appropriate level of consistency in what we do. Each firm is responsible for utilising the resources provided by the network as part of our efforts to deliver quality to meet the expectations of our stakeholders”.

## PWC Tax Scandal

In the background of this tall claim it will be interesting to look at the early parts of the following article that appeared in ‘The Guardian’ on 31<sup>st</sup> May, 2023 ([PwC Australia scandal: what actually happened and will it be fatal for the advisory firm? | Australia news | The Guardian](#))

### The Guardian

#### PwC Australia scandal: what actually happened and will it be fatal for the advisory firm?

**The Australian affiliate of PricewaterhouseCoopers is subject to a police investigation in a crisis that could have global implications.**

PricewaterhouseCoopers’ public slogan is to “**build trust in society and solve important problems**”. But its embattled Australian affiliate breached that trust when it misused confidential government tax information for commercial gain, creating its own crisis that threatens to extend beyond national borders. While the scandal is Australia-centric, PwC used its global network to profit from privileged information, drawing in other parts of one of the world’s biggest professional services firms. Its admitted failings are now subject to a police investigation, and **governments around the world** will be taking note amid a growing reliance on private consultants to formulate public policy.

### What happened at PwC Australia?

In 2015, the now former PwC adviser Peter Collins, the international tax chief at the Australian affiliate, was helping the federal government design tougher multinational tax laws. Australia’s treasurer at the time, Joe Hockey, was concerned about the rise of opaque structures such as the “double Irish, Dutch sandwich” that involved sending profits through one Irish company, then to a Dutch company, and back to another Irish company in a tax haven.

Such schemes were particularly popular with US tech firms, including Google (which has said it no longer uses the loophole).

Collins, who had signed confidentiality agreements with the Australian government, fed intelligence on the government plans to PwC personnel both in Australia and abroad. The firm used that information to give more than a dozen US companies an early warning of the changes, netting additional fees and potentially

depriving Australia of tax revenue. The question of which colleagues received Collins' communications, and what they did with the information, would become a central part of future inquiries.

The structure of firms providing advice to government agencies on sensitive topics is also now under scrutiny. Unlike a pure advisory firm, PwC's practice of advising authorities on the design of tax laws, and creating tax arrangements for clients, creates a devastating conflict if not strictly managed.

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### **Will ATR Make a Difference?**

What do the tall PwC claims of Strong Quality Infrastructure & Global Assurance Quality (GAQ) Organisation on the one hand and the taxation scandal on the other by PwC

tell us? It tells that there seems to be no inter-connectivity between an audit firm's governance structure and frauds perpetrated by its functionaries. It is common knowledge that in a large number of corporate governance failures and consequent frauds of billions of dollars all over the globe, including India, top auditing firms have either been least diligent or connived with the management, and the phenomena continues unabated. Solution to this problem lies not in mandating the ATR but in self-governance of the highest order by the audit firms' functionaries. If they do not perform their work with utmost honesty, integrity and clear conscience the problem will continue perpetually. And the ATR will be reduced to a mere decorative piece of paper on the auditors' websites.

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The author may be reached at M:9810274067/ambrish.phd.ca@gmail.com