H3C | Haut Conseil du Commissariat aux Comptes

JOINT AUDIT IN FRANCE

1. INTRODUCTION

Joint audit is a process in which statutory audit is carried out jointly by two (or more) auditors.

Since 1966 joint audit is mandatory in France for listed entities. It was set up in response to significant deficiencies in audits of corporate reporting and in entities' governance. The objectives were to improve audit quality and auditor independence and thereby to increase financial security. The joint audit requirement was expanded in 1984 and 2003 to include companies that are required to prepare and establish consolidated financial statements, credit institutions, finance companies and investment companies and political parties.

The practice of joint audit evolved over time as guidance was provided by the prudential and market regulators, and by the audit regulator, H3C when established. This guidance was aimed to ensure a consistent application of certain requirements, in particular as an imbalance in the allocation of audit work between auditors had been observed in some cases, resulting in an ineffective application of the Law[1].

In addition to improving audit quality, auditor independence, and financial security, both the legislator and economic agents share the view that joint audit improves transparency and contributes to reducing market concentration.

Indeed the French market has seen significantly less high-profile fraud and accounting scandals than similar European markets, including in recent times when auditing standards have put a greater focus on audit quality controls and management. In H3C's view, this illustrates that several layers of effectively implemented controls contribute to ensuring good audit quality.

2. MAIN CHARACTERISTICS OF JOINT AUDIT

A joint audit means that the audit work is divided up between auditors. This requires joint auditors to work in a concerted manner on the preparation of the audit work to define and formalise jointly their audit approach, their audit plan and their audit work programme.

This necessitates that each auditor:

- Obtains an understanding of the entity and of its environment;
- Assesses the risks of material misstatements in the financial statements; and
- Determines materiality.

Joint auditors define in a concerted manner the allocation of the controls to be carried out between them, ensuring that the split of work is balanced. Qualitative criteria (experience of the members of the audit team, allocation of the work according to the organisation of the accounting and financial system of the audited person or entity, etc.) should be taken into account to assess the balance of the work entrusted to the joint auditors.

Regulators pay close attention to the allocation of audit work between joint auditors as too much imbalance renders the legal requirement ineffective. According to Opinion 2012-01 issued by the H3C,

[1] Professor Oliver Marnet (University of Southampton), notes that "The Danish Companies Act 1930 introduced joint liability of both auditors, without providing specific regulation on how the audit was to be shared and no apparent regulatory intervention or monitoring of actual fee distribution between the two audit teams, a decision left with the company that hires the auditors", and that "Thinggaard and Kietzner (2008) suggest that this lack of specification regularly resulted in a skewed share of the audit between the two auditors, with one firm typically taking on a dominant role, where one of the two audit firms received more than 80 percent of the audit fees in over half of the audits surveyed, a dominance further reflected in the share of non-audit services supplied to the audit client by the audit pair. Such dominance effectively undermines the ability of the (now) minor audit team to critically review the other team's work, may impede any positive effect on audit quality from reputational and liability concerns, and acts as a disincentive to capacity and capability building by the challenger firm. A main argument during the discussion that ultimately led to the abolishment of the joint audit requirement in 2005 was that the system was seen as a burden to Danish companies (Thinggaard and Kietzner, 2008), reflecting a frequent argument elsewhere that joint audit inherently increases fees and bureaucratic overhead (Neveling, 2006)." Source: Joint audit and audit quality – An independent review by Dr. Oliver Marnet – August 2021.

a split of the volume of hours allocated to each auditor and of the amount of total fees, within a 60%-40% ratio, leads to a simple presumption of a balanced distribution of work. An allocation of the volume of hours and/or the amount of total fees that exceeds a 70%-30% ratio leads to a presumption of an unbalanced allocation of work.

In a coordinated discussion between the joint auditors and with the audited entity, the allocation of audit work is regularly adjusted to ensure that each joint auditor has a comprehensive understanding of the audited entity's activities and of its control processes throughout the engagement.

The French Commercial Code provides that joint auditors "carry out together a contradictory examination of the conditions and procedures for drawing up the accounts". This means that each auditor performs its share of the audit work, reviews the audit procedures performed by the other joint auditor, evaluates the audit evidence collected and the conclusions reached by the other joint auditor (the so-called "cross review"). Key audit issues are analysed jointly by the auditors and discussed jointly with the audited entity management and its governance bodies.

After finalisation of the audit work, joint auditors provide a joint opinion on the financial statements of the audited entity. When the joint auditors disagree on the audit opinion, the audit report reports in a transparent manner the divergent opinions.

A standard, NEP 100[2], sets the requirements for performing an audit jointly.

On the basis of what is described above, joint audit favours professional scepticism, and reduces the risk of excessive familiarity that may exist between a single auditor and the management or the governing body of the audited entity.

3. JOINT AUDIT AND AUDIT MARKET STRUCTURE

Joint audit has a positive impact on the structure of the French audit market. It contributes to a lower level of market concentration. Joint audit allows mid-tier and smaller audit firms to access significant parts of the PIE market, in particular that of listed entities.

France has maintained a high number of audit firms on the PIE market. Six audit firms are involved in the audit of the 35 French entities from the CAC40 index. 15 additional audit firms are involved in the audit of the 118 French companies included in the SBF 120 index. About 250 audit firms are involved in the audit of PIE.

During the Joint Audit Day, an event organised by H3C in November 2021[3], the audience was told by one of the participants that it was very unlikely that HSBC would be able to rotate its auditor due to the market concentration in the UK, to the global footprint of the group which requires an equivalent footprint from its auditor, and to advisory services rendered by the other Big-4 which make them ineligible to becoming the group's new auditor. Based on the state of the audit market in France, H3C observes that joint audit allows second-tier firms to develop their expertise in highly specialised markets which contributes to increasing competition in the market, resulting in improved independence from audit clients and better audit quality.

4. FREQUENTLY ASKED QUESTIONS ABOUT JOINT AUDIT

1. Is really joint audit more expensive?

Empirical evidence from numerous academic studies on the cost of joint audit has been inconclusive. While some investigations suggest lower costs from joint audit, others point to higher costs, without agreement on magnitude or persistence, at times highlighting perceived increases in audit quality as a possible cause for higher fees.

Joint audit does not mean that audit work is done twice. As mentioned in paragraph II. above, joint auditors define in a concerted manner the allocation of the controls to be carried out between them and carry out a contradictory examination of their respective work files ("cross-review"). Bearing this in mind, an increase in the cost is to be expected as a result of adopting joint auditing, however this increase should be limited. Some sources assess the additional cost relating to joint audit at 10%, others sources assess that it could reach up to 30%. H3C is of the view that such a cost increase, if observed in the above-mentioned ranges, is the counterparty to increased audit quality and financial security.

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[2] NEP: « Norme d'Exercice Professionnel » or Professional standard (for auditing).

[3] Link to the replay of this event on YouTube: **https://www.youtube.com/watch?v=kcm59Ok8dcU**

2. Why do the "Big -4" have such a large market share in the French audit market in terms of fees?

In 2018, the market share of each of the five largest networks ("Big-4" plus Mazars) was between 13.6% and 22.3% of PIEs audit fees, totalling 88%.

The French market is characterised by numerous highly globalised listed groups which in turn appoint auditors with a global footprint. The audit of these groups is procuring high audit fees to their auditors. The concentration of audit fees on the Big-4 and on Mazars stems from these characteristics.

3. Does the fact that the H3C has findings related to cross review in their inspections means that joint audit does not lead to better audit quality?

As the opinion on the financial statements of the audit entity is a joint opinion, there is a requirement that the audit files of both auditors document that each joint auditor has obtained an understanding of the entity and of its environment, assessed the risks of material misstatements, is satisfied with the conclusions stemming from the work of the other joint auditor and with the way the other joint auditor has assessed materiality in forming its opinion ("cross review"). The French audit regulator's inspections are following a risk-based approach, which conducts to inspected audits being often joint audits. The focus during inspections on the cross review is to ensure that this audit procedure, which is central to joint audit (and central to an effective application of the Law), has been appropriately conducted.

4. In case one of the joint auditors fails to meet the auditing standards requirements how will joint auditors' liability apply in France?

In case auditing standards requirements related to joint auditing are not complied with, like any failure in the professional practice, the auditors may incur disciplinary, civil or administrative liability.

The civil liability of joint auditors is, in accordance with the general principles of French civil law, an individual liability which purpose is to repair a damage. It is incurred when the joint auditor has committed a fault which has caused damage to another person, the client or a third party. With regard to the opinion given by the joint auditors in a joint report, unless there is a difference of opinion expressed in the report, even if each is personally liable for his or her own professional faults or failures, they are deemed to have the same opinion. Therefore each can be found to have committed the same fault, and if it appears that the fault committed contributed to the damage, they shall be condemned severally. Several liability allows the victim to claim full compensation for the damage from the joint auditor of his / her choice. The one who has paid the totality has a recourse against the other to be reimbursed the part paid on his behalf. The civil liability insurance taken out by professionals covers this risk.

The disciplinary liability of joint auditors is also an individual liability. The purpose is to sanction disciplinary faults (failure to comply with the legal conditions for exercising the profession, serious negligence or acts contrary to probity or honour). The fault of each joint auditor is assessed independently. Disciplinary sanctions are personal sanctions, even if two joint auditors could be sanctioned for having committed the same fault in the exercise of their duties.

The administrative sanctions that the French financial markets regulator, AMF, may impose on auditors in certain cases are also personal sanctions.

5. Is there convincing evidence that joint audit improves audit quality?

Assessing audit quality thanks to measurable indicators is quite a challenge. Academic studies have tried to establish if there is a relationship between joint audit and abnormal accruals in the financial reporting of the entity. There is debate about the results of this line of research.

Another way to assess the impact of joint audit on quality is to consider whether joint audit has contributed to identifying financial reporting issues or fraud. One can note that even if the French financial markets have experienced corporate failures because of inappropriate corporate governance, no major listed entity suffered from a fraud leading to the entity's bankruptcy. On the contrary, several cases[4] were reported where financial reporting issues or management fraudulent activities were discovered thanks to the presence of two auditors rather than just one.

[4] For instance, Vivendi Universal and Marionnaud.

Another line of research has been investigating behavioural patterns. Professor Marnet notes that "joint audits can provide beneficial synergy including higher scepticism, higher accountability, bias mitigation […], peer consultation and review, and, overall, higher joint expertise […]. We suggest that joint audits can also contribute to enhancing audit quality by reducing auditor dependence." Professor Marnet further notes that "bias mitigation from appropriately designed joint audit arrangements has the potential to allow for a more consistent application of an appropriate level of professional scepticism, a characteristic of critical importance to audit quality."

6. Is joint audit applied in other jurisdictions?

IFAC estimates[5] there are as many as 55 jurisdictions where joint audits occur.

- The majority (70%), either permit joint audits (in 22 jurisdictions, an audited company voluntarily elects a joint audit engagement) or require its use under OHADA[6] requirements (17 jurisdictions).
- France is the largest economy to require joint audits for all listed companies (since 1984) that prepare consolidated financial statements.
- Denmark required joint audits for all listed companies from 1930 to 2005.
- Countries that require joint audits for entities in specific industries or sectors include Bulgaria, Dominican Republic, Egypt, India, Liberia, Saudi Arabia and South Africa.

7. Are there specific challenges with the implementation of joint auditing?

Experience shows that where specific expertise of auditors is needed, for example in the banking and insurance sectors, the appointment of joint auditors may be quite a challenge if the process is not correctly anticipated by the audited entity. However, joint audit also represents an opportunity to build capacity for smaller audit firms to enlarge their expertise and as such to provide more choice for the audited entities.

For entities with a European footprint, the options that the 2014 Directive and Regulation have left open to Member States may be a source of difficulties for joint auditors in particular due to differing audit engagement durations. H3C observes that a longer engagement duration increases the auditor's independence as the audit client cannot dismiss an auditor which would have raised significant concerns with decisions taken by its audit client. Such a longer duration also allows an incoming auditor to spread over time the additional audit costs incurred in the first year of the engagement. However, for groups with subsidiaries in different countries the variety of audit engagement durations adopted by the Member States makes it more difficult to change the allocation of audit work between the joint auditors.

[5] IFAC-Joint-Audit-The-Bottom-Line.pdf

[6] OHADA is a system of corporate law adopted by 17 African nations in 1993. Most participants are francophone countries and are understood to require joint audit—as is the case in France. (Source: IFAC)