

UNIVERSIDAD ESAN



Policies that cushion the dimension of pressures on independent auditor – Evidence from France

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**Gieme German Carhuapoma CHacón
Cod. 1700999**

Advisor: Professor Joshua O. Imoniana

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EXECUTIVE SUMMARY

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Autor: Gieme Germán Carhuapoma Chacón

This study provides an interpretative analysis of the different policies implemented by French companies to mitigate the dimensions of pressures faced by auditors. Given the role of the auditors, who provide reasonableness of the financial statements and given the financial scandals in which they have been involved, ensuring the independence of the auditor has gained renewed attention (Piot and Janin, 2004)

Many studies are based on the American market (Hottegindre and Lesage, 2009). Enron, leading commodities and Services Company with revenues of US \$ 101 billion in 2000, was declared bankrupt in 2001. Arthur Andersen, considered one of the largest audit firms at the time, (Cunningham and Harris, 2006) was dissolved in 2002. Consequently, regulations were created such as the Sarbanes-Oxley Law, designed to oversee the financial reporting landscape and to protect investor by improving the auditor's independence.

In Europe, there were also fraud cases such as the Royal Ahold, a Dutch company, considered the third largest food retailers in the world (Knapp M and Knapp C, 2007). Through economic incentives and bonuses offered to its managers, Royal Ahold, increased its sales creating a fraud environment. Initially its Deloitte auditors identified the fraud, but were persuaded not to disclose information for years until finally it was published in 2013.

The other example was Parmalat, one of the financial scandals that shook the European market, Parmalat invented assets to offset debt for more than 16 million dollars, falsifying information for more than 15 years (Prat Dit Hauret C and Komarev I, 2005). According to Roberts, et al. (2004), the responsibility for the Parmalat bankruptcy was in part due to the audit firms Grant Thornton and Deloitte&Touche, which were its auditors. However, in January 2004, Price Waterhouse Copper discovered the bad management and practices. According to Roberts et al. (2004), it cannot determine the degree of participation of auditors and that is why Prat Dit and

Komarerev I, (2005), mentions the importance of the application of Sarbanes-Oxley - regulations, which were highly criticized by the European government.

Specifically in France, in October 2018, the holding company Rallye, which owns the well-known French company Casino, has been accused of manipulating its financial statements in order to maintain unchanged Casino's market capitalization recorded in its books of account. Because of the aforementioned and financial scandals of Enron and Worldcom, which strongly shake the investor's confidence in the transparency of financial statement, the French financial Law called "Loi de Sécurité Financier (LSF) was enacted on August 2003, in r

esponse to the crisis in lack of trust. According to Cappelletti, (2004), the LSF based on the reliability of the information depends on the company's internal controls.

The increased importance to understand the different pressures that auditors face to improve the quality of financial statements is indirectly reinforced through legislation such as Sarbanes Oxley Law. Despite that it is an American initiative, it greatly influences the practices and changes in the French structure. French entities were alarmed by the cases of American financial frauds such as Enron and WorldCom (Baker, et al 2014). The main objective was to generate confidence in the French market. Since the French auditing profession is highly regulated, and taking into account that changes in governmental structures is not part of French culture (Hofstede, 2000). The Law N° 2003-706 dated 1 August 2013 (LFR) was created, with three fundamental changes. The latter are: the creation of an external regulator for the audit profession (HC3), strengthening the independence policies in the auditor, and the creation of new powers for the Garde des Sceaux (Ministry of Justice). This in turn, would suggest that the pressures faced by the auditors are moderately controlled by legislation. However, it also suggests that there are other factors that have not yet been studied, mainly during the entire audit process. Those factors would expand from the initial negotiation between the audit firms and the companies, called the costs and coverage (Gul, 1991). Examples of pressures in negotiation may be the complexity to understand the business, the delays in receiving the documentation and the final negotiation to get the handed out the Final Audit Report.

The remainder of this paper is structured as follows. First, a brief overview of the underlying gap and research objective. Second, the background literature and the proposition given on main theories, that is an analysis of the social factors that influence the independence of the auditor, as well as an analysis of the sources of pressures that auditors face in French companies. Third, the outlines of the research method used, followed by the results of the study and the analysis of the results in phase of to the theoretical position. Finally, this study presents the conclusions.