

THE INTERNATIONAL JOURNAL OF BUSINESS & MANAGEMENT

Legal Aspect of the Auditing Profession: From the Antiquity to the Financial Security

Dr. Jamel Azibi

Assistant Professor, Department of Accounting, Arab East for Graduate Studies, KSA
Faculty of Law Sciences, Economics and Management of Jendouba, Tunisia
Member of Life, El-Manar University Tunisia and Lirsa Cnam, Paris, France

Amri Hanen

Doctoral Student (Private Law), Department of Law and Political Sciences,
Faculty of Tunis, Tunis El-Manar University, Tunisia

Hamza Azibi

Doctoral Student, Department of Management,
Faculty of Economics Sciences and Management of Tunis. Tunis El-Manar University, Tunisia

Hubert Tondeur

Professor of Accounting, Cnam-Intec, Paris, France

Abstract:

The series of the financial scandals of 2001 accelerated the adoption of the most important reform in the audit profession since 1934. The aim of these laws is to improve the financial security and regain the investor confidence. One of these new rules is to reformulate the audit profession. The purpose of this paper is to study the development of the audit profession in France after the adoption of the security law act (Loi de la sécurité financière) in 2003.

Keywords: Audit history, Financial Security Act, H3C.

1. Introduction

The analyses of the audit market demonstrate that the audit quality is associated positively to the Big Four auditor. DeAngelo (1981) define this notion as “the probability that the auditor will both detect and report a breach in the contract to provide fair accounting information”. This is due to their competence and their independence (DeAngelo, 1981). Other researches demonstrate that the audit quality is related to the office size (Becker et al. 1998). But the scandal series of 2001 to 2003 demonstrate the implication of the Big networks in the most popular scandals series. According to the SEC, the Enron scandal has generated losses more than 300 million dollars.

Since the Enron failure, the stakeholders are increasingly interested to the financial transparency. An important number of studies in relationship with corporate governance were appeared after this date. The role of the Arthur Andersen in Enron failure was determinant. For this reason, the new law focus on the corporate governance mechanisms. The financial auditing is one of these mechanisms. To restore the financial market confidence, the security law act developed new rules in accordance with the main principal objective of the audit. In sum, these new rules seek to define new audit procedures and search to guarantee the independence of auditors.

To restore the financial confidence on the US market, the Congress adopted the Sarbanes-Oxley Act in 2003. This security act has established a new rule and especially in audit profession. The most important reform of this security act is the creation of the Public Company Accounting Oversight Board (PCAOB). This new authority seeks to guarantee the auditor independence. In France, the parliament established a similar act on the financial security in 2003. This new act created the new organism like PCAOB entitled “*Haut Conseil Commissariat aux Comptes: H3C*”. The mission of this new authority in France is to ensure the auditor independence through the series of audit inspection and other different procedures.

The aim of this research is to focus on the development of the audit profession after the adoption of the Law security act in 2003 in France. The remainder of this paper is organized as follows: Section 2 the audit history. Section 3 treats the legal approach of the development of the audit profession in France, and Section 4 the conclusion.

2. A Brief History of the Audit

The auditing appeared in with the early civilizations. The experience of Sumerians, Egyptian, Greek and Roman empires support this hypothesis (Flesher, 2005). The publication of the book of Lucca Pacciolo (1445-1523) in 1494 is the important contribution to

establish inventories. In France, the Colbert Ordinance of 1696 imposed an inventory every two years. The aim of this procedure is to reconstruct the assets for the corporation in the event of bankruptcy.

The industrial revolution in 1835 and the development of the firms and the financial market accelerated the adoption of the *British Companies Act* in 1845. This law established new rules and obliged the administrators of England companies to present audited balance sheets (Littleton, 1933). This is a fundamental determinant of the creation of the Society of Accountants in Edinburgh in 1853. The flow of British financial investment in the United States explains the transfer of the audit knowledge. The detection of the fraud is the new dimension of the audit profession at this moment (Brewster, 2003). In his book entitled *Auditor's Guide* published in 1869, J.H. Mettenheimer describes the audit practice introduced in the railways firms in Britain. In 1875, the audit profession became an independent function in United Kingdom. After four years, a new dimension has been given to the profession. The auditing has become a mandatory for banks. In 1880, the Institute of Chartered Accountants (ICAEW) was founded. After one year, the Society of Accounting (*Société de Comptabilité*) was created in France. In 1885, the Society of Incorporated Accountants and Auditors was established in the United Kingdom. Under the influence of UK, the American Association of Public Accountants was created in 1887. In 1890, the modern audit methods appeared in England. For the first time, the audit use samples and examination of the organization of companies according to the internal control procedures. In 1900, the Companies Act in the UK introduced the requirement for an annual audit, accompanied by an annual report confirming the fair view on the financial statements. In the same year, the certification of banks' balance sheets was mandatory and is the essential work of Certified Public Accounting in the United States.

In France, the Neymarck parliamentary committee rejected the idea of common an accounting plan in 1902. Nine years later, the *Compagnie des Experts Comptables* de Paris was created. After two rejected proposals (Fleury-Ravarin and Chastenet), the certificate of accounting expert is recognized by the French State. In 1930, the proposal of Daladier on the permanence of disclosure, the evaluation of the different element of the Balance sheet and the reform of the accounting profession is presented to the National Assembly. Two years later, Senator Lesache's proposal to improve the disclosure to shareholders and their control by the auditors was submitted to the National Assembly, but was not followed up. 1942 was marked by two major events: the adoption of an accounting plan and the creation of the Order of Chartered Accountants. Seven years later, the Superior Council of Accounting was established. And it was in 1967 that the Ordinance creating the COB, and subsequently the AMF, appeared.

3. Audit profession: the legal aspect

3.1. In France

The sources of standardization of the audit are different from countries to another. In France, the *Compagnie Nationale des Commissaires aux Comptes (CNCC)* et *l'Ordre des Experts-Comptables (OEC)* are two different organizations. The first group certify the financial statement. It's under the ministry of the Budget. The second group is responsible on the supervision and the preparation of the financial statements in the companies. It's under the Ministry of Justice.

In France, the profession of certified public account is subject to strict rules. Each auditor must be registered on a special list. He must be of French nationality or have a nationality of one country of European Union (Ramirez, 2003). He must respect all conditions set by the legislative authorities, in collaboration with the Ministry of Higher Education. It is possible that the French auditing firms taking a company form. In this case, 3/4 of the capital must be held by certified public account.

The main mission of the statutory auditor is to certify that the annual financial statement in accordance with current regulations. The CPA plays an important role in relation with the Financial Market Authority. The French law and the ethics code require that the mandate is in the order of six years. He must retain his independence, his competence and avoids any situation of conflict of interest (Code of Ethics, Article 5, 6, 7, 2005).

Each company must appoint a substitute auditor. His mission is to replace the incumbent auditors in the event of refusal or resignation or death of one of them (Financial Security Act, 2003, Statutory Auditors' Code of Conduct, 2005). It is useful to note that the appointment of French auditors is made by the general meeting of shareholders on the proposal of the directors for six renewable. Several activities are classified as incompatible with the profession of auditor. The French law describes as an incompatible activity any element that affects negatively the independence of the auditors.

In 2006, the key statistics published by the *Compagnie Nationale des Commissaires aux Comptes* in France show the strong growth of this profession. The turnover of companies audited in France represents nearly 1,500 billion euros. More than 15,000 professionals, 4,500 are presented by public limited companies belong to the CAP Board (CNCC, 2007).

After the financial scandals of 2001, the Financial Security Act of 2003 in France established a new authority entitled H3C (*Haut Conseil du Commissariat aux Comptes*). This new organization ensures the independence of the auditors and must sanction audit professionals in case of breaches of the audit rules.

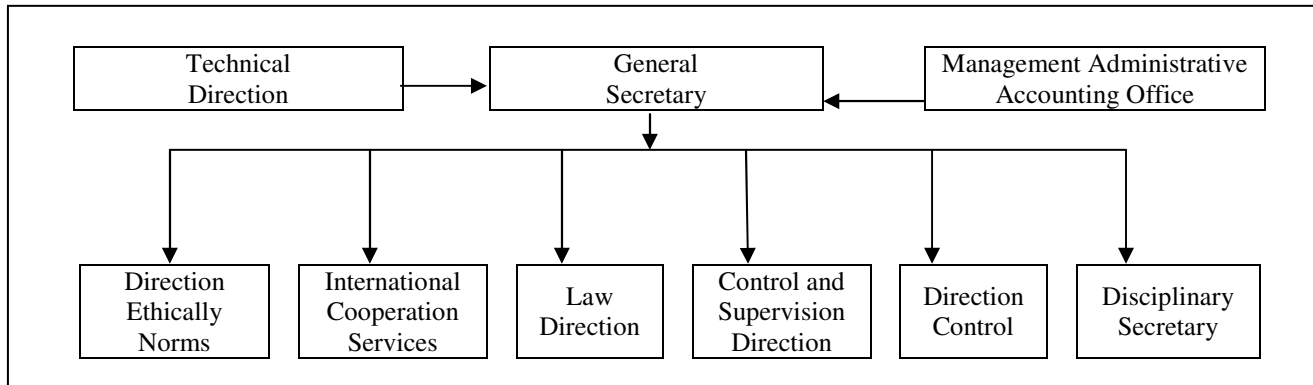


Figure 1: The organization of the H3C

Services directed by the general secretary that several decisions were made to meet the mission of the authority.

- Technical direction: assure the coordination on the specific topic
- Norms and ethics direction: investigation and consultation on the relativity practice and doctrine;
- Services of international cooperation: established the partnership with the foreign supervisory authority;
- Law direction: responsible for the law auditor control and the role of the authority;
- Direction of the supervision and control: Guides the control activity. They supervise the control realized by the professional instance. They elaborate the recommendation on the control.
- Control direction: control the auditors in the public corporation.

3.2. In Forgien Countries

In the United States, listed companies are required to submit their annual reports to the Security Exchange Commission in the form of 10-k for annual reports and 10-Q for quarterly statements. All investors have online access to all annual reports. The Security Exchange Commission is responsible on enforcing rules and sanctions for auditors and managers in case of fraud or violation of rules (Bush et al., 2007). Audit firms have a duty to register with the SEC.

In 2002, the US Financial Security Act, known under the acronym SOX (Sarbanes-Oxley Act), established a new auditing and auditing agency called the Public Company Accounting Oversight Board. This organization is funded by the SEC.

The objective of the audit in the United States is to detect and prevent fraud in the financial statements (PCAOB, 2004). His mission is to ensure that financial statement disclosed in confirmation to generally accepted standards. At this level, we conclude that the credibility of the financial statements is the primary objective (Lee, 1979, Edwards et al., 1999). The mandate of the statutory auditors in the United States is only for one year renewable.

In UK, listed companies must submit their annual reports to the Financial Services Authority and to all shareholders. The Financial Services Authority is responsible for the regulation of London Financial Market, while the Financial Reporting Council (FRC) is responsible for the accounting and auditing standards which including the auditor independence. The mandate of the legal auditor in UK is the same as in the US (Compagnies Act, 1985; Sec. 384).

In Germany, auditing focuses on the legal aspect. The priority gives to tax administration. The appointment of auditors in Germany is ensured by the shareholders. In Belgium, the auditor is chosen by the managers and must be submitted to the board of directors before his proposal to the general meeting of shareholders. The designation of the auditor is for three years, whereas in the Netherlands the duration of the assignment remains indeterminate.

In Greece, the 8th European Directive has influenced auditing practices in this country. According to the Companies Act (Article 36, paragraph 1) the corporation must be audited by two auditors in order to approve the true and fair view of the firms (Ballas, 1999).

In the Czech Republic, the audit developed after the Velvet revolution and the separation between the Czech Republic and Slovakia. The Czech government has put a legislative measure to privatize the economy and integrate the European Union after the adoption of the open market economy. The role of private and institutional investors is becoming increasingly important. This change affected the commercial code and the accounting rules. An audit law was promulgated in 1992, but it did not specify the procedures of appointing auditors (Bychkova, 1996).

In Europe, the Treaty of the 8th Directive responded to questions concerning the status of statutory auditors and their assignments in member countries. The aim of this 8th directive is to r harmonize the accounting practice and auditing rules. This directive requires that the auditors acquire the legal and professional expertise in accounting and auditing. This new directive obliges the states members to adopt the ethics principles of the International Federation of Accountants (IFAC), the liberalization of the capital of audit firms, the strengthening of the independence rules of independence, the establishment of national oversight organization to ensure the control quality (8th European Directive, 2006).

4. Conclusion

During the last ten years, the audit profession was developed significantly. This is due to the financial scandal series in US context and other countries at the end of 2001. Several previous studies show that financial markets reacted negatively following the announcement of these various scandals. To restore this confidence on the financial market, a new organization authority was

established to control audit quality and auditor independence. In the United States, the Public Companies Accounting Oversight Board is in charge of this mission, whereas in France it is entrusted to the H3C. The impact of the new audit reform on control processes is a new dimension of the audit research.

5. References

- i. 8th European Directive, 2006.
- ii. Ballas, A, «Privatizing the statutory auditing services in Greece. Accounting, Business and Financial History, Vol.9, n°3, 1999, p.349-74.
- iii. Becker, C., Defond, M., Jiambalvo, J., and Subramanyam, K.R, «The effect of audit quality on earnings management», Contemporary accounting research, Vol.15, n°1, 1998, p.1-24.
- iv. Brewster, M, «Unaccountable: How the accounting profession fortified a public trust». John Wiley & Sons, 2003.
- v. British Companies Act, 1985.
- vi. Bychkova. S., (1999). «The development and status of auditing in Russia», The European Accounting Review, Vol.5, n°1, 1996, p. 77 – 90.
- vii. Code de déontologie, 2005.
- viii. DeAngelo, L, «Auditor size and audit quality», Journal of Accounting and Economics, Vol. 3, n° 3, 1981, p.1983-1999.
- ix. Edwards et al, 1999
- x. Flesher D.L, Previt G.J and Samson W.D, «Auditing in the United States: a Historical Perspective», Abacus, Vol.41, n°1, 2005, p.2-21.
- xi. Lee 1979
- xii. Littleton, A.C, «Accounting Evolution to 1900», 1933, Garland, New York.
- xiii. Loi de la sécurité financière en France, 2003.
- xiv. McConnell Jr Donald K et Banks George Y, «A Common Peer Review Problem», Journal of Accountancy, Vol. 185, n°6, 1998, p.39-44.
- xv. Public Companies Accounting Oversight Board, 2004.
- xvi. RAMIREZ, C, «Du commissariat aux comptes à l'audit. Les BIG 4 et la profession comptable depuis 1970 ». Le Seuil Actes de la recherche en sciences, 2003, p.62-79.