The case for joint audit

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The case for joint audit
What is a joint audit?

Joint audit is a well-known and experienced regime in 55 jurisdictions around the world

- Joint audit is neither a new nor a specifically French regime: it has been tested on 3 continents for almost a century.
- According to the IFAC, in 2021, joint audits took place in 55 jurisdictions, either on a voluntary (22 countries) or mandatory (33 countries) basis. France is the largest economy to require joint audits for all listed companies with consolidated financial statements (since 1984). Joint audits are required for entities in specific industries or sectors in 33 other countries. Joint audit has been abandoned as a mandatory regime in only 2 jurisdictions: Canada (1991) and Denmark (2005).
- Whilst mandatory joint audit was removed in Denmark in 2005, some firms voluntarily continue with joint audits (16 of 64 Danish PIEs in 2011 completed joint audits): ***"Clients intention to appoint two different audit firms in a (voluntary) joint audit setting may be explained by signalling a higher level of audit quality to the market."*****

- In the EU, joint audit is mandatory in 3 countries and incentivised in 10 countries:
  - According to the latest EU data**, in these countries, **the joint audit rate has increased significatively (+15%) since 2013 in the financial services sector, and slightly (about 2%) across the full audit market**.
  - in 2017, 20 Member States had at least one PIE client engaged in a joint audit, and **the average percentage of PIE joint audits in the EU was 9.1%** (excluding France).

***** Lesage C., Ratzinger-Sakel N., V.S. Kettunen, Jaana M, Is Joint Audit Bad or Good? Efficiency Perspective Evidence from Three European Countries (November 28, 2011. CAAA Annual Conference, 2012)

** European Parliament Study, *Statutory Audit Reform: Impact on costs, concentration and competition,* 2019

The case for joint audit
How does a joint audit work?

What are the main features of a joint audit?

An audit of an entity by two (or more) auditors to produce a single audit report.

Audit planning is performed jointly and fieldwork is allocated between auditors to avoid duplication.

The work performed by each auditor is subject to a cross-review by the other auditor.

The auditors jointly review the critical issues affecting the entity.

The auditors jointly report to the entity's management, its Audit Committee and its shareholders.

Much like a solo audit, the joint audit of a group's consolidated financial statements is divided into 5 key phases:

1. Defining the audit approach or audit strategy;
2. Auditing the financial statements of subsidiaries;
3. Auditing the holding company or parent company's individual financial statements (Phase 2 & Phase 3 could take place simultaneously);
4. Auditing the consolidated financial statements;
5. Establishing a joint audit opinion.

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What are the main differences between joint and shared audit?

Joint audit

- Can be mandated by law or implemented voluntarily.
- Two or more firms are jointly responsible for the audit opinion on the group financial statements, **i.e. both firms sign the audit opinion.**
- To sign the audit opinion, each firm must have sufficient audit evidence that the financial statements are fairly presented.
- Each auditor obtains audit evidence either:
  - By performing the audit work;
  - By reviewing the work performed by the joint auditor.

Shared audit

- Can be mandated by law or implemented voluntarily.
- **One firm** (the primary auditor) **remains solely responsible for the audit opinion** on the group financial statements.
- **Another firm** (the shared auditor) **will perform the audit work on certain components:**
  - non-material subsidiaries requiring a statutory audit but outside group reporting requirements;
  - material components where the shared auditor group reports to the primary audit in accordance with instructions;
  - a significant group area, e.g. shared based payments, where the shared auditor reports to the primary auditor.

In terms of audit quality and market opening, joint audits benefits outweigh those of shared audits

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What are the main differences between joint and shared audit? (cont.)

Feature	Joint audit	Shared audit
Fosters capital market resilience	Yes, challengers in upper DAX/CAC40/…	Yes, challengers in upper DAX/CAC40/… although not with group responsibility
Enhances audit quality	Yes, four eyes on whole of group accounts	Partly, four eyes on part of group audit
Enhanced challenger firm capability of large PIE company audits	Yes, evidenced	Partly, but at a very slow pace as it does not provide an effective “escalator”
Shareholder retains choice of group auditor	Yes, of JAs of group	Yes, of group auditor
Treats different PIE & listed companies fairly	Yes, similar approach across PIE & listed companies	Yes, similar approach across PIE & listed companies
Encourages audit firms and market to share expertise	Yes, firms working together across group audit (subject to Big 4 firms willingness to do so)	Partly, firms working together on parts of audit (subject to Big 4 firms willingness to do so)
Reduces audit market concentration at reasonable pace with inbuilt mechanism to increase challengers’ market share in early years	Yes, 15/ 20% after 5 to 7 years with build up of share on larger PIE companies	Yes, but at a much slower pace than the alternative option

The case for joint audit

Joint audit and quality

Joint audit is the solution to address audit quality challenges

The most recent analysis on joint audit experiences shows that they significantly contribute to strengthening auditors' independence and consensus; mitigating bias, increasing professional scepticism, and facilitating rotation – which all play a significative role in enhancing high audit quality outcomes.

"The four eyes principle" mitigates bias, increases professional scepticism and decreases the risk of overfamiliarity

"*If implemented to provide an independent, possibly even forensic, quality review of the other engagement team, and to provide a second, independent review of the assumptions and processes underlying the formation of critical judgements and the overall opinion, joint audits may be particularly useful to counter the effects of biases that have been found to strongly affect single engagement teams."* (O. Marnet & al, 2018).

Joint audit successfully enhances fraud detection

"*One of the advantages of joint audit is that it constitutes a systematic peer-review system fraud (…). In France, the Vivendi Universal scandal in the early 2000s revealed that the joint liability of joint auditors creates a strong incentive to reveal fraudulent behaviour and accounting irregularities. Whereas Arthur Andersen remained silent about the accounting treatment of the BSkyB acquisition, the non-Big-4 auditor Salustro Reydel disclosed the accounting irregularity with the support of the financial market authorities*" (Piot & Schatt 2010)

Joint audit increases auditors' independence towards firms and management

"*The threat to auditor independence due to economic bonding is likely to be a less significant issue with the joint audit approach than it is with the single auditor approach. This is simply because in joint audits the amount of audit fees and lucrative consulting fees are distributed between two different audit firms (i.e., there are lower fees at stake). (…) Probability that both auditors simultaneously acquiesce to client pressure to be lower than the probability that either of them do so alone (i.e., higher assurance value)*" (Zerni, 2012 + Patrick Velte, 2017)

"*The risk of overfamiliarity with the client can be mitigated by joint audits*." (Okara S. 2018)

Joint audit allows rotation and prevents competence discontinuity

By appointing two different audit firms, the client firm allows audit firms to rotate, safeguarding auditor independence, but also retains the remaining auditor's knowledge and understanding of the client's business operations, thereby avoiding the potential downside of auditor rotation of a discontinuity in competence." (Carcello and Nagy, 2004)

Joint audit is perceived as of higher quality and value compared with single auditor audits, and thus associated with lower perceived credit risk

"*In the voluntary Swedish joint audit setting, companies opting voluntarily have better credit ratings and lower risk forecasts for insolvency (both being proxies for perceived audit quality) than companies with only one auditor."* (Zerni 2012)

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Joint audit and choice

Joint audit is a solution to mitigate audit market structure concentration in the EU

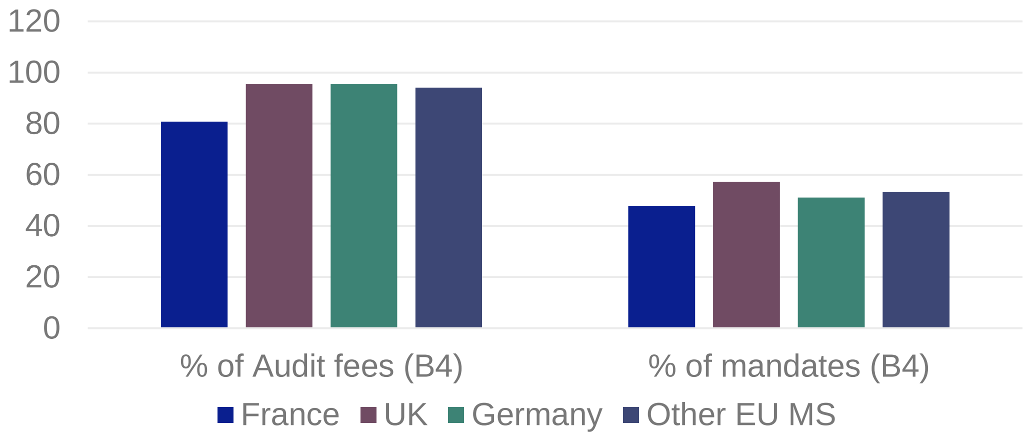
The small number of statutory audit players in the PIE market poses a systemic risk to the EU economy. The Big 4 have become “too big to fail”: the current market structure in the EU leads to a situation of regulatory capture, where, in case of audit shortcomings, regulators and governments cannot sanction one of the biggest audit companies – or take the risk of threatening its presence in the market, hence audit capacity for major companies.

In France, where joint audit has been mandatory since 1966, market structure data and analysis (1998-2003; 2003-2009) show “*the positive effects of the mandatory joint auditing system on the audit market dynamics”, maintaining market openness and mitigating the Big 4 domination in the long run*” (Kermiche & Piot 2016).

In 2018, 379 different auditors held PIE mandates. In 2021, 17 audit firms share the 233 mandates of the French prime listed companies market (ex-SBF120) and non Big 4 audit firms have more than one third of PIEs’ joint audit mandates (782).

The French audit market is more open than the EU (2010-2018)

- The latest Commission Market Monitoring Report (2021)* stresses “persistently high market concentration in 2015-2018”: Big 4 firms hold “an average EU market share of 70% of all PIE statutory audits and over 90% of total revenues”
- In 2021, there were **10 companies with no auditors** in the Netherlands (same problem in Denmark)



Data from Audit Analytics Europe: % of audit fees in 2018 and % of mandates all years combined (2010-2018)

The case for joint audit
Joint audit and cost

Joint audit doesn't imply additional cost

The French case shows that, **for the biggest companies, joint audit is not more expensive** than single audit:

- According to a study by Audit Analytics across quartiles of the SBF 120 and FTSE100, "*at the top of the market – companies in the fourth quartile of revenue, i.e., greater than €20.4 billion – the cost of a joint audit is essentially equal to the cost of an audit using only one auditor. A joint audit costs about €492 per million euros of revenue, compared to €491 for a single audit (in the UK)"*.
- In Denmark (Holm, 2016), Finland & Sweden (Ittonen and Peni 2012, Ittonen & Tronnes 2015), academic studies show that joint audit is not associated with higher audit fees.
- Recent investigations on the relationship between joint audit pairing and costs highlight that, **provided a balanced allocation of work between auditors, joint audits are not associated with higher audit fees** (Bielh 2021, Holm 2016, Thinggaard 2008).

Joint audit provides higher insurance value

In cases where extra costs might be generated by joint audit (in comparison with single audit), they are mitigated by increased reliability and trust in the information – hence lower "agency" costs which benefits investors and all stakeholders (lower perceived credit risk; decrease cost of capital).

- *"The insurance hypothesis (e.g., Wallace 1980), predicts that audits are expected to add value by providing a type of implicit insurance to investors. In the case of joint audits, the two audit firms together by definition have deeper pockets (i.e., higher insurance value) than either of them do alone"* (Zerni and al 2010).
- In the voluntary Swedish joint audit setting - around 10% of 1,667 Swedish non-financial publicly listed firms have voluntary joint audit – "*companies opting voluntarily for joint audits benefit from a higher (perceived) assurance and/or insurance value (...). Compared to single audit cases, firms with joint auditors (regardless of the type of auditor selected) have the highest perceived audit quality, because the market values joint auditors as a monitoring mechanism that helps prevent the expropriation of minority shareholders (…) Companies opting to employ joint audits have a higher degree of earnings conservatism, lower abnormal accruals, better credit ratings and lower perceived risk of becoming insolvent within the next year than other firms*" (Zerni, 2012).

The case for joint audit
Joint audit and cost

Case studies on CAC40 firms

What are the additional time and costs incurred by joint audit on a CAC40 company

Case study by Mazars (2019): joint audit costs for two large listed groups ranking in the middle of the CAC40 index.

- Analysis conducted from the actual fee budgets agreed upon for both groups (by the joint auditors, the management and governance), prepared from the global fee budget in hours, then valued in Euros and translated in percentages terms for confidentiality reasons.
- Joint audits implies specific and additional tasks to optimise the “four-eyes principle” and double-check performance, through defining and documenting the audit approach in a concerted fashion, conducting analytical procedures that allow the overall consistency of the financial statements to be reviewed, and reviewing the procedures performed by the other joint auditors.

In both CAC40 companies, extra tasks completed because it’s a joint audit account for 2.5% to 5% of the total audit costs. Indeed, joint audit adds about one quarter to one third to the coordination time required for a group audit, and group audit coordination itself represents about 10% to 15% of the total audit cost for a major group (the balance representing the audit time devoted to individual entities).

The case for joint audit
Joint audit and cost

Case studies on CAC40: Company A

COMPANY A (CAC40)							
Scope: Latest FY audit fees	Deliverables	Budget in K€ translated in %					Of which additional work
		Total	Local	Coord	Conso	Mother company	
Coordination							
Audit risks assessment	Audit approach memorandum						
• at country level		2.20%	2.20%				
• at group level		0.29%		0.29%			0.14%
Audit instructions	Audit instructions (one common set)						
• at group level		0.15%		0.15%			0.08%
Budget negotiation	Audit proposal (one common set)						
• by country		0.44%	0.44%				
• at group level		0.15%		0.15%			0.07%
Group coordination	HY, IC, YE meetings						
• HY limited review		0.50%		0.50%			0.22%
• IC review		0.22%		0.22%			0.10%
• YE audit		0.75%		0.75%			0.35%
Total		4.69%	2.64%	2.05%			0.82%
Audit							
• locally by country	HY, IC, YE memorandum (one common portal of coordination and one common set of reports)	88.12%	88.12%				
• mother company		0.33%				0.33%	
cross review							
• mother company		0.04%		0.04%			0.04%
• countries		0.44%		0.44%			0.44%
• transversal matters and major issues		0.26%		0.26%			0.26%
Total		89.18%	88.12%	0.73%	0.00%	0.33%	0.73%
Consolidation							
• audit of consolidation and specific topics		4.02%			4.02%		
• common progress meetings at corporate level (preparation included)		0.51%		0.51%			0.26%
• cross review of consolidation paper		0.22%		0.22%			0.22%
• review of Notes to financial statements		0.51%		0.51%			0.26%
• review of DDR		0.37%		0.37%			0.18%
Total		0.49%	0.00%	1.61%	4.02%	0.00%	0.91%
Audit reports issuance							
• mother company diligences		0.07%				0.07%	0.06%
• consolidated financial statements diligences		0.22%		0.22%			0.22%
• special audit reports		0.05%		0.01%		0.04%	0.05%
• Board meetings & audit committee meetings		0.12%		0.12%			0.12%
• shareholder general meetings		0.02%		0.02%			0.02%
Total		0.49%	0.00%	0.38%	0.00%	0.11%	0.49%
TOTAL		100.00%	90.76%	4.78%	4.02%	0.44%	2.95%

The case for joint audit

Joint audit and cost

Case studies on CAC40 firms: Company B

COMPANY B (CAC40)								
Scope: Latest FY audit fees	Deliverables	Budget in K€ translated in %						Of which additional work
		Total	Local	Sector	Coord	Conso	Mother company	
Coordination								
Audit risks assessment	Audit approach memorandum							
• at sector level		0.34%		0.34%				
• at country level		3.41%	3.41%					
• at group level		0.34%			0.34%			0.17%
Audit instructions	Audit instructions (one common set)							
• at sector level		0.20%		0.02%				
• at group level		0.14%			0.14%			0.07%
Budget negotiation	Audit proposal (one common set)							
• by country		0.41%	0.41%					
• at group level		0.31%			0.31%			0.15%
Sector coordination	HY, IC, YE memorandum (one common portal of coordination and one common set of reports)							
• HY limited review		3.96%		3.41%	0.55%			
• IC review		3.75%		3.41%	0.34%			
• YE audit		5.46%		4.37%	1.09%			
Group coordination	HY, IC, YE meetings							
• HY limited review		0.60%			0.60%			0.30%
• IC review		0.33%			0.33%			0.16%
• YE audit		1.04%			1.04%			0.34%
Total		20.29%	3.82%	11.74%	4.74%			1.20%
Audit								
• locally by sectors	HY, IC, YE memorandum (one common portal of coordination and one common set of reports)	67.88%	67.88%					
• mother company		0.31%					0.31%	
cross review								
• countries (France / UK / Switz / Germany)		0.43%			0.43%			0.43%
• mother company		0.15%			0.15%			0.15%
• transversal matters and major issues		0.18%			0.18%			0.19%
Total		68.95%	67.88%	0.00%	0.76%	0.00%	0.31%	0.76%
Consolidation								
• audit of consolidation and specific topics		8.26%				8.26%		
• common weekly progress meetings at corporate level (preparation included)		0.82%			0.82%			0.27%
• cross review of consolidation paper		0.36%			0.36%			0.36%
• review of Notes to financial statements		0.48%			0.48%			0.25%
• review of DDR		0.34%			0.34%			0.18%
Total		10.26%	0.00%	0.00%	2.00%	8.26%	0.00%	1.06%
Audit reports issuance								
• mother company diligences		0.11%			0.04%		0.07%	0.11%
• consolidated financial statements diligences		0.20%			0.20%			0.21%
• special audit reports		0.05%			0.01%		0.03%	0.05%
• Board meetings & audit committee meetings		0.11%			0.11%			0.11%
• shareholder general meetings		0.03%			0.03%			0.03%
Total		0.50%	0.00%	0.00%	0.40%	0.00%	0.10%	0.49%
TOTAL		100.00%	71.70%	11.74%	7.89%	8.26%	0.41%	3.52%

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Contact

Clémence Valleteau

Global Head of Public Affairs

clemence.valleteau@mazars.com

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