

Les corrigés des examens DPECF - DECF 2005

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SUJET

HALF MEASURES

The auditing industry still needs more reforms

In the three years since accounting fraud at Enron came to light, followed quickly by accounting trickery at WorldCom, Parmalat and others, the auditing profession has been trying to sort itself out and steer clear of trouble. But accounting scandals continue to surface - most recently at Fannie Mae, America's giant mortgage company. More trouble

5 may be brewing: in the newest twist in America's unfolding insurance-company scandal, regulators have recently launched investigations into companies' use of certain insurance products to "manage" earnings. If they unearth dodgy doings, the auditors who signed off on company accounts could find themselves in hot water. Indeed, Deloitte & Touche, the world's biggest audit firm; faces a lawsuit of up to \$ 2 billion for its audit of Fortress Re, a
10 re-insurance firm that allegedly used certain insurance products to inflate profits.

The continued inability of auditors to thwart accounting trickery means that, even after the flood of reforms put in after Enron's collapse, the industry remains a problem. The concentration of the industry into the "Big Four" accountancy firms-Deloitte, PriceWaterhouseCoopers, Ernst & Young and KPMG-that now audit the lion's share of the
15 world's large, public firms heightens these concerns. Given the implosion of Arthur Andersen, Enron's auditor and once the fifth biggest accountancy firm in the world after a criminal indictment for obstruction of justice, there is a real question about how aggressively regulators can now pursue the surviving four big auditing firms for any future misconduct. Would the world's financial system really be safe with just the "Big Three" or
20 "Big Two", or even a single giant firm auditing most large corporations? That sounds untenable.

It is all the more important, then, that the rules governing the audit industry itself are sound. Certainly, these are in better shape today than they were five years ago, at least in America. The Sarbanes-Oxley act passed in the wake of the Enron and other scandals made non
25 executive directors on company boards (...) responsible for hiring and firing auditors, and created an independent oversight body to inspect accountancy firms regularly.

Yet more still needs to be done. Accountancy firms remain riddled with conflicts of interests. The most basic is that they are responsible for auditing managements that, ultimately, pay them to do so. Often, auditing relationships span decades, increasing the
30 likelihood that familiarity breeds over-cosy ties. And while, ideally, audit firms would compete on the basis of reputation, so that providing the highest quality audits and maximising profits would go hand in hand, in the real world this applies at best imperfectly. Each of the "Big Four" accountancy firms and many of the second-tier ones have been sullied by accounting scandals, yet they continue to attract business because they are no
35 other options, particularly for large, international companies. The professions' shift from a pure audit model to a multi-disciplinary one, in which accountancy firms provide companies with tax, advisory and other services along with audits, only increases the potential for conflicts of interests.

There is no single or simple solution to the over-concentration of the auditing industry. Nor
40 could any regulatory changes eliminate scandals altogether. But recent changes could be taken another step. Sarbanes-Oxley, for example, requires the periodic rotation of the senior

partner on audit teams and bans accountancy firms from providing certain (but not all) non-audit services to their clients. So why stop half way? The goal of audit reform must be to reduce potential conflicts of interests as much as possible. This should mean requiring the periodic rotation of entire audit firms, and not just the audit-team leader. A ban on the provision of all non-audit services to audit clients by the same accounting firms should also be adopted. And European countries (...) should act as soon as possible to put similar rules in place.

Such reforms could well require wide-ranging changes among the Big Four accounting firms themselves, and might open the way to competition from other firms to tax, advisory and other non audit services to the world's biggest firms. The Big Four would object. However the rules should not be tailored to suit them, but to serve the wider public interest and that of shareholders. Given the critical role that auditing firms play in the financial markets and in checking management behaviour, to do any less would be irresponsible.

adapted from The Economist, November 20th 2004

Travail à faire :

I. COMPREHENSION DU TEXTE 40 points

Answer these questions briefly and precisely in your own words. It is advisable to read all the questions before starting.

1. Why has the situation of auditing firms evolved over the past three years?
2. What problem does Deloitte & Touche face?
3. Has the ability of auditors to make a good job improved?
4. Explain the cause and the consequence of the "implosion of Arthur Andersen".
5. Did the Sarbanes-Oxley act better the situation? How?
6. How should audit firms work ideally?
7. What are the main elements that increase the conflicts of interest in accountancy firms?
8. How could the Sarbanes-Oxley act go further?
9. What could consequences be for the Big Four?
10. Why is it important to manage such reforms?

II. VERSION 30 points

1. Translate the text from "Yet more still needs to be done" (line 25) to "...span decades." (line 27)
2. Translate the text from "Such reforms could well..." (line 45) to "...would object." (line 47)

III. EXPRESSION 30 points

The Economist wonders "if the world's financial system would really be safe with just the "Big Three" or the "Big Two", or even a single giant firm auditing most large corporations" (lines 19-20). What are the possible consequences of an over-concentration or of monopolies of firms on the economy and on consumers? You can base your answer on examples taken from audit and accountancy firms or from any other economic sector.

PROPOSITION DE CORRIGE

I. COMPRÉHENSION DU TEXTE (40 points)

1. Why has the situation of auditing firms evolved over the past three years?

The recent evolution in auditing is rooted in the 2001 Enron scandal (l. 1). It had a major impact on the situation of auditing firms. First, Enron's auditor, Arthur Andersen has collapsed (l. 12), so that there are now only four big accountancy firms, the so-called "Big Four" (l. 15). And second, several reforms, among which, the Sarbanes-Oxley act, have been trying to prevent accounting fraud (l. 24), by increasing the regulation of the relationship between "large corporations" (l. 20) and "big auditing firms" (l. 8).

2. What problem does Deloitte & Touche face?

Deloitte & Touche is being sued for signing off on Fortress Re's accounts, which could cost them up to \$2 billion. They are charged with having "used certain insurance products to inflate profits" (ll. 9-10).

3. Has the ability of auditors to make a good job improved?

In spite of all the legislative reforms that were passed in the aftermath of Enron's scandal, the ability of auditors to prevent accounting fraud has not improved (l. 11): trickery went on in WorldCom, Parmalat, and Fannie Mae (ll. 2-4).

4. Explain the cause and the consequences of the "implosion of Arthur Andersen".

The "implosion of Arthur Andersen" takes its origin in the fact that they were charged for "obstruction of justice" (l. 17). Now there are only four big accounting firms, so that, not only is it going to be hard for regulators to enforce the law, but also questions are raised about the danger such a concentration could represent.

5. Did the Sarbanes-Oxley act better the situation? How?

The Sarbanes-Oxley act improved the situation by two new measures. First, appointing and dismissing auditing companies was now the job of "non-executive directors on company boards" (ll. 24-25). Second, the act called for a more regular and independent control of auditing firms.

6. How should audit firms work ideally?

Ideally, audit firms should compete with other firms on the basis of the quality of the service they provide. Unfortunately, with only four competitors, even if their auditing service is bad, they still attract customers (ll 30-35).

7. What are the main elements that increase the conflicts of interest in accountancy firms?

The major aspects that heightens the conflicts of interest are twofold. First, the paradox that auditors have to audit the very same firms that eventually pay them. Second, one auditing company often audits the same corporations for several years, so that, in the end, bonds are created (ll. 28-30).

8. How could the Sarbanes-Oxley act go further?

According to The Economist, the Sarbanes-Oxley act could go further: it could force companies to change their auditors every few years (instead of only changing the leader of the auditing firm). Furthermore, it could also forbid accountancy companies from providing more than audit to their customers (advisory for instance).

9. What could consequences be for the Big Four?

These restrictions could open the market of services other than audit to competition. The Big Four could then lose their prominent role.

10. Why is it important to manage such reforms?

Such reforms are vital for the public interest. If not, accounting fraud will not stop. The system needs more transparency: conflicts of interest needs to be ended, and the market of non-audit services has to be opened up to competition.

II. VERSION (30 points)

1. Translate the text from "Yet more still needs to be done." (line 27) to "... span decades" (line 29).

Et pourtant, il y a encore bien plus à faire. Les cabinets d'expertise comptable restent gangrenés par des conflits d'intérêt. Le conflit premier vient du fait qu'ils doivent procéder à l'audit des organes de direction qui, en fin de compte, les payent pour le faire. Bien souvent, les relations entre auditeur et audité s'étalent sur des dizaines d'années.

2. Translate the text from "Such reforms could well..." (line 49) to "... would object" (line 51).

De telles réformes pourraient bien nécessiter des changements de grande ampleur au sein même des quatre principaux cabinets d'expertise comptable, surnommés "Big Four". Cela pourrait peut-être ouvrir la voie à la concurrence d'autres entreprises dans les domaines de la fiscalité, du conseil, et d'autres services ne relevant pas de l'audit auprès des entreprises les plus importantes du monde. Les "Big Four" auraient quelque chose à redire.

III. EXPRESSION (30 points)

With globalisation and the expansion of markets, firms tend to concentrate more and more at a national and international level. But there are different kinds and levels of concentration, from monopoly to oligopoly. Many examples show that concentration has both advantages and drawbacks. This essay intends therefore to go through the varied consequences of such a phenomenon, from the point of view of the firm, of the consumer, and of society.

Most of the advantages of concentration are felt by the firms themselves which, when they make profit, aim at regrouping their production by acquiring and integrating other firms. The recent news of a possible take over of Danone by PepsiCo shows how a profitable multinational firm is likely to want to concentrate. Concentration indeed reduces competition, increases profits, widens the corporation's market share and makes it strong and well-known.

On the other hand, to keep its customers, the company which is part of an oligopoly has to spend a lot of money on R&D to offer innovations on products, packaging, services etc. Moreover, such a firm has to take care of its image, mostly through advertising campaigns.

From the point of view of the consumer, there are likewise both advantages and drawbacks. First, being confronted to a concentrated market gives consumers the opportunity to benefit from a large array of personalised services. This is due to the fact that, since a reduced number of firms offer the same type of product, each of them has to differentiate itself from the others in some way. For instance, the three French mobile phone operators propose similar products at similar prices, but their services differ. However, the consumer may have the feeling that there is less and less variety offered, and he may feel that he is deprived of his right to chose. This is especially true when firms make illegal agreements to set the prices, as was the case for mobile phone operators in France. This prevents prices to be fixed through the law of supply and demand.

As far as the market and society are concerned, too much concentration means the end of small independent business. Independent business owners encounter difficulties in accessing bank loans and, therefore, often accept to be taken into a group that acts as a guarantor. But when a company faces financial problems, it has to cut its expenses, which often ends up in massive lay off all around the world. Furthermore, concentration, as the example given in the text shows, tends to induce a lack of transparency, which may open the way to trickery.

To sum up, concentration seems to be a general trend among multinational firms. But too much concentration may be dangerous, for the firms and the consumers. The lack of competition, the huge profits at stake, and the globalisation of brands tend to disturb the market, make it uniform and may lead to world wide scandals.