# Nothing Like the Enron Affair Could Happen in France (!)

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ABSTRACT *This article reviews the reactions of the French accounting profession and academia following the collapse of both Enron and Andersen. It considers policy statements and declarations on the part of the accounting profession, legislative changes, the general impact on University accounting education programmes and specific developments in accounting teaching at my own institution, HEC. It considers the value of using corporate scandals in the teaching process and claims that more accounting theory and ethical issues should be introduced in accounting educational programmes.*

## 1. Introduction: Enron and the French Academic Community

When news of the Enron scandal broke in October 2001, there was no immediate reaction from the academic community in France. This was in considerable contrast to what happened in the USA at the Academy of Management congress, when a special session was devoted to this type of problem and the responsibility of academics. An unofficial resolution - never submitted to a vote at the Academy of

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Management congress, but circulated via the internet - sounded remarkably like a confession of guilt:

> "As professors of business we recognize that we bear some responsibility for our contribution to the present crisis. (…) Our teaching has allowed far too much emphasis on notions of maximization, opportunity cost, present value, and the exploitation of externalities. (…) We have not placed enough focus on the societal effects stemming from decisions made based on these techniques. Instead, we (…) have placed too little of our attention toward the second and third order impacts of decisions - especially as they affect community, stakeholders, employees, suppliers, customers, family, and the society as a whole. Instead we have taught that such externalities can be exploited for profit. We have spent too much time in the classroom teaching what can be done in grey areas and too little on the consequences of acting in grey areas. We have done far too little to teach business school students notions of boundaries beyond which they should not cross - in areas of ethics, values, responsibility, and integrity" (Faujas, 2002b, p. X)[1].

The reaction of the French accounting profession, as expressed largely through its representatives heading up the two main professional bodies, the *Ordre des Experts Comptables* (Institute of Public Accountants) and the *Compagnie Nationale des Commissaires aux Comptes*[2] (Institute of Statutory Auditors), came in two stages. At first, the French profession considered that the Enron scandal and other such cases were not of great concern, as the French regulatory system was 'better'. Thus, while Cazes (2002), the president of the *Ordre des Experts Comptables,* declared that "we cannot (…) assert that an Enron-type scandal would be unthinkable in France" (p. 6), he believed that "the financial scandals that have shaken the finance markets and the accounting profession in the US have caused no real upset in France. These scandals arose from serious defects in the protective system [of the quality of financial information] which are not found in Europe in general, and France in particular" (p. 6). To highlight the 'particularity' of the situation, the French accounting profession's initial reaction presented the advantages of the *exception française*[3] evident in its auditing system, seeking to demonstrate that it would have been difficult for such a scandal to have happened in France. The specificities of the French system include the statutory (external) auditor being appointed for a renewable term of 6 years (even if there is a change of controlling shareholder during that time), while two joint auditors must be appointed if the company publishes consolidated financial statements. It is also forbidden for an accounting firm to provide auditing and consulting services to the same client[4].

Nahum (2002), the vice-president of the *Ordre des Experts Comptables* at the time and now its president, drew a parallel between the difficulties encountered by Andersen and those created by the mad cow disease epidemic: “The whole profession is not contaminated by the actions of just a few individuals and (…) the cure should not be of the type adopted for mad cow disease, when the entire herd is eliminated or declared unfit for use” (p. 3).

*Dissenting Views*

As time went by and further scandals kept coming to light in the USA and Europe, some dissenting views began to appear. The opposition came partly from members of the minority French professional accounting union, the *Experts Comptables de France*. Curiously, their main argument was also based on a defence of the French ‘exception’ (Helenne, 2002). However, this is not the paradox that it appears at first sight - the dissenters reproached the profession for having failed to respect a number of the rules in the French system, particularly the prohibition on accountants performing both auditing and other services for a single client. Germond (2002) argued that “over the last eight years, under pressure from the *Comité Arnaud Bertrand* lobby group formed by international firms, there has been an organized, systematic relaxation of the rules and special arrangements” (p. 2). A past president of the *Compagnie Nationale des Commissaires aux Comptes*, Germond also raised an issue relating to the appointment of joint auditors, pointing out that the rule stipulating that both joint auditors could not belong to the same firm was still very much a new law, having only been in existence since 1993[5]. Prior to this, some creative ways had been utilised to get around the joint auditor requirement - "the big firms (…) were in the habit of having the firm as an entity, and an individual partner of the firm, appointed as joint auditors" (p. 3).

In response to the mad cow image, Eichel (2002), a well-known accounting professional, spoke of the "the tip of the iceberg", saying that the Enron/Andersen scandal concealed "accommodating arrangements, not to say amazing collusion, between the global American businesses, the largest commercial banks and the biggest audit and consulting firms" (p. 11). In terms of the USA, Eichel did not see it as a case of one mad cow but a general illness on the part of a profession contaminated by excessive collusion with corporate management.

*Subsequent Reaction: "We Have to Acknowledge That It Does Concern Us"*

The French profession duly revised its communication policy, especially once it became clear that France was going to enact a law equivalent to the Sarbanes-Oxley Act. The French Financial Security Law (FSL), which came into effect on August 1, 2003, mainly focuses on the modernisation of the statutory audit, including a new, compulsory disclosure item, in the form of an auditor's report on the state of the audited company's internal control systems and strict rules against performing audit and consulting services for the same client[6]. Officially, the FSL is not directly modelled on the Sarbanes-Oxley Act, although the latter Act is mentioned as an element of the environment (Marini, 2003, p. 15). The FSL is technically the result of a reflective review process that started pre-Enron (Marini, 2003). However, the law's promoters acknowledge that it does originate in the dysfunctions of the financial markets and a loss of confidence in the quality of financial information. In this context, it is hard to believe that the adoption of the Sarbanes-Oxley Act and the FSL, about a year after, constitutes a pure coincidence.

For statutory auditors, the principal change is the introduction of a *Haut Conseil du Commissariat aux Comptes* (Statutory Auditing High Council or *H3C*[7]) to act as a watchdog and monitor the auditing profession, in liaison with the *Compagnie Nationale des Commissaires aux Comptes*. As auditors are in the minority on this council (just 3 out of 12 members), this move in fact represents a significant loss of power for the profession, given that, before the adoption of the FSL, the profession was not subject to any form of external control (Marini, 2003, p. 28).

The recent legal evolution in France is difficult to explain and understand. If 'nothing was wrong', why was a new law adopted and why was there no strong reaction from the accounting profession? It might be assumed that this situation reflects the government's deep lack of confidence towards the profession in general, and the big accounting firms, in particular. It might also represent the inability of the profession's leaders to oppose a major reform. Change in France is also going to depend on the attitudes of the French courts. Two court cases in 2003, stand out as indicators of French judges' reluctance to convict management and auditors. In the case of Crédit Lyonnais, the statutory auditors were discharged on all counts (Bohineust, 2003) while in the Pallas-Stern case the Appeal Court discharged all the defendants (management, directors and statutory auditors), overturning their initial conviction. Neuville (2003), a representative of a not-for-profit organization in charge of the defence of minority shareholders, noted the contrast with the "severity of American rulings against white collar criminals" (p. 8).

## 2. Impact of the Enron Scandal on Financial Accounting Education

In France, in recent years there has been a tremendous improvement in the image of financial accounting in introductory courses. As Faujas (2002a) notes, "the auditing departments of top French business schools [we could add, and universities] are breathing a sigh of relief. The directors of these courses were wondering how the Enron and WorldCom scandals would affect students, fearful that they might shun what some considered a corrupt discipline. In fact, the opposite is happening, and Auditing majors have never been so popular". Baudet (2003) makes the same observation in an article provocatively entitled: "Arthur Andersen is dead, long live accounting…".

Colleagues teaching on executive programs also often report that participants have been 'sympathetic' to accounting. Executives are coming to realize that financial accounting cannot be reduced to notions of debits and credits and are recognising the importance (and relevance) of financial accounting issues for (strategic) decision-making.

*Changes In Academia*

Many French accounting academics felt personally concerned by the Enron scandal and started to think about how to incorporate the issue into their teaching. With this in mind, the Francophone Accounting Association (FAA - formerly the French Accounting Association[8]) took two significant steps:

- At its annual meeting in Louvain-la-Neuve (Belgium, May 2003), the Enron scandal was one of the topics for the 'doctoral session' (in fact open to all members). More than 200 French academics attended this session.
- At the annual 'teacher training day', organized by the FAA in September 2003 in Paris, four 'hot' issues were addressed, one of which being 'creative accounting'. About 250 participants were present.

The big question, however, was whether the content of French accounting courses should be changed to incorporate issues raised by Enron, and other such scandals? Several aspects of the accounting educational process can be considered in this respect, including the critical question of a principles vs. rules orientation. This question is not easily resolvable (Schipper, 2003) but the issues are exacerbated in France because (a) little time is devoted to financial accounting in many French institutions – and teaching principles takes time! and (b) French professional accounting exams are always very technical and heavily rules-based.

*Teaching Accounting Scandals and Ethics*

There are several pedagogic issues being debated informally in French academic accounting circles:

- Should ethics be taught? If so, should there be a separate ethics course or should ethical issues be explicitly included in all management courses, including those related to financial accounting?
- Are there any fundamental dangers in teaching students about 'accounts manipulation' (creative accounting, earnings management, etc.)?
- Should accounting scandals be covered in the first financial accounting course, at a more advanced stage, or at both levels?

Each proposed solution has its relative advantages and disadvantages. For example, putting accounting scandals into the first level accounting course certainly makes the course more attractive, but it requires a certain level of understanding on the part of students. There is also the risk that students might begin to think that accounting means that "you can do anything you like" – such cynicism coupled with a lack of technical and theoretical knowledge can be counterproductive.

At HEC School of Management, where I currently teach, the following compromise solution has been adopted. In 2002-03, a special session on accounting scandals and ethics was added to HEC's introductory accounting course[9]. To make it a significant event, this session took place in the main lecture theatre and all students (close to 400) attended - all the other sessions on the course are taught in a workshop format, in 10 groups of 40. The special session covered topics such as: the objectives of financial accounting, the image of accounting in the financial press, the accounting profession's share of responsibility in recent scandals and economic and social consequences of accounting policy choices. The session was very well received by the students and was replicated in 2003-04.

For the academic year 2004-05, due to a major reform of the course structure, the duration of the introductory financial accounting course was increased from 27 to 39 hours (26 sessions of 1½ hours, over 13 weeks)[10]. Given this increase, the above-mentioned special session was cancelled and the topic of accounting scandals was integrated into the syllabus – being studied in a workshop format by all 10 workshop groups. It now covers two sessions, i.e. 3 hours. The first session is an introduction to 'accounts manipulation' on the basis of a case study that simulates a meeting between different corporate managers who disagree on what actions to take with regard to certain end-of-period accounting entries. The second session (which is the last session of the whole course) is a case study on Vivendi Universal[11]. This study shows the changes in the group's acquisition strategy and more importantly, the difficulties in financing such a strategy. The 'moral' of the story is that a rather 'simple' financial statement analysis can provide a lot of useful information.

An optional course unit at HEC has also been created (entitled 'Grey Areas in Financial Reporting') for Masters' students specializing in international management. Such specialist students are mostly overseas exchange students, with just a minority of French students taking such a specialism. The duration of the course unit is 39 hours (13 sessions of 3 hours). Relying solely on real-life case studies (put together from publicly available material), the course unit addresses: ‘Revenue recognition’ (Enron and Merrill Lynch, MicroStrategy, Xerox, Ahold), ‘Cost recognition and classification’ (Ahold, André-Vivarte, Coca-Cola), ‘Long-lived asset recognition and valuation’ (AOL, WorldCom, Ryanair, Renault, Delta Airlines, Vivendi Universal), ‘Mark to market accounting’ (Freddie Mac), and ‘Related party transactions’ (Ford, Enron). I run the course with my colleague, Yuan Ding, and we have prepared all the above-listed case studies. As it is given on a Community of European Management Schools (CEMS) Master’s program, it had first to be ‘accredited’ by a special Board of the CEMS and meet several conditions relating to its scope and professional relevance.

The course unit was given for the first time in 2003-04, but its success was ‘relative’, if I may use this understatement, for the following reasons. Although I ensured that all the students had taken one financial accounting course beforehand, I underestimated the high level of accounting knowledge required in order for students to grasp all the elements of the case studies. Another problematic issue was the use of case studies themselves. As the students were coming from different countries where teaching methods are different, some of them were not used to working with case studies, especially those constructed from, and involving the need to read, real-life accounting documents. Finally, the amount of work required was considerable and probably beyond what was reasonably possible. One solution to overcome these difficulties would be to restrict the course unit to those students specializing in Financial Accounting[12].

It is still early days to judge the impact that any such curriculum changes have had on the accounting educational process, both at HEC and, more generally, in France. My own personal experience suggests that the study of accounting scandals (or ‘grey areas’, as we prefer to call them) is both important and valuable but to work properly it does require students to have good, prior background knowledge in accounting.

An interesting, indirect, consequence of the rise in accounting scandals has been the increased usage for teaching purposes of on-line and CD-Rom resources covering corporate scandals. At HEC, we have created one website for use in teaching about Enron and one CD-Rom to cover the ‘grey areas in financial reporting’.

*The Link between Accounting Education and Professional Exams*

In France, the *Expert Comptable* professional qualification is obtained after several steps[13]. The first step, which leads to the DESCF (Degree of Higher Accounting and Finance Studies), includes 16 credits. However there are different routes to prepare for the professional exams, some of which make it possible to bypass some of these credits.

The first possibility is to obtain a University Master’s degree in accounting (*MSTCF - Maîtrise des Sciences et Techniques Comptables et Financières*). Holders of this degree are exempted from 14 out of the 16 credits constituting the DESCF above-mentioned. The second possibility can be to study at University in another program (such as a Master’s degree in Management) or in a business school. In this case, depending on the final year’s specialization, the student will benefit from more or less exemptions. In practice, students specialising in accounting will be exempted from several credits. Finally, various training centres offer courses leading to the various credits needed by students who choose not to follow one of the first two routes.

On successfully completing the theoretical educational stage, the next step towards professional qualification is the undertaking of a full-time, three-year internship, usually in a public accounting firm located in France. At the end of this period, the third step to qualification takes the form of the 'final exam' which includes the writing and the defence of a dissertation (approximately 100-page long) on a subject related to the professional domain and two examinations: a written test on the statutory and contractual auditing of financial statements, and an oral test with a jury relating to the internship and covering professional knowledge in general.

In summary, it takes approximately seven years after the *Baccalauréat* (high school degree) to get an *expert comptable* qualification (including four years to obtain the DESCF, a three-year training period and the final exam). It takes even longer for students having a scientific background – they get no exemptions and must start their accounting studies from the very beginning.

Significantly, in all the above cases, approval for exemptions rests ultimately with a Commission within the Ministry of Education (on which French accounting academics also sit). As such, French academics still have a degree of flexibility to determine what they teach and to influence what is accepted as appropriate professional accounting educational material.

## 3. Concluding Comments and Outstanding Issues

In terms of the teaching of accounting in French universities and business schools, I anticipate that increased coverage of corporate accounting and auditing scandals will prove essential, whether as part of general or specialist courses. Ethical behaviour and issues also require more emphasis. It is also essential to convince students that they must not 'throw the baby out with the bathwater' and take the view that accounting information is of no value. However, the case studies that I have used on the accounting scandals course clearly show that financial statements contain several valuable indicators, and, carefully handled and analysed, can lead to the right questions being asked.

The scandals also reveal some quite poor performance and ethical standards on the part of corporate accountants/directors and external auditors. As such, I believe it is crucial not to teach accounting and auditing in purely normative terms but also to give students a critical perspective and an informed historical standpoint on the way in which accounting/auditing responsibilities and concepts have developed over time. This is the 'principled' education that many think professional accountants need, although it is not reflected in the present professional exam structure, which still has a highly technical and rule-based approach. Furthermore, at French universities and business schools, such 'accounting theory' courses are almost non-existent, the only exception being the first year of doctoral studies in financial accounting which often covers such a topic. Such positions could be set to change, with the Ministry of Education, under the direction of Professor Alain Burlaud, having launched a major review of the content of professional accounting exams. According to the information currently available (Anonymous, 2004-2005, p. 15), the new program of financial accounting education should stress notions of deontology (doing the right thing regardless of the consequences) and also the relationship between accounting and finance.

I believe that French educators in universities and business schools could put more emphasis on ethics in management in general but also on the ethical behaviour which should prevail in the 'strategic' use of financial accounting information. They also have the capacity to develop financial accounting theory courses and/or strengthen the theoretical content of other accounting courses, including those delivered on programmes closely linked to the professional exams (such as the MSTCF).

In terms of accounting and auditing research, we should be challenging rather more the scientific validity of articles which have demonstrated that auditors from the Big firms provide better quality work and reduced earnings management on the part of client management (Becker *et al*., 1998), or that companies audited by Big firms have lower amounts of estimated discretionary accruals (Francis *et al*., 1999). The Becker *et al*. article's principal regression had an adjusted $R^2$ of 1%, and included two very ill-matched samples, with 10,397 observations for Big Six auditors, but only 2,179 for non-Big Six auditors. Selection bias was clearly possible here, since Big Six auditors are quite capable of choosing more 'reliable' clients, where they will expect less manipulation of earnings. Current research should better integrate the institutional specificities of countries other than the USA and also refine the statistical methodology, to avoid the above-mentioned caveats. Cultural aspects also need to be brought more into the picture. In addition to some 'traditional' (Hofstede, 2001) but criticized cultural values (McSweeney, 2002; Baskerville, 2003), researchers could integrate alternative values: including conservatism, autonomy, hierarchy, mastery, egalitarian commitment and harmony (Schwartz, 1994; see also Inglehart and Baker, 2000).

We also need to promote the value and importance of financial reporting and the responsibilities of directors and auditors to ensure that financial reports are fairly and accurately presented. Such improvement could help to bolster the perceived usefulness of corporate financial statements and reduce managerial temptation to act unethically by manipulating such reports. As an illustration, in preparing the above mentioned corporate case studies, I found several 'basic' mistakes in the balance sheets, income statements or cash flow statements of the companies concerned, including typos (even in the title of the financial statements - e.g., using the wrong year); and sub-totalling errors of financial figures. Large accounting firms had audited all these statements - which does suggest that they had not put much emphasis on the financial reporting aspects of their job.

Overall, France may have been relatively untouched by scandal, but there is one residing reason for this which must be noted: namely, that the French government plays a significant protective role, being a major shareholder, in many large companies. We cannot be certain that French companies will always enjoy that kind of financial and political protection, and, educationally in accounting, need to act now to ensure that nothing like the Enron affair ever happens in France…

## Notes

[1] The full text used to be available at http://www.isce.edu/wwwboardmessages/138.html but appears to have been removed.

[2] Readers interested in the French statutory auditor profession can refer to Baker *et al.* (2001).

[3] A phrase borrowed from the field of the arts meaning the French difference or exception, often used to defend a French specificity. Over the years, the status of the 'French exception' has moved on to be recognised as having established 'French-style auditing', based on the specificities mentioned in the text.

[4] Other elements include a requirement for the Minister of Justice to be informed if any misdemeanour and crime (or '*faits délictueux*') is detected in the course of the audit. Company directors must be alerted when the statutory auditor, in the course of his/her duties, observes anything likely to compromise the company's going concern status.

[5] Official bulletin of the *Compagnie Nationale des Commissaires aux Comptes (*Institute of Statutory Auditors) (Bulletin CNCC), No. 90, June 1993, p. 181.

[6] The statutory auditor will present an additional report, detailing his/her observations on the internal control procedures related to the preparation and treatment of accounting and financial information (Commercial Code, art. L. 225-235).

[7] H3C because of the three Cs: *Haut Conseil du Commissariat aux Comptes.*

[8] This association, created as the French Accounting Association in 1979, was renamed in 2002. As an academic organization, its main objective is to promote research and teaching in the field of accounting (see www.afc-cca.com).

[9] This introductory course is the only required financial accounting course. 50% of the students usually take an additional optional course on intermediate accounting in their second year at HEC.

[10] This increase was obtained with no real difficulty given the current moves to adopt international accounting standards in the EU and the rise of accounting scandals.

[11] This case study was created by my colleague (Yuan Ding) and I.

[12] In France, a financial accounting 'specialist' would typically take the following courses: introduction to financial accounting and financial statement analysis, intermediate and advanced (financial) accounting, financial statement analysis, corporate finance, managerial accounting and management control.

[13] The following description is partly based on the website of the *Ordre des experts comptables* (http://www.experts-comptables.fr/html/countries/gb/index.html).

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