International Auditing Considerations at Carrefour S.A.

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ABSTRACT

Carrefour S.A. is a multinational retailer headquartered in France that operates over 10,800 stores worldwide consisting of hypermarkets (a supermarket and department store under one roof), supermarkets, and convenience stores, as well as e-commerce websites. The objective of this three-part case study is to expose students to international (or multi-national client) audit issues/considerations. Multi-national clients often have multiple locations or components that require separately audited financial information that is included in consolidated or group financial statements. The first case exposes students to the need to allocate materiality across components of a group audit. The second part of the case then introduces information about a certain country (i.e., component) and requires students to consider how increased business risk would influence the audit. The third part of the case provides Carrefour's group audit report and exposes students to differences in regulatory reporting between France and the U.S.

Keywords: Carrefour, auditing, component materiality, business risk, audit reporting

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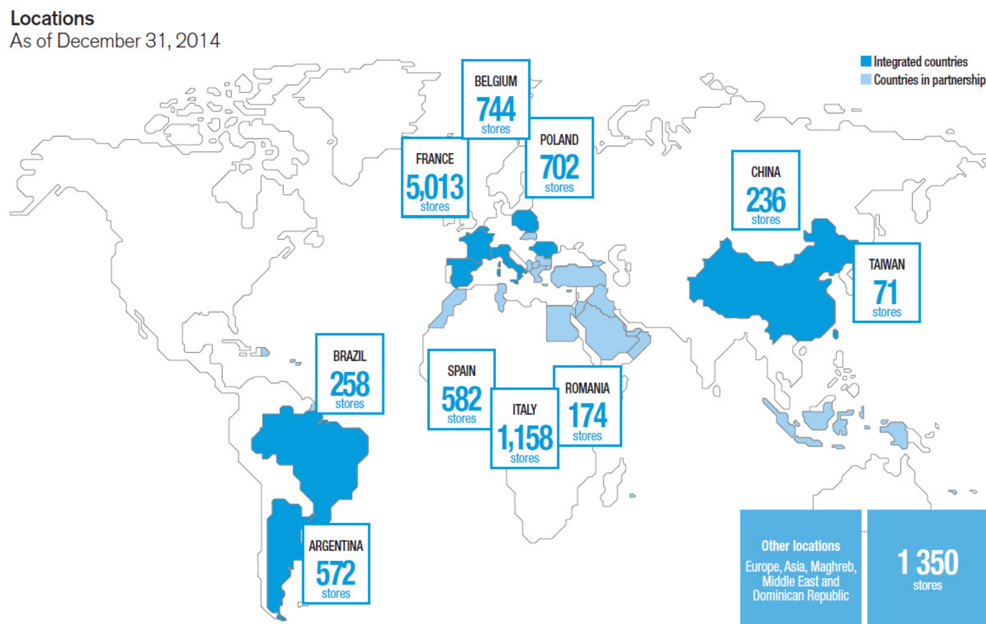
COMPANY HISTORY AND OVERVIEW

Carrefour S.A. is a multinational retailer headquartered in Boulogne Billancourt, France, a suburb of Paris. The company trades on the Paris stock exchange (Euronext Paris) and is part of the Euro Stoxx 50 stock market index. Carrefour simply means *crossroads* in French. The first Carrefour store opened in 1960 and was situated near a crossroads, and was named accordingly.

With over 10,000 stores and nearly 400,000 employees worldwide, Carrefour is the largest retailer in Europe and one of the largest in the world. Carrefour operates hypermarkets (a supermarket and department store under one roof), supermarkets, convenience and cash and carry stores, as well as both food and non-food e-commerce websites. In 2014, Carrefour's gross revenue was in excess of 100 billion euros. Forty-seven percent of the company's sales are generated in France with twenty-six percent coming from other European countries (Belgium, Spain, Italy, Poland and Romania). Carrefour also operates in South America and Asia where it generates nineteen and eight percent of its sales, respectively.

Figure 1: Carrefour Store Locations



Source: Carrefour 2014 annual financial report.

CASE 1 – MATERIALITY FOR MULTI-NATIONAL AUDIT ENGAGEMENTS

Establishing Materiality Levels for Group Audits

Many audit clients have operations in multiple locations. Often, those operations are located in foreign jurisdictions. When companies are required to file separately audited financial information for a component of the group that is included in consolidated or group financial statements, the auditor considers the applicable reporting framework and establishes appropriate levels of materiality for the group as a whole and the individual components requiring separate audits. The audit of Carrefour, Inc. is a group audit because the consolidated financial statements also have separate, audited, financial information for components of the company.

International Standard on Auditing (ISA) 600, issued by the International Auditing and Assurance Standards Board provides guidance on establishing materiality for group audits. The standard states that "the group engagement team shall determine… materiality for the group financial statements as a whole…[as well as] the component materiality …Component materiality shall be lower than materiality for the group financial statements as a whole."

Further, ISA 600 explains that "different materiality levels may be established for different components" and "component materiality need not be an arithmetical portion of the materiality for the group financial statements as a whole and, consequently, the aggregate of component materiality for the different components may exceed the materiality for the group financial statements as a whole."

The following table is one method of using the overall group materiality and number of components to establish individual component materiality levels (see Glover, Prawitt, Liljegren, and Messier 2008). MACM stands for the *maximum aggregate component materiality*. Based on the number of significant components identified by the engagement team, the MACM to be allocated among components would be the multiple in the right hand column multiplied by the overall group materiality.

Table 1: Maximum Aggregate Component Materiality

Number of significant components to which MACM will be allocated	Multiple applied to group overall materiality to determine maximum aggregate component materiality (MACM)
2	1.5
3–4	2.0
5–6	2.5
7–9	3.0
10–14	3.5
15–19	4.0
20–25	4.5
26–30	5.0
31–40	5.5
41–50	6.0
51–64	6.5
65–80	7.0
81–94	7.5
95–110	8.0
111–130	8.5
131+	9.0

Source: Glover et al. (2008).

Once the MACM is established, the engagement team then needs to allocate the MACM across the significant components. The use of either a proportional or weighted allocation technique (as shown below) is appropriate. In the case of a proportional allocation, if sales are used to determine size, then the engagement team would multiply the MACM by the proportion of individual component sales to total group sales. In the case of a weighted allocation, the engagement team would multiply the MACM by the square root of each individual component's sales divided by the sum of the square roots of all individual components' sales. The table below provides an illustrative example.

Table 2: Example Group Materiality Allocation

Number of components	6	
Total Group Sales	176,000,000	**A**
Total Group Pretax income	18,000,000	**B**
Group overall materiality	900,000	**= B * 0.05**
Benchmark multiples	2.5	**C (based on number of components from table above)**
MACM based on benchmark multiples	2,250,000	**D = B * C**

Component Revenues			Proportional Allocation		Weighted Allocation	
1	50,000,000	**E**	639,205	**= (E/A) * D**	507,035	**= (SQRT E/ sum of SQRT of E through J) * D**
2	45,000,000	**F**	575,284	**= (F/A) * D**	481,016	**= (SQRT F/ sum of SQRT of E through J) * D**
3	34,000,000	**G**	434,659	**= (G/A) * D**	418,112	**= (SQRT G/ sum of SQRT of E through J) * D**
4	20,000,000	**H**	255,682	**= (H/A) * D**	320,677	**= (SQRT H/ sum of SQRT of E through J) * D**
5	16,700,000	**I**	213,494	**= (I/A) * D**	293,030	**= (SQRT I/ sum of SQRT of E through J) * D**
6	10,300,000	**J**	131,676	**= (J/A) * D**	230,129	**= (SQRT J/ sum of SQRT of E through J) * D**
Total	**176,000,000**		**2,250,000**		**2,250,000**	

Assignment

Using the following information from Carrefour's 2013 and 2014 financial statements, and assuming that Carrefour issues separately audited financial information for each country listed, provide an initial allocation of materiality for 2014 among Carrefour's group components (consisting of France, Other European countries, Latin America, Asia). Use total group sales as the basis for establishing materiality.

Table 3: Carrefour 2014 Sales by Segment/Country (in € millions)

	2013 Net Sales	2014 Net Sales
France	35,438	35,336
Total France	**35,438**	**35,336**
Spain	7,798	7,787
Italy	4,771	4,688
Belgium	3,968	3,968
Poland	1,677	1,679
Romania	1,006	1,069
Total Rest of Europe	**19,220**	**19,191**
Brazil	10,855	11,148
Argentina	2,930	2,743
Total Latin America	**13,785**	**13,891**
China	4,990	4,888
Taiwan	1,453	1,400
Total Asia	**6,443**	**6,288**
Total	**74,886**	**74,706**

Source: Carrefour 2014 annual report.

CASE 2 – ADJUSTING FOR RISK: SOMETHING SMELLS FISHY IN SPAIN

Spain is the second most important market for Carrefour after France. Carrefour has 174 hypermarkets in Spain and there are more hypermarkets under construction or planned.

Figure 2: Number/Type of Stores in Spain

	Number of stores as of December 31		Sales area *(in thousands of sq.m.)*	
	2013	2014	2013	2014
Spain	**456**	**582**	**1,733**	**1,770**
Hypermarkets	172	174		
Supermarkets	118	123		
Convenience stores	166	285		

Source: Carrefour 2014 annual financial report.

Spain suffered during the financial crisis of 2008-2012. According to an article in 2013 in *The Telegraph*, a British news outlet:

“Spain [was] forecast to be the only country among the 17 nations of the Eurozone to remain in recession in 2013. Unemployment, already at 24.3 percent, is expected to worsen. Half of all Spaniards aged between 18 and 25 are out of work – youth unemployment in Spain now exceeds 50 percent, matching that of Greece. Blocked out of a labour market that favours older employees on permanent contracts who are expensive to fire, youth workers in Spain have suffered the brunt of the economic crisis” (Govan 2012).

During 2014, increased attention to operating costs and product pricing led to cost reductions and higher gross margins. The trend in sales in Spain also reversed in 2014. According to the *Financial Times*, “Carrefour said fourth-quarter [2014] sales in Spain returned to growth for the first time since the financial crisis, adding to an improving outlook for the group’s European operations” (Thomson 2014).

Figure 3: Carrefour Stock Price Trend, July to December 2014

Source: Carrefour Group website.

However, given the decline in Carrefour stock price during the fourth quarter of 2014, pressures and incentives to improve earnings were likely very high.

Allegations have been made about potential mislabeling of fish sold by grocers in Spain, including Carrefour. According to an article by the Center for Public Integrity, updated in May 2014, a DNA study found that almost one in 10 fish were mislabeled (see Cabra, Rey, and Willson 2014). A later study discovered mislabeling in almost 40 percent of samples.

According to the article,

> "The Spanish public is being cheated by a seemingly pervasive and dangerous form of commercial fraud: Different species — including cheaper fish such as catfish from Vietnam and grenadier from the Pacific Ocean — are sold as hake in markets across Madrid … Mislabeling could bump the bottom line of companies that pass off cheap fish as higher-quality fillets, and may even mask illegal fishing, marine biologists and economists say. The European Union has strict regulations requiring that a paper trail follow fish from ship to shop. But the law doesn't require that inspectors implement DNA testing to verify accurate labeling."

Carrefour has been associated with controversies in the past that resulted in fines and public acknowledgement of these practices. Specifically, the company was convicted of false advertising and accepting kickbacks from wholesalers to sell products below cost. The company has also been fined in the past for violations related to insufficient tracking of food products,

incorrect labeling (e.g., where packaged meat labels indicated an inflated weight or expiration dates were modified to sell products after expiration), and improper storage of food products (e.g., keeping refrigerated products in warehouses at warmer temperatures to reduce utility costs).

Mislabeling certain fish could lead to increased margins and profitability. Given that impairment losses had been incurred in recent years on assets located in Spain due to the recession, improved profitability could potentially lead to reversals of impairments on certain stores in Spain, further boosting current period earnings. Under International Accounting Standard (IAS) 36, *Impairment of Assets*, an impairment loss is recognized whenever the recoverable amount of the asset is below the carrying amount. However, unlike U.S. GAAP, the reversal of an impairment loss related to tangible or intangible assets (other than goodwill) is also recognized when there is an indication that an impairment loss may be decreased. The increased balance after the reversal should not exceed what the depreciated historical cost would have been had the impairment never been recognized. The reversal of an impairment loss is recognized in earnings.

Assignment

Answer the following questions:

1) Given that Carrefour has been involved in controversies in the past and pressures are high to increase earnings in a country that has sustained impairment losses in previous years, how would this information affect your inherent risk assessments for Spain? How would it affect your allocation of materiality to the Spain component of the group financial statements?
2) Why would this practice of fish mislabeling be difficult for auditors to detect? In what ways could it lead to misstatements in the financial statements? Which accounts/assertions would be most likely affected?
3) In what ways does IAS 36 increase the risk from an audit perspective as opposed to ASC 360-10-35 under U.S. GAAP?
4) What specific audit procedures would you propose to include?

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CASE 3 – REGULATORY AND REPORTING DIFFERENCES

French Audit Regulations

In France, joint audits became a legal requirement in 1966. A joint audit is an audit by two or more audit firms to produce a single audit report. In a joint audit, each audit firm is typically involved in planning where the allocation of audit fieldwork is decided. Each audit firm prepares reports summarizing the audit work performed, which are reviewed by the other audit firms. Significant group-level issues are reviewed jointly (i.e., by all audit firms) and reports are issued jointly to various stakeholders.

In 2014, the European Union (EU) enacted legislation which requires publicly listed companies, including banks and insurance companies, to rotate auditors after 10 years.[1] This rotation period can extend an additional 10 to 14 years if the company allows other audit firms to bid on the audit engagement or is subject to a joint audit. The legislation also places certain restrictions on providing non-audit services to audit clients.

Reporting on Financial Statements

Below is the audit report issued for Carrefour's 2014 consolidated financial statements.

Figure 4: Carrefour 2014 Audit Report

1. **Opinion on the Consolidated Financial Statements**

We conducted our audit in accordance with the professional standards applicable in France; those standards require that we plan and perform the audit to obtain reasonable assurance that the Consolidated Financial Statements are free of material misstatement. An audit involves performing procedures, using sampling techniques or other methods of selection, to obtain audit evidence about the amounts and disclosures in the Consolidated Financial Statements. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made, as well as the overall presentation of the Consolidated Financial Statements. We believe that the evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

In our opinion, the Consolidated Financial Statements give a true and fair view of the financial position and the assets and liabilities of the Group as of December 31, 2014, and of the results of its operations for the year then ended, in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union.

Without qualifying our opinion, we draw your attention to the matters set out in Notes 1.2 and 4.1 to the Consolidated Financial Statements which expose the first application as of January 1, 2014 of standards IFRS 10, 11, 12 and IAS 28 revised and the early application as of January 1, 2014 of the interpretation IFRIC 21 retrospectively.

2. **Justification of assessments**

The accounting estimates used to prepare the Consolidated Financial Statements were made in an uncertain economic environment in several countries in the euro zone, in particular Italy, which makes it difficult to anticipate the economic outlook. It is within this context that, in accordance with the provisions of Article L. 823-9 of the French Commercial Code relating to the justification of our assessments, we bring to your attention the following matters:

Note 1.3 to the Consolidated Financial Statements states that the Company's Group's Management uses estimates and makes assumptions that may affect the book value of certain assets and liabilities as well as the accompanying notes to the Financial Statements. Note 1.3 also states that, depending on the evolutions of those assumptions, the book value of these assets and liabilities in the future Financial Statements may differ from the current estimates.

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[1] The EU refers to these companies as public interest entities.

We have notably verified the followings:

- your Group has performed at year-end an impairment test of goodwill and an assessment of the recoverability of other intangible and tangible assets as soon as there was any indication of impairment, according to the methodology described in Note 2.6.4 to the Consolidated Financial Statements. We have reviewed the methodology used to conduct the impairment tests and the identification of triggers of impairment, as well as the cash flow forecasts and assumptions used and verified the appropriate information provided in Note 17 to the Consolidated Financial Statements. We have reviewed the calculations performed by your Group; we have compared previous periods' accounting estimates with actual results and reviewed Management's approval process of these estimates;
- with respect to provisions, we have assessed the basis upon which such provisions have been set up, reviewed the Group's procedures to identify them, their assessment, and their recording and reviewed the information relating to the risks presented in Notes 29, 30, and 31 to the Consolidated Financial Statements.

These assessments were made as part of our audit of the Consolidated Financial Statements taken as a whole and therefore contributed to the opinion we formed which is expressed in the first part of this report.

3. Specific verification

As required by French law, and in accordance with the professional standards applicable in France, we have also verified the information presented in the Group's management report.

We have no matters to report as to its fair presentation and its consistency with the Consolidated Financial Statements.

The Statutory Auditors

Courbevoie, Paris-La Défense and Neuilly-sur-Seine, March 4, 2015

French original signed by

MAZARS	KPMG audit Department of KPMG SA	DELOITTE & ASSOCIÉS
Pierre Sardet	Éric Ropert Patrick-Hubert Petit	Arnaud de Planta

Source: Carrefour 2014 annual financial report.

Assignment

Answer the following questions:

1) What are the potential benefits of having a joint audit? What are some potential unintended consequences or difficulties that arise with joint audits?
2) What are the potential benefits of audit firm rotation? What are the potential costs? Why do you think the EU implemented these rules?
3) How does the audit report for Carrefour differ from the typical audit report of a U.S. publicly listed company such as Walmart?
4) What reporting option does an auditor have in the U.S. that is similar to the third paragraph under the first section titled Opinion on the Consolidated Financial Statements? Why do you think auditors in the U.S. don't use this option more often?

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