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Legal Supervision of Audit Practice in Corporate Takeovers

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ABSTRACT

Auditing services are active throughout corporate takeover process. Audit issues not only affect the nature, efficiency and consequences of takeovers, but also matter the quality and social effects of corporate development after the successful reorganization. This paper aims to enhance the audit quality in the takeover process, and further improve the structure, productivity and social responsibility of takeover parties. Qualitative analysis method and case study are adopted in this paper to investigate the legal issues on audit involved in the takeover process, and explores their fundamental reasons and negative effects on the development of companies and society. This paper finds that since the acquiring companies need to master the comprehensive information of target companies, they incline to choose the audit firms associated with the target companies. Those firms have the opportunity to collude with the target companies and may damage the takeover performance by hiding decision-making power or even falsifying financial data[1]. In addition, in order to defeat other potential competitors, acquiring companies need to review the financial records and assess the key personnel of target companies within a limited time. They may miss out some technical issues of corporate governance at the stage of pre-takeover due diligence.[2] *Therefore, this paper suggests that takeover parties adopt shared audit. As the information intermediary, shared audit could effectively eliminate the illegal acts caused by the collusion among auditors and auditees, convey accurate information and promote higher-quality takeovers.[3]*

Keywords: Audit quality; corporate takeover; decision-making power; due diligence; shared audit

INTRODUCTION

The rapid expansion of economic scale accelerates takeover activities among companies,[4] and some companies even undertake unrelated takeovers in order to increase product lines or diversify businesses.[5] As a significant way of asset restructuring, corporate takeovers have some superiorities. For instance, before a takeover the acquiring company needs to select a target company in accordance with their own business conditions. The target company usually has certain comparative resource advantages, such as human resources, market resources and mature operation system. These could bring beneficial effects to the development of acquiring company, and enhance its competitiveness.[6] On the other hand, in the long run takeover transaction creates value, and its earnings are commensurate with the historical performance of acquiring company and the pre-takeover value of target company.[7]

However, not all corporate takeovers are favorable. Alhenawi and Stilwell addressed that the takeover value creation depends on not only the pre-takeover value of target company, but also the capability of acquiring company.[8] In other words, if the acquiring company has weaker takeover capability, it may result in a failure to create business value after the takeover or even damage the original interests of both parties. In addition, corporate takeover is a process of resource integration. If the regulatory bodies do not closely supervise such a process, it may lead to the market monopoly, which will ultimately harm the fair and stable development of companies, society and even the nation.

Corporate takeover process usually begins with due diligence, which must be based on multilevel analysis to identify the market risks and opportunities, industrial characteristics and competitive positioning advantages of target company.[9] Rigorous auditing on due diligence process could help the acquiring company to legally make use of new business opportunities and minimize takeover risks.[10] On the contrary, if the auditor or auditing agency misstates the takeover risks due to insufficient experiences or information asymmetry, or in collusion with any takeover party for financial fraud, it will damage the takeover benefits, or even lead to the failure of takeover. Thus, although takeover activity has drawbacks, it can still bring value to the companies by improving audit supervision and enhancing audit quality in the takeover process.

Abdelmoula and Affes argued the need for supplementary regulation to preserve the independence of auditors and restore the confidence in audited financial statements.[11] In October 2010, the European Commission (EC) had published a 'Green Paper'—Audit Policy, which is one of the measures taken to develop audit system, enhance audit quality and generate competitive market.[12] In China, corporate takeover legislation and supervision have been progressively highlighted along with the development of economy. It is considered that the government needs to attach importance to constitute safe legal norms, and provide clear legal references for takeover activities.[13] Besides, the 'Measures for Administration on Major Asset Reorganization of Listed Companies (2020 Version)' also prescribes that China Securities Regulatory Commission (CSRC) should strengthen the scrutiny of legal and financial issues in corporate takeover process.[14] To ensure the audit quality and audit supervision, this paper proposes both acquiring company and target company to adopt shared audit in the takeover process. The purpose of promoting shared audit is to guarantee the independence of auditors and further enhance their professional services. It is believed that shared audit could effectively evade the legal problems affecting the takeover quality and efficiency in practice.

LITERATURE REVIEW

Takeovers could facilitate companies to expand business scale, save their time for market development and talent training, and further generate corporate synergetic effect among production, technology, capital, management and other aspects. Granlund argued that the motives of corporate takeovers are usually related to strategic concerns with explicit value-adding objectives.[15] Zhang and Ebbers emphasized that obtaining advanced technology is one of the most important motivations for developing countries to promote corporate takeovers.[16] Fraser and Zhang found that corporate takeovers particularly cross-border takeovers could effectively improve target performance after they investigate the representative takeover cases between 1980 and 2001 from banking organizations.[17] Hund, Monk and Tice further pointed out that the short-term valuations of corporate takeovers could be misleading since the true benefits of takeovers gradually materialize over time as the value of new entity progressively moves towards a new equilibrium.[18]

Nevertheless, takeovers could also bring adverse effects on companies. Burns and Scapens argued that institutionalized practices in corporate takeovers could discourage changes, particularly the changes that endanger the existing norms, values and cultures.[19] Merrett and Houghtou explained that corporate directors have potential opportunity to undertake adverse selection and moral hazard. They might recommend acceptance of a takeover bid to protect their own tenure rather than maximize shareholders' wealth. They might also auction the company to maximize the bid price despite they have little equity exposure. When negotiating with the bidders, corporate directors might seek to protect the interests of staff. They might intentionally cover up this behavior in front of shareholders, which could threaten the success of negotiations.[20] Dounis claimed that takeover transactions are frequently accomplished in a limited timeframe, whereas the senior management of acquiring company could not manage to fully take into consideration the deficiencies of target company. It might lead to a high failure rate of takeovers in creating value for the shareholders of acquiring company.[21]

Han opined that corporate takeover should be monitored by the board of supervisors, whereas their independency and capability are not strong enough. The representatives of board of supervisors are usually nominated and appointed by major shareholders, whose role is to safeguard the interests of major shareholders and cooperate with the board of directors and the management in their work. On the other hand, the representatives of employees recommended by labor union are under the leadership of directors and managers in the company, and their behaviors are susceptible to the influence of board of directors and management. As a result, the supervisory function of board of supervisors and representatives of employees becomes ineffective, and the supervisors from employees and shareholders could not play their due role in monitoring the malpractices of major shareholders and management.[22] Lu indicated that the anti-monopoly issues in corporate takeovers need special attention, and the anti-monopoly declaration is crucial. If the asset acquisition meets the threshold value of business operation against Anti-monopoly Law, it should be declared to the Ministry of Commerce.[23]

Chiriac argued that the lack of due diligence analysis is one cause of takeover failure. Due diligence is a detailed analysis of both acquiring company and target company about their finances, management and assets.[24] Tang, Xia and Lian clarified that in the process of due diligence, accountants could perform the function of risk filtering, and issue audit reports as an independent third party for most takeover transactions.[25] Dounis elaborated that corporate takeovers are usually bounded with rigorous regulatory frameworks in order to promote competitive advantages and avoid monopolies. This has increased the takeover cost and resulted in their high failure rate, particularly in the European Union (EU). Internal auditors could help to ensure these tough financial and management issues in compliance with laws and regulations in the takeover process on the basis of their expertise and responsibilities.[26] Chiriac also addressed that the internal auditors have evolved from traditional roles to active consultants. They could analyze the takeover deficiencies and examine the takeover risks, and provide the acquiring company with vital information about the financial condition and value of target company to safeguard the successful takeover process.[27]

On the other way round, Lei and Wang found that in the takeover process the target company might make use of accounting policy change, accounting estimate change and accounting error correction to overstate its profits and net assets, and sugarcoat its accounting statements to raise the takeover price.[28] Jiang and Xu mentioned that corporate takeovers involve two or more stakeholders, who might influence or interfere the audit work in various ways. If the auditors are affected by emotion, the objectivity of their work will not be guaranteed. The audit firm usually conducts due diligence with the focus on financial statement analysis rather than system testing, certificate review, circularization and other procedures. It results in the inadequate execution of audit procedures, e.g., substandard sampling proportion of inventory and underestimated physical asset inventory, which further leads to the deviation on the actual value of target company.[29] Iyer, Bamber and Barefield opined that corporate employees usually keep good relationship with audit firms, and they might provide economic benefits to those firms. If they are senior corporate officers, they might recommend the company to appoint those audit firms to serve takeover transactions.[30] This could threaten the audit quality and results argued by Lennox and Park.[31] Campa and Donnelly indicated that audit independence is compromised by the size of non-audit service fees, particularly for clients who pay below the level of expected audit fee. If the non-audit service fees remain high, the clients might overlook the objectivity, comprehensiveness, rigor and accuracy of audit procedures and focus more on audit behavior itself. As a result, the audit for corporate takeovers will be merely a formality rather than a matter of quality.[32] Liu and Wang found that there is a significant negative correlation between shared audit and the probability of financial irregularities in many enterprises, particularly supply chain enterprises. In other words, shared audit could effectively reduce corporate financial violations.[33] Cao and Pham further explained that shared auditor could act as an informational intermediary to facilitate the behavioral spillover between their clients when exposed to higher reputation and litigation risks. The spillover of accounting conservatism from recipient clients to nonrecipient clients of the same auditor is more pronounced when their financial statements are more comparable. Additionally, the impact of shared auditor on financial reporting can also attract the attention of capital market investors.[34]

RESEARCH METHODOLOGY

This paper mainly adopts qualitative analysis to investigate the impacts of takeovers on business operation and development, clarify the role of auditors in servicing both takeover parties, and determine the legal boundaries for such auditing services in the context of corporate governance. After examining the data and information collected from academic articles and social media, it is found that corporate takeovers have dual effects on business development and market competition. To identify the negative effect, this paper scrutinizes the potential risks of takeover process, pinpoints the loopholes of due diligence, and appraises the dilemma of audit practice, particularly through the case studies of Ruihua Certified Public Accountants (Ruihua) in *Hercules Logistics vs. Osman Investment & Development* and *Yunfeng Group vs. Greenland Group,* as well as Deloitte and KPMG in *Hewlett-Packard Enterprises (HP) vs. Autonomy Corporation (Autonomy)*. In addition, the particular interview feedbacks from auditors also demonstrate that either acquiring company or target company may cook the books with the help of accountants to manipulate takeover prices and disturb market competition. They may collude with accountants and auditors to fabricate data in corporate financial reports to achieve the ultimate takeover objectives for their own benefits. In response to these problems and minimize the negative effect of fraud and collusion, this paper advocates rigorous legal supervision on the auditing practice for corporate takeovers.

However, some limitations also apply to the methodology of this paper. It is difficult to conduct large-scale surveys and in-depth interviews among the auditors and practitioners in takeover transactions due to the research budget limit. The case studies have to be mainly based on the government announcements, institutional reports and media news rather than the internal information directly from the companies due to their business secret protection. These could create the obstacles to clarifying the legal boundary of auditing services.

CASE REVIEW

CASE 1: RUIHUA IN HERCULES LOGISTICS VS. OSMAN INVESTMENT & DEVELOPMENT AND YUNFENG GROUP VS. GREENLAND GROUP

Ruihua ranked the second among China's accounting firms according to the comprehensive evaluation by Chinese Institute of Certified Public Accountants (CPA) in 2016. In 2014, Hercules Logistics had large capital transactions with Osman Investment & Development. Although Ruihua's accountants understood the relevant situation and randomly checked the capital transaction certificates, they did not pay special attention to them, did not make proper judgment on the nature of large amount of capital transactions between Hercules Logistics and its controlling shareholders, and did not find the disclosure problem of related parties' transactions. On 20th April 2016, Hercules Logistics received the administrative punishment decision issued by Shenzhen Securities Regulatory Bureau. It shows that Ruihua and its accountants have problems in their practice, and requires Ruihua to submit a written report on its rectification within 20 working days after receiving the decision.

In June 2016, National Association of Financial Market Institutional Investors (NAFMII) found that the financial information of Yunfeng Group disclosed by Greenland Group was significantly different from the financial information disclosed by Yunfeng Group itself. As the annual report auditor of Greenland Group, Ruihua should be fully aware of the bond issuance report data, which can also be found on the website of National Interbank Funding Center, disclosed by its merged company Yunfeng Group. However, Ruihua did not pay attention to the data differences between the report issued by Greenland Group and the report issued by Yunfeng Group, and it deliberately hid the facts in order to retain its clients. As a result, Ruihua received a fine from NAFMII, and a further warning letter from Shenzhen Securities Regulatory Bureau on 29th November 2016. In the first quarter of 2017, Ruihua was severely punished by the CSRC for failing to exercise duty of diligence and maintain professional suspicion and caution. On 21st June 2017, NAFMII issued a penalty notice to Ruihua to suspend its business for a year.

From the perspective of listed companies, three consecutive years of annual losses will result in the company facing the risk of suspension from securities trading. Some companies chose to falsify their financial reports in order to maintain 'good' business performance. Driven by economic interests, auditing service nowadays has become a kind of commodity traded by money in the market economy. In order to increase audit income and gain the favor of listed companies, accounting firms may violate professional standards, reduce the cost of quality control, relax the supervision of internal staff, and further disrupt market competition. On the other hand, the implementation of external supervision on accounting firms is insufficient, and the administrative punishment measures do not play better warning roles. As a result, corporate management maintains long-term personal relationship with auditors, and can do anything for profits, including financial fraud. A Chinese accounting expert Ma wrote sharply in his article '*Do not expect CPA to find financial fraud*': the listed companies pay audit fee to accounting firms. Can listed companies invite CPA to slap their own face? If yes, they will not invite CPA next time.[35]

CASE 2: DELOITTE AND KPMG IN HP VS. AUTONOMY

In the summer of 2011, HP announced its USD 11.1 billion takeover of Autonomy, a British software company, as it tried to catch up with rivals such as IBM in the market for enterprise application software. The deal, pushed by HP's former CEO Leo Apotheker, was eventually approved by the Board of Directors, although it was criticized by Silicon Valley too expensive and strongly opposed by the company's CFO. At the time, the Board of Directors relied on Deloitte's financial review of Autonomy. As part of its due diligence, HP also hired KPMG to audit the review report of Deloitte, and investment banking intermediaries such as Barclays were involved into the deal too. However, none of them could find anything wrong. Until April 2012 when Autonomy's founder Mike Lynch was fired and a senior member of Autonomy's leadership team stepped forward to blow the whistle, HP just found a series of questionable accounting and business practices at Autonomy. It led HP to acquire Autonomy at a wildly inaccurate valuation, and resulted in a USD 8.8 billion write-down on the USD 11 billion deal. HP blamed the write-down on Mike Lynch and several other executives of Autonomy, leading to investigations by the US Securities and Exchange Commission and the UK Serious Fraud Office in late 2012. After a two-year investigation, the UK Serious Fraud Office announced its findings: there was not enough evidence to prove that Mike Lynch and other former Autonomy executives orchestrated the financial fraud.

Although HP did not directly identify Autonomy's actions as business fraud, its specific allegations against Autonomy clearly indicated the nature of these actions. The allegations included falsifying low-margin hardware sold at a loss into high-margin software sales; falsifying the losses caused by the sales of above products as marketing expenses; concealing licenses for software sold through reseller channels; and improperly recording software service revenues, etc. HP's former CEO Leo Apotheker worked with HP and regulators to get to the bottom of the matter, and claimed that the takeover due diligence process was 'meticulous and thorough'. As a matter of fact, the accounting scandals surfaced at Autonomy as early as 2009, which had alarmed some audit analysts. However, instead of conducting a thorough and adequate investigation internally, HP preferred to hire external auditing institutions to investigate. When HP announced its takeover of Autonomy, it ignored the analysts' warnings of serious accounting fraud. Autonomy took the liberty of treating deferred revenue as current revenue, which did not include any revenue for future services. Such a big problem would be easy to spot, but CPA never raised it. Deloitte and KPMG, the auditors involved in the takeover, also issued statements saying that they had absolutely no knowledge of any misrepresentation in Autonomy's financial statements and denied complicity in any accounting misconduct or misrepresentation.

Nevertheless, the impact of this takeover scandal on HP is not short-term. The change of corporate management, the transformation of business model, the sharp decline of market value, the great difficulty of new business development, and the lack of customer trust had resulted in the great negative impacts on the long-term stable development of HP. HP's attorney Laurence Rabinowitz said that 'Autonomy increasingly cooked its books to keep revenue on an upward trajectory until the whole company began to resemble a Ponzi scheme'. The root causes for this takeover scandal are deeper and structural, more difficult to manage, especially where their weight in the calculus of decision making may be underestimated due to other biasing factors such as monetary incentives, personal ego, professional self-aggrandizement and groupthink, etc.[36] Hence, the performance of shared audit as a check on bad accounting is material, and the responsibility of CPA in a corporate takeover case should be consistent with the norms of 'best practices of professional standards'.[37]

RESULTS AND DISCUSSION

The audit of accounting firm plays an effective role in monitoring asset appraisal in the takeover process. It can restrain the opportunistic behaviors of management and make up the deficiencies of internal governance mechanism to a certain extent.[38] Shared audit is a wake-up call for management opportunistic behaviors, and could effectively restrain the financial irregularities of enterprises. During the takeover transaction, acquiring company shall conduct the maximum due diligence on target company, fully disclose the pricing information, valuation methods and important financial information to the society, and minimize the financial risks resulted from asset appraisal manipulation through extensive supervision by the public, media and regulatory agencies, etc. Anandarajan, Kleinman and Palmon argued that enhancing the independence of auditors has been far reaching.[39] In the EU, the Enterprise Code Amendment Act provides for the statutory audit of annual accounts and consolidated accounts. It strengthens the importance of internal control systems to minimize financial, operational and compliance risks, enhance the quality of financial reporting, and provide wider competences for the audit committee. On the other hand, it also imposes more rigorous requirements on auditors, including compliance with international accounting standards and internal rotation systems, plus cooling-off periods for key audit partners to ensure the independence of auditors. Furthermore, this Act provides that stock-listed companies must issue annual corporate governance declarations in which they declare which provisions of the corporate governance they do or do not comply with and explicate their implementation of those provisions.

The audit failure of Arthur Andersen on Enron Corporation confirms the importance of audit independence. As an energy company in Houston, Texas, Enron Corporation formally filed for bankruptcy protection to the court on 2nd December 2001, with assets itemized in the bankruptcy list as high as USD 49.8 billion. Arthur Andersen had begun to audit Enron Corporation since 1985 and subsequently performed its internal audit, external audit and consulting services. On 14th March 2002, the US Department of Justice filed criminal charges of obstruction of justice against Arthur Andersen for destroying corporate documents and computer records in the wake of the Enron scandal, which created the first criminal investigation on a major accounting firm in the US history. Since 31st August 2002, Arthur Andersen ceased to engage in the audit business for public listed companies. From then on, more than 2000 listed company clients successively left Arthur Andersen.

Some business media opined that Arthur Andersen was unfortunately picked as a scapegoat by the federal government. It sent a message to the public accounting community that accountants must take more responsibilities for the financial irregularities of their auditing clients. Arthur Andersen later acknowledged that the audit committee and its advisory team had identified a number of Enron Corporation's transactions, in which Arthur Andersen had played a significant role. These transactions had either been improperly interpreted or improperly reported to the shareholders. In 2000 alone, the auditors found that the improper accounting on Enron Corporation's business transactions in which Arthur Andersen played a significant role was nearly USD 1 billion in additional net income, USD 1.3 billion in additional cash flow, a USD 2.9 billion reduction in debt on the balance sheet, and USD 1.4 billion in additional shareholder equity. The released audit report concluded that Enron Andersen could not make many misrepresentations in its financial statements without the active assistance of independent auditors.

An investigation by the US regulatory authorities found that more than 100 of Enron Corporation's employees came from Arthur Andersen, including the senior staff such as Chief Accountant and Chief Financial Officer. Whereas half of the directors on Enron Corporation's board of directors were directly or indirectly related to Arthur Andersen. Media and other critics had focused on the consulting fees and other non-audit service fees paid by Enron Corporation to Arthur Andersen. Critics accused Arthur Andersen of losing its responsibility to provide effective and independent oversight on the accounting practice of Enron Corporation from which it collected large amount of non-audit fees.

The International Auditing and Assurance Standards Board (IAASB) also emphasizes on audit quality and uniformity of audit practice throughout the world, and strengthens public confidence in the global auditing and assurance profession.[40] Its strategy for 2020-2023 and work plan for 2020-2021 sets three objectives during 2020–2023: 1) to increase the emphasis on emerging issues to ensure that the IAASB International Standards provide a foundation for high-quality audit, assurance and related services engagements; 2) to innovate the IAASB's ways of working to strengthen and broaden our agility, capabilities, and capacity to do the right work at the right time; 3) to maintain and deepen relationships with stakeholders to achieve globally relevant, progressive and operable standards. These objectives require the independence of auditors. The appointment and payment of auditors must independent from clients and corporate management. In addition, due professional care requires the auditor to exercise professional skepticism. If performing non-audit services for clients impair auditors' attitude of professional skepticism, the auditors are not in compliance with the standard. Audit frauds, whether committed by corporate senior management or other employees, should be directly reported to the audit committee. Meanwhile, the clients should also be aware of the risk of information leakage by auditors.

From the perspective of regulatory supervision, the corporate takeover risk monitoring system should be established. The Institute of Certified Public Accountants, CSRC and the public are all important external supervisors. Once they found that corporate takeovers involve financial fraud and other related behaviors, they should severely punish those who violate the law and discipline. Moreover, other parties involved in the audit may provide incorrect information about corporate takeovers, and their opinions on the financial statements may affect the objectivity and fairness of takeovers. Rigorous guidelines must therefore be imposed on them to minimize the possibility of potential dispute and to establish accountability for the work done.

The low audit pricing strategy adopted by accounting firms in the face of competitive pressure has seriously affected the reasonable allocation of audit resources, and making it difficult to supply high-quality audit. Whereas the lawsuit mechanism has little effect on audit quality. In this case, the government control implemented by the regulatory department with CSRC is indispensable to the audit quality. Liu and Li found that administrative punishment could improve audit quality through the audit market reputation mechanism. As the public is more sensitive to bad news than good news, when an accounting firm is punished by CSRC or a listed company audited by an accounting firm is punished by CSRC for financial fraud or self-seeking misconduct, it sends a signal of low audit quality to the public.[41] At this time, such an accounting firm will usually face more and more severe supervision from the regulators and the public, which could force it to improve its audit quality.

In the process of takeover transactions, shared audit could generate a potential 'external supervision mechanism'. It could increase the probability of detecting improper trading of management, alert the manipulation of management, and protect the interests of stakeholders.[42] On the other hand, it could also facilitate to assess the risk of material misstatement, identify corporate financial irregularities, and further target audit procedures. Meanwhile, auditors themselves could benefit from knowledge sharing within audit firms, and enhance their professional service capabilities and experiences.

As the increasing participation of accounting firms in the takeovers of listed companies, the government should strengthen the regulation on auditors' occupational ethics, prevent the occurrence of collusive behaviors, keep this kind of 'active participation' in a virtuous circle, realize the fusion of formal system and informal system, and promote the sustainable development of corporate takeover market. It is also necessary for CSRC and the related regulatory bodies to impose strict administrative penalties on accounting firms that violate laws and regulations.

Wang, Li, Su and Tang however found that based on the sample study of accounting firms and CPA punished by CSRC from 2001 to 2009, the audit quality of both accounting conservatism and discretionary accrual measures has not improved.[43] Li and Ren further argued that from the perspective of audit opinions and audit fees, administrative penalties do not significantly reduce the probability of issuing non-standard audit opinions, nor make the accounting firms and CPA punished by the market for reputation damage. It does not have a significant error correction function.[44] Hence, legal supervision and penalty should play a dominant role ensuring audit quality in corporate takeovers.

In the case of transnational takeovers, auditors should be more independent to ensure audit quality, maintain fair and equitable market competition and safeguard the interests of companies, industries and countries. The objectives of transnational takeovers are normally to expand and diversify the market and gain profits by exporting capital, technology and management experience. At the same time, transnational takeovers could also weaken the competitiveness of target companies, and result in the disappearance of national brands. The foreign companies with strong financial backing, advanced technology and management experience could easily beat out their domestic competitors and monopolize the market. In addition, due to the impact of international financial crisis, trade protectionism in the United States, the European Union and other major countries and regions has risen. It leads to the increased mistrust and wariness among countries, and sparks a wave of anti-globalization.

Typically, transnational takeovers initially need to go through the review and examination of foreign investment committee in the target country to determine whether they generate monopolies or endanger national economic security. The government usually formulates industrial guidance directories for the foreign investors, including 'industrial directory encouraging foreign investment', 'industrial directory restricting foreign investment' and 'industrial directory prohibiting foreign investment'. Foreign takeovers must be carried out in strict accordance with the directories, whereas violations of directories will trigger the punishment by Anti-monopoly Law, Competition Law, Antitrust Law, National Security Law and other laws. In addition, transnational takeovers could also involve money laundering. In order to protect market competition and the interests of consumers, many countries have enacted Anti-money Laundering Laws to maintain financial order, and curb money laundering crimes and other related crimes, such as drug crime, gangdom crime, terrorism crime, smuggling crime, corruption and bribery crime, financial fraud crime and so on.

Once passing the examination of foreign investment committee, transnational takeovers move to the substantive action stage, at which point auditors step in. It is worth noting that due to the different national conditions of takeover parties, the due diligence and corporate performance evaluation are more challenging for auditors. They should not only consider the rigid indicators such as corporate industrial structure, governance structure and business performance, but also take into account the uncertain factors such as foreign exchange rates, international financial risks and international relations. Thus, shared audit is more necessary for transnational takeovers to ensure audit independence and audit quality. In practice, many companies incline to choose world-renowned accounting firms, such as Deloitte, KPMG, Pricewaterhouse Coopers and Ernst & Young, to conduct the shared audit and facilitate the smooth progress of transnational takeovers. If any audit dispute is raised in the takeover process, it is more convenient to find legal remedies to protect the legitimate rights and interests of takeover parties. Besides, the communication and information exchange among shared audit firms could improve audit quality in the global capital market.[45] Effective audit cooperation could not only crack down on the illegal acts of cross-border securities trading, but also eliminate administrative barriers, reduce regulatory costs, and safeguard the economic security and national interests of the country.

CONCLUSION

It is worth noting that the independence of auditors could be promoted by shared audit in the process of corporate takeovers. As informational intermediaries, auditors could assist in reducing the information asymmetry and the agency conflicts among managers, directors and shareholders, and between shareholders and creditors.[46] Chircop, Johan and Tarsalewska addressed that shared audit could alleviate the information asymmetry, fully enhance the level of information disclosure in the process of corporate takeovers, and effectively improve the exchange and communication efficiency of both takeover parties. Meanwhile, it could also maximize the convergence of the interests of both takeover parties, and effectively restrain the degree of takeover premium.[47]

A bidder who shares an audit firm with a potential target may have information advantages over other bidders during the bidding process, and this advantage will manifest in an increased likelihood of submitting a bid for the target. The shared audit could not only help the acquiring company to obtain information in time and select the appropriate target company, but also help the target company to choose the acquiring company that can bring more development space for itself. This could effectively reduce the takeover transaction cost, and improve the takeover performance of both parties.[48] The studies show that auditors play a key role in improving the transparency of accounting information and exposing corporate financial irregularities. There is a significant negative correlation between the shared audit of supply chain enterprises and the probability of financial violations. In other words, shared audit could effectively reduce financial violations, and improve corporate governance efficiency by improving accounting information quality and reducing management earnings manipulation.

In addition, industry correlation affects the strength of shared audit in the takeover process. When both takeover parties are in the unrelated industries, the shared audit could play a better role. It is found that the shared audit conducted by both acquiring company and target company could to a large extent improve the possibility of a takeover, and in many cases is more favorable to the acquiring companies, which makes them have stronger bargaining power and bid less.[49] In the cases of cross-border takeovers, shared audit might minimize the uncertain factors, improve the takeover efficiency, and reduce the takeover premium.[50] In addition, shared audit is also a better approach to fight bribery and resist pressure from the senior corporate officers as they can force the managers to participate in informal discussions to reach their objectives.[51]

Nevertheless, shared audit might also be detrimental to corporate takeovers. As sharing confidential information about target companies with acquiring companies sometimes violate conflict of interest rules, the high (low) quality auditors will be less (more) likely to act as intermediaries in takeover transactions. When the shared auditors represent both acquiring company and target company in a takeover transaction, they are more likely to favor the acquiring company.[52] Although auditors are supervised and regulated on their services, they are still incentivized to provide value to clients beyond the scope of audit in order to retain clients and associated fees. Therefore, while promoting the positive role of shared audit in takeover transactions, its potential negative impact should also be considered and eliminated.

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