

# MAZARS LLP

## AUDIT QUALITY INSPECTION

JUNE 2018

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# The FRC

Our mission is to promote transparency and integrity in business.

transparency



We have responsibility for the public oversight of statutory auditors.

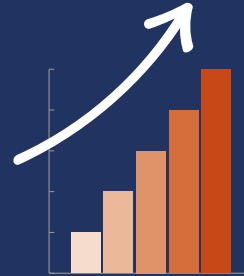
The FRC works with European, US and global regulators to promote high quality audit and corporate reporting.



# AQR

We monitor the quality of UK Public Interest Entity audits.

+1.55	0.20%	+2.27%	-11.48%	POS	-3.2320
+3.20	0.21%	+2.83%	-15.93%	NEG	-3.9993
+3.85	0.14%	+2.42%	-17.67%	POS	-4.2421
+3.38	0.27%	+2.19%	-18.32%	NEG	-4.2083
+3.12	0.27%	+2.28%	-14.73%	NEG	-3.5708
+3.31	0.20%	+2.76%	-20.12%	NEG	-2.8339



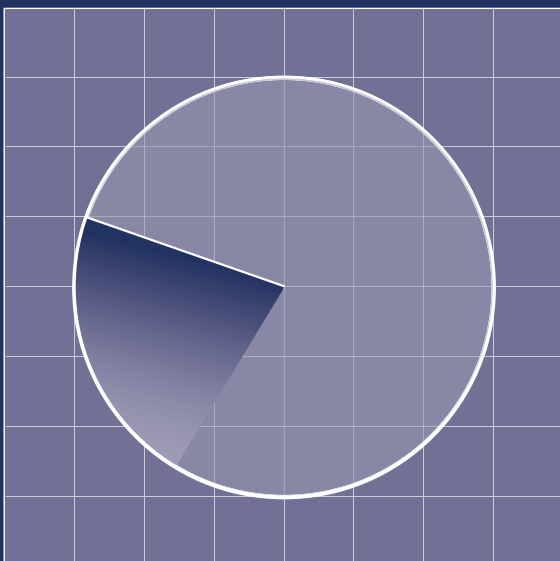
We promote continuous improvement in audit quality.

Our team of over 40 professional and support staff has extensive audit expertise to provide rigorous inspection of audit firms.



# The Firm

Mazars LLP has 36 audits within the scope of AQR inspection, none of which are in the FTSE 350.



# Our inspection process

There are around 2350 audits within the scope of AQR inspection. In total, we inspected 145 individual audits in 2017/18, including 5 at Mazars.



We work closely with audit committee chairs to improve the overall effectiveness of our reviews.

We assess the overall quality of each individual audit reviewed.



# Financial Reporting Council

## Mazars LLP

Audit Quality Inspection

### Contents

<b>1</b>	<b>Overview</b>	<b>4</b>
<b>2</b>	<b>Key findings requiring action and the firm's response</b>	<b>8</b>
<b>3</b>	<b>Good practice examples</b>	<b>15</b>

AQR's objective is to monitor and promote improvements in the quality of auditing.

AQR assesses the quality of audit work and policies and procedures supporting audit quality at firms which audit Public Interest Entities.

The FRC's mission is to promote transparency and integrity in business. The FRC sets the UK Corporate Governance and Stewardship Codes and UK standards for accounting and actuarial work; monitors and takes action to promote the quality of corporate reporting; and operates independent enforcement arrangements for accountants and actuaries. As the Competent Authority for audit in the UK the FRC sets auditing and ethical standards and monitors and enforces audit quality.

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# 1 Overview

This report sets out the principal findings arising from the 2017/18 inspection of Mazars LLP (“the firm”) carried out by the Audit Quality Review team (“AQR”) of the Financial Reporting Council (“the FRC”). We conducted this inspection in the period from May 2017 to March 2018 (“the time of our inspection”). Our last full inspection of the firm was in 2014/15. Going forward, we will inspect Mazars annually and report publicly on our findings.

Our report focuses on the key areas requiring action by the firm to safeguard and enhance audit quality. It does not seek to provide a balanced scorecard of the quality of the firm’s audit work. Our findings cover matters arising from our reviews of both individual audits and the firm’s policies and procedures which support and promote audit quality<sup>1</sup>.

We are grateful for the co-operation and assistance received from the partners and staff of the firm in the conduct of our 2017/18 inspection.

## Our assessment of the firm’s performance

The results of our reviews of individual audits showed that four of the five audits required no more than limited improvements. Across all our reviews, there are a number of findings that the firm needs to address, some of which are similar to findings from our last inspection in 2014/15.

The firm had made progress in revising its policies and procedures to address the new requirements of the revised Auditing and Ethical Standards. At the time of our review, improvements were required in certain areas, including the firm’s arrangements for the recording and monitoring of partner and staff financial interests and identification of Public Interest Entity (PIE) audits.

## Key findings in the current year requiring action

Further details of all our key findings are given in section 2, together with the firm’s actions to address them.

Our other key findings in the current year requiring action by the firm are set out below.

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<sup>1</sup> The firm was also included within the scope of our thematic review on Audit Firm Culture. The report, published in May 2018, sets out how audit firms are seeking to embed a culture which supports high quality audit: [Audit Culture Thematic Review](#)

### Review of firm-wide procedures

The firm should require specific performance objectives for audit quality in partner and staff appraisals.

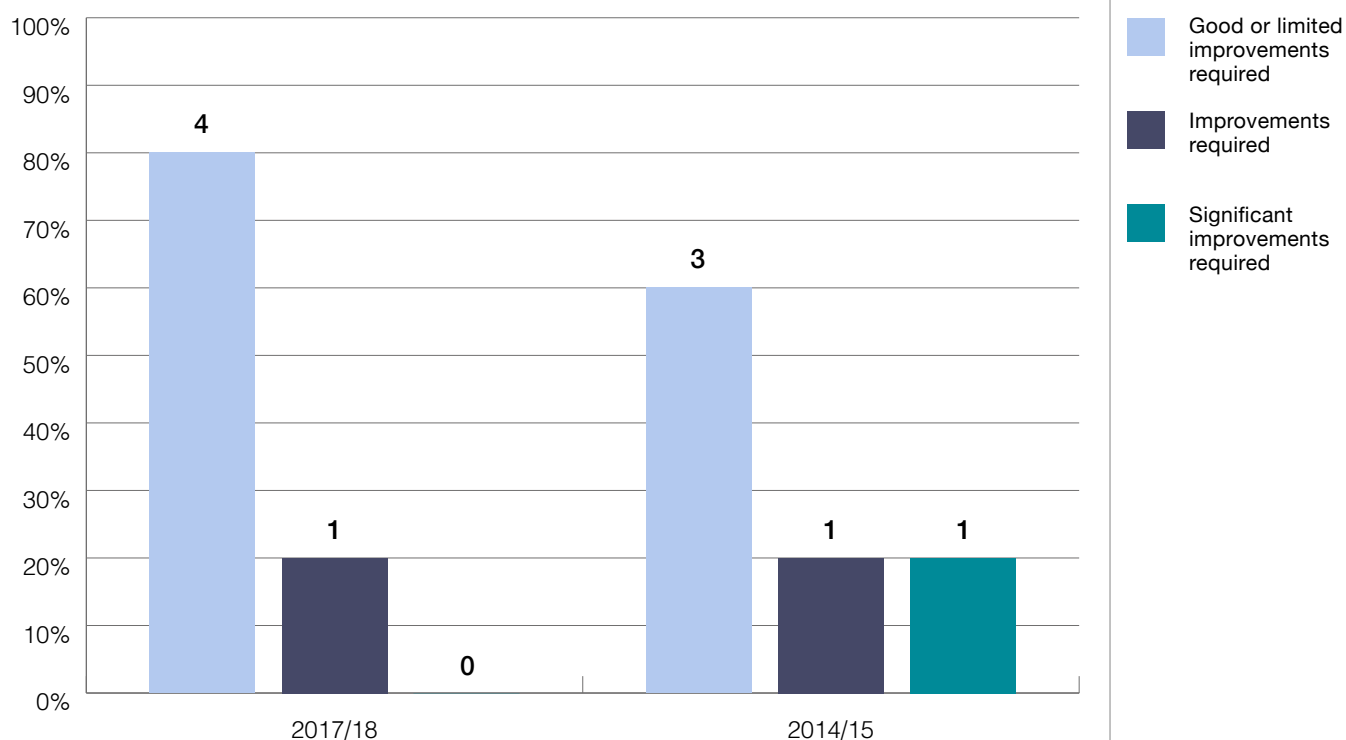
### Individual audit reviews

The firm should:

- Continue to improve the audit of banks' loan loss provisions and IT general controls.
- Improve the evidence of appropriate challenge in areas of judgement, such as impairment.

### Assessment of the quality of audits reviewed

The results of our assessment of the quality of the five audits we reviewed (four in 2017/18 and one in 2015/16) are set out below. The comparatives are from our previous inspection in 2014/15<sup>2</sup>.



<sup>2</sup> Changes to the proportion of audits falling within each category from year to year reflect a wide range of factors, which may include the size, complexity and risk of the individual audits selected for review and the scope of the individual reviews. For this reason, and given the sample sizes involved, changes from one year to the next are not necessarily indicative of any overall change in audit quality at the firm.

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## Good practice identified

Examples of good practice we identified in the course of our work include the following:

- Changes to the firm’s leadership structure which better supports the firm to deliver high audit quality.
- Voluntary adoption of the FRC’s revised Audit Firm Governance Code.

Further details are set out in section 3.

## Root cause analysis

Thorough and robust root cause analysis (RCA) is necessary to enable firms to develop effective action plans which are likely to result in improvements in audit quality being achieved.

Our report on Audit Firm Culture stated that, based on RCA undertaken through 2017, all firms covered by that review had improved their RCA since our 2016 thematic review. We also reported that firms should seek to develop their RCA techniques “to identify the behavioural or cultural factors that contributed to either good or poor quality outcomes”.

The firm has performed RCA in respect of our key findings and considered the outcome in developing the actions included in this report. We will continue to assess the firm’s RCA process and encourage all firms to develop their RCA techniques further.

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### **Firm's overall response and actions:**

We welcome the challenge of the AQR review as it provides us with an objective measure of audit quality and aids in highlighting areas we need to further focus on going forward.

As set out in our response to the specific findings, we are already underway in our actions to address those areas identified as needing improvement or systems that need strengthening. These include changes to our processes for performance reviews to ensure audit quality is more clearly given greater priority and a continuing development in the quality of our bank audits.

In addition, we have invested in our audit training so that we deliver training and feedback to smaller groups to encourage greater engagement and we have also recruited an Audit Quality Manager with a full-time role in quality monitoring so we can better assess the audit quality on our audit files.

We believe that to improve audit quality, we need to do things differently. It is the auditors in the firm that make a good audit, not the processes or templates, training or guidance by themselves. To ensure that we consider these wider aspects we have appointed a Head of Quality to the Executive Board, created an Audit Quality Board and chosen to voluntarily measure ourselves against the FRC's Audit Firm Governance Code. We are also planning a firm-wide culture audit to ensure our values are those that support and promote quality in all aspects of our work.

Like many audit firms, more is required to further embed root cause analysis into our quality monitoring process as a way of understanding, and so really addressing, why an audit finding has occurred. However, we are already finding this has changed our response to issues.

We have kept our Independent Non-Executives updated with our ongoing development of audit quality and they have provided challenge through either the Public Interest Committee or the Audit Quality Board.

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## 2 Key findings requiring action and the firm's response

We set out below the key areas where we believe improvements are required to enhance audit quality and safeguard auditor independence. The firm was asked to provide a response setting out the actions it has taken or will be taking in each of these areas.

### Review of firm-wide procedures

#### Further improve the firm's systems to ensure compliance with the revised Auditing and Ethical Standards

Revised Auditing and Ethical Standards became effective during the year. These include a number of enhanced requirements and stricter prohibitions, particularly in relation to the audit of public interest entities.

The firm had made progress in updating its policies and procedures to address the new requirements of the revised Auditing and Ethical Standards. At the time of our review, improvements were required in the areas set out below.

#### *Personal independence – systems and monitoring of compliance*

The revised Ethical Standard introduced more stringent prohibitions relating to financial interests which may be held by partners and staff. The firm does not have a system to record such interests, nor does it perform compliance testing on financial interests held by partners and staff. As a result, the firm is overly reliant on annual fit and proper self-declarations from partners and staff, and on manual controls that operate within its acceptance process for new clients.

#### *Identification of Public Interest Entities*

Audits of public interest entities ("PIEs") are subject to more stringent Auditing and Ethical Standard requirements. During our inspection cycle, the firm informed us that it had found that its list of PIEs that the firm audits was incomplete. As a result, one audit had been completed without complying with some of the requirements for PIEs, for example an Engagement Quality Control Reviewer had not been appointed.



## Firm's actions:

We are continually looking to improve our systems and processes to ensure we comply with Auditing and Ethical Standards specifically and best practice generally.

### Personal independence – systems and monitoring of compliance

Although no specific breaches were identified in relation to personal independence, we have reviewed our processes and are introducing the following changes to strengthen them further:

- our prohibited investments list will be given greater prominence on our intranet, and we will issue a reminder to all staff of the importance of this list;
- we will provide the prohibited investments list to all partners (as defined in the Revised Ethical Standard) on a quarterly basis, and require them to provide a positive confirmation that no investments are held individually or by those closely associated with them;
- we are introducing a system of testing of the financial interests of partners (as defined in the Revised Ethical Standard); and
- we are amending our systems to ensure that all partners (as defined in the Revised Ethical Standard) receive conflict clearances for all new audit mandates.

In addition to the above we are establishing a database of all partner interests in the medium term.

### Identification of Public Interest Entities

We have performed a root cause analysis to understand the failure to identify the one PIE which was not included within our central register and have issued additional guidance. We have already undertaken a detailed review of our client listings which did not identify further PIEs. The entity which was excluded as noted above had listed debt.

We fully recognise the importance of ensuring we identify when an audit client is a PIE and are making changes to our client acceptance systems, providing additional training in respect of the relevant definitions and also establishing a dedicated area within the firm's intranet to provide greater support and guidance to teams in this area.

## Require specific performance objectives for audit quality in partner and staff appraisals

Partner and staff performance appraisals should include specific objectives relating to audit quality against which performance can be evaluated. Individuals need to understand how they contribute to achieving high audit quality and how this has been assessed.

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The performance of partners and staff is critical to achieving consistently high audit quality. Firms need to establish a clearer link between the assessment of audit quality and overall performance, with controls over the objectives set for partners and staff.

We reviewed a sample of partner and staff appraisals completed in 2017. We identified the following concerns relating to the effectiveness of the firm's partner and staff appraisal processes in supporting audit quality:

- In the sample of partner and staff appraisal forms reviewed, there was insufficient prominence given to audit quality relative to other performance considerations.
- A number of the sample reviewed did not include specific audit quality objectives.

#### **Firm's actions:**

Focus groups and meetings have been held with both partners and staff to understand the cultural and behavioural aspects, as well as the procedural factors, contributing to this finding.

There has been increased investment in this area, including for partners:

- the development of new partner performance tools, with a clearer prominence of audit quality;
- training to all partners which specifically included the importance of quality;
- closer monitoring of the objective setting and performance reviews of all audit engagement partners (and relevant Audit Directors);
- developing and monitoring of Audit Quality Indicators; and
- mandating upward feedback for performance reviews of all partners going forward.

Similarly, for staff, we are making changes to the performance systems to provide greater focus on the importance of audit quality, providing additional guidance in this area and performing compliance reviews to assess the success of these measures and to determine whether further changes are required.

In addition, for both partners and staff there has been a reduction in the number of appraisers with a greater concentration of knowledge and skill in this area.

As part of addressing the cultural aspects which may have contributed to this finding we are updating our Code of Conduct and the associated Partner Conduct Framework.

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## Individual audit reviews

### Continue to improve the audit of banks' loan loss provisions and IT general controls

Our last public report on Mazars LLP (March 2015) stated that, in order to enhance audit quality, the firm should improve its approach to the audit of banks' loan loss provisions and related IT controls.

Since our last inspection the firm has strengthened its bank audit expertise and increased the training and guidance available to audit teams. We saw these improvements reflected in the audit work we reviewed relating to two bank audits. Further improvements were, however, required relating to the audit of loan loss provisions and IT general controls.

On one audit, further challenge was needed in relation to the collective impairment provision and further evidence to support the audit team's conclusions concerning certain non-performing loans. On the other audit, there was insufficient evidence of robust challenge of management's assessment of certain inputs used in assessing specific loan loss provisions.

The testing of certain IT general controls required improvement on both bank audits, in particular controls relating to change management and logical access.

## Firm's actions:

We are committed to the banking sector. As such, we have invested significantly in developing a team of specialist banking auditors who can respond to the complex areas and judgements within banking audits, as well as embedding an appropriate IT audit response to the reliance our clients place on IT systems and processes in their business.

We are pleased inspections have seen improvements in audit quality and have noted our investment in this area, including increased training and guidance. We will build on these foundations to continue to improve our quality and approach.

### Loan loss provisioning

The nature of loan loss provisioning makes it a complex area involving a high level of management judgement around specific and collective provisions and requires our teams to have good technical knowledge to deliver an audit engagement demonstrating a high degree of challenge and scepticism.

We have developed a training programme in the banking sector which covers technical concepts such as loan loss provisioning to ensure all audit team members understand the concepts and the audit risks. We are also enhancing our current banking audit manual to ensure it provides a sufficient level of detail. We will involve the firm's credit specialist in the training provided to our audit team to enhance their understanding of credit risks.

We recognise that our audit teams need to be equipped with the skills and mind set to challenge management's decisions and seek strong audit evidence. To do this we have embedded training which encourages professional scepticism and challenge. This training includes case studies and discussions of what scepticism and challenge look like and how we can document this more effectively.

We believe training which looks at mind sets and attitudes, as well as practical documentation skills, is better delivered in small groups to encourage discussions and hence have invested a significant amount of time and resource to run this training in smaller groups around our local offices.

Our root cause analysis work around the loan loss provision audit work demonstrated that the risks and judgements had been well understood by the audit team in the planning documents and client communication, but this had not been translated into straight-forward and comprehensive audit programmes setting out in detail the required level and depth of testing.

Additionally, there were insufficient prompts for cross checking to ensure the understanding of the risks had been reflected in the planned testing. We will address this point in our feedback workshops to our banking audit teams, as well as practical pointers on how to do this.

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## Firm's actions:

### IT general controls

In recognition of the key role IT testing plays in audits, we continue to invest in our specialist IT audit teams and have delivered a significant amount of training to our audit teams in this area. We are also in the process of enhancing our tools and guidance as part of a review of our IT audit approach.

Our IT auditors are experienced in understanding and testing the IT systems and controls of our clients; equally our audit teams have a strong technical knowledge of our clients' sector and background and the risks that need to be addressed in an audit. We recognise that the key to an effective audit is to bring these together in a seamless fashion so that our audit teams have a better understanding of the evidence specialist IT auditors can provide in an audit and the work undertaken by IT auditors is sufficiently documented for audit purposes.

We will continue to deliver training in IT auditing in our masterclasses. We will also specifically require team briefing meetings to more explicitly address the scope of the IT audit work and a discussion on how the work performed by the specialists will be incorporated into the audit files.

## Improve the evidence of appropriate challenge in relation to areas of judgement such as impairment

Testing non-current assets for impairment is highly judgemental. Auditors need to apply sufficient rigour and challenge in their audit in order to provide reasonable assurance that no material misstatement exists.

Given the potential impact on the financial statements, we considered the extent of challenge by the audit team in this area on every audit we reviewed. We identified one instance where there was insufficient challenge of a key assumption used by management in their impairment review.

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### Firm's actions:

Our audit approach contains templates and prompts to ensure audit teams document the areas of key judgements and assumptions around accounting estimates, valuations and related impairment review considerations, and the audit of accounting estimates features heavily in our training programme.

Our review of this file showed that while the audit teams had recorded the key judgements and assumptions and related impairment triggers in the planning documents and client communications, one of these had not been included in the planned testing.

As with our response to the finding above on loss loan provisioning, we recognise the need to ensure the work we intend to do is set out in clear steps in the audit programmes so it is appropriately completed and documented.

This is being addressed through a clear reminder to all teams as well as looking at how our new audit software, which is due to be launched in the forthcoming year, creates prompts to ensure the risks identified in planning are reflected in testing for all audits.

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## 3 Good practice examples

We set out below the key areas where we noted examples of good practice, either from our review of audit work on individual engagements or from our review of firm-wide procedures.

### Firm-wide procedures

There have been several changes to the firm's leadership structure since our last inspection which better supports the firm to deliver high quality audits and increased the prominence of audit quality within the organisation. Changes included:

- Appointing the Head of Quality to the Executive Board, which is responsible for the strategic and operational leadership of the firm.
- Creating an Audit Quality Board ("AQB"), to focus exclusively on quality and risk considerations for the audit service line. The AQB is chaired by the Head of Quality and the members include the UK Senior Partner.

In addition, the firm voluntarily adopts the FRC's Audit Firm Governance Code ("AFGC") and was one of the first firms to report under the revised AFGC (2016). The AFGC provides a benchmark of good governance practice against which the firm reports annually in its Transparency Report. Measures adopted by the firm also include the appointment of Independent Non-Executives to the firm's Public Interest Committee.

### Individual audit reviews

We considered the combination of the procedures performed on one audit in relation to a particular revenue stream (review of the reasonableness of management's estimates in prior periods, the use of flowcharts to understand the revenue stream, testing of key controls and sample testing for recoverability) to be good practice.

### Audit Quality Review

FRC Audit and Actuarial Regulation Division

June 2018

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