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Dear Mr Grant

Promoting Audit Quality

Mazars congratulates the Financial Reporting Council (FRC) on its publication of a thoughtful and comprehensive discussion paper on the vitally important issue of 'Promoting Audit Quality'. Mazars is an international, integrated and independent organisation with more than 7,000 employees in 40 countries in our worldwide partnership and is the leading auditor of global companies in Europe outside the Big 4.

We concur with the view expressed in the discussion paper that 'while financial reporting in the UK operates effectively and audit is fundamentally sound, there can be no place for complacency. This is an appropriate opportunity to consider whether there are ways of promoting audit quality'.

We strongly support the view that the culture and leadership in an audit firm are key drivers of audit quality. In this context, we would emphasise the importance of an internationally integrated model for delivering audit quality as it provides the best means of ensuring that audits are undertaken to the same common high standard in different countries across the organisation. It is clearly not easy to create an integrated international organisation but we have followed this path because of the benefits it brings to our audit and other clients.

We believe the current debates on audit quality, competition and choice and the limitation of audit liability are inextricably linked and need to be considered together. Reforms to introduce greater competition and choice in the audit market and a fair liability system are needed as a matter of priority and would have, we believe, a positive impact on audit quality.

The following are among our principal recommendations aimed at creating a dynamic audit profession that is innovative in meeting users' needs and which actively promotes audit quality:

- a new qualification of Chartered Auditor should be established;
- an independent study should be undertaken of the parts of the corporate reporting package on which users would find assurance helpful and how it may be provided (eg. with regards to assurance related to narrative reporting);

- the recommendations of the Auditor Reporting Working Party of the Audit Quality Forum should be followed up;
- an independent study should be undertaken to assess the potential merits of introducing joint audits for listed companies – we strongly believe they would enhance audit quality;
- the forthcoming review of the Combined Code should include a detailed review of the guidance in relation to audit committees. This should cover assessing audit effectiveness in more detail and the periodic tendering of audits as well as disclosures to be made by audit committees and whether their report should be voted on by shareholders at the AGM;
- the way in which various aspects of auditing are co-ordinated within the FRC should be the subject of a review with the aim of promoting a culture that fosters high quality auditing in a continuous learning environment and takes account of changes such as the move to International Standards of Auditing and the promulgation of the amended Eighth Directive.

It would be helpful for FRC to discuss how it plans to take the audit quality agenda forward. We believe FRC has a valuable role to play in promoting a better understanding of the drivers of quality in the marketplace. Ultimately though the shareholders and board of a company have to make their assessment of the quality of the audit having regard to their particular circumstances.

Our detailed response to the questions in the discussion paper are included as an Appendix to this letter.

If you would like to discuss any aspect of our response, please do not hesitate to contact David Herbinet (020 7220 3249) or Anthony Carey (020 7220 3282).

Yours faithfully

Mazars LLP

Appendix

Responses to detailed questions

The culture within an audit firm

Q1 Are there other important indicators of an audit firm's culture that are not referred to above?

In addition to the factors mentioned, we would add the following indicators of an audit firm's culture:

- the degree of cohesiveness internationally of the firm or the network to which it belongs as this will have an impact on the way in which decisions are made and its ability to work effectively across national boundaries. We believe there are strong merits in an internationally integrated model;
- the importance of audit work to the firm which may, for example, be measured by reference to the proportion of total income derived from audit work and the extent to which the firm's growth is expected to come from audit work;
- the ownership and management structure of the firm. One would expect, all other matters being equal, that where auditors and other members of the accountancy profession are represented both in the management of the firm and its ownership at levels well above the minimum required it will be easier to gain an understanding of the primacy that needs to be attached to the auditor discharging his or her professional responsibilities;
- the extent to which the firm is willing to contribute to profession-wide initiatives to promote the development of auditing, as this provides an indicator of its commitment to the public interest;
- the firm's experience and that of its partners and staff in dealing with substantial public interest audits.

We recognise that some of the above points come to some extent within the first of the principal indicators set out in paragraph 3.3 of *Promoting Audit Quality* which focuses on the whether the firm's leadership promotes effectively the importance of the firm properly discharging its professional responsibility as an auditor. We do, however, believe more explicit reference to them would be helpful.

Q2 Are there pressures that could compromise the culture of audit firms that have not been identified above?

In addition to those pressures which are already mentioned in paragraph 3.5 of the paper, we believe the shortage of experienced audit professionals in the marketplace, especially in certain specialist areas such as those dealing with ethics, risk management and technical issues (financial reporting and auditing) raises challenges for audit firms generally. The demand for experts in these areas which has outstripped supply has increased significantly in line with increasing regulation and the increasing complexity of financial statements and has come simultaneously from regulators, professional bodies and firms.

Paragraph 3.5 of the paper refers to the threats arising from excessive cost-cutting during times of economic downturn. Regard also needs to be had to the pressures placed on firms on a continuing basis if they, for example, have substantial pension deficits to be funded.

Q3 Are there any further steps that should be taken to build confidence in the culture of audit firms and, if so, what might they be and why are they needed?

Please see our responses to Q1 and Q2.

The skills and personal qualities of audit partners and staff

Q4 Do you agree that technical skills, personal qualities and practical experience are key drivers of audit quality?

We strongly agree that technical skills, personal qualities and practical experience are key drivers of audit quality.

Q5 Has this paper identified the issues that could result in an inadequately trained or skilled workforce for audit- if not, what other issues are there and why are they issues?

The paper has identified important issues in terms of staff retention and having sufficient experienced auditors for mentoring which could threaten the ability across the profession to have an adequately skilled or trained workforce.

We would also add the importance of seeking to ensure that major firms guard against audit partners retiring too early and thereby causing a potential loss of wisdom and experience on key audits. We note, for example, in Appendix 4 to the paper that only 43.6% of audit partners in the firms surveyed had more than 10 years experience as a partner.

Q6 Should there be a fundamental review of the qualification and training requirements for auditors?

We believe there should be a fundamental review of the qualification and training requirements for auditors and that this should be undertaken as a matter of priority.

We recommend the creation of Chartered Auditor as a qualification for members of the relevant qualifying accountancy bodies - principally the Institutes of Chartered Accountants in England and Wales, of Scotland and in Ireland, the Chartered Association of Certified Accountants (ACCA) and the Chartered Institute of Public Finance and Accountancy (CIPFA) - who wish to make their career in auditing.

We believe there is a need for post-qualification formation for auditors and we believe the institution of a formal qualification would enhance recognition of the specialist skills that now have to be displayed by the auditor in addition to other more general business and accountancy skills. The new qualification would also facilitate an increase in the formal study of issues related to auditing and address the issue raised in *Promoting Audit Quality* that the time set aside for the study of auditing issues in the accountancy qualifications is coming under pressure.

We would encourage the relevant accountancy bodies to organise the qualification on a joint basis and would suggest it should be a requirement in the future for newly qualified accountants who wish to go on to be able to sign audit opinions. Consideration would need to be given on whether to establish 'grandfathering' provisions for existing Registered Auditors wishing to become Chartered Auditors and, if so, the form they should take.

We accept our proposal would be likely to increase the training and development costs for us and other firms but believe the initiative to be in the public interest and so we would be happy to bear them.

The effectiveness of the audit process

Q7 Are there other factors that determine whether an audit process is effective?

We agree that the factors identified are essential to ensuring that the audit process is effective. We do not have any additional factors to add to those discussed in the paper.

Q8 Are there threats to the effectiveness of the audit process that have not been identified above?

We believe it would be helpful to make mention of the threat of a less than fully effective audit that can arise from insufficient partner and manager time being committed at the planning stage to ensure the appropriateness and sufficiency of proposed procedures. Successful risk-based auditing requires significant input of time at the right stage by partners and managers and suitably qualified teams. In some cases, the implications of a move to risk-based auditing may not in practice have been fully taken on board by some firms.

We would also mention the risk of failing to track key audit risks identified and following them through to ultimate resolution and conclusion. We hope, however, that the implementation of International Standards of Auditing (ISAs) will prove to have a positive impact in this area.

Q9 Are there further steps that could be taken to counter the threats to the effectiveness of the audit process?

We believe an independent study should be undertaken, under the auspices of the FRC, to assess the potential merits of introducing joint audits for large listed companies. We believe the introduction of joint audit would help to mitigate the systemic risk that would arise if a major audit firm were to leave the market unexpectedly as a result of a catastrophic claim against it or due to regulatory action arising from an unsatisfactory audit. Joint audit also helps to counter the threats to the effectiveness of the audit process that can arise from over-familiarity as it enables fieldwork to be rotated by geographical segment or service line without the need for a change of auditors. It also provides for joint review and discussion of critical issues arising on the audit with group management and the audit committee of the client. A fuller discussion of joint audit is contained in the article 'Two's company' in the March 2007 edition of *Accountancy*.

The reliability and usefulness of audit reporting

Q10 Are there other factors that determine whether audit opinions command confidence?

Q11 Are there other reasons why users may not have confidence in the audit opinion?

Q12 Are there further steps that could be taken to reinforce confidence in an audit opinion? In particular, what changes to the form and content of an audit report should be considered?

With regard to Q10, Q11 and Q12, we believe it is very important that the recommendations contained in the report of the Working Party of the Auditor Quality Forum on Auditor Reporting be fully explored by the DTI and the FRC and its constituent bodies.

In particular, consideration needs to be given to how the expressed desire of a number of leading institutional investors for more company-specific information can best be met. They have indicated that they, as owners, would like more information on

- emphases of matter and risks and uncertainties;
- material issues arising during the audit and their resolution;

- alternative accounting treatments considered and the reasons for adopting the treatment chosen where material;
- material areas of judgment and difficult or sensitive areas.

Some of this information should be made available, at least by listed companies, under IFRS, the new Companies Act requirements on enhanced business reviews and the revised Turnbull Guidance though we note that the Financial Reporting Review Panel has suggested the relevant disclosures required under IFRS could usefully be expanded by a number of companies.

In addition audit committees could be asked through a revision to the Combined Code on Corporate Governance to provide more explanation of key issues discussed by them with the auditors if this were considered helpful.

As discussed above, it may be that much of the additional information sought could be made available in the audited financial statements or as part of the disclosures on corporate governance, with the auditors expressing a view if they did not concur with the disclosures made. On balance, we can see benefits in the disclosures being made in this way as it indicates that the directors, who have the responsibility for preparing financial statements that show a true and fair view, agree with the information provided. If this were done, some amendments may be needed to enable the auditors to highlight in their report where they did not agree with relevant new disclosures being called for from the audit committee.

Factors outside the control of auditors affecting audit quality

Q13 Are there other external factors that have the potential to adversely affect audit quality?

The management, audit committee and shareholders of a company all have an essential role to play if it is to publish high quality audited financial statements.

Looking at auditing at the profession-wide level, we also note the important role played by regulators and standard-setters and by initiatives such as the Audit Quality Forum.

With the move to ISAs and the issuance of the new Eighth Directive on auditing, we believe it would now be timely for the FRC to undertake a wide-ranging review with a view to ensuring the it's work on auditing, which involves the APB, the Audit Inspection Unit (AIU) and the Professional Oversight Board (POB), is effectively co-ordinated and that the various bodies involved are working together to promote a culture that fosters high quality auditing and a continuous learning environment across the profession. This will involve significant emphasis on educational and communications initiatives as well as on formal regulation and standard-setting and we welcome steps taken to date in this regard. There may be merit in looking to appoint a lead staff member to cover the work of both the APB and the AIU just as an overarching appointment is being made in respect of corporate reporting.

We believe an independent study is needed of what institutional and other investors expect by way of assurance on public interest entities, including which parts of the corporate reporting package they would value assurance on. The study should also look at the feasibility of providing the desired assurance, eg. with regards to narrative reporting, and, if appropriate, how any obstacles to doing so may be overcome. We need a stronger culture of innovation in auditing and this must address both what is audited and the way in which auditors report on their findings. We need to narrow expectations gaps that exist and this involves far more than telling users and others about the current system.

Q14 Are audit committees discharging their responsibilities in relation to audit adequately, and if not, what further steps might be taken to make their role more effective?

We believe that the extent to which audit committees are adequately discharging their responsibilities varies between companies but it is very important for the quality of auditing that they do so. Audit Committees need members collectively to have the appropriate mix of financial and business expertise including that in the areas of financial reporting and auditing, to have suitable terms of reference and sufficient time and support to undertake their duties.

A review of the current guidance on audit committees in, and appended to, the Combined Code on Corporate Governance would be helpful.

Q15 Should the FRC develop more detailed guidance for audit committees in relation to the evaluation of audit effectiveness?

In the forthcoming review of the Combined Code we do believe it would be helpful to provide more detailed guidance on the evaluation of audit effectiveness. Perhaps as part of that guidance, it would also be helpful for the Combined Code to stress the importance of putting the audit out to tender at suitable periodic intervals.

Q16 Should annual reports include a summary of the work undertaken by the audit committee to evaluate audit effectiveness?

We believe a broad-based review of the information expected to be disclosed by audit committees should be undertaken as part of the forthcoming review of the Combined Code. The review should also look at the issues raised recently by the *Auditor Reporting* paper issued by the Audit Quality Forum. The review should also consider whether the audit committee report of listed companies should be subject to a vote by shareholders at the Annual General Meeting.

Q17 Are there further steps that should be taken to reduce the risk that these external factors may adversely affect the audit process?

We have discussed a number of steps that we believe should be taken to promote high quality auditing which has the confidence of users of audited information in our response to Q13, Q15 and Q16 above.