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For the attention of Ms Christina Trickett

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Dear Ms Trickett

#### **REPORTING ON AUDIT QUALITY MONITORING**

Mazars welcomes the opportunity to comment on the Consultation Paper, *Reporting on Audit Quality Monitoring* ('the Consultation Paper') prepared by the staff of the Financial Reporting Council ('FRC'). Our general comments and responses to the specific questions of the Consultation Paper are presented below.

As a preamble, we wish to highlight the interconnections that exist between this consultation and two other current projects of the FRC: Choice in the UK Audit Market and Transparency Reporting by Auditors of Public Interest Entities.

In relation to the first, we are concerned that Companies, Audit Committees and the Market in general may form the view that only firms currently reviewed by the Audit Inspection Unit (AIU) are suitable for public interest audits. This may create an additional barrier for firms that wish to enter this market. If more prominence is to be given to the AIU inspection reports as a tool to market the quality of audit firms, the AIU should increase its resources to be able to also cover firms that want to become more significant players in this market.

In relation to the second, the natural and justified desire of certain firms to promote themselves in the audit market on the back of their strength in audit quality should not distract the AIU from its initial objective of 'raising the bar' of the audit profession as a whole. We certainly believe that more transparency on the quality of audit firms is required, and in particular on their adherence to ISQC1 quality standards but it is our view that this transparency should be provided by the audit firms themselves through more comprehensive Transparency reports. This is further commented on in question 3 below.

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### **Question 1**

**To which of the arguments set out in Part 5, for and against extending public reporting of AIU inspection findings, do you attach most weight and why? Are there other important arguments which we have not captured?**

Overall we believe that there are few valid reasons for materially extending the public reporting on the results of the AIU inspections as the expected benefits can mostly be obtained by alternative means while there are potentially significant risks in extending this reporting.

As we have commented above, there should be greater transparency on the internal functioning of Audit Firms and on their approach to audit quality. However we do not believe that it is the main role of the AIU to provide this information as it should be provided by the Audit Firms in the first instance.

Secondly we agree that investors and audit committees should be provided with more information to be able to reach a more informed view on the appropriateness of using a non Big 4 firm. However we understand from our discussions with investors and company Boards that they are a number of barriers to appointing non Big 4 firms and concerns about Audit Quality is usually not a critical one. The AIU could simply confirm in its Annual Report that it has found no material issues that create risks to the public interest in having the inspected firms continue to audit public interest entities.

Thirdly we agree that the AIU, through its inspections, should continue to drive improvements in audit quality. However we do hope that the incentive for firms to deliver the highest possible audit quality is there 'no matter what' and that more extensive reporting is more likely to drive a more antagonistic interaction between the firms and the AIU which would be detrimental to its longer term objective.

We would also like to comment on two further arguments against more extensive reporting:

- While the AIU focuses on certain dimensions of audit quality, it cannot cover all such dimensions and it should not be assumed that it does. For example the quality of audits of large international groups depend to a large extent on the quality of the auditors of the subsidiaries. While the AIU considers the coordination of the group audit by the UK auditors, it is not able to review the quality of the work performed by the subsidiary auditors. More extensive reporting may lead stakeholders to a restricted interpretation of audit quality and audit firms to a narrower view of what is needed which could stifle innovation.
- There is danger in the AIU becoming the principal 'marketing tool' of certain audit firms through public endorsement of their quality standards which could be against the development of the audit profession and hence the public interest. Again it is up to the audit firms, not to the FRC, to promote their capabilities, their approach to audit quality and their performance thereon.

### Question 2

**Which of the options set out at para. 6.1 below do you favour, and why? In particular, do you share our view, set out at para 6.2 below, that the nature of weaknesses at a named firm should be disclosed only after the firm, in the opinion of the Oversight Board, has failed to respond positively and promptly to recommendations made to them by the AIU?**

In line with the views expressed above, we would favour a combination of Options B and C whereby:

- With regards to Option B, instead of ‘naming and shaming’, we suggest that where a firm is clearly dealing more effectively than others in addressing certain key issues that affect audit quality, this firm should be named and congratulated;
- The AIU has the ability to ‘name and shame’ an Audit firm that has made insufficient progress in addressing the AIU recommendations or has failed to cooperate with the AIU, but only insofar as the weaknesses raised are material and pose risks to the public interest.

### Question 3

**Do you think that information from AIU inspections on individual audit firms and/or their audits of individual companies should be made available privately to audit committees? If so, what do you think is the most appropriate way of achieving this?**

We do not believe that the detailed findings of the AIU inspections should be made available privately to audit committees, unless these findings relate specifically to the audit of a company and that the findings are communicated to the Audit Committee of that company alone, in a way similar to the approach adopted by the FRRP:

- Arguably, a wide communication to all audit committees of all public interest companies make it difficult to keep the findings of the AIU ‘Private’;
- We are unclear as to which objectives would be met with communication to audit committees of the AIU findings on individual audit firms and we are concerned that these findings could be misconstrued when taken out of context. For example, lack of documentation to support an audit judgement does not imply that the audit judgment made was incorrect;
- Again we believe that the main objective of the AIU should be to further improve the overall level of audit quality delivered by audit firms, raise confidence in the quality of UK audits, not raise additional unwarranted barriers for firms to operate in the public interest market and stay clear from the marketing initiatives of individual firms;

It is our view that more transparent reporting should be achieved through the audit firms’ Transparency Reports. We will respond separately to the FRC consultation on Transparency Reporting by Auditors of Public Interest Entities but we comment below on the key points which we feel are pertinent here. Each audit firm should include in their Transparency report a narrative on how it adheres to ISQC1 quality standards and comment on the findings of the AIU inspections as well as how it is responding to these findings. Other issues such as claims records or strength of financial position should also be covered as they can be clear indicators of a firm’s ability to deliver audit quality. To provide public confidence in these reports, the AIU could consider:

- How the ‘Audit Quality’ section of the Transparency reports should be structured and what minimum information it should contain;

- whether it could produce a commentary on the fairness and openness of these Transparency reports as part of their annual visits to the firms and comment on these in their Annual Quality Inspections Public Report;
- whether it could produce a ‘negative assurance’ opinion to be inserted by the audit firms in their Transparency report to confirm that the AIU inspections have not identified any material weaknesses, other than disclosed in the Transparency report, that should be brought to the attention of the readers of the Transparency report.

#### **Question 4**

**How would you quantify the costs and/or benefits of the options set out at 6.1 below, taking into account Annex A?**

In the overall scheme of things, costs are unlikely to be very significant and should therefore not be a main driver in this discussion. How best to serve the public interest by further improving audit quality and raising confidence in the audits of UK Plcs is the key objective that should prevail.

We remain at your disposal should you require further clarification or additional information.

Yours sincerely



**David Herbinet**

Head of Corporate and Public Interest Markets