

s.currie@frc.org.uk

Direct line +44 (0)207 063 4880

Email phil.verity@mazars.co.uk

8 September 2015

Dear Susan

Audit Firm Governance Code; A review of its implementation and operation

Mazars, the integrated international accountancy, auditing and advisory organisation, welcomes the opportunity to provide comments on the FRC's consultation on *Audit Firm Governance Code: A review of its implementation and operation*.

Overall comments

We consider that the Audit Firm Governance Code (the Code) has generally worked well since its introduction and that it should broadly continue in its current form. In particular, we believe it should operate on a 'comply or explain' basis and that it should not formally be part of the regulatory process.

The purpose of the Code should be set out clearly. The purpose should be to promote effective governance amongst firms auditing listed or other PIE companies. In doing so, the primary aim should be to secure high quality audits.

We believe that INEs should be fully within the firm's governance structure and they should have roles on the firm's audit and remuneration committees and ideally should form the membership of the firm's Public Interest Committee. If there is not such a committee, the INEs should periodically meet on their own. There should be a minimum of two INEs. We do not consider there should be an expectation that an INE would be appointed as the chair of the firm.

INEs should be appointed after a rigorous and transparent selection procedure which would be expected to involve the use of headhunters or public advertising. We would support the introduction of criteria identifying circumstances which would prima facie challenge an INE being considered to be independent. There should also be transparency on the remuneration of INEs. We would not expect the FRC to be involved in the appointment of INEs.

Mazars LLP - Tower Bridge House - St Katharine's Way - London - E1W 1DD

Tel: +44 (0)20 7063 4000 - Fax: +44 (0)20 7063 4001 - www.mazars.co.uk

Mazars LLP is the UK firm of Mazars, an integrated international advisory and accountancy organisation. Mazars LLP is a limited liability partnership registered in England and Wales with registered number OC308299 and with its registered office at Tower Bridge House, St Katharine's Way, London E1W 1DD.

Registered to carry on audit work in the UK and Ireland by the Institute of Chartered Accountants in England and Wales. Details about our audit registration can be viewed at www.auditregister.org.uk under reference number C001139861.

VAT number: 839 8356 73



If amendments are proposed to the role and responsibilities of INEs, or with regard to other matters related to their appointment, it will be important to consult with them on their views on the feasibility and likely impact of such changes.

Firms should continue to be able to apply the code on a national or international basis as appropriate to their structure. Where applied on an international basis the firm should explain how the INEs have been involved at UK level in relevant issues. We believe this is a preferable approach to expecting the Code to be applied on a UK basis in all circumstances. Similarly, we do not consider there should be an expectation that the arrangement for the governance of audit should necessarily be ring-fenced from those for the rest of the firm but we would propose that the governance arrangements for both the firm as a whole and the audit practice should be set out including how they link together.

Our response to the individual questions in the review is set out in the attached appendix.

Further discussion

If you would like to discuss further any of the issues covered in our response, please contact Philip Verity, Senior Partner, on 0207 063 4880.

Yours sincerely



Mazars LLP

Appendix 1 Response to specific questions

1 Do you agree that the Code's purpose should be redefined in this way [ie a focus on public interest with a focus 'Firstly, and of greatest importance, audit quality. Secondly the firm's reputation more broadly...Finally, prevention of a firm failure']?

The purpose of the Code is not set out explicitly at present and we believe it would be helpful for the revised version of the Code to have a clear and inspiring purpose.

The Code currently states 'The Working Group has drafted the Code to serve the interests of shareholders in listed companies to whom auditors address their reports. The Code supports firms in their objectives of performing high quality work that gives confidence to shareholders. It should also benefit capital markets by enhancing choice and helping to reduce the risk of a firm exiting the market for large audits...'

It was also considered that the Code should play four additional roles:

- enhance the status of firms as highly visible exemplars of best practice governance;
- enrich firms' transparency reports;
- encourage changes in governance which improve the way that firms are run; and
- strengthen the regulatory regime by achieving transparent and effective governance without disproportionate regulation.

We would suggest that the purpose be defined along the lines of:

'The purpose of the Audit Firm Governance Code is to promote effective governance amongst firms auditing listed or other PIE companies. In doing so, the primary aim is to secure high quality audits. In addition, it also aims to:

- encourage a culture of continual improvement and innovation in the firms applying the Code including with respect to governance matters;
- provide audit committees and investors with relevant governance information on the firms to assist them when selecting or assessing auditors; and
- reduce the risk of a firm applying the Code failing and exiting the market.

In setting out the purpose of the Code it is important to keep the focus on governance matters. Within that scope we agree that the primary emphasis should be on securing high quality audits, recognising that there are also other means for promoting them including regulation, the technical work of professional bodies and auditing education and development.

We consider that the firms expected to apply the Code should be those auditing listed companies, as is now the case, and other PIEs that are determined to be within the scope of the EU Audit Regulation, having regard to the way in which the Member State option in the UK is exercised. These are the audits which, by definition, are of the greatest public interest and so it is reasonable for the firms undertaking them to be expected to apply the highest governance standards. As a practical measure, we would retain the approach of firms needing to have a minimum number of qualifying audits before being expected to apply the Code. It may be appropriate to reduce this from the current level of more than 20 to say at least 10 but care should be taken to ensure application of the Code remains proportionate:

those having literally one or two small PIE audits should not as a matter of course be expected to apply the Code though it would be appropriate to encourage voluntary adoption by larger firms not formally within its scope.

2 Should there be separate governance arrangements for audit? What might such arrangements look like?

We consider that undertaking high quality audits requires a supportive culture both across the firm as a whole and within its audit practice. It also needs to be borne in mind that the extent to which audit is a significant part of the whole firm will vary between firms as will the way firms manage themselves in terms of decisions taken on a firm-wide basis and those taken on a service line basis.

Moreover, it is not clear whether turning audit into a ring-fenced area would be to its long-run benefit. A move in this direction would be a very significant one and should only be made after careful consideration of the likely implications. It may, for instance, make it more difficult to recruit the most able graduates into the audit service line if opportunities for moving around the firm become more restricted, as might happen if the audit practice were ring-fenced. Furthermore, if audit is to remain relevant to investors' needs and those of wider society, it is increasingly likely to need to make use of a broader range of skill sets than has traditionally been the case, eg for human rights assurance and cultural audits, and having fairly rigid barriers between the different service lines may mitigate against such necessary innovation. A linked question is whether the audit practice, as defined for such governance purposes, would include other closely related assurance services or be limited to statutory audit.

Paragraph 64 refers to the threat to the reputation of audit being more likely to come from outside the audit practice and this is not a hypothetical concern as around the time the Code was being drafted one of the largest firms experienced significant issues from outside the UK in relation to its tax practice. This paragraph of the review also quite reasonably points out that there is a risk that ring-fencing audit would lead to a different culture more clearly emerging in the rest of the firm and indeed if audit accounted for only a relatively modest share of the total that outside audit would be likely to be the predominant one in the firm as a whole.

At this stage, we consider it would be better to call on firms applying the Code to set out their governance arrangements for the firm as a whole, as at present, and for their audit practice and to explain how the two link together.

3 Should the Code include more detail and impose more requirements on tone at the top and professionalism more generally?

We would support the Code including more discussion on 'tone at the top' and on taking steps to embed high standards of professionalism throughout the firm and, very importantly, on the firm's leadership checking on whether the desired culture does seem to permeate the organisation. Such steps may include appropriate recruitment processes; employee engagement surveys; feedback from clients and the market more generally; 'speak up' (whistleblowing) procedures and perhaps a review of interviews with staff leaving

the organisation. 'Tone at the top' can never, however, by definition be reduced to compliance with a number of detailed requirements.

We also consider that in addition to including appropriate references to it in the Code, the FRC should more broadly promote discussion of the importance of 'tone at the top' in audit firms

**4 Do you agree that the concept of the Code should be spread elsewhere in the world?
How might this be achieved?**

As an integrated global firm, we see the merits of spreading the concept of the Code elsewhere in the world and indeed our independent non-executives are fully part of our global structure, being members of our Global Governance Council (GGC), chairs of the audit and remuneration committees and sole members of the GGC's Public Interest Committee. We are conscious, however, that this approach might not work so well in firms that are part of networks where there is a different balance of rights and responsibilities between the global organisation and the member firms at national level. Our integrated structure, for example, facilitates setting the 'tone at the top' at a global level for the firm.

That said, if significantly more jurisdictions were to adopt the concept of the Code, it would be helpful if a code were developed on a global basis to save firms/networks the challenge of implementing markedly or even slightly different codes in different jurisdiction around the world. The International Federation of Accountants (IFAC) and the Independent Federation of Independent Accounting Regulators (IFIAR) would seem to have important roles to play in the development of an international code just as the Institute of Chartered Accountants in England & Wales (ICAEW) and the Financial Reporting Council (FRC) worked together on the development of the Code in the UK.

If an international code were to be developed, it would be vitally important to involve the firms/networks in its preparation both to secure their buy-in to the concept and to ensure it was written in a way that enabled it to be implemented in a practical fashion having regard to the different structures in different firms/networks. Care would also need to be taken to take account of different legislative requirements in different jurisdictions and indeed it may turn out to have been easier to implement a Code in the UK than it would be in many other countries as the firms in the UK are used to making significant disclosure given that most are LLPs including making public their audited accounts. At Mazars we also publish global audited accounts, prepared in accordance with IFRS, but at present networks do not generally have their global accounts audited and our understanding is that the necessary control structure would not exist to enable global consolidated accounts to be prepared under IFRS.

5 How might the independence of INEs be protected and demonstrated?

We note that the question only addresses the issue of the independence of the INEs and not the equally important issue of their effective involvement in decision-making. We think both issues need to be considered together.

We consider that the best balance can be struck by the INEs being fully part of the firm's governance structure, either through being on the board in a unitary structure or most likely

by being on the supervisory board/governance council in a two-tier structure such as exists in our firm. This enables the INEs to have a real influence at a strategic level and on the oversight of the firm. In addition, we see merit in them also meeting separately, as happens in our firm, through their being the sole members of the firm's Public Interest Committee. If there is not a Public Interest Committee the INEs should be expected to meet on their own from time to time. Such meetings provide a formal independent forum within the firm in which the INEs can discuss any issues of concern to them.

On the criteria for determining independence, there may be merit in the Code moving in the direction of the UK Code on Corporate Governance and setting out criteria which would normally call a director's independence into question. That said, such criteria will never be able to cover every situation and common sense is needed in both identifying relevant criteria and by the firms in applying them. Care needs to be taken, particularly with regards to the largest audit firms which have relationships with a very substantial number of listed companies, to ensure that the criteria are not so restrictive that it makes it difficult for them to appoint independent non-executives of sufficient seniority and relevant expertise. Appropriate reporting of past and current business relationships is, however, important. At present the Code calls for the procedures to be set out for dealing with any fundamental disagreements between the independent non-executives and members of the firm's governance structure(s). This provision should be strengthened by providing that INEs may set out the reasons for their resignation, if applicable, where they consider such disclosure to be necessary.

6 Should the firms follow a standard process in appointing INEs, including all such positions being publicly advertised? What engagement, if any, should investors in audited entities have in an audit firm's appointment of INEs?

We believe firms, like listed companies, should engage in a formal, rigorous and transparent process when appointing INEs. Before making an appointment they should consider the skills and experience necessary to fill a particular role at a given time and we believe best practice would be for them either to appoint head-hunters or to advertise a position publicly.

Given the challenges that the firms have experienced, as noted in the review, in seeking to ensure reasonable engagement with investors for an annual meeting it is unlikely that the latter will generally wish to get involved in discussing appointments. We can envisage circumstances where, for example, there has been a serious loss of confidence in a firm, when consultation with investors might be helpful but, unlike in the case of listed companies, the investors are not the owners of the firm and so it would not necessarily be expected to be consulted in normal times. We support the approval of the appointment, and reappointment, of INEs by the wider partnership as the firm's owners and this is the process which we follow in our firm.

7 Should the FRC or any other regulator have a role in the appointment of INEs, perhaps a right of veto?

This question raises a fundamental issue on the nature of the Code and its role in audit regulation.

We believe that, as is the case currently, the Code, just as the equivalent for listed companies generally, best operates on a 'comply or explain' basis whereby firms are not under a direct obligation to implement any particular provision although their clients, the investors in any company they audit, may choose to make judgements on the appointment of an audit firm having regard to how they implement the Code. We are not persuaded the case has been made for a major change such that the regulator gets directly involved in the appointment of INEs in audit firms and were they to wish to have such a role they should do it directly through audit regulation rather than using the Code for these purposes.

8 Which of these aspects of the Corporate Governance Code, if any, should be incorporated into the Code? Are there any other aspects of the Corporate Governance Code which should also be considered?

When the Code was being prepared, although consideration was given to the issues covered in the UK Corporate Governance Code, it was designed as a bespoke code relevant to the circumstances of audit, accountancy and advisory firms. Thus, although providing a useful starting point, it is likely that some of the areas listed might usefully be included and others not.

In response to the items listed:

Whilst we think it could be helpful to include relevant disclosures on long term solvency and liquidity we expressed significant reservations about the form of the viability statement which was subsequently included in the UK Corporate Governance Code and so would have similar points to make about its inclusion within the Code. That said, in this area we can see the merit of having similar content in respect of the viability statement as for listed companies.

We do see benefit in including a presumption as to term limits for appointments of around 9 years though, as for the Code on Corporate Governance with regard to presumptions concerning the independence of non-executive directors, we think they should, as with other provisions in the Code, be introduced on a 'comply or explain' basis.

We would support transparency around the remuneration of INEs.

We would support a presumption as to the minimum number of INEs. We think there should be at least two in order that the INEs can consult with each other but that the minimum should not exceed two except perhaps in the case of the largest audit firms.

We would not have a problem with there being an expectation that at least one INE should have recent and relevant financial experience though given the nature of the business of the firms we are not persuaded it is essential since if there are partners outside the management of the firm involved in its governance they are likely to have the necessary expertise. The prior issue relates to the firms being expected to have an audit committee. We would support this being an expectation of the Code which currently it is not.

We do not see a need for one of the INEs to be chairman though we think the Code should make clear that the chief executive/senior partner of the firm should not also be the chair of the board where there is a unitary structure. Alternatively, there should be a two tier

structure with a management/executive team and a separate supervisory body/governance council.

We support firms giving full consideration to diversity issues, across the range of relevant attributes, both with regards to the selection of their board, including INEs, where there is a unitary structure, or their management/executive team and supervisory body/governance council where a two-tier structure is in place.

We would support a formal role for INEs on remuneration and risk/audit committees and, if it exists, on the nominations committee. In our firm, our INEs act as chair of the audit committee and of the governance and remuneration committee respectively. We do not currently have a nominations committee at global level. Again as earlier discussed, this question raises the issue of whether the Code should call for these committees to exist in firms. We consider there should be an expectation that firms at least have risk/audit and remuneration committees. Our governance and remuneration committee, for example, considers the remuneration of members of our Global Executive Board.

9 To whom should the boards, INEs and public interest committees be accountable? How should this accountability be discharged, including to the FRC?

This section raises fundamental issues on the role and accountability of INEs and serious consideration is needed before the intentions of the current Code are changed.

The Code is quite clear that the duty of care, just as for partners involved in the governance of the firm, is to the firm. This is in support of the fundamental principle that decisions should be taken by the governance structure of firms on the basis of those taking them accepting collective responsibility for the decisions reached, a similar principle to that which exists on the boards of listed companies in the UK.

The Code does not state, as the review seems to imply, that the responsibility of INEs is to the public interest in the sense of their having a different kind of formal accountability than that applicable in the case of other members of the governing structures of the firm. In performing their duties effectively as INEs they will help ensure that the firm is well governed and thus that *the firm* promotes the public interest in the manner in which it discharges particular responsibilities such as those linked to statutory audit. Naturally in fulfilling their governance roles INEs will have a particular focus on public interest issues within their wider contribution to the good governance of the firm but governing structures never work well when different members of them owe their primary allegiance in different directions. In line with this view, we do not see INEs as having specific responsibilities to the FRC.

10 Should the Code include specific provisions on the firms' Boards and public interest bodies engaging with and disclosing certain matters to regulators?

We fully support the FRC engaging with INEs, as a group or with respect to those in a particular firm, but this is different from saying they should have a responsibility to 'whistleblow' to the FRC. Where INEs have a fundamental disagreement with the firm which cannot be resolved they should, as discussed above, have the right, and indeed the responsibility, to make a statement setting out the reasons for their resignation.

The core issue is whether INEs should have a similar regime to that prevailing in the financial services sector or should it be more akin to that for independent NEDs in the business community generally. We consider great caution is needed before embarking on a model, with its additional cost, such as one similar to that in the financial services sector.

11 Is greater transparency sufficient? What else can be done?

We would be supportive of increasing the disclosures in the Transparency Report through, for example, the disclosure of additional information such as the principal KPIs the firm uses to measure its success. Similarly, we would support the board, or both tiers in a two-tier structure, confirming that in their opinion the disclosures in the Transparency Report, and more broadly those relating to the Code a number of which do not have to be in the Transparency Report, are fair, balanced and understandable. Significant information is also made available through the reports published by FRC on firms following audit inspections.

12 Should the Code be applied to a wider group of firms?

There would be benefit in encouraging more firms to apply the code voluntarily, as we do, on the grounds that it promotes good governance within the firm and thereby helps to serve the public interest. The group of firms applying it at present represents the vast majority of those auditing listed companies and so we are not persuaded that a significant extension in those to whom it applies is justified though we have suggested a modest extension in our response to Question 1 above such that it covers all PIEs within the scope of the EU Audit Regulation, once determined in the UK, and with perhaps a lower de minimis threshold than currently applies.

13 Do you have any further comments on the role of the FRC in this context [ie whether the FRC should be the sole owner of the Code]?

We would see merit in the Code being owned jointly by the FRC and the professional bodies involved in the regulation of auditors as we believe it is essential that it is seen as a co-operative exercise between the firms, regulators and the auditing profession as a whole. However, regardless of ownership, the key issue, as discussed, is that the Code should continue to operate on a 'comply or explain' basis, as in the case of its counterpart for listed companies, and be seen as existing alongside but not directly part of the regulatory process.

14 Do you have any further issues on any of the issues raised in this report?

In paragraph 72 you mention that in our firm we have appointed INEs on a European-basis and neither of them is UK-based. As previously advised, they are appointed on a global basis and as we are an integrated firm they are involved in decisions at a global level which have a key impact on partners in the UK, for example including those relating to remuneration of members of our Global Executive Board. They also take a direct interest in UK-specific matters and discuss these on a regular basis with the UK senior partner and others involved in the UK firm's governance.

As covered in the code applicable in Ireland, which is explicitly derived from the Code, there would be merit in making clear that where matters are dealt with on an international basis

aspects relevant to the UK in relation to them and any other UK specific issues should be considered by the INEs.