MAZARS

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Dear Keith

Consultation: Auditing and ethical standards

1 Introduction

Mazars, the independent integrated international audit, accountancy and advisory firm which has a turnover in excess of 1 bn euros and 14,000 staff in 73 countries with more than 1500 partners and staff in the UK, is pleased to offer its views on the above consultation paper.

2 Principles which should be applied by FRC in determining its approach

We would encourage FRC, like BiS, to determine its approach to the various issues which it needs to address in order to implement the European audit reform legislation and related issues by reference to the following principles:

- An overriding commitment to **promoting the public interest** as regards the role, activities and regulation of auditors and in so doing **ensuring the system of regulation for listed companies and financial services businesses forms a coherent whole.**
- A commitment to **seeking to follow the objectives of the European audit reform package** as set out in the Regulation and Directive.
- A commitment to **fostering the creation of an innovative and competitive audit profession** focused on meeting the needs of those to whom auditors report and the wider public interest.
- A commitment to **proportionate regulation** which seeks to avoid 'gold plating' when implementing the Regulation and Directive and ensures, as far as possible, that implementation has appropriate regard to the size, degree of complexity of a business and the degree of public interest related to it or to services provided to it.

We recognise that in applying the above principles there will be a need for the exercise of significant judgment and on occasion for striking a balance between potentially conflicting principles.

3 Our overall conclusions based on applying the principles set out above

Having regard to the above principles our overall conclusions are:

- **We would welcome the FRC placing stronger emphasis in its analysis and tentative conclusions on its role in fostering the creation of an innovative and competitive audit market.** It would, for example, be helpful for FRC to consider issues related to EU audit reform alongside the relevant recommendations of the Competition and Markets Authority as they are very closely related to each other.

- **A consequence of the relatively narrow scope of the FRC paper is that there is no discussion of how PIEs will be expected to fulfil their obligation to involve all eligible audit firms when they undertake a tender of their audit.** This is an important new requirement with significant implications for promoting competition in the PIE audit market.

- **We believe that the starting point in looking at audit regulation now that the Regulation and Directive have been published should be implementing their core requirements**. Our view is that it should not be seeking to maintain the current status quo where this is different without a full review. Thus additional requirements in addition to the core ones set out in the Regulation and Directive, even if already implemented in the UK, should only be introduced or retained where they can be justified by reference to a clear impact assessment and where they enjoy the support of key stakeholders and especially shareholders.

- **The definition of PIEs should be based on the minimum set out in the Regulation, ie fully listed companies and some financial services businesses. We consider that companies with a main market listing in the UK but incorporated outside the EEA should adopt similar requirements to their UK-incorporated counterparts. Apart from this, the only extension to the minimum requirements as regards the scope of the Regulation which we would foresee would be with regards to the very largest AIM companies.** There may be a case, subject to applying the tests set out in the above paragraph with regards to an impact assessment and the support in particular of shareholders, for extending some of the requirements for PIEs to the largest AIM companies. This would probably be in the areas of restrictions on non-audit services, mandatory tendering and rotation, the audit report and the long-form report to the audit committee.

Our responses to the detailed questions in the Consultation Paper are contained in the Appendix to this letter.

Further discussion

If you would find it helpful to discuss further any issues raised in this letter, please do not hesitate to contact David Herbinet on 0207 063 4419 or Anthony Carey on 0207 063 4411.

Yours faithfully

Mazars LLP

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Section 1 – Auditing Standards

Question 1 (see pages 11 – 13)
Do you agree that the FRC should, subject to continuing to have the power do so after the Audit Directive and Regulation have been implemented, exercise the provisions in the Audit Directive and Audit Regulation to impose additional requirements in auditing standards adopted by the Commission (where necessary to address national law and, where agreed as appropriate by stakeholders, to add to the credibility and quality of financial statements)?
We agree that the FRC should have power to impose additional requirements in auditing standards in addition to those in standards adopted by the European Commission but consider that such powers should be exercised very sparingly such as at present to deal with particular regulatory and statutory issues. Where any additional requirements are proposed, they should be subject to an impact assessment that demonstrates the merit of introducing them and such additional requirements should be supported by key stakeholders, especially shareholders. Subject to this, we would be supportive, in principle, of maintaining the requirements for auditors to report on matters related to the application of the UK Code on Corporate Governance and with regards to materiality.

Section 2 – Proportionate Application and Simplified Requirements

Question 2 (see pages 14 – 15)
Do you believe that the FRC's current audit and ethical standards can be applied in a manner that is proportionate to the scale and complexity of the activities of small undertakings? If not, please explain why and what action you believe the FRC could take to address this and your views as to the impact of such actions on the actuality and perception of audit quality.
We are generally satisfied that auditing standards can be applied in a proportionate manner for small undertakings. As discussed below, we believe ethical standards should be reviewed especially with regards to their application to most AIM companies.

Question 3 (see pages 15 – 17)
When implementing the requirements of Articles 22b, 24a and 24b, should the FRC simplify them, where allowed, or should the same requirements apply to all audits and audit firms regardless of the size of the audited entity? If you believe the requirements in Articles 22b, 24a and 24b should be simplified, please explain what simplifications would be appropriate, including any that are currently addressed in the Ethical Standard 'Provisions Available for Small Entities', and your views as to the impact of such actions on the actuality and perception of audit quality.
We would generally be supportive of the provisions of Articles 22b, 24a and 24b applying to all audits and audit firms.

Section 3 - Extending the More Stringent Requirements for Public Interest Entities to Other Entities

Question 4 (see pages 18 – 25)
With respect to the more stringent requirements currently in the FRC's audit and ethical standards (those that are currently applied to 'Listed entities' as defined by the FRC) that go beyond the Audit Directive and Regulation:
(a) should they apply to PIEs as defined in the Audit Directive?
(b) should they continue to apply to some or all other Listed entities as currently defined by the FRC? If so, which of those requirements should apply to which types of other Listed entities?
There are two issues to be addressed; should the more stringent requirements continue to apply and, if so, to which companies? On the first point, we consider that there should only be requirements in addition to those in the Directive and Regulation if they are subject to an impact assessment and if they command support among stakeholders and particularly investors. On scope, we believe they should only apply to PIEs as required to be included in the definition by the Regulation and to companies with a full market listing in the UK but which are incorporated in another country. In addition, there may be a case for applying some of the additional requirements applicable to PIEs to the very largest AIM companies, subject to the outcome of an impact assessment and to support for the proposals on consultation and especially from shareholders.

Question 5 (see pages 18 – 25)
Should some or all of the more stringent new requirements to be introduced to reflect the provisions of the Audit Regulation apply to some or all other Listed entities as currently defined by the FRC? If so, which of those requirements should apply to which types of other Listed entities?
Apart from companies with a full market listing in the UK but which are incorporated in another country, we believe that the new more stringent requirements should as a matter of course only apply to fully listed companies and other businesses required to be treated as a Public Interest Entity (PIE) by the Regulation. There may be a case for some of the additional requirements applicable to fully listed companies to also be applied to a small number of the very largest AIM companies. Appropriate requirements to be applied may be those relating to limits on non-audit services, mandatory tendering and rotation, the audit report and the report from the auditors to the audit committee. In deciding whether to apply any additional requirements to the very largest AIM companies, an impact assessment should be undertaken and consultation held with stakeholders, especially shareholders to ensure there is support for imposing additional requirements.

Question 6 (see pages 18 – 25)
Should some or all of the more stringent requirements in the FRC's audit and ethical standards and/or the Audit Regulation apply to other types of entity i.e. other than Listed entities as defined by the FRC, credit institutions and insurance undertakings)? If yes, which requirements should apply to which other types of entity?
Apart from companies with a full market listing in the UK but which are incorporated in another country, the only entities in addition to those required to be covered by the Regulation to which additional requirements should possibly apply are the very largest AIM companies as discussed in the response to the previous question.

Section 4 – Prohibited Non-audit services

Prohibition of additional non-audit services **(see pages 29 – 35)**

Question 7

What approaches do you believe would best reduce perceptions of threats to the auditor's independence arising from the provision of non-audit services to a PIE (or other entity that may be deemed of sufficient public interest)? Do you have views on the effectiveness of (a) a 'black list' of prohibited non-audit services with other services allowed subject to evaluation of threats and safeguards by the auditor and/or audit committee, and (b) a 'white list' of allowed services with all others prohibited?

We would support the publication of a 'black list' of prohibited services, with such a list of course being required by the Regulation, and would explore the merits of supplementing it with a short 'white list' of services that it would normally be expected could be provided by the auditor. Our views would be subject to widespread agreement being reached on the contents of the 'white list', with support, especially from shareholders, on the contents of the 'white list'.

Question 8

If a 'white list' approach is deemed appropriate to consider further:
(a) do you believe that the illustrative list of allowed services set out in paragraph 4.13 would be appropriate or are there services in that list that should be excluded, or other services that should be added?
(b) how might the risk that the auditor is inappropriately prevented from providing a service that is not on the white list be mitigated?

We believe the list of audit-related services which it may be appropriate for the auditor to provide, as set out in paragraph 4.11 and 4.13, is a reasonable list of services to be included on the 'white list'. To mitigate the risk that the auditor is inappropriately prevented from providing a service that is not on the white list, it should be made clear that the 'white list' is not a definitive list of services that may be provided by the auditor though for non-audit services beyond the 'white list' which the audit committee wishes the auditor to provide, the audit committee should confirm that it is satisfied that no equally suitable alternative was available and that the auditor was chosen after an appropriate tendering of these services.

Question 9

Are there non-audit services in addition to those prohibited by the Audit Regulation thatyou believe should be specifically prohibited (whether or not a 'white list' approach is
adopted)? If so, which additional services should be prohibited?

Derogations in respect of certain prohibited non-audit services **(see pages 35 – 36)**

In line with our general approach on proportionality, we do not consider there is a need for a general prohibition of other services in addition to those prohibited in the Regulation. In applying the 70% cap on non-audit services able to be provided by the auditor, we would, however, consider applying the limit, where applicable, both to services provided by the auditor of the UK subsidiary and by the auditor's network or its global firm at group level.

Question 10
Should the derogations that Member States may adopt under the Audit Regulation - to allow the provision of certain prohibited non-audit services if they have no direct or have immaterial effect on the audited financial statements, either separately or in the aggregate - be taken up?
We are not persuaded of the merits of providing a derogation from the provision of certain prohibited services. This is due to our considering that limiting the provision of non-audit services by listed companies is one way of enabling them to get to know other firms which may subsequently be interested in tendering for the audit. Furthermore, we consider the meaning of services which have 'no direct or have immaterial impact' on the financial statements is very unclear.

Question 11
If the derogations are taken up, is the condition that, where there is an effect on the financial statements, it must be 'immaterial' sufficient? If not, is there another condition
that would be appropriate? *Audit Committee's role in connection with allowed non-audit services* (see page 36)
Not applicable, given our answer to Question 10.

Question 12
For an auditor to provide non-audit services that are not prohibited, is it sufficient to require the audit committee to approve such non-audit services, after it has properly assessed threats to independence and the safeguards applied, or should other conditions be established? Would your answer be different depending on whether or not a white list approach was adopted?
Yes, as discussed in our response to Question 8, our answer would differ if a 'supplementary' 'white list' were adopted as a guide to services which the auditor could normally provide. In such cases, if the auditor were to provide services in addition to those on the 'white list' and which are not specifically prohibited, the audit committee should confirm that it is satisfied that no equally suitable alternative was available and that the auditor was chosen after an appropriate tendering of these services.

***Geographical scope of the prohibitions of non-audit services, by the audit firm and all members of its network, to components of the audited entity based outside the EU* (see pages 37 – 39)**

Question 13
When implementing the provisions of the Audit Regulation in the Ethical Standards, should the FRC require the group auditors of PIEs to ensure the principles of independence set out in the FRC's standards (including the provisions relating to the provision of non-audit services) are complied with by all members of the network whose work they decide to use in performing the audit of the group, with respect to all components of the group based wherever based? If not, what other standards should apply in which other circumstances?
Yes, we consider that the group auditors of PIEs should ensure that all members of the network, or parts of the global firm providing audit services to the group on which they rely in performing the group audit, should comply with the FRC's standards on matters of independence.

***Applying restrictions to other group auditors that are not part of the group auditor's network* (see pages 39 – 40)**

Question 14
When implementing the provisions of the Audit Regulation in the Ethical Standards, should the FRC require the group auditors of PIEs to ensure the principles of independence set out in the FRC's standards (including the provisions relating to the provision of non-audit services) are complied with by all other auditors whose work they decide to use in performing the audit of the group? If not, what other standards should apply in those circumstances?
We consider that parts of the network or global firm not providing audit services on which the group auditor relies should be required to follow the FRC's standards on independence, except perhaps in respect of services provided that are trivial in amount.

Section 5 – Audit and Non-audit Services Fees

Fees for non-audit services **(see pages 42 – 46)**

Question 15
Is the 70% cap on fees for non-audit services required by the Audit Regulation sufficient, or should a lower cap be implemented for some or all types of permitted non-audit service, including the illustrative 'white list' services set out in Section 4?
We believe, in line with our approach to proportionality, that the 70% maximum cap, as set out in the Regulation, is appropriate but, as discussed above, it should be applied at both a UK and group level.

Question 16
If the FRC is made the relevant competent authority, should it grant exemptions from the cap, on an exceptional basis, for a period not exceeding two years? If yes, what criteria should apply for an exemption to be granted?
Given that, as pointed out in the Consultation Paper, a reasonable number of companies currently exceed the 70% cap, care should be taken only to grant exemptions in genuinely exceptional levels (which should be rare). Moreover, where granted, we would suggest the regulator call for the appointment of a joint auditor to buttress the independence of the current auditor.

Question 17
Is it appropriate that the cap should apply only to non-audit services provided by the auditor of the audited PIE as required by the Audit Regulation or should a modified cap
be calculated, that also applies to non-audit services provided by network firms,?
As discussed above, we believe the cap should apply at both the UK and group levels.

Question 18
If your answer to question 17 is yes, for a group audit where the parent company is a PIE, should the audit and non-audit fees for the group as a whole be taken into consideration in calculating a modified alternative cap? If so, should there be an exception for any non-audit services, including the illustrative 'white list' services set out in Section 4, be excluded when calculating the modified cap?
We believe the same principles should apply in determining the cap at both UK and group levels as regards which services may be provided. All non-audit services provided should be included in the calculation of the fees earned from the provision of non-audit services as compared to the audit fee.

Question 19
Is the basis of calculating the cap by reference to three or more preceding consecutive years when audit and non-audit services have been provided by the auditor
appropriate, given that it would not apply in certain circumstances (see paragraphs 5.3 and 5.15)?
We are puzzled by this question as it seems fairly obvious that if no services are provided in one of the preceding three years, one simply includes nil in the numerator for that year, rather than saying, as proposed, that the provision of no services means the determination of the three consecutive years has to subsequently restart. The proposed approach does not seem to be in line with the intention of the Regulation.

On a separate point, we note that the consultation does not seem to cover the question of prohibited services that a newly appointed auditor may not have provided in the year before appointment. We believe discussion of this matter would be helpful.

***Total fees for audit and non-audit services* (see pages 46 - 48)**

Question 20
Do you believe that the requirements in ES 4 should be maintained?
As discussed above, we believe any additional restrictions in addition to those required by the Regulation, should only remain if they are subject to an impact assessment and have the support of stakeholders and especially shareholders.

Question 21
When the standards are revised to implement the Audit Directive and Regulation, do you believe that these more restrictive requirements in ES 4 should apply with respect to all PIEs and should they apply to some or all other entities that may be deemed to be of sufficient public interest as discussed in Section 3? If yes, to which other entities should they apply?
Again as discussed above, any more restrictive requirements should only apply to PIEs required to be included by the Regulation. The only possible extension of scope should possibly be with regards to the very largest AIM companies and an impact assessment should be carried out and the support of stakeholders, especially shareholders, sought for any particular extensions in the areas already mentioned (none of which are covered by paragraph 5.20).

Question 22
Do you believe that an expectation that fees will exceed the specified percentages for at least three consecutive years should be considered to constitute an expectation of "regularly" exceeding those limits? If not, please explain what you think would constitute "regular"
Subject to a sensible understanding of the meaning of three consecutive years, as discussed above, we think such a period provides a reasonable basis for the definition of the meaning of 'regular' if such a requirement is to be retained.

Section 6 – Record Keeping

Question 23 (see page 49)
Should the FRC stipulate a minimum retention period for audit documentation, including that specified by the Audit Regulation, by auditors (e.g. by introducing it in ISQC (UK and Ireland) 1)? If yes, what should that period be?
We would be content to see a minimum period for the retention of audit documentation. We would support a period of 5 years as set out in the Regulation, or 6 years as for retention of records by companies.

Section 7 – Audit Firm and Key Audit Partner Rotation

***Audit firms* (see page 50)**

Question 24
Do you believe that the FRC's audit and/or ethical standards should establish a clear responsibility for auditors to ensure that they do not act as auditor when they are effectively time barred by law from doing so under the statutory requirements imposed on audited PIEs for rotation of audit firms?
Such a responsibility would not be unreasonable.

***Key audit partners* (see pages 50 - 51)**

Question 25
Do you believe that the requirements in ES 3 should be maintained?
If the FRC is to go beyond the requirements of the Regulation concerning the rotation of 'key audit partners', as regards the maximum period before rotation, we believe that in the interests of proportionality, it needs to be able to demonstrate that there is clear benefit in doing so and that there is significant support for such an approach from key stakeholders, especially shareholders.

We also consider the references to 'engagement partner' should be changed to 'key audit partner' and the definition aligned with that set out in the Regulation, unless there is an impact assessment and demonstrable benefit in retaining the current title and definition and again, significant support from stakeholders and especially shareholders for doing so.

Question 26
When the standards are revised to implement the Audit Directive and Regulation, do you believe that these more restrictive requirements in ES 3 should apply with respect to all PIEs and should they apply to other entities that may be deemed to be of sufficient public interest as discussed in Section 3? If yes, to which other entities should they apply?
As discussed above, in addition to PIEs required to be covered by the Regulation, the only other companies we consider should possibly have additional requirements placed on them are the very largest AIM companies and more restrictive audit partner rotation periods are not one of the possible additional requirements we think should be considered.

Consultation Stage Impact Assessment

Question 27 (see pages 52 – 60)
Are there any other possible significant impacts that the FRC should take into consideration?
As discussed in our covering letter, we think it is vitally important that full regard be had to the likely impact of any proposed requirements on the creation of an innovative and competitive audit market for PIEs.