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11 December 2015

Mr Paul Smith
Corporate Frameworks, Accountability and Governance Team
Department of Business, Innovation and Skills
1 Victoria Street
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Dear Paul,

**Auditor regulation - Consultation on the technical legislative implementation of the EU Audit Directive and Regulation**

**Introduction**

Mazars is an international, integrated and independent organisation, specialising in audit, advisory, accounting and tax services. As of 1st January, 2015, the Group operates in 73 countries and draws on the expertise of 15,000 professionals to assist major international groups, SMEs, private investors and public bodies at every stage in their development. In the UK, Mazars has over 1600 partners and staff serving clients from 19 offices, and is ranked as the ninth largest firm nationally.

**Our overall views**

Whilst we are supportive of a number of the proposed ways of enacting the Regulation and Directive, we also have a number of significant concerns.

The consultation recognises that a substantial change is being made in enshrining FRC's powers directly in legislation whereas currently they are derived from agreement with the RSBs. As previously mentioned we believe such a change needs to be accompanied by a thorough review of FRC's governance which should include a review of its accountability and of how board members are appointed.

Further discussion is also needed of the impacts of the above change on FRC's powers on disciplinary matters with particular reference to those which it will exercise in the future and those which will belong with the RSBs. It would seem likely that there will be changes to the current arrangements which are not openly discussed in the consultation. The effectiveness and fairness of the FRC's disciplinary system should be subject to periodic review and this should include consideration ofthe timeliness with which it undertakes its investigations.

More generally, there seems some risk of going beyond the general approach of 'minimum implementation' in relation to sanctions. There is also a question of whether the sanctions are too open-ended and whether natural justice would be better served by setting them out more clearly. This whole area would benefit from further review.

We are surprised there is no discussion of Article 7 of the Regulation which deals with the reporting of irregularities with respect to the financial statements. The meaning of the definition of a 'legal breach or breach of administrative rules' also needs to be clarified.

We are particularly concerned with a number of the proposals which we believe will reduce competition, or at least forego the opportunity to increase it:

- We firmly believe the option should be taken to allow joint auditors a maximum term in office of 24 years before mandatory rotation is required.
- We consider the means by which PIEs ensure all eligible audit firms are aware of forthcoming tenders for PIEs should be covered in the legislation.
- We regard the exemptions from the need to tender on first appointment of auditors and when a casual vacancy arises are unnecessarily wide and clearly undermine the goal of having regular tenders.

In addition, we consider FRC should have a statutory responsibility to promote a competitive audit market for PIEs given the importance of this goal for the long-term health of the market and the audit profession.

With regards to competition, we further believe the review of firms auditing listed PIEs by FRC should be such that individual firms should not be subject to competitive disadvantage by the periods between their reviews being longer than that of other firms which they regard as their peers. Where the proposed period between reviews is longer than for other firms subject to direct regulation by FRC, a firm should have the right for it to be increased to a similar frequency.

**Detailed response to consultation questions**

Our detailed response to the consultation questions in section 14 of the consultation is set out in the appendix attached to this letter.

**Further discussion**

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

Yours sincerely

Mazars LLP

**Appendix Response to consultation Questions**

**General question on the draft clauses prepared to complement the discussion in chapters 5, 6, 7, 8 and 12**

**1. Do you agree with the approach the draft implementation regulations take given the Government's conclusions as set out in these chapters? Why?**

***Chapter 5 Which audits are affected?***

We agree with the Government's decision that it should not take up the Member State option to define additional PIEs for the purpose of the application of the Regulation and the provisions of the Directive in relation to the audits of PIEs.

***Chapter 6 How are audits regulated?***

We believe the proposed approach of designating FRC as the competent authority whilst requiring it to delegate regulatory tasks, as far as possible, to the Recognised Supervisory Bodies is a reasonable one in relation to the allocation of responsibilities.

It is noted that the proposed Regulation introduces a significant change in that FRC's responsibilities are to be set out in legislation replacing the current regime under which the inspection, investigation, sanctions and standard-setting functions are carried out by agreement with the RSBs. We believe that such a major change should be accompanied by a thorough review of FRC's governance with appropriate amendments to ensure there are the necessary checks and balances on the exercise of its powers, that board members are appointed in an appropriate manner and that it is suitably accountable for its effectiveness. Thought is also needed on the implications of setting out FRC's responsibilities directly in the legislation. FRC's legislative authority will presumably relate to stopping a member of an RSB from undertaking statutory audits rather than removing their right to remain a member of a particular professional accountancy body and so additional proceedings may be needed under the new structure unless a new agreement is reached between FRC and the RSBs. It is also not clear whether FRC will in future only deal with disciplinary matters related to auditing, as covered by the legislation, or more broadly as at present. Moreover, will FRC's scope be limited to public interest cases, as is currently the case, or extend more broadly to all statutory audits?

We also consider the sanctions available to FRC to be too open ended as currently proposed and it would be in the interests of natural justice for their limits to be spelled out with greater clarity.

We are satisfied with the manner of the proposed implementation of the requirements relating to the recognition of statutory auditors from another Member State under which the FRC will be free to determine whether an EEA auditor wishing to practice in the UK should be subject to an aptitude test or to an adaptation period.

Whilst supporting a proportionate and risk-based approach to the regulation of non-PIE auditors, we do think there is a merit in all non-PIE auditors being reviewed periodically and this happening at

least once every 6 years does not seem excessive. We are therefore not persuaded of the merit of not including a maximum period between reviews in the proposed legislation.

For the regulation of firms auditing PIEs, we believe the review of firms auditing listed PIEs by FRC should be such that individual firms should not be subject to competitive disadvantage by the periods between their reviews being longer than that of other firms which they regard as their peers. Where the proposed period between reviews is longer than for other firms subject to direct regulation by FRC, a firm should have the right for it to be increased to a similar frequency.

With regards to investigations, sanctions and powers, it is stated in paragraph 6.19 that it is not intended to exclude infringements that are already subject to criminal law from the scope of administrative sanctions. Whilst it is reasonable that, as a consequence of a completed criminal process, a member of a professional body may be subject to disciplinary proceedings brought by the regulator concerning whether they should remain on the register of statutory auditors, or by their professional body, care should be taken to avoid double jeopardy, for example where they are acquitted of charges brought against them relating to a particular audit. We also consider the investigations process should be subject to periodic review of its effectiveness and fairness including with regards to the time taken to complete investigations.

The stated intention of the Government that it intends that competent authorities or other authorised bodies should retain the ability to apply other sanctions does seem to constitute a form of 'gold-plating' with regards to the implementation of the Regulation which does not seem to be altogether in line with the general approach of 'minimum implementation.'

It is also stated that details of sanctions against statutory auditors should remain publicly available for at least five years. In the interests of natural justice it would also be helpful to state the maximum period in particular cases during which such details should remain on the public record.

In paragraph 6.20 it is stated that it is intended to make clear that the competent authority should have powers to suspend directors of PIEs for up to three years. This does not seem unreasonable in itself and will presumably end the anomaly that it is only directors who are members of professional accountancy bodies who are subject to disciplinary action by FRC in relation to accounting or auditing issues.

On other matters, we are surprised there is no discussion of Article 7 of the Regulation which deals with the reporting of irregularities with respect to the financial statements. The meaning of the definition of a 'legal breach or breach of administrative rules' also needs to be clarified.

***Chapter 7 Length of audit engagements***

We do not agree with the proposal set out in the third bullet point of paragraph 7.9 that indicates it is not proposed to take advantage of the option to extend the maximum period before the mandatory rotation of auditors to 24 years where there are joint auditors. We believe this is another selective instance of 'gold-plating' of the requirements of the Regulation with no reason being given for why this decision has been reached. Moreover, it is a decision which takes away an incentive for companies, as intended in the Regulation, to appoint joint auditors which over time would be most

likely to increase competition in the audit market and reduce the very heavy degree of concentration that already exists in it, especially with regards to the audit of FTSE 350 companies. Furthermore, this decision sits rather uncomfortably with the statement in paragraph 7.10 that 'The other elements of the process under the new Regulation would be by way of a minimal implementation taking advantage of the flexibilities available under the new Regulation.'

We also note that the Regulation calls on the board to state in certain circumstances, i.e. where it does not accept the audit committee's recommendation as to auditor, the name of the two firms proposed by the audit committee to it for appointment as auditor. Surprisingly, this matter does not seem to be covered in the proposed Regulation. It is similarly surprising that the proposed legislation does not deal with the requirement in the CMA Order for relevant disclosure where a tender has not taken place in the last 5 years. Whilst the CMA order strictly only applies to FTSE350 companies there would seem to be merit in applying its requirements to PIEs covered by the new Regulation.

The proposal, relating to joint audit, will also adversely affect UK subsidiaries of groups with holding companies, say in France, that are audited globally by joint auditors each of whom has a maximum period in office of 24 years before mandatory rotation as permitted by the new Regulation. The proposed approach will mean that the UK subsidiaries will not be able to synchronise the necessary periodic change in audit appointments on a European-wide or global basis, placing avoidable burdens on them. It will also significantly reduce the choice of audit firms for the provision of non-audit services as neither the group auditors nor the auditors of the UK subsidiary/subsidiaries will be able to provide such services.

In paragraph 7.13 the Government has set out its intentions concerning the circumstances in which it intends to provide exemptions from mandatory tendering. These seem far wider than is needed and, to the extent that tenders help to promote competition, will have an adverse impact on it. It is not clear why the directors should not generally be able to arrange a tender before appointing their first auditors or when a casual vacancy arises. The current proposals clearly undermine the goal of having regular tenders.

We are similarly surprised at the proposal to abandon the advance notice of tendering in legislation. Whilst the particular proposed approach was not the only one possible, it is very important that full consideration is given to how companies can best comply with Article 16.3 of the Regulation requiring them to invite all eligible firms to submit a tender if they wish. We note the FRC is proposing advance notice of tendering but we think consideration of how to address the issue in legislation would have been preferable given its central role in promoting the creation of a more competitive audit market.

We are broadly supportive of the proposals relating to the Competent Authority being able to grant an extension in exceptional circumstances of up to two years to the maximum duration of the period before mandatory rotation of the audit firm is required.

We consider the proposals to treat a tender of the audit engagement resulting in the reappointment of the incumbent auditor for an accounting year beginning up to 10 years before the application date for the Regulation as a tender for the purposes of the transitional provisions will again have the impact of postponing the intended impact of mandatory rotation of auditors and serve to delay the introduction of much needed and overdue competition into the PIE audit market. Moreover, such earlier tenders are very unlikely in practice to meet the requirements in paragraph 7.19 that the

process adopted should have been broadly equivalent to that set out in the Regulation as they would have needed to have been open to all firms eligible to undertake the relevant audit which is most unlikely to have been the case.

***Chapter 8 Standards and standard setting***

We agree, as discussed in paragraph 8.9, that the current disclosure relating to non-audit services will need to be revised to facilitate monitoring of the new cap on the provision of non-audit services. We also agree with the proposal in paragraph 8.10 that subsidiaries audited by an auditor other than the group auditor should disclose audit and non-audit fees in their own accounts as they will not have been included in the calculation for inclusion in the consolidated accounts. In addition, we believe they should be separately disclosed in the consolidated accounts.

Given their public interest nature, we are not persuaded of the merits of revoking the proposed disclosures in paragraph 8.10 relating to disclosure of audit and non-audit fees by companies falling under the small to mid-sized accounting regimes.

***Chapter 12 Restrictive clauses in contracts with third parties***

We agree that the legislation should provide that restrictive contractual clauses have no legal effect.

**General questions on the proposed legislative approach in Chapters 10 and 11**
***Chapter 10 Cooperation, transferring information and confidentiality***

**2. Do you agree with the Government's proposals on amendments to the Companies Act to reflect Articles 15 and 18 of the Regulation and the amendments to Articles 23, 45 and 47 of the Directive? Do you agree that these are all that is needed to reflect the provisions of the new Directive and Regulation on cooperation, transferring information and confidentiality? Why?**

We think that the approach to matters discussed in chapter 10 seems reasonable.

We think it is reasonable that there are sanctions when auditors fail to keep statutory records for the period required by Article 15 of the Regulation. We think the proposed retention period being considered by the FRC of six years is not unreasonable.

We also believe it is reasonable to include in the Companies Act the requirements of Article 18 of the Regulation relating to auditors making information available to a successor firm.

The proposed changes in legislation relating to co-operation between competent authorities in the EU seems reasonable including the list of three Supervisory Authorities in the EU that it proposed could request an investigation.

The proposed changes in legislation relating to the cooperation of competent authorities with third countries seem reasonable.

***Chapter 11 Other audit measures***

As discussed in 'Our overall views' in the covering letter, whilst we note the FRC is now working on arrangements to enable the initial report to be prepared at EU level on developments in the market for providing statutory audit services to PIEs, we believe there should be a legislative obligation on the FRC to promote a competitive market for the audit of PIEs in order to reflect the importance attached to it be the CMA Order and which similarly should be attached to it by Government.

**Impact assessment**

**3. Given the analysis of costs and benefits in the Impact Assessment in general, do you have any comments on how our estimates or underlying assumptions might be improved? Please explain your answer.**

Any estimate of costs of implementation is likely to be of the nature of a broad estimate and care should be taken not to attribute too much meaning to modest differences in costs under different approaches.

Our main comment would be that the Impact Assessment focuses on the costs and does not take into account the potential benefits over time resulting from greater competition in the marketplace as a consequence of the regular retendering of PIE audits.

**Familiarisation costs**

**4. Responses to our Discussion Document suggested that familiarisation and implementation costs to:**

- **newly designated PIEs; and,**
- **audit firms that become auditors of PIEs for the first time …**

**… would be disproportionately higher. We propose that in the final IA we should uplift the estimated costs for such businesses by a percentage to reflect the additional resource costs to such firms arising from their lack of experience of the requirements of the Regulation and of those provisions of the Directive applying to audits of PIEs. For each category listed above, what do you consider to be a reasonable percentage?**

Any figure of a reasonable uplift of additional costs incurred by newly designated PIEs and their auditors is only going to be able to be very approximate and will vary significantly from one PIE to another but a figure of the order of a 20% increase on the general level for the first year might not be unreasonable.

**5. In the consultation IA we have estimated the direct costs to PIEs of having to tender the audit engagement every 10 years. In our final analysis, we also plan to include an estimate of the additional costs that would be incurred by a new auditor that has to familiarise itself with the**

**business of a new PIE client. We propose that the additional familiarisation cost to auditors engaged in a new audit could be estimated is an additional 10-30% of the cost of the audit in the first two years. Is this reasonable?**

As discussed above, any estimate of the additional familiarisation costs for a new auditor to a PIE client needs to be weighted against the benefits to the client and society that arise from tendering and, where applicable, the mandatory rotation of the auditor. Again as discussed above, familiarisation costs will vary from client to client but a broad estimate of around 15% of the first year's fee might not be unreasonable.

We are slightly surprised at the degree of attention being afforded to modest changes in the Impact Assessment at this stage of deliberations given the high degree of estimation in the figures and the fact that the costs on the areas mentioned are not really variable as they relate to implementation of the Regulation on matters such as tendering issues for which there is broad support given the alternative is shorter periods before mandatory rotation.

**Costs to non-PIEs and their auditors**

**6. Our preliminary analysis suggested that the costs and benefits of the measures in the new Directive affecting audits of non-PIEs would be negligible. This has been assumed in the consultation IA. Is this reasonable? If not, what do you estimate will be the main changes giving rise to costs and benefits for non-PIEs and their auditors? Can you provide quantitative estimates?**

In line with our previous response, we would not encourage more work in this area as we share the view that the costs are negligible in broad terms.

**7. It is particularly important to assess the costs and benefits arising from the new Directive for non-PIE LLPs and their auditors as the implementation of the new Directive is not required by EU law for these audits. Would your answers to question 6 differ for non-PIE LLPs? How and why?**

We consider the issue of whether the Directive should be applied to non-PIE LLPs should be governed by the general principle of whether legislation relating to auditing and reporting matters is generally applied to them which we understand to be the case.

**Further questions on application to non-PIE LLPs**

**8. Do you think that the Government should:**

- **implement the changes required by the new Directive for audits of non-PIE LLPs alongside those same changes for entities (such as companies) that are required to be audited by EU law; or,**
- **implement some or all of the changes required by the new Directive for audits of non-PIE LLPs at a later stage?**

**… please give reasons for your answer.**

On balance, we believe changes in the relevant legislation should apply to non-PIE LLPs at the same time as to their company counterparts.

**9. Do you think there would be cost savings from implementing the changes required by the new Directive for non-PIE LLPs at the same time as for entities (such as companies) whose audits are subject to EU law? Please give reasons for your answer. Can you provide any estimate of the extent of these savings?**

We are not persuaded that phasing the timing of implementation in the case of non-PIE LLPs would materially alter the costs for them.