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Dear Financial Reporting Council

### **Consultation on Firm-level Audit Quality Indicators**

Mazars, a leading international firm providing audit, accounting and advisory services, welcomes the opportunity to comment on the above consultation document. Founded in Europe, Mazars is an integrated international partnership and is present in over 90 countries and territories, with 40,400 professionals – 24,400 in our integrated partnership and 16,000 through the Mazars North America Alliance. In the UK Mazars is a leading auditor of Public Interest Entities (PIEs) and employs over 2,500 people across 16 locations.

#### **General comments**

##### *Purpose of AQI publication*

It is not clear from the proposals whether the publication of AQIs is intended to drive enhanced audit quality or to provide greater information to the audit market and users. As we set out in our responses to individual questions, it is not always clear how the proposed indicators will lead to enhanced audit quality.

It is not clear that there is a market driver for the introduction of these requirements, whether Audit Committee Chairs have a genuine interest in such AQIs and how these AQIs will lead to enhanced interaction between firms, companies, investors and Audit Committees regarding Audit Quality. In our view the FRC should consider whether an appropriate approach may be to challenge firms to publish a common set of AQIs in their transparency reports as a first step and obtain feedback from the market on how these indicators may be used and evolved in the future. This will help to address some of the data collection challenges mentioned in our later responses.

As with all performance indicators, there is a risk that individuals and firms may focus on managing better performance against an indicator rather than focussing on delivering higher quality audit work. It will be important that the final mix of indicators truly drives enhanced audit quality to avoid the unintended consequences arising from indicators for which performance can be manipulated to reflect a better outcome.

*Consistency and comparability*

We are supportive of the introduction of firm-level Audit Quality Indicators in principle, providing users of audit with greater information on audit quality for discussion with current and prospective auditors. However, it is essential that any such published indicators are consistently defined, and data is consistently collected, to ensure appropriate comparability between audit firms. However, it is not clear how the FRC intends to achieve this level of consistency and comparability based on the information in this consultation. Much greater clarity over the definitions and basis of calculation of individual indicators is needed and publication of the consultation without such detail and guidance makes it, in some ways, difficult to comment on whether the proposals will achieve the desired outcomes. As ever, “the devil is in the detail”, which we have not been provided with.

We are concerned that the publication of the proposed indicators will inevitably be seen as a “league table” of audit quality and it is imperative that sufficient narrative can be provided alongside the raw numbers, which will inevitably vary depending on firms’ business models and individual firm’s performance in individual years. Furthermore, the driver behind performance against an individual indicator may not necessarily be an indicator of better audit quality (for example, in the narrative for proposed indicator 3a, the FRC notes that a higher percentage of hours spent in planning may indicate better planning and bringing work forward to alleviate pressure later in the audit to indicate higher quality. However, it is also possible that this could reflect a possible lack of resource and under-performance of work at the fieldwork stage which might lead to poorer audit quality).

*Scope*

We are concerned at the FRC’s proposal to broaden the scope of published AQIs to all audits, including non-PIEs. Given the scope of the proposals includes those firms which are required to comply with the Audit Firm Governance Code (based on PIE audits), the scope of the AQIs should similarly be restricted to the PIE audit population for those indicators where it is appropriate and possible to collate data for PIE audits only.

**Responses to Consultation questions****Question 1. Do you agree that the firms reporting their AQIs should be aligned to the scope of the revised 2022 Audit Firm Governance Code? If not, what scope would you prefer and why?**

Yes, we agree that reporting should be aligned, and restricted to, those firms complying with the Audit Firm Governance Code. Over time, it may be possible to expand the scope of reporting to other firms in the PIE market. However, implementing AQIs would be burdensome and could be seen as a barrier to entry or continuing in the PIE Market and may impact competition and resilience, and those firms would require a much longer lead-in time to develop appropriate systems.

Presumably, the FRC could make it optional for firms to publish AQIs in much the same way that firms could voluntarily adopt the governance code. In which case, we believe that a firm voluntarily adopting either the code or AQIs should be required to adopt both at the same time.

**Question 2. Do you agree that the AQIs should include all audit engagements, but segmented between PIE and non-PIE audits? If not, which engagements do you think should be included?**

No, we do not agree with the proposal to include AQIs for non-PIE audits for indicators where data can be collected for different types of audits. For some indicators (e.g. Culture) it will be impossible to collect data for PIE/Non-PIE audits separately, but for more engagement based AQIs it may be possible to collect data separately, although these may require system developments. Given the scope of the proposals includes those firms which are required to comply with the Audit Firm Governance Code (based on the number of PIE audits), the scope of the AQIs should similarly be restricted to the PIE audit population. We also believe that the scope should be restricted to entities within the FRC/AQR audit quality remit.

There will likely be significant differences in operating models and working practices between PIE and non-PIE audits within individual firms, which may make some of the indicators at best difficult to measure and, at worst, irrelevant for non-PIE engagements.

Greater clarity is needed over the definition of AQIs for PIE Groups which may be composed of a number of PIE and non-PIE entities; for example, would the indicator be for just the group audit opinion, or would indicators also need to be collected for any individual PIE within a group as well as for the group audit?

**Question 3. Do you expect any additional costs to be incurred by firms reporting over a period which is not aligned with their financial years? Are there ways to minimise these costs?**

It is not clear why there is a benefit to Audit Committee Chairs and other users of having coterminous reporting of Audit Quality Indicators. In our view, the FRC should consider whether an appropriate approach may be to challenge firms to publish a common set of AQIs in their transparency reports as a first step and obtain feedback from the market on how these indicators may be used and evolved in the future before introducing additional requirements on firms to produce AQI data on periods which do not coincide with their normal reporting periods (e.g. for AQI reporting in transparency reports. This may also address some of the other data collection challenges mentioned in our later responses.

We do not agree with the alignment of the reporting periods for all firms to a certain date as this will require firms to collect similar data for different purposes covering different periods. However, if the FRC concludes such reporting should be required, given the range of firms' financial year end dates, it will be important for appropriate transitional arrangements to be in place for firms whose year end falls at the "wrong time" based on the implementation date.

Furthermore, we do not believe that 31 March is an appropriate date for reporting given that PIE audits typically have 31 December year end and reporting deadlines for listed entities are normally four months after year end (30 April), meaning quality information relating to audit engagements would be split over two periods of AQI reporting. We believe that 30 June or 31 December would be a more appropriate AQI reporting period to minimise these overlapping periods, subject to our overarching comment above.

As firms currently report AQIs in their transparency reports based on their financial period, the implementation of these proposals would lead to duplicative processes and additional costs for AQI collection but with inconsistent published audit quality data between the FRC publication and

transparency reports. We suggest, therefore, that the requirements for transparency reports could be revised to align the FRC and Transparency reporting periods for AQIs.

**Question 4. Do you agree that it would be useful to include supporting narrative? Please provide suggestions to ensure that the information is concise and useful for users of audit services.**

Not only do we agree that it would be useful to include supporting narrative, but we also believe that it is essential to enable firms to provide appropriate commentary on how the firms sees its performance to support the published AQIs. Without such context, the AQIs themselves, in some cases, may be meaningless or, worse, misleading. For example, in a year of implementing new standards or a new audit system, a firm may provide a higher level of training than usual and the following year return to a more typical amount of training; without context the reader would merely see a significant reduction in training year on year and be concerned about the impact on audit quality.

With regard to comparative information, we agree with the proposals to include comparative information from year two. We do not believe that average performance over a period of time is necessarily useful information in regard to AQIs, as one would expect to see year on year changes. The FRC may wish to consider whether publishing the previous two years data alongside current year may give an appropriate view of how firms' performance against the AQIs is trending.

**Question 5. Do you agree with our proposed AQIs? If not, or in addition, do you prefer some of the alternatives presented above? Please explain, using the reference numbers.**

As noted in our general comments, we are concerned that the lack of detailed definitions and guidance makes it difficult to comment on the appropriateness of the indicators. However, in the absence of this detail, we have set out our thoughts on the proposals below:

**A. Performance monitoring & Remediation**

*Indicator 1 – Staff / culture survey results*

While we appreciate that this indicator may be useful, there are likely to be significant differences between firms' approaches to surveys leading to difficulties in understandability and comparability of published AQIs. Furthermore, we understand that there is anecdotal evidence of some firms linking survey results to reward, incentivising the reporting of good results in such surveys. It is not at all clear how "favourable" and "unfavourable" outcomes will be defined and the use of different scoring mechanisms makes comparison almost impossible. It may be easy to "game" the system with such an indicator; for example using a 5-point scale and claiming that only a score of 1 is "unfavourable" while 2-5 are all "favourable".

Although we disagree with the proposal to publish non-PIE performance and that only PIE indicators should be published, it may be difficult to disaggregate results from staff surveys for PIE auditors only, in which case this indicator may need to reflect the views of all audit staff.

*Indicator 2 – Audit planning milestones*

This is an indicator which we do not believe is appropriate for non-PIE audits as there are likely to be less structured/rigid milestones in such audits, compared to expectations on PIE audits.

*Alternative 3a – Proportion of audit hours by phases of audit*

Such indicators would be very data hungry and therefore difficult to collect. Many firms may need to make changes to systems and data collection to enable this indicator to be published, especially given the short implementation period proposed. We therefore do not support the inclusion of this indicator at this time.

We believe that the proposed alternative indicator 3b, “Average percentage of audit hours spent in the two weeks before sign off” would be the better quality measure of the two proposals, but again refer to the difficulty in collecting the data and the need for firms to have the ability to add narrative to provide the appropriate context of reported performance against AQIs.

**B. Quality Monitoring**

*Indicator 4 Internal Quality Review* – Although these results are already published by the FRC, we do not believe that this indicator is relevant as it reflects outcomes and does not drive audit quality. Furthermore, it is unclear from the proposals how this indicator would be measured (e.g. what time is included in the firm’s internal review program, does it include overall management of the internal review program, what about time spent by engagement teams etc.). In the absence of the detailed definition and guidance on ensuring consistency and comparability, we do not support the inclusion of this indicator, especially as it is not clear how scalability from the largest firms to challenger firms would be reflected in this indicator.

*Indicator 5 External inspection results* – we have no comments

*Indicator 6 Internal inspection results* – we have no comments

*Alternative 7 Involvement of EQCR* – We believe that this is a much better indicator of quality than the proposed indicator 4 above, as it is likely more of a driver of audit quality. We therefore suggest that the FRC considers removing indicator 4 and replacing it with this alternative indicator.

**C. Resource planning and people management**

*Indicator 8 Partner involvement* – We have no comments. However, we note that the FRC considers Partner Workload (Indicator N8 in Appendix 1) to be an engagement level AQI. We believe that this may be a driver of audit quality and might be a useful firm-level AQI if the FRC restricts the AQI population to PIE audits only, despite there still being variation in size and complexity of audits. As with other indicators, the definition and guidance would be key in ensuring consistency and comparability.

*Indicator 9a Staff utilisation* – Audit firms measure utilisation in many different ways and without the definitions and guidance it is not possible support this indicator as currently drafted, although in principle it may be useful if consistent, comparable data could be achieved.

*Indicator 9b Staff Utilisation (“busy period”)* – we do not believe that this indicator is appropriate as so-called “busy periods” are not necessarily restricted merely to January to March.

*Indicator 10 Staff attrition* – We are satisfied with the inclusion of this indicator, although we believe there are other reasons why it is important including the impact of new employees’ understanding of the methodology on audit quality as well as the impact of high turnover on a firm’s culture. Furthermore, such an indicator needs to be carefully defined as performance against staff attrition should not act as a barrier to firm’s exiting poor performers.

*Alternative 11 Use of Specialists* – as specialists are not always needed, even on PIE audits, we do not see the benefit of this indicator in the absence of more detailed definition and guidance.

*Alternative 12 Staff/partner/manager ratios* – this appears to be a reasonable AQI but may be difficult to identify the data for PIE only engagements depending on a firm's operating model. Different firm operating structures may make comparability difficult.

#### **D. Information and communication**

*Indicator 13* – we agree with the inclusion of a training AQI. However, this is an indicator which may need context to explain the comparability between firms who may deliver training in different ways. Furthermore, the AQI measures only formal training inputs and not outcomes, nor does it reflect the less formal, on the job training that is equally, if not more, important.

#### **E. Governance and leadership**

*Indicator 14* – We appreciate that diversity and inclusion are important drivers of many aspects of business and that the indicator proposed is easy to measure. However, the indicator as drafted takes account of a very narrow definition of diversity within audit skills referring only to gender and ethnicity. There are many other aspects of diversity which are equally important, for example socio economic backgrounds, academic backgrounds including subjects studied, specialist skills and knowledge etc. Furthermore, it is not clear how the FRC intends this AQI to measure “inclusion” or “belonging” (which are equally as important as diversity), nor is it clear how the FRC is defining “audit leadership” in regard to the diversity indicator. As such, it may be difficult to interpret this indicator and to demonstrate its impact on audit quality.

**Question 6. Do you think there are any other firm-level AQIs that we should consider? If so, please explain. (If relevant, please refer to the list of AQIs we have considered but not proposed, in Appendix 1.)**

Please see our comments in Question 5 regarding some of the alternatives which we believe are as good, if not better, AQIs than the proposed indicators. With regard to indicators in Appendix 1:

*N4 Unplanned prior adjustments* – we believe that this is a strong indicator of audit quality and should be included in the firm-level AQIs. We disagree that these are not always under the firm's control and note that academics consider that a PYA is a key indicator of audit quality as it indicates where the prior year audit did not identify a material error.

*N8 Partner workload* – see our comments in Question 5

**Question 7. Are there any other comments you wish to make about these proposals, including concerning costs, benefits, or impacts not discussed above?**

We have set out some general comments at the beginning of our letter which are also relevant to this question. We set out some further detailed comments on specific areas below.

#### *Implementation timeline*

As with all management information and quality indicators, the highest levels of data quality underpinning reported performance are required. There are a number of areas where many, if not all, audit firms may not be immediately able to achieve sufficiently reliable data quality as a result of

legacy practice management systems which weren't designed with this level of data collection in mind. It will take time for appropriate systems and processes to underpin data quality to be developed and we believe a sufficient lead time for introduction should be allowed to ensure data quality and enable consistent and comparable indicators to be published.

The proposed timeline is, in our view, too short for many firms, in particular challenger firms, to ensure appropriate data is collected.

It is also not clear from the proposals what the implementation date of 1 April 2023 means, for example is the intention to collect data for audits commencing on or after that date or for data collected after that date but relating to earlier audits such as December 2022 year ends?

Furthermore, we note that the reporting timeframe of end of May is only two months after the relevant period. We believe that this period may be difficult to achieve, particularly in the early years of adoption, and recommend that the FRC allows three months for firms to compile and assure the data prior to submission.

#### *Publication*

We note that in section 6, the FRC notes that it proposes to tabulate the scores. We have commented elsewhere in this response around our concerns over this publication being seen as a league table and it is imperative that audit firms have the ability to add narrative commentary to support the numbers published. We do not believe that the alternative of linking to other publications providing additional data/context is appropriate.

#### *Verification/attestation*

As with other aspects of the consultation, we are not able to reach a view on whether the attestation by the firm's managing partner is appropriate in the absence of the detailed proposal and guidance on what this statement "confirming the accuracy of the data" would include and what expectations there are regarding assurance provided to the managing partner.

The FRC may wish to consider whether they should undertake reviews as part of the AMS programme with reporting in firms' annual Public Reports.

#### **Further discussion**

If you would find it helpful to discuss any issues in this letter, please contact David Herbinet, Global Head of Audit ([david.herbinet@mazars.co.uk](mailto:david.herbinet@mazars.co.uk)) or Paul Winrow, Head of Audit & Assurance Methodology ([paul.winrow@mazars.co.uk](mailto:paul.winrow@mazars.co.uk)).

Yours faithfully

*Mazars LLP*

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