Financial Reporting Council

March 2015

Mazars LLP

Audit Quality Inspection

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1. Background information and key messages

1.1. Introduction

This report sets out the principal findings arising from the 2014/15 inspection of Mazars LLP ("Mazars" or "the firm") carried out by the Audit Quality Review team of the Financial Reporting Council ("the FRC"). This inspection was conducted at various times in the period from January 2014 to September 2014 (referred to as "the time of our inspection"). We inspect Mazars every three years, our previous inspection report was published on 10 May 2012. The objectives of our work are set out in Appendix A.

Our inspection comprised reviews of individual audit engagements and a review of the firm's policies and procedures supporting audit quality.

We reviewed five audit engagements undertaken by the firm, all of which were audits that were not reviewed in our previous inspection. These related to listed and other major public interest entities, with financial year ends between March 2013 and December 2013. Each review covered only selected aspects of the relevant audit.

Our responsibility is to monitor and assess the quality of the audit work performed by the UK firm. Accordingly, our reviews of group audits covered the planning and control of the audit by the group engagement team, including their evaluation of the adequacy of the work performed by component auditors, and selected aspects of other work performed by the UK firm at group and/or component level. Our reviews did not cover audit work relating to components undertaken by other firms within or outside Mazars' international network.

Our review of the firm's policies and procedures supporting audit quality covered the following areas:

- Tone at the top and internal communications
- Transparency report
- Independence and ethics
- Performance evaluation and other human resource matters
- Audit methodology, training and guidance
- Client risk assessment and acceptance/continuance
- Consultation and review
- Audit quality monitoring
- Other firm-wide matters

We exercise judgment in determining which findings to include in our public report on each inspection, taking into account their relative significance in relation to audit quality, both in the context of the individual inspection and in relation to any areas of particular focus in our overall inspection programme for the relevant year. Where appropriate, we have commented on themes arising or issues of a similar nature identified across more than one audit.

Further information on the scope of our work and the basis on which we report is set out in Appendix A.

All findings requiring action set out in this report, together with the firm's proposed action plan to address them, have been discussed with the firm. Appropriate action may have already been taken by the date of this report. The adequacy of the actions taken and planned will be reviewed during our next inspection.

The firm was invited to provide a response to this report for publication. The firm's response is set out in Appendix B.

We acknowledge the co-operation and assistance received from the partners and staff of Mazars in the conduct of our inspection.

1.2. Background information on the firm

Mazars LLP is a limited liability partnership with 19 offices in the UK as at 31 August 2014. The UK firm does not have offices or branches in the Crown Dependencies, being Jersey, Guernsey and the Isle of Man.

The firm is a member of the Mazars organisation, which comprises member entities which have signed a co-operation agreement with Mazars Scrl, a Limited Responsibility Co-operative Company based in Belgium. The shareholders of Mazars Scrl are all partners in the Mazars member entities. The majority, but not all, of the Mazars UK partners are shareholders of Mazars Scrl. Shareholders in Mazars Scrl elect a Group Executive Board and Group Governance Council and share a proportion of their profits.

At 31 August 2014 the UK firm was divided into six management units; two of the units are sector focused (insurance and banking) and four were geographic. Audit work is undertaken in all six management units.

For the year ended 31 August 2014, the firm's turnover was £131 million, of which £41 million related to audit work and other assurance services. There were a total of 126 partners, of whom 53 were authorised to sign audit reports, and three employees (audit directors) were also authorised to sign audit reports[1].

We estimate that the firm audited 20 UK entities within the scope of independent inspection as at 31 December 2013. Of these entities, our records show that nine had securities listed on the main market of the London Stock Exchange.

The UK firm audits two entities incorporated in Jersey whose securities are traded on a regulated market in the European Economic Area. Such entities are inspected by us under separate arrangements agreed with the relevant regulatory bodies in those jurisdictions and, if selected for review, the results of these reviews are included in this report.

[1] As disclosed in the annual return to the ICAEW as at March 2014.

Mazars supplies audit services to local authorities and the NHS (Local Public Audits - LPAs). Whilst we review LPAs undertaken by firms, this is done under separate arrangements agreed with the Audit Commission. The results of these reviews are not included in this report because the LPA inspections fulfil a different purpose to those considered in this report. The reviews of LPAs form part of the Audit Commission's assessment of the quality of contracted-out audits. The Audit Commission publishes its assessment both in overall terms and individually by firm. The most recent report can be found on its website.

1.3. Overview

We focus in this report on matters where we believe improvements are required to safeguard and enhance audit quality. We set out our key messages to the firm in this regard in section 1.4. While this report is not intended to provide a balanced scorecard, we highlight certain matters which we believe contribute to audit quality, including the actions taken by the firm to address findings arising from our prior year inspection.

The firm places considerable emphasis on its overall systems of quality control and, in most areas, has appropriate policies and procedures in place for its size and the nature of its client base. Nevertheless, we have identified certain areas where improvements are required to those policies and procedures. These are set out in this report.

Our findings relating to reviews of individual audits, as set out in section 2, largely relate to the application of the firm's procedures by audit personnel, whose work and judgments ultimately determine the quality of individual audits.

The firm responded promptly and positively to all the findings in our 2011/12 report, which was our first full scope inspection. While not all actions taken have proved completely successful, good progress has been made in many areas, as set out in section 2.2.

1.4. Key messages

The firm should pay particular attention to the following areas in order to enhance audit quality and safeguard auditor independence:

- Improve the firm's capabilities, audit methodology and guidance related to the IT aspects of auditing.
- Improve the firm's approach to the audit of loan loss provisions and related IT controls in bank audits.
- Take action to ensure that audit teams provide comprehensive reports to Audit Committees.
- Implement more robust measures to identify and consider the appropriate response to former partners taking up appointments at audited entities.
- Put greater emphasis on audit quality feedback and assessment in partner and staff appraisals.

2. Principal findings

The comments below are based on our reviews of individual audits and the firm's policies and procedures supporting audit quality.

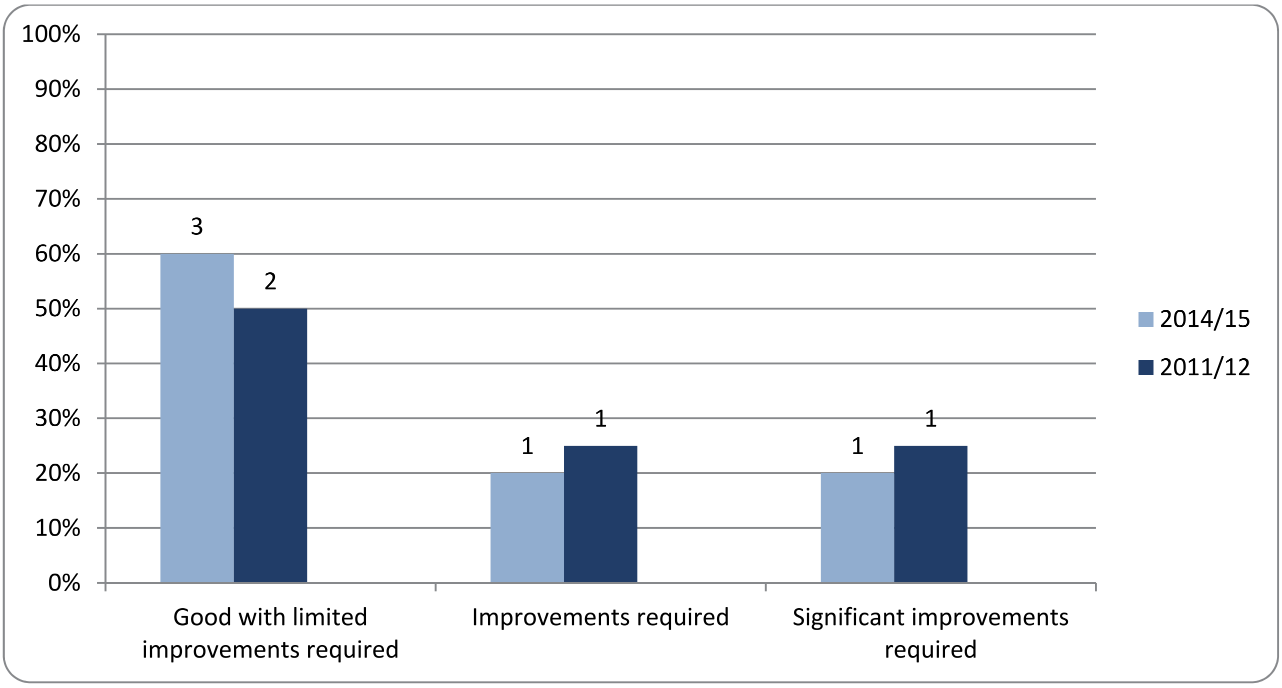
2.1. Reviews of individual audits

We reviewed and assessed the quality of selected aspects of five audits (2011/12: four audits). None of these audits were reviewed in our last inspection.

Three of the audits we reviewed were performed to a good standard with limited improvements required and one audit required improvements. One audit required significant improvements in relation to the audit of provisions and related general IT controls. Further details are set out below.

An audit is assessed as requiring significant improvements if we had significant concerns in relation to the sufficiency or quality of audit evidence or the appropriateness of significant audit judgments in the areas reviewed or the implications of other matters are considered to be individually or collectively significant. This assessment does not necessarily imply that an inappropriate audit opinion was issued.

The bar chart below shows the results of our reviews in 2014/15, with comparatives for 2011/12 (our first full scope inspection). The number of audits within each category is shown at the top of each bar.



Changes to the proportion of audits falling within each category from year to year reflect a wide range of factors, which may include the size, complexity and risk of the individual audits selected for review and the scope of the individual reviews. For this reason, and given the sample sizes involved, changes in the results of our audit reviews from one year to the next are not necessarily indicative of any overall change in audit quality at the firm.

Findings in relation to audit evidence and judgments

Our reviews focused on the audit evidence and related judgments for material areas of the financial statements and areas of significant risk. We draw attention to the following findings which the firm should ensure are addressed appropriately in future audits.

The significance of these findings in the context of an individual audit reviewed, and therefore the implications for our grading of that audit, will vary. However, whatever the implications for the specific audits reviewed, we nevertheless include the relevant findings in this report if we consider them important in the broader context of improving audit quality at the firm.

Loan loss provisions

We reviewed the audit of loan loss provisions on one audit. We concluded that the audit work required improvement in the areas set out below.

There was insufficient evidence that the audit team had assessed the accuracy and completeness of the large exposure, credit limits or utilisation limits reports or the loan impairment watch list. This included insufficient assessment of the appropriateness of management's review of these reports and the loan impairment watch list and whether any actions proposed as part of the review were followed-up appropriately. There was also insufficient evidence that the auditors had considered the appropriateness and reliability of the annual credit reviews prepared by management.

The audit team did not consider all relevant potential impairment indicators. In the audit of both specific and collective provisions, insufficient professional scepticism was applied in the challenge of management's conclusions and inadequate evidence to support the accuracy and completeness of loan loss provisions was obtained.

IT controls

In three audits, we reviewed the audit work performed in relation to IT controls and concluded that improvements were required in each case.

In two audits, the completeness and accuracy of reports relied upon for work in other areas of the audit were not tested and, in one of these, audit exceptions identified in logical access control testing were not followed-up. In one audit, inadequate audit evidence was obtained from other auditors who performed a significant amount of the IT controls audit work.

In two audits, general IT controls were not tested, although reliance was placed on the operating effectiveness of IT application controls. In one of these audits, the auditor relied on the testing of general IT controls performed in the previous audit. Audit work in the year we reviewed was limited to confirming that there were no changes in the IT environment and following-up the limited weaknesses identified in the prior year. If reliance is to be placed on the operating effectiveness of IT application controls, the operating effectiveness of general IT controls should also be tested.

Use of IT audit specialists

In one audit, testing of IT application controls over revenue systems was performed by a team from another Mazars network firm, who were incorrectly treated as experts, rather than part of the audit team. The result of this was that only a report on the findings of the IT audit work, but not the underlying working papers, was provided to the audit team. Detailed working papers related to the testing of the operating effectiveness of IT application controls were therefore not subject to review by the UK audit team or held on the audit file as they should have been.

Journals

We reviewed the work performed on journals in four audits and identified weaknesses in the work performed in two of these audits. These included a lack of appropriate judgment and targeting in the method used to select the sample of journals for testing; spreading the sample of journals selected for testing across a group of companies without appropriate justification; and failure to consider whether the whole population of journals had the potential to be included in the sample selected.

Impairment reviews

In one audit, there was a lack of evidence that the audit team had considered the directors' impairment assessment and sought appropriate corroborative evidence to support the directors' conclusion.

Property valuations

In one audit, the audit approach to property valuations was to rely upon a third party expert. The most significant assumption used in the valuations was the discount rate. There was a lack of adequate challenge and understanding by the audit team of the basis for the discount rate used by the external valuer. Furthermore, there were insufficient audit procedures performed to evaluate the accuracy of the disclosures related to the sensitivity of the valuations to changes in the discount rate.

Other findings

Communications with Audit Committees

We noted weaknesses in or omissions from communications with Audit Committees in four of the audits reviewed. In one audit the audit team did not communicate the audit plan to the Audit Committee prior to the commencement of the audit fieldwork, even though several months elapsed between the audit planning and the commencement of the audit fieldwork. Although the Audit Committee did not meet during this period, the audit team should have ensured that the required communications were made. In the same audit, the audit team did not report an incorrect classification of material assets in the balance sheet to the Audit Committee and request its correction. In three audits, the audit teams failed to report certain disclosure errors, which should have been brought to the attention of the Audit Committee.

Auditor Regulatory Sanctions Procedure

The audit requiring significant improvement was considered by the FRC's Monitoring Committee under the provisions of the FRC's Auditor Regulatory Sanctions Procedure. Sanctions were determined which are set out on the Auditor Regulatory Sanctions page of the FRC website[2].

2.2. Review of the firm's policies and procedures

The firm's policies and procedures and audit methodology and software are developed in the UK, although designed to be in line with any Mazars' international requirements. The UK Executive has responsibility for setting the national strategy, within the framework of the international strategy. It

[2] https://www.frc.org.uk/Our-Work/Conduct/Audit-Quality-Review/Auditor-Regulatory-Sanctions-Procedure/Auditor-Regulatory-Sanctions.aspx

is led by the Senior Partner, who was appointed in September 2012. Candidates for Senior Partner must be approved by the Global Executive Board of Mazars Scrl. The Senior Partner nominates other partners to become members of the UK Executive.

The firm's strategy is to be a "Top 8" firm in terms of income by 2016 and to focus on a "one firm" approach; creating economies of scale through larger teams and promoting greater consistency around core services, including audit. The new Senior Partner reorganised the UK firm's structure following his appointment, creating six management units. Audit services are provided in all units, with a Head of Audit appointed for each management unit and the firm as a whole.

We were informed that the firm does not use off-shore centres to conduct any audit work.

Improvements made since our last inspection

Following our 2011/12 inspection the firm took action to address all of our findings. These actions included developing new template forms for areas such as going concern, use of experts, communicating with Audit Committees and subsequent events. These actions appear to have helped to reduce the number of findings in these areas although, as noted above, issues are still arising regarding communicating with Audit Committees.

The firm has also enhanced its own internal quality monitoring process to include, for a proportion of audits reviewed each year, reviews of matters relating to independence and ethics and consideration of the role performed by the Engagement Quality Control Review partner (the "Independent Partner" in Mazars' terminology) on an audit. Independent Partners are given feedback as a result of these reviews and poor results may affect an individual's internal licence to act as an Independent Partner.

The firm introduced new client and engagement acceptance software soon after our last inspection, which has enhanced its ability to monitor compliance with ethical requirements.

Prior inspection findings not adequately addressed

As noted above, the firm has taken action regarding all of our prior inspection findings related to policies and procedures. However, in one area these actions, despite leading to improvements, have not yet fully addressed the issue, as set out below.

Partner and staff appraisals

A number of partner and staff appraisals reviewed included comments indicating that the individuals concerned appeared to expect to be given credit for sales of non-audit services to entities they audited. This was broadly consistent with the firm's own review of appraisal documentation which identified that, for some 11% of audit staff, an objective had been set or comments on their performance included which could be construed as seeking credit for selling or attempting to sell non-audit services to entities they audited.

In one management unit, partners had not used the standard performance management forms for their appraisal discussions. In addition, in a significant number of cases reviewed, appraisal forms for partner and staff were incomplete regarding either the performance discussions held or the objectives set for the future. It was therefore not clear whether appropriate weight had been given to audit quality factors within the appraisal process.

Current inspection period findings

We identified certain further areas where improvements to the firm's policies and procedures are required, as set out below.

Former partners joining audited entities

If a partner in the chain of command or who has acted as audit engagement partner leaves the firm and within two years is appointed as a director or to a key management position at an audited entity, the firm is required to resign as auditor.

We identified one instance where a former partner, who had been in the chain of command, accepted appointment as a director of an unlisted audited entity shortly after leaving the firm. The firm did not resign as the entity's auditor as required by Ethical Standards in these circumstances. This matter has been drawn to the attention of the ICAEW and it will consider whether any disciplinary action is appropriate.

In a further instance, a former audit partner consulted a member of the firm's Executive before accepting a role at an entity for which he had been the audit engagement partner immediately prior to leaving the firm. A formal consultation with the Ethics Partner regarding a potential independence threat arising from the former partner's role only took place some months later. The Ethics Partner concluded that the role taken up by the former partner was not a key management position and therefore did not compromise the firm's independence.

The delay in both matters being brought to the attention of the Ethics Partner is a cause for concern. The firm needs to strengthen its arrangements for identifying and addressing potential threats to independence where a former partner joins an audited entity, including ensuring that the Ethics Partner is required to be consulted in any such cases on a timely basis.

Attendance at mandatory induction training

The firm provides mandatory induction courses for newly appointed or promoted audit staff at various levels of seniority. Attendance levels at these mandatory courses were significantly less than 100%. The firm should take action to improve attendance at mandatory training and ensure that individuals who are unable to attend the courses subsequently receive the relevant training.

Guidance on specialist sectors

The firm's audit manual indicates that guidance will be made available for a number of specialist industry sectors. The firm provides guidance in the form of specialist training, audit packs and other documentation. At the time of our review, however, there was no audit manual section for brokers and underwriters; the energy and extractive industries; charities; and the education sector.

IT audit capability

The firm currently employs seven IT audit specialists in the UK and makes use of specialists elsewhere in the Mazars network. The firm's IT auditors did not receive audit specific training until July 2014 and attendance records were not maintained for this training. The firm's IT audit methodology, including the approach to assessing and testing both general and application IT controls, required further development. There are a number of areas where the guidance provided to IT audit specialists, or to audit teams generally, was insufficient or incomplete. The firm should further develop its IT audit methodology and guidance.

Banking thematic review

In December 2013 the FRC announced that during 2014 it would perform a thematic review of the quality of bank and building society audits, focusing on the audit of loan loss provisions and related IT controls. The thematic review sought to identify why progress across the audit profession in improving audit quality in these areas had been slow and what further action was needed to achieve the necessary improvements. As part of the thematic review, we reviewed the policies and procedures applied by the firm in conducting bank and building society audits.

The firm has developed certain internal procedures to promote appropriate audit quality for banking engagements. Partners and other senior staff can only audit banks if they hold an internal bank audit licence. The accreditation required to obtain and maintain this licence is monitored on an annual basis.

The firm had not significantly enhanced its procedures for the audit of loan loss provisions and related IT controls at the date of our review, but it was in the process of developing additional guidance on this area.

The firm does not have procedures in place to ensure that all banking audit personnel attend relevant training courses and should take appropriate action to address this weakness.

The FRC published a report in December 2014 setting out the principal findings of the thematic review and identifying key messages arising for both auditors and audit committees.

Other matters

Transparency report

We reviewed the firm's transparency report for the year to 31 August 2013, which was published in November 2013, to assess whether the information in the report was consistent with our understanding of the firm's quality control and independence procedures. We did not identify any inconsistencies with our understanding of the firm's quality control and independence procedures.

Andrew Jones

Director

Audit Quality Review

FRC Conduct Division

March 2015

Appendix A – Objectives, scope and basis of reporting

Scope and objectives

The overall objective of our work is to monitor and promote improvements in the quality of auditing. As part of our work, we monitor compliance with the regulatory framework for auditing, including the Auditing Standards, Ethical Standards and Quality Control Standards for auditors issued by the FRC and other requirements under the Audit Regulations issued by the relevant professional bodies. The standards referred to in this report are those effective at the time of our inspection or, in relation to our reviews of individual audits, those effective at the time the relevant audit was undertaken.

Our reviews of individual audit engagements and the firm's policies and procedures supporting audit quality cover, but are not restricted to, the firm's compliance with the requirements of relevant standards and other aspects of the regulatory framework. Our reviews place emphasis on the appropriateness of key audit judgments made in reaching the audit opinion together with the sufficiency and appropriateness of the audit evidence obtained. We also assess the extent to which the firm has addressed the findings arising from our previous inspection.

We seek to identify areas where improvements are, in our view, needed in order to safeguard audit quality and/or comply with regulatory requirements and to agree an action plan with the firm designed to achieve these improvements. Accordingly, our reports place greater emphasis on weaknesses identified which require action by the firm than areas of strength and are not intended to be a balanced scorecard or rating tool.

Our inspection was not designed to identify all weaknesses which may exist in the design and/or implementation of the firm's policies and procedures supporting audit quality or in relation to the performance of the individual audit engagements selected for review and cannot be relied upon for this purpose.

The professional accountancy bodies in the UK register firms to conduct audit work. Their monitoring units are responsible for monitoring the quality of audit engagements falling outside the scope of independent inspection but within the scope of audit regulation in the UK. Their work, which is overseen by the FRC, covers audits of UK incorporated companies and certain other entities which do not have any securities listed on the main market of the London Stock Exchange and whose financial condition is not otherwise considered to be of major public interest. All matters raised in this report are based solely on the work which we carried out for the purposes of our inspection.

Basis of reporting

We exercise judgment in determining those findings which it is appropriate to include in our public report on each inspection, taking into account their relative significance in relation to audit quality, in the context of both the individual inspection and any areas of particular focus in our overall inspection programme for the year. Where appropriate, we have commented on themes arising or issues of a similar nature identified across more than one audit.

While our public reports seek to provide useful information for interested parties, they do not provide a comprehensive basis for assessing the comparative merits of individual firms. The findings reported for each firm in any one year reflect a wide range of factors, including the number, size and complexity of the individual audits selected for review which, in turn, reflects the firm's client base. An issue reported in relation to a particular firm may therefore apply equally to other firms without having arisen in the course of our inspection fieldwork at those other firms in the relevant year. Also, only a small sample of audits is selected for review at each firm and the findings may therefore not be representative of the overall quality of each firm's audit work.

The fieldwork at each firm is completed at different times during the year and rigorous quality control procedures are applied. These procedures include a peer review process at staff level and a final review by independent non-executives who approve the issue of all reports. These processes are designed to ensure both a high quality of reporting and that a consistent approach is adopted across all inspections.

We also issue confidential reports on individual audits reviewed during an inspection. While these reports are addressed to the relevant audit engagement partner or director, they are copied to the chair of the relevant entity's audit committee (or equivalent body).

Purpose of this report

This report has been prepared for general information only. The information in this report does not constitute professional advice and should not be acted upon without obtaining specific professional advice.

To the full extent permitted by law, the FRC and its employees and agents accept no liability and disclaim all responsibility for the consequences of anyone acting or refraining from acting in reliance on the information contained in this report or for any decision based on it.

Appendix B – Firm's response

MAZARS

Andrew Jones
Audit Quality Review
Financial Reporting Council
8th floor
125 London Wall
London
EC2Y 5AS

19 March 2015

Dear Mr Jones

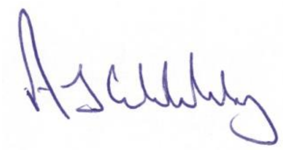
Audit Quality Inspection Report 2014/15

We are pleased to respond to the public report arising from the Audit Quality Review team's inspection of Mazars LLP.

We are grateful for your recognition of the prompt and positive response to the team's previous findings and the progress made. Quality is at the top of our agenda and we take very seriously the recommendations made in this report. As you are aware we have developed a detailed action plan in response to these and also to our own internal monitoring findings. Many of these actions are well progressed.

Independent challenge is welcome and contributes to our focus on continual improvement of our audit work.

Yours sincerely



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