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Ms Shamima Hussain
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Dear Shamima,

PROPOSED REVISIONS TO THE AUDIT FIRM GOVERNANCE CODE ('the Code')

We write in our capacity as Independent Non-Executives of Mazars LLP, which is one of the leading challenger firms in the UK audit market. The firm has complied with the existing Code for several years and its Public Interest Committee, of which we are members, exercises oversight of its compliance.

We welcome the opportunity to comment on the proposed revisions. We recognize the significant work that has gone into clarifying the Code and commend the team at the FRC that has worked on it for the improvements.

Strategic Positioning Comments

At the outset, we think it worthwhile to make some 'strategic positioning' comments, which might inform your development of the revised Code.

First, we would suggest regarding governance in the corporate sector as 'the norm' and the desirable model to move towards could present some incongruities. Importantly, fundamental governance differences exist, both between the public and private sector, and between partnerships, which are the

‘normal’ model for the professional sector, and the corporate sector where there are clear differences between the interests of shareholders, as represented on the Board by the non-executives, and management and employees. We submit that it is not helpful to try to regard partners in a firm as similar to shareholders, for example. In most accounting firms, partners do not purchase their interest when they join the partnership and cannot sell it when they leave. In fact, their share of profits reflects their contribution heading up the firm’s services, and the firm’s commercial success, for as long as they are engaged in doing so. Almost all the ‘management’ of the firms have been, and in many cases, still are, practitioners, and most of them, and most partners, notwithstanding greater mobility at the margins, have worked in the same organization for most of their professional lives. We find that all this is worth reciting because it adds up to a profound difference in basis compared to the corporate sector, which cannot safely be ‘assumed’ away.

Second, if there are a series of incremental adjustments to the role of INEs, for example, that gradually bring them into closer alignment to the position of corporate non-executives, but without the powers or constituency of shareholders to support them, this could well render the role unworkable and seriously discourage strong participants for the role.

Third, we think it important to recognise that business failure is part of the economic cycle, and not automatically scandalous or even necessarily undesirable. Startup, development, and often disappearing are part of the well documented life-cycle of firms. The circumstances of smaller energy suppliers provide an interesting current example. While it is important for regulators to point to, and sanction, failures of duty by any participants, directors, auditors, or others, the acceptance of fair risk is fundamental to both business and investment, and this should not be overlooked.

Fourth, the concept of ‘public interest’ is at the root of much of the FRC’s regulatory approach and is cited as the basis for the FRC’s stance on a wide range of issues. We think it is reasonable that the FRC should say what it means, and just as importantly, does not mean when using the term ‘public interest’. We think it unreasonable that the meaning of such an important phrase should be left up to each of the firms to interpret on an individual basis, particularly as that meaning may come to be tested in the Courts at some future point. This subject is discussed in more detail below.

Turning to our more detailed comments and recommendations:

Separating the Roles of Chair and Managing Partner

Regarding the roles of the Chair and Managing Partner being filled by separate partners, we strongly support this provision in the revised draft Code. We have found that having a Governance Council chair who is separate from the CEO/Managing Partner has strengthened good governance at Mazars LLP and Mazars SCRL (the Group).

People, Culture and Related Issues

We are very supportive of the emphasis that the new Code places on people, culture, and all related issues. We are fully supportive of the view that the firms are a people business. The three Mazars INEs

consider their time spent on culture meetings with partners and staff across the firm, which are conducted under the Chatham House Rule, and the resulting feedback provided to the UK Executive to be of critical importance.

Sustainability and Resilience – The Role of Independent Non-Executives

The proposed wording of the revised Code reads that INEs will “safeguard sustainability and resilience of the audit practice and the firm as a whole.” INEs are Independent Non- Executives. As non-executives they can counsel, advise and challenge the executives. They cannot take actions other than reporting failings to the FRC. Given this situation we recommend reintroducing language that reads “help and urge the safeguarding of”

Openness between Independent Non-Executives and the FRC

We agree with the FRC that there should be openness between the INEs and the FRC. We would suggest considering that the FRC would be conflicted were it to act as “proxy for the public” and be the regulator. One cannot be a party in a disagreement and also a judge in the same disagreement. We suggest that the language around proxy be removed because it is not necessary to create an environment where the INEs feel comfortable reporting concerns to the FRC.

Public Interest and the Role of Independent Non-Executives

We acknowledge the emphasis placed in the consultation and revised draft Code to the public interest and we concur with the assertion in Appendix 1 that the public interest is ‘an abstract concept for which there is no single definition’ (page 26). An abstract concept is ‘An idea that people can understand that has no physical form¹’. As a matter of good governance, people should not be accountable to ‘an idea’. Therefore, we suggest that it is neither possible for independent non-executives ‘to represent the public interest’ (page 26) and be ‘accountable’ (page 37) to it, nor effectively fulfil the roles and responsibilities described in Principle N of the draft Code, which provides that ‘independent non-executives should provide constructive challenge and specialist advice with a focus on the public interest’ (page 33).

Indeed, to suggest that they do represent the public interest appears to expose independent non-executives to potentially very significant litigation and liability risks, which we believe are not commensurate with the intention of the role and might deter many suitable candidates from becoming independent non-executives of audit firms, to the detriment of the Code’s purpose. Accordingly, if it is decided to retain the responsibilities to the public interest in the Code then we believe it would be useful and appropriate for the FRC to obtain independent legal counsel, as part of a transparent and open process, to ascertain the legal liabilities that might accrue to the independent non-executives or provide reassurance that such legal liabilities would not arise. We recommend that the findings of legal counsel be shared fully and openly publicised.

¹ <https://simplicable.com/new/abstract-concept>

Different Definitions of the Public Interest by Firms

We believe it would be unhelpful and confusing for independent non-executives of different firms ‘to reflect and form views on what the public interest means in the context of audit and the activities of the firm as a whole’ (page 26) and thereby to apply different definitions of the public interest from firm to firm. Pending any judicial determination in due course, we think it is the responsibility of the government and the regulator to define public interest for all audit firms within the scope of the Code.

Stakeholder Engagement

We recognise from our own experience the reference to ‘limited appetite, in particular among investors, for engagement on governance matters’ (page 11) and, therefore, we welcome the proposal to remove Principles F.2 and F.3 from the Code ‘with a view to tackling this in the next revision of the UK Stewardship Code and the introduction of standards for audit committees’ (page 12). That said, the status quo is a sad situation, especially when considered in the context of the current BEIS proposals to give shareholders greater responsibilities for audit. Also, we are concerned that investors and audit committees will focus their Stewardship Code engagement activities on the so-called Big 4 firms to the detriment of the challenger firms and the achievement of long-awaited market reform.

In the light of our experience and mindful that the FRC cannot enforce the provisions of the UK Stewardship Code, we think it might be wise to retain the spirit of Principles F.2 and F.3 within the Audit Firm Governance Code as well as including new provisions in the UK Stewardship Code and the proposed standards for audit committees. By having mutual obligations on the parties to engage, the regulatory framework would be far more robust than otherwise.

The Invisible Code

In our view, the existence of the Audit Firm Governance Code and its principles and provisions are not well-known amongst the FRC’s many stakeholders, including many audit firm partners and staff. Because of the importance which we and the FRC attach to the Code, we encourage the FRC and its leadership to lift the cloak of invisibility by referencing the revised Code and its importance on a regular basis in their public pronouncements and, thereby, help to ensure it plays its part in restoring trust and confidence in audit and audit firms.

Conclusion

Significant steps are undertaken towards clarity in the proposed Code, which we warmly welcome. That said, we encourage the FRC to consider comments from all INEs, since our collective experience should provide valuable insights that will help to ensure the revised Code is pragmatic and fit for purpose.

We strongly recommend reintroducing some flexibility into the language and give emphasis to the Code’s ‘comply or explain’ operational basis, so that the FRC and succeeding entities – and other stakeholders - can judge the governance of audit firms on their own merits.

We hope our comments and views will receive favourable consideration and if you wish clarification or suchlike, please do not hesitate to get in touch.

Yours sincerely,

Denise Fletcher

Lord Morse of Aldeburgh

Guy Jubb