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Dear All

Consultation Document: Proposed Revisions to the Audit Firm Governance Code

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.

1. Overall views

In overall terms, we welcome the intention to strengthen the code and are supportive of many of the recommendations, as discussed in our detailed response to the questions on the proposed code which is attached as an appendix. In this covering letter we focus on significant areas where we consider the proposed changes require further consideration.

2. Redrafting the purpose of the code

We believe the proposed purpose of the code should be revised. Fulfilling the code's purpose should ensure the public interest is secured by firms applying it in matters related to audit firm governance. This has, in effect, been the approach to date. We believe this is preferable to securing the public interest forming part of one of the sub-elements of the purpose as proposed. The proposed code does not propose to define the public interest, instead leaving it to the INEs in each firm to do so, meaning in the same situation the code could be applied in different ways in different firms.

Secondly, the purpose should have a very strong focus on the audit practice, again in line with the current code, published in 2016. It should only extend beyond the audit practice where this is reasonably necessary to protect the audit practice from significant problems elsewhere in the firm that would be likely to have a significant negative impact on the reputation or resilience of the audit practice. The reasons for this are again two-fold: the impact on stakeholders and society of audit failures, especially in PIEs, is potentially substantial and so this is where the focus should be and, linked to this, this is the area subject to regulation by FRC.

We therefore suggest the purpose should be:

... to help ensure the public interest responsibilities of firms applying the code are met in matters related to audit firm governance through:

- 1 *Promoting high quality audit; and,*
- 2 *Safeguarding the sustainability, reputation and resilience of audit practices including from substantial challenges arising in other parts of the firms.*

3. The role of INEs

We consider a substantial review of the new proposed role of INEs, as set out in the proposed code, is needed. We have concerns that the cumulative impact of the proposed substantial increase in the responsibilities of INEs, the failure to ensure a clear distinction between their role and that of Management and the Board, and requiring them to determine what constitutes the public interest will make the role far less attractive in the future to current and potential INEs. In so doing, it will have the opposite effect to that intended which is to strengthen the INEs' contribution within the firms and therefore help fulfil the purpose of the code.

With regard to the above, the proposed code, for example, calls on INEs to have *full* visibility of the *entire* business (our italics) which is not proportionate nor necessary on an ongoing basis though they should have rights to receive any information they determine they need across the firm as a whole.

4. The relationship between INEs and ANEs and their number

We consider further work is needed on the proposed code to integrate properly the approach to Operational Separation within it. As discussed above, we believe the INEs' role is primarily in relation to the audit practice and that, to the extent it extends beyond it, it is because of a significant potential negative impact on the audit practice. Accordingly, we do not see the roles of ANEs and INEs as separate or in conflict and believe they should be combined in practices where there is Operational Separation. Also, we would therefore not see a need for at least one ANE not to be an INE.

To avoid confusion and duplication, if the roles of ANEs and INEs are to be kept separate, where there are ANEs it should be clear the ANEs are responsible for the audit practice and the role of INEs in the firm relates to matters beyond the audit practice in the UK which may impact on it. This will leave the INEs role as a narrow one. At network, or equivalent level, the ANEs should engage on audit-related issues.

The wording of the derogation from the normal need for firms to have three INEs in the case of smaller firms applying the code, where two is acceptable, should be amended. The current reference calls on firms to 'explain' where only two are appointed. The wording should be changed to 'discuss' or similar to make it clear this is in compliance with Provision 29.

5. Engagement with investors and the regulator

We support effective two way dialogue by each of the firms and their INEs, and not just INEs as proposed, with investors and audit committees but agree, as suggested in the consultation, that for this to be effective similar expectations should be placed on investors and audit committees to engage with the firms and their INEs.

6. Thresholds for applying the code

In order to have consistency of thresholds, we consider there should be a single threshold for applying the code and for being subject to annual review by the FRC. We consider this should be where a firm audits a FTSE350 company or a substantial number of PIEs, the number to be determined but not to be higher than the current threshold for annual review.

7. Review of reporting expectations

The consultation makes the point that the FRC's 2019 thematic review on 'Transparency Reporting' found that, among those who are aware of the transparency reports, the view is that they are too long and overly positive to be useful.

The proposed code adds a number of new reporting expectations and it would be helpful to have a holistic review of all reporting expectations to consider their impact on the length and clarity of focus of Transparency Reports before the new code is finalised. In saying this, we do, however, for instance, support firms providing appropriate information on substantial threats to their resilience, at a national or international level, where these may have a substantial negative impact on the UK audit practice.

Of existing expectations, we note the expectation in Provision 14 that 'A firm should introduce meaningful key performance indicators on the performance of its governance system and report on performance against these in its transparency reports'. There is no equivalent requirement in the UK Corporate Governance Code and, if it is to be retained, the need for it should be justified and more information provided on what is expected.

8. Review of the wording of the proposed code

Whilst the overall structure of the proposed code is clear, it would be helpful to review the structure and wording of the proposed Principles and Provisions before the new code is finalised to ensure that it is concise. A review of its drafting was undertaken the last time the UK Corporate Governance Code was updated and the results were positive.

9. Further discussion

If you would find it helpful to discuss any issues in this letter or the Appendix to it, please contact David Herbinet, Global Head of Audit [REDACTED], or Anthony Carey [REDACTED]

Yours faithfully

Mazars LLP

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Appendix: Audit Firm Governance Code Consultation Document-Response to Questions

Q.1: How appropriate do you feel that the revised purpose of the proposed 2022 Code is?

- 1.1 We consider serious further thought needs to be given to the proposed revised purpose of the code particularly with regards to references to the public interest.
- 1.2 The code should indicate that the public interest will be met by meeting its purpose as set out in the key elements (bullet points). This will avoid the current major problem with the proposed code that it does not set out what constitutes the public interest leaving it to INEs at different firms to form their own view as to what does. This is not desirable from a public policy perspective as it will mean the code is potentially being applied differently in different firms even where the same circumstances apply. It also causes serious problems for the INEs as they do not know if their interpretation will be accepted if subsequently challenged by the regulator.
- 1.3 In addition, the purpose of the code should have a very strong focus on the audit practice in line with the current code, published in 2016. It should only extend beyond the audit practice where this is reasonably necessary to protect the audit practice from significant problems elsewhere in the firm that would be likely to have a significant negative impact on the reputation or resilience of the audit practice. The reasons for this are two-fold: the impact on stakeholders and society of audit failures, especially in PIEs, is potentially substantial and so this is where the focus should be and, linked to this, this is the area subject to regulation by FRC.
- 1.4 To address the challenges identified above, we would therefore propose the following wording for the purpose:
The purpose of the code is to help ensure the public interest responsibilities of firms applying the code are met in matters related to audit firm governance through:
- 1 Promoting high quality audit; and,
 - 2 Safeguarding the sustainability, reputation and resilience of audit practices including from substantial challenges arising in other parts of the firms.

Q.2: What are your views on the proposed thresholds for application of the proposed 2022 Code?

- 2.1 We consider there needs to be greater clarity on the logic in determining the threshold for audit firms to be brought within, and remain, within the scope of the code.
- 2.2 We believe there should be a single threshold for audit firms to be subject to annual review by the FRC and to be required to apply the code.
- 2.3 We support the threshold being based on the number of PIEs audited by the firm, rather than the number of listed companies, recognising that the former is the basis used for determining whether a firm is subject to annual review by the FRC. If the threshold is to be the same for annual review and code purposes, it should bring firms within scope that audit a substantial number of PIEs, or a FTSE350 company, and the number of PIEs should not be higher than the current threshold for annual review purposes.
- 2.4 We consider, however, that on the grounds of equal treatment for firms in a similar situation, there should not be a lower threshold set for firms stopping to apply the code than for them starting to do so. We would propose though that once a firm becomes eligible to apply the code by virtue of the number of PIEs it audits, or the fact that it audits a company in the FTSE350, there should be a two year period before it is required to apply the code. This is to allow for situations where a firm does not wish to be considered a significant PIE auditor and 'trips over' the threshold with little notice, eg because an existing client grows and becomes a PIE or enters the FTSE350. The transition period will enable it to review the companies it audits if this is its preferred course of action.

**Q.3: Should the proposed 2022 Code apply to any firm that audits a FTSE 350 company?
Please suggest alternatives.**

- 3.1 Yes, given the substantial public interest in such clients, we believe this is a reasonable approach.
- 3.2 Our comments are subject, as discussed above, to there being a two year transition period after appointment as the auditor of a FTSE350 company before a firm is required to apply the code.

Q.4: What are your views on the proposed effective date of the proposed 2022 Code?

- 4.1 We consider the proposed effective date for the code to apply, namely in respect of accounting periods beginning on or after 1 January 2023, provides sufficient time for firms currently applying the code to make any necessary adjustments and note that there would be a transition period for firms being required to apply the code for the first time. As a firm that has been applying the code for a number of years on a voluntary basis, we would expect to apply it with effect from our first accounting period commencing after 1 January 2023.
- 4.2 Our views on the appropriate start date for the new code are subject to respondents, particularly firms affected, being able to offer supplementary views once the Government's announcement on the proposed way forward on its White Paper 'Restoring trust in audit and corporate governance' is made if it includes unanticipated changes which would have an impact on the application of the code.

Q.5: What are your views on the priorities for engagement with investors, audit committee members and other external stakeholders and how could we encourage interaction with INEs?

- 5.1 Provision 34 calls on INEs to have dialogue with audit committees and investors to build their understanding of the user experience. We believe it is also valuable for partners and team members in the firm with appropriate roles also to engage with audit committees and investors and believe such an expectation should also be included in the code (not least to broaden and widen their perceptions when considering the third party test in ES19). If the meeting is between an individual firm and their INEs and investors this can generally be achieved by everyone participating in most of the meeting and investors being given an opportunity, if they wish, to speak with the INEs on their own at the end of it.
- 5.2 We also strongly support FRC seeking to include an expectation that investors and audit committees will engage with audit firms applying the code in the next version of the Stewardship Code and at the time of the introduction of standards for audit committees respectively. As the FRC is aware, it is very difficult for audit firms, and especially challenger firms, to secure the participation of investors, and to a lesser extent audit committee chairs- other than those of companies audited by the firm- in meetings whether one-on -one or as part of a roundtable organised by the firm. Engagement by investors and PIE audit committees with challenger firms is very important as it enables them to get to know the firms and their INEs better and to understand their perspective on key auditing issues of mutual interest.

Q.6: To what extent do you support the changes proposed in the areas of partner oversight and accountability to owners?

- 6.1 We fully support effective accountability by those responsible for the management of the firm to those charged with oversight of the governance of the firm. Different partnerships have different structures with Management being separate from those responsible for governance oversight, as in our case, or Management being represented on the Board in other instances. We

welcome the fact that the proposed Principles and Provisions of the code are able to be applied in both situations.

- 6.2 In Principle B, we support placing an explicit responsibility on boards for the oversight and challenge of management but would encourage reference being made to those responsible for oversight providing both challenge and support to management as both are important.
- 6.3 In Provision 2, we support clarifying that a majority of the Board should be partners without significant management responsibilities.
- 6.4 In Provision 3, we support the separation between the roles of Board chair and managing/senior partner
- 6.5 In Provision 5, we support establishing arrangements for determining remuneration and progression matters for members of the Board which support and promote effective challenge to Management.
- 6.6 We consider that the current wording of Provision 8 could be made clearer. It currently says 'Management should ensure that, wherever possible and so far as the law allows, members of governance structures and independent non-executives have access to the same information available to Management'. We consider that partners involved in governance structures providing oversight and challenge and INEs should have all the information they determine they need to perform their roles effectively provided in a timely manner. They should also have the right to access any additional information from Management and the Board, as appropriate, where they consider this would be helpful to them. The Board and INEs should also be kept actively informed of all developments in the firm relevant to their roles. Within this context, however, it will be of assistance for the effective conduct of their meetings if the Board and INEs are able to determine the information provided to them on a regular basis and the way in which it is presented.
- 6.7 With regards to Provision 9c), whilst we fully support encouraging reflection at firms on the balance of powers between different parts of the Management and governance oversight structures, we are not persuaded that requiring detailed reporting on this will lead to meaningful disclosure and runs the risk of significant amounts of 'boilerplate' disclosure. The control of potentially dominant individuals requires appropriate structures to be in place but also involves all those involved in governance being willing to call out and resist domineering behaviour if it starts to emerge and it is hard to capture thus aspect of board culture in practice through disclosure.

Q.7: What are your views on the proposals to underpin connectivity with the global network and monitoring of its potential to impact the UK Firm? Do you have other suggestions for how this could be addressed?

- 7.1 The relevant provisions with regard to connectivity with the global network are Provisions 28.30 and 32.
- 7.2 Provision 28(g) calls for 'a description of how the firm interacts with the firm's global network, and the benefits and risks of these arrangements with reference to the purpose of the code. This should include an assessment of any risks to the resilience of the UK firm arising from the network and any actions taken to mitigate those risks'. We are broadly supportive of these disclosures though the practical limitations of them in practice need to be realised, for example other firm in a network may not be very forthcoming on potential major litigation issues which are not in the public domain. It will also be important for disclosures related to networks and global firms to focus on the key issues involved and not descend into detailed 'boilerplate' disclosures of the relationships with them.

- 7.3 Provision 30 indicates that 'Independent non-executives should have *full* visibility of the *entirety* of the business (*our italics*). They should assess the impact ofglobal network initiatives on the firm and the audit practice in particular'. The level of visibility anticipated seems rather more than would generally be expected for INEs and we would suggest the wording be reviewed. Naturally if it were known that there were significant or potentially significant issues in a major part of the business outside of the UK that could have a major impact on the UK firm, as regards its reputation and resilience, and particularly if the future of the network or global firm concerned were under challenge, it would be expected that the INEs would be fully briefed on them. In more normal times, the emphasis should be on global initiatives of significant emphasis to the audit practice in the UK such as a major changes in audit methodology or the UK practice gaining or losing significant international subsidiaries of group audits where the corporate group headquarters is based in another jurisdiction.
- 7.4 Provision 32 states that 'A firm should provide access for independent non-executives to the activities of the global network such that they can assess global governance standards and the impact of the network on the UK firm and the public interest in the UK'. Our previous comments in response to issues related to the public interest apply here. Another key issue is the scope and nature of access expected. Whilst periodic conversations with relevant senior members of the international network are likely to be relevant, it would be expected that much of the access would be by briefings from UK partners involved in network or global firm activities or reviews of network/group firm quality control reports on the UK audit practice or particular audits undertaken by it.

Q.8: How supportive are you of the approach taken to people and culture in section B of the proposed 2022 Code? Please include any suggestions for how we could improve it further.

- 8.1 We strongly support:
- bringing together in a single part of the code issues related to the various people and conduct-related issues including those linked to values, culture, whistleblowing and people management
 - placing a strong emphasis on long-term sustainability, culture and employee engagement as these are vital to the promotion of high quality audit.
- 8.2 In Principles F and G, we consider the references to the public interest should be taken out. As discussed above, in discussing its purpose, the code should make clear that the public interest will be served by applying the code with its focus the promotion of audit quality and the sustainability of the firm.
- 8.3 We note the expectation in Provision 14 that 'A firm should introduce meaningful key performance indicators on the performance of its governance system and report on performance against these in its transparency reports'. There is no equivalent requirement in the UK Corporate Governance Code and, if it is to be retained, the need for it should be justified and more discussion provided on what is expected.
- 8.4 The explanation on the contents of the proposed new code envisages that Management and the Board will be involved in the monitoring of the firm's culture. We consider Provision 15 should make clear that the Board, in consultation with Management, should determine the appropriate culture and, with the support of Management, should monitor its implementation and develop a programme to close any gaps between the desired and actual cultures.
- 8.5 Provision 15 currently states that the INEs should be involved in the review of the promotion and setting of an appropriate culture. We believe that, in order to distinguish their role from that of Management and the Board, it would be more appropriate to say they should be involved in the oversight of the work on culture undertaken by the Board and Management.

- 8.6 We support the proposals in Provision 16 relating to a firm establishing mechanisms for delivering meaningful engagement with its people. We also support the proposed role for INEs in terms of being satisfied that there is an effective whistleblowing policy and procedure and with them monitoring issues raised under the process in place.
- 8.7 Provision 17 currently indicates that INEs ‘should be involved in reviewing people management practices and procedures, including remuneration and incentive structures, recruitment and promotion processes, training and development activities, and diversity and inclusion, to ensure the public interest is protected. They should monitor the firm’s success at attracting and managing talent, particularly in the audit practice.’ Greater clarity is needed on the INEs’ role and care taken to ensure that it is realistic and, in line with our earlier views, reference to the public interest should be taken out. Accordingly, we suggest the wording be changed to ‘INEs should be involved in monitoring the work of Management and the Board in relation to attracting managing and developing talent in the audit practice so as to achieve the purposes of the code. This should include having regard to remuneration, incentive and promotion processes and those related to diversity and inclusion’.
- 8.8 We support the proposals in Provision 18 including those calling on INEs to use a range of data and engagement mechanisms to understand the views of colleagues throughout the firm though we think it should be clear the main focus should be on the audit practice.

Q.9: Are there any matters you believe we should include in section C that do not currently feature and/or can you suggest other improvements to how the proposed 2022 Code approaches operational matters and resilience?

- 9.1 We consider that in overall terms the appropriate range of issues has been covered in Section C. As noted in the code consultation, many of the issues covered in Section C relate to operational and financial matters covered in the current 2016 code and we continue to be supportive of them.
- 9.2 We support Principle K that indicates ‘A firm should communicate with the regulator in an open, co-operative and transparent manner’. With regard to the implementation of this principle, we believe firms, INEs and the regulator should periodically review whether they consider that the relationship is operating between them in a fair and transparent manner and whether there is any scope for improvement.
- 9.3 In Provision 22, we agree that ‘a firm should develop robust datasets and effective management information to support monitoring of the effectiveness of its activities’ but it should be clear the activities referred to, for the purposes of the code, are primarily in the area of audit and this is consistent with the example given in the consultation of Audit Quality Indicators.
- 9.4 Provision 24 indicates ‘a firm should monitor its risk management and internal control systems and, at least annually, conduct a review of their effectiveness. Independent non-executives should be involved in the review...’. The provision should indicate that Management and the Board should ensure there are appropriate risk management systems in place and that, at least annually, they should conduct a review of their effectiveness. It should go on to indicate the INEs should monitor the review of effectiveness to ensure it is reasonable in the circumstances and should ensure that the findings of the review are appropriately followed up where necessary.
- 9.5 Provision 25 refers to the firm carrying out a robust assessment of the principal risks facing it and that the INEs should be involved in the review. Again, consistent with our proposal in respect of Provision 24, it should indicate that Management and the Board should carry out the review and the INEs should monitor the assessment and be satisfied that it appears reasonable. The current wording is too vague on the INEs’ role.

- 9.6 We have commented above in response to Question 7 on Provision 28 relating to the new reporting expectations on how a firm interacts with its network or global firm.

10: Do you think that the proposed 2022 Code is clear enough about the role INEs play in the Firms?

- 10.1 No. We believe this is the principal area of the revisions to the 2016 code which requires further thought in particular in the areas set out below.
- 10.2 We consider references to the INEs determining what constitutes the public interest should be taken out. We believe it would not satisfy the public interest for the group of INEs at each firm to be left to determine what represents the public interest as a private matter without it being set out in the code. Moreover, as discussed, we believe it should be made clear that the public interest as regards auditing matters would be met by firms fulfilling the purpose of the code.
- 10.3 The primary focus of the INEs should be on the audit practice and promoting audit quality whilst recognising that a threat to a firm's sustainability can come from beyond it and so to some degree a wider focus is required. The current focus beyond the audit practice seems to extend more widely and in more depth than needed and risks detracting attention from the INEs' primary role.
- 10.4 There should be greater clarity on the nature of the role of the INEs' in particular areas with it being clear their role is to monitor and assess reviews carried out by Management and the Board rather than more general expressions being used such as they should be involved in the review. We have discussed this matter in relation to Question 9 above.
- 10.5 We have concerns that the cumulative impact of the proposed substantial increase in responsibilities for INEs, the failure to ensure a clear distinction between their role and that of Management and the Board and requiring them to determine what constitutes the public interest will make the role far less attractive in the future to able INEs and potential INEs and so will have the opposite effect to the intended in terms of strengthening the INEs' contribution within the firms.

Q.11: What are your views on the proposals for strengthening the status and role of INEs? Please include any suggestions for other ways to increase their impact and effectiveness.

- 11.1 Principle M indicates INEs should 'observe, challenge and influence decision-making'. It would be helpful to add, as clearly indicated in the notes on the consultation, 'without taking part in decision-making' in order to provide greater clarity on the nature of their role.
- 11.2 Principle N currently states that 'Independent non-executives should provide constructive challenge and specialist advice with a focus on the public interest. They should assess and promote the public interest in firm operations and activities as they relate to the purpose of this code, forming their own views on where the public interest lies'. In line with our views on not including references to an undefined public interest in setting out the responsibilities of INEs, we would suggest the following revised wording: 'Independent non-executives should provide constructive challenge, support and advice to support the implementation of the Code by the firm'.
- 11.3 We support Principle Q that 'Independent non-executives should have an open dialogue with the regulator'.
- 11.4 We support the proposal in Provision 29 that all firm should have a public interest body, with a majority of INEs and chaired by an INE. This is in line with our current practice where, in addition to the INEs, the Senior Partner and the Head of Quality, who is a member of the Executive, are also members. In order to support increasing awareness of the role of INEs with

investors and others, we would suggest that the public interest bodies have a common name across the firms, say a Public Interest Forum.

- 11.5 In Provision 29, we support INEs as a group being embedded in other governance structures within the firm as members or formal attendees with participation rights. We consider it would be helpful to make clear that different INEs may participate in different parts of the governance structure.
- 11.6 When referring to the possibility of 'smaller' firms possibly only having two rather than three INEs, the current reference that indicates they should 'explain ' this should be changed to 'discuss' to avoid doubt that they might not be complying with this provision by taking this approach.
- 11.7 With regard to Provision 30, as discussed above in response to Question 7, we have suggested the wording be reviewed.
- 11.8 In Provision 31, we support the establishment of a Nominations Committee, with the participation of at least one INE, to lead the process for the appointment or re-appointment of INEs. We are not persuaded that all additional external appointments of INEs should require prior consultation with the Nominations Committee and would suggest the reference be to all 'significant' additional appointments.
- 11.9 We support Provision 37 which provides for the establishment of a clear escalation procedure to seek to resolve any fundamental disagreement between an INE and the firm's Management or parts of the governance structure.
- 11.10 In Provision 38, in line with our previously expressed views, we consider the reference to an INE alerting the regulator if they feel the firm is acting contrary to the public interest should be taken out as this will be covered, if our proposals on the purpose are accepted, by the second bullet point, namely referring to alerting the regulator when they feel the firm is endangering the objectives of the code.

Q.12: What are your views on the proposed boundaries between the responsibilities of INEs and Audit Non-Executives? Please give examples of any potential difficulties you foresee with what is proposed

- 12.1 We consider further work is needed on the proposed code to integrate properly the approach to Operational Separation within it. As discussed above, we believe the INEs' role is primarily in relation to the audit practice and that, to the extent it extends beyond it, it is because of a significant potential negative impact on the audit practice. Accordingly, we do not see the roles of ANEs and INEs as separate or in conflict and believe they should be combined in practices where there is Operational Separation. Also, we would therefore not see a need for at least one ANE not to be an INE.
- 12.2 If both INEs and ANEs are to be retained, we think that where there are INEs and ANEs in firms practising Operational Separation, to avoid confusion in terms of overlapping roles, it should be clear that the ANEs should be responsible for the application of the code within the audit practice and INEs for aspects in the wider firm outside the audit practice whereas the proposed code refers to INEs operating at the firm-wide and network levels. This raises two issues: references to firm-wide are confusing, it should be clear that the audit practice is not included and it makes better sense for auditing issues at a network level to be dealt with by the ANEs. If both INEs and ANEs are to be retained, the role of the INEs will be relatively limited if duplication with that of ANEs is to be avoided.

18 November 2021