

The Director
Market Investigation into Statutory Audit Services
Competition Commission
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Dear Sirs

Audit Market Investigation - Development of the statutory financial audit

1. Introduction

Mazars, the leading international integrated auditing and advisory organisation with 14,000 staff in 69 countries is pleased to submit its comments on the above working paper.

2. Purpose of working paper

Whilst the working paper provides an interesting overview of selected key developments in the development of the statutory financial audit its purpose is not altogether clear and this may account for the omission of certain issues that we feel are important in order to set the current market investigation in its appropriate context. We note, for instance, that there is not much coverage of auditing standards and regulation in the paper. Indeed, it may also be helpful to look at issues within a thematic framework, as we do below, rather than just chronologically.

3. Many reforms in the areas of accounting and auditing in response to market failures

In recent decades certainly, many of the reforms to the standard-setting process have come about as a result of failures or perceived failures in accounting and/or other reporting disclosures. Some of these are covered in the paper namely the failure of Rolls Razor and the problems associated with the GEC/AEI merger leading to the establishment of the original Accounting Standards Steering Committee. Subsequently, the high profile failure of companies such as Polly Peck and BCCI contributed to accounting standards being set independently of the profession and the structure and scope of the Financial Reporting Council was strengthened in the wake of Enron, WorldCom and the collapse of Arthur Andersen a decade ago. This highlights that a number of major structural reforms and also accounting reforms have occurred at times of crisis when it is clear changes have to be made suggesting major opportunities probably exist to enhance the culture of innovation on an ongoing basis.

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To cite a few examples the original ASSC looked at revenue recognition; the ASB post 1990 clamped down on provisioning and the use of extraordinary items; in the wake of the banking crisis the use of the incurred loss model and going concern reporting requirements have been subject to scrutiny.

There may be merit in looking at the significant corporate failures of, say, the past two decades or so and understanding the accounting and auditing implications, recognising different views may exist on these matters, and any resultant follow-up action by the profession, standard-setters and regulators.

4. Substantial influence by the dominant firms in standard-setting and regulation

Throughout the modern period, the dominant players have had a substantial influence on standard-setting both through former partners and members of staff having influential position on the staffs of the bodies concerned and through current or former partners having senior positions as volunteers or part-time members of the governing bodies of standard-setting and regulatory organisations. This is true on both a UK and global basis.

Economic theory would suggest that dominant players will use such advantages to shape standards in their desired form and this is an issue worthy of further exploration. For example, though the accounting frameworks suggest that accounting and other information provided in annual reports is to help users make decisions, accountants in the major firms rather than investors have been more influential in the standard-setting process.

5. Concern that standards have over-reduced judgement in reporting and auditing

Linked to 4 above, significant concern has been expressed that there has been a tendency to move towards auditing to standards and conversely reducing the exercise of judgement. On reporting issues, this was a particular concern to investors who pushed for it to be made clear in the Companies Act 2006 that the financial statements had to show a true and fair view rather than allowing ambiguous wording to continue which suggested the true and fair view was qualified by the nature of the standards under which they were prepared.

Economic theory might again suggest dominant players would prefer the primary focus to be on conformity with standards rather than leaving significant scope for the exercise of judgement as this reduces the risk of litigation and enables uniform approaches to be adopted across the network if IFRS (reporting) or ISAs (auditing) are being used.

The development of detailed standards also generates revenue for the dominant players as, for example, was witnessed by the implementation of the Sarbanes-Oxley Act for companies with a listing in the US when firms were called on to express an opinion on financial reporting controls of certain companies in the wake of Enron and WorldCom.

6. Move to international standards providing economies of scale and experience

Again linked to 4 above, the move to international standards in reporting and auditing in recent years, though we are supportive of the move, has brought considerable benefits to the dominant players. They have earned considerable revenues in the switch from national to international reporting standards and have been able to make significant cost savings in terms of being able to centralise technical centres and standardise training globally to a significant extent around harmonised requirements.

To the extent that the dominant players hold that position in nearly all parts of the world, a move to international standards for Public Interest Entities in the areas of reporting and auditing has also meant

that their advantage in terms of experience of applying them has increased relative to their non-Big 4 counterparts as a greater proportion of their clients use them in each jurisdiction.

At Mazars, we have invested significantly in building our expertise in global reporting and auditing standards due to our significant number of global audit clients.

7. Conclusion

If you would like to discuss any of the issues raised in this letter further, please do not hesitate to contact David Herbinet, UK Head of Public Interest Markets, on 0207 063 4419 or Anthony Carey on 0207 063 4411.

Yours faithfully



Mazars LLP