



22 November 2012

Mr. Kevin J. Dancey
President & CEO
The Canadian Institute of Chartered Accountants
277 Wellington St. West
Toronto ON M5V 3H2
Canada

Email: eaq.ai@cica.ca

Ref.: ETH/PRJ/HBL/LFU/PCO

Dear Mr. Dancey,

Re: FEE comments on CICA – CPAB Discussion Paper “Enhancing Audit Quality: Canadian Perspectives – Auditor Independence”

- (1) The Federation of European Accountants (FEE¹) is pleased to provide you with its comments on the Discussion Paper “Enhancing Audit Quality: Canadian Perspectives – Auditor Independence” issued by the Canadian Institute of Chartered Accountants (CICA) and the Canadian Public Accountability Board (CPAB) (“the Discussion Paper”).

General comments

- (2) FEE very much welcomes this collaborative initiative by CICA and the CPAB focussing on three interrelated key areas in enhancing audit quality - the independence of auditors, the role of audit committees, and auditor reporting. FEE has been interested in and contributed to these specific areas for a number of years. On the auditor reporting model, FEE has recently issued a letter in response to the CICA – CPAB Discussion Paper “Enhancing Audit Quality: Canadian Perspectives – The Auditor Reporting Model”².

¹ FEE (Fédération des Experts comptables Européens) is the Federation of European Accountants, an international non-profit organisation based in Brussels that represents 45 professional institutes of accountants and auditors from 33 European countries, including all of the 27 European Union (EU) Member States. FEE has a combined membership of more than 700.000 professional accountants, working in different capacities in public practice, small and big accountancy firms, business of all sizes, government and education, who all contribute to a more efficient, transparent and sustainable European economy.

² To view the FEE Comment Letter on the CICA – CPAB Discussion Paper “Enhancing Audit Quality: Canadian Perspectives – The Auditor Reporting Model”, see at:
<http://www.fee.be/fileupload/upload/CPAB%20121010%20enhancing%20audit%20quality10102012361536.pdf>

- (3) We are delighted to enclose with this letter a copy of the following FEE publications³ that we deem are relevant to the Discussion Paper:
- The FEE Briefing Paper “Appointment of the Auditor”
 - The FEE Briefing Paper “Provision of Non-Audit Services to Audit Clients”
 - The FEE Policy Statement “Provision of Non-Audit Services to Audit Clients that are Public Interest Entities (PIEs)”
- (4) Our comments on the Discussion Paper are limited to those areas of most relevance for FEE to comment on. Our detailed responses to the questions posed in the Discussion Paper are included as an Appendix to this letter. In summary:

Mandatory audit firm rotation and tendering

- (5) In a recent survey conducted by FEE, 80% of FEE Member Bodies indicated that they are against mandatory audit firm rotation with only a minority of them supporting the principle. One of the countries supporting mandatory firm rotation is Italy, where mandatory firm rotation is currently in operation.
- (6) We believe that mandatory audit firm tendering will not meet the expectation of reducing concentration and that a move towards a system of voluntary tendering, with the provision of enhanced disclosures on the qualitative aspects of reappointment, would leave the decision in the hands of the audit committee who are ultimately better placed to make such a judgement.

The prohibition of providing Non-Audit Services to Audit Clients

- (7) Non-audit services provided by auditors to their audit clients should not be treated as if every service endangers the auditor’s independence in every circumstance. To prohibit provision of non-audit services to audit clients as a whole would unnecessarily restrict the ability of business to choose the most appropriate adviser in circumstances when threats to independence would be absent or minimal or could be managed with safeguards. In reality, there are different types of services.
- (8) Non-audit assurance or so called audit related services should, without limitations, be permitted provided that potential threats to independence are addressed. Other non-audit services should be subject to a case by case analysis in accordance with the conceptual approach of the International Ethics Standards Board for Accountants (IESBA) Code. In addition, as the audit committee has a determining role in the procurement of significant non-audit services in public interest entities from the auditor, it would be subject to the involvement of or approval by the audit committee of permissible services.

³ To view these publications online see at:

http://www.fee.be/publications/default.asp?library_ref=4&content_ref=1405

http://www.fee.be/publications/default.asp?library_ref=4&content_ref=1406

http://www.fee.be/publications/default.asp?library_ref=4&content_ref=1535

Audit-only firms

- (9) We agree with the Discussion Paper's recommendation to reject the proposal for audit-only firms. It is more than doubtful how the proposal for audit-only firms would enhance audit quality and, in our view, it may even weaken it as well as it may have unintended consequences.

Joint audits

- (10) We note that joint audits could have an impact on helping to change the concentration in the audit market, although its impact on audit quality is unclear. Joint audits will bring about some practical difficulties compared to having only one auditor carrying out the audit.

For further information on this letter, please contact Hilde Blomme on +32.2.285.40.77 or via email at hilde.blomme@fee.be or Leyre Fuertes on +32.2.285.40.76 or via email at leyre.fuertes@fee.be from the FEE Secretariat.

Yours sincerely,



Philip Johnson
FEE President

Enclosures:

- The FEE Briefing Paper "Appointment of the Auditor"
- The FEE Briefing Paper "Provision of Non-Audit Services to Audit Clients"
- The FEE Policy Statement "Provision of Non-Audit Services to Audit Clients that are Public Interest Entities (PIEs)"

Appendix - Responses to questions

Mandatory audit firm rotation, tendering and comprehensive review: A continuum of alternatives

Consensus and Questions – page 23 of the Discussion Paper

The Independence Working Group (IWG) recommends mandatory comprehensive review as both audit committees and auditors would focus more on audit quality and on the exercise of professional skepticism. Audit committees would undertake a comprehensive review process and make related disclosures at least every five years, while continuing their annual auditor assessments. This recommendation will be further developed by the Role of the Audit Committee Working Group (ACWG).

Do you agree with the IWG's recommendation? Please explain why.

Do you believe that mandatory audit firm rotation or mandatory tendering is a preferred alternative?

Please explain why.

Do you think that the current rules are appropriate and no changes are required at this time?

Do you have any other suggestions?

- (11) To contribute towards answering these questions, we refer to the FEE Briefing Paper "Appointment of the Auditor"⁴ enclosed with this letter. This FEE Paper highlights some key aspects related to the appointment of the auditor which encompasses considerations for companies regarding the process of how the auditor is selected prior to commencing the audit work, how many auditors a company selects and how often the company would appoint and/or reappoint its auditor.

Appointment of the Auditor and Audit Firm Rotation

- (12) As already noted above (in paragraph 5 of this letter), recently FEE has firmed up its position in relation to mandatory audit firm rotation as the vast majority of FEE Member Bodies are against mandatory audit firm rotation while a minority of them support the principle.
- (13) The arguments against mandatory audit firm rotation are that there is a risk of increased concentration in the audit market, that there are other measures to safeguard the independence of auditors, that it ignores judgement of those charged with corporate governance, especially the audit committee, to determine if and when to rotate auditors and that there are undoubtedly financial and time costs in making sure the "new" auditors get to know the business, sometimes against the backdrop of pressure of audit fees.

⁴ To view the FEE Briefing Paper "Appointment of the Auditor" online, see at:
http://www.fee.be/publications/default.asp?library_ref=4&content_ref=1405

Appointment of the Auditor and Retendering

- (14) Audit firm rotation has to be balanced with the growing trend in EU Member States for audit committees to opt for voluntary re-tendering of the audit.
- (15) Audit committees would seem to be well placed to undertake the task of assessing what the impact on audit quality will be, should there be a change in auditor. A mandatory process of audit tendering, which would define a fixed term appointment for the auditor, would detract from the audit committee's ability to take any specific circumstances into account and exercise their judgment on whether the timing is right for such an appointment.
- (16) By opting for a system of voluntary retendering, the reappointment process could be effectively and efficiently managed by providing enhanced disclosure of the rationale behind the reappointment, which may be less expensive and disruptive and prove to be more conducive to gradual change in market dynamics. In this context, laws, regulations or general practices should not restrict the choice of an audit firm to a smaller selection of the market and "Big 4 clauses" or "covenants" should therefore be eliminated. Please note that while we refer to a system of voluntary re-tendering, whereas the Discussion Paper uses the term mandatory comprehensive review, the concept behind the different terms is essentially the same.

Non-audit services

Consensus and Questions – page 25 of the Discussion Paper

The Independence Working Group (IWG) recommends the continued use of the Canadian principles-based approach to evaluating threats to, and safeguards for, the provision of non-audit services, with appropriate rule-based prohibitions for services when threats cannot be overcome. The IWG identified three differences between the Canadian and SEC/PCAOB prohibitions and recommends that those establishing independence rules in Canada assess these differences on a rule by rule basis. The three differences are personal tax services for individuals in financial reporting oversight role, aggressive and confidential tax transactions and providing non-audit services on a contingency fee basis. The IWG would support additional prohibitions with respect to the first two in the Canadian independence rules. The IWG recommends further study on the question of non-audit services being performed on a contingency fee basis to assess the impact on auditor independence.

Do you agree that additional prohibitions similar to the SEC/PCAOB rules would be appropriate?

Do you believe further restrictions are necessary and, if yes, what further restrictions should be considered and why?

- (17) Regarding the provision of non-audit services, we would like to refer to some of the recent work developed by FEE in this area, mainly the two following publications enclosed with this letter:
 - The FEE Briefing Paper "Provision of Non-Audit Services to Audit Clients"⁵; and

⁵ To view the FEE Briefing Paper "Provision of Non-Audit Services to Audit Clients" online, see at: http://www.fee.be/publications/default.asp?library_ref=4&content_ref=1406

- The FEE Policy Statement “Provision of Non-Audit Services to Audit Clients that are Public Interest Entities (PIEs)”⁶.
- (18) As explained in detail in these two documents, there are different categories of non-audit services and not all non-audit services should be treated as a monolithic bloc endangering the auditor’s independence and thus be prohibited as a whole.
- (19) Non-audit assurance or so called audit related services should, without limitations, be permitted provided that potential threats to independence are addressed. Other non-audit services should be subject to a case by case analysis in accordance with the conceptual approach of the IESBA Code. In addition, as the audit committee has a determining role in the procurement of significant non-audit services in public interest entities from the auditor, it would be subject to the involvement of or approval by the audit committee of permissible services.
- (20) The provision of other services to audit and especially non-audit clients are seen by many to enhance the quality of the audit as well as its effectiveness and efficiency. Indeed, in performing auditing, advisory, assurance and even other non-audit services, members of the audit profession obtain complementary and specialised knowledge and competence. Also, it is a reality that this variety of work attracts talented young graduates and other highly skilled resources which is crucial for the provision of high quality audit services.
- (21) Regarding the question of non-audit services being performed on a contingency fee basis, we support, as provided for in the IESBA Code, the prohibition of contingent fees for audits or assurance engagements or, when material to the audit firm, for non-assurance services to the audit client.

Audit-only firms

Consensus and Questions – page 27 of the Discussion Paper

The Independence Working Group (IWG) recommends the rejection of the audit-only proposal.

Do you agree with the IWG’s recommendation? Please explain.

Would audit-only firms offer any benefit to audit quality that would outweigh any potential disadvantages?

- (22) We agree with the IWG’s recommendation to reject the audit-only proposal. The idea of breaking large professional firms into audit-only firms, if at all achievable in a global environment, may not only imply serious disruption for markets and for the whole accounting profession, but also may have unintended consequences; it will be detrimental to the quality of all audits as much needed expertise will be lost and firms will find it more difficult to attract high quality talent.

⁶ To view the FEE Policy Statement “Provision of Non-Audit Services to Audit Clients that are Public Interest Entities (PIEs)” online, see at: http://www.fee.be/publications/default.asp?library_ref=4&content_ref=1535

Joint audits

Consensus and Questions – page 28 of the Discussion Paper

The IWG recommends the rejection of joint audits.

Do you think joint audit should be considered? If so, why?

- (23) To help answering this question, we refer again to the FEE Briefing Paper “Appointment of the Auditor”⁷ enclosed with this letter. In particular, we would like to note the following considerations which provide arguments for and against the question of whether there should be joint audits:

Appointment of the Auditor and Joint Audits

- (24) Having more than one statutory auditor is already an option that EU Member States and entities can adopt, should they choose to do so. Whilst this is not widely adopted in practice and a minority of companies have chosen voluntarily to do so, it is recognised that certain jurisdictions see merit in this approach as a possible solution to the current levels of concentration in the audit market. How the concept of joint audit works in practice when two audit firms jointly carry out an audit at national and international level as well as the effect it can have on audit quality are to be considered as well.
- (25) Only few countries have experience with joint audits, and one example is France, where joint audits are mandatory for the audit of consolidated financial statements of all companies. There are no restrictions on the size of the audit firms which are involved in the joint audits. The auditors are required to take a balanced approach using quantitative as well as qualitative criteria, and to have a proportionate repartition of hours, experience and qualifications of the members of the audit teams. Even with these principles in mind, the concentration in the audit market for large listed entities is still relatively high. However, for smaller listed entities, more audits are carried out as a joint audit between a small and a large audit firm.
- (26) Another example, which originated from other concerns than the audit market, is Denmark. In Denmark, a mandatory joint audits requirement was introduced at a time where the audit firms lacked the capacity to carry out audits of very large, complex and global companies. Joint audits were therefore used to ensure the sufficiency of audit resources for such companies. The concept of joint audit was abandoned as of 2005, as it was considered that the administration and financial burden placed on entities did not necessarily result in any tangible benefits for the business from an audit quality perspective. The original concerns with audits of large multinational companies are now addressed through independence requirements, review partner requirements, key audit partner rotation and effective internal and external quality control.
- (27) The main objective of using joint audits would be to decrease audit market concentration by building capacity for smaller audit firms in the audit market over a period of time and to enlarge their global reach. This could in due course change the dynamics of the audit market. Making joint audits work in practice necessitates considering a number of issues

⁷ To view FEE Briefing Paper “Appointment of the Auditor” online, see at:
http://www.fee.be/publications/default.asp?library_ref=4&content_ref=1405

like transitional measures in the initial years, how companies can coordinate and cooperate with two instead of one single audit firm, how the audit work can be divided, performed and reviewed, what the cost implications are for the audit firms and for the companies, etc. Further consideration should also be given to how differences of opinions between the auditors involved would be approached and how each signing auditor can take sole responsibility for the audit.

Briefing Paper

Standing for trust and integrity

June 2011



The Provision of Non-Audit Services to Audit Clients

One of the issues raised by the recent European Commission Green Paper on Audit Policy focused on the provision of non-audit services to audit clients and its potential impact on the independence of an auditor.

The principle of objectivity is imposed on all auditors and for all services they perform, which is the obligation not to compromise their professional or business judgment because of bias, conflict of interest or the undue influence of others. The concept of independence is a proxy to deal with objectivity in a regulatory, practical and measurable way.

In the current debate, services other than audit have been discussed as if they were all the same and as having the same impact on the independence of the auditor, thus questioning whether all non-audit services should be prohibited. In reality, there are different types of services.

Some non-audit services can indeed compromise an auditor's independence and should ultimately be prohibited, which is already the case in most EU Member States. Other services do not pose a threat to auditors' independence and can thus be allowed.

In order to assess whether the provision of a particular non-audit service will, may, or will not compromise the auditor's independence, the non-audit services can be categorised as follows:

- To be generally prohibited;
- To be permitted only if, following rigorous analysis, appropriate safeguards are in place to mitigate or even eliminate any threat to auditor independence to an acceptable level; or
- To be generally permitted.

Public interest entities

Public interest entities (PIEs) are under heightened public scrutiny, governance, transparency and other requirements. The independence requirements imposed on their auditors are more rigorous which results in more prohibitions of non-audit services for auditors auditing PIEs than for those auditing other companies, as depicted below in Figure 1.

Non-public interest entities

Such rigorous requirements are less justifiable or relevant for other entities or non-PIEs, including Small and Medium-sized Entities (SMEs). This, compared to audits of PIEs, results in less prohibitions of non-audit services and more permitted services for auditors auditing non-PIEs, as illustrated below in Figure 2.

Further explanation on the differences between the three types is given below. Most EU Member States have used a similar approach to regulate the provision of non-audit services by auditors and their audit firm network, although there are local differences as far as the categorisation of individual services is concerned.

Prohibited non-audit services

Certain non-audit services represent such a significant threat to the independence of the auditor that the only possible solution is to prohibit the provision of such services to audit clients, if they have an impact on the financial statements to be audited; in some cases even if the service has no such impact. These include for example:

Prohibited non-audit services for auditors of all entities:

- Assuming a management responsibility;
- Serving as General Counsel and negotiating for the audit client;
- Promoting, dealing in, or underwriting client shares;
- Bookkeeping and accounting services beyond routine and mechanical;
- Valuation services involving subjectivity;
- Corporate finance advice that depends on a questionable particular

Figure 1 : Non-audit services in public interest entities

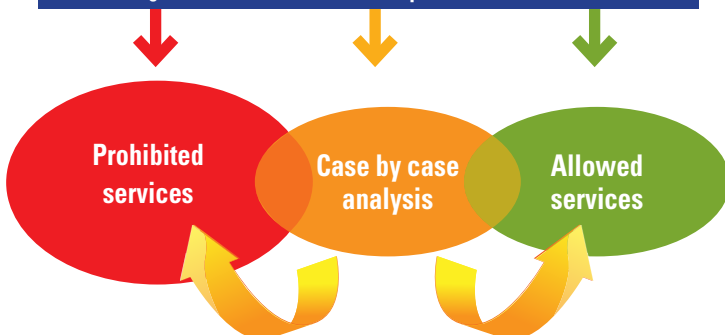
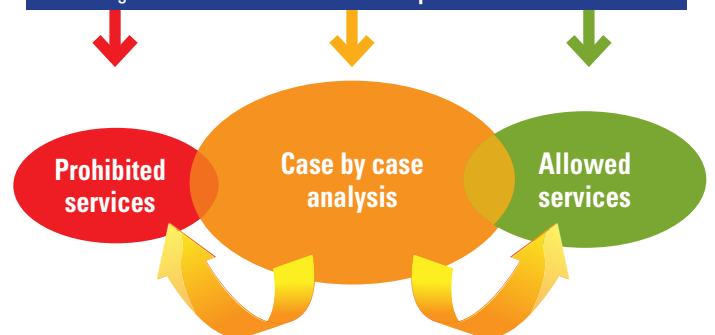


Figure 2 : Non-audit services in non-public interest entities



- accounting treatment and financial statement presentation;
- Acting as an advocate before a public tribunal or court.

For auditors of public interest entities additional non-audit services are prohibited:

- The preparation of financial statements and related financial information;
- Payroll services;
- Valuation services;
- Calculations of current and deferred taxes;
- Internal audit services relating to internal controls over financial reporting or systems;
- Designing and implementing financial reporting IT systems.

It should also be noted that evaluating or compensating a key audit partner based on that partner's success in selling non-audit services to the partner's audit client is always prohibited.

Case by case analysis - for non-audit services creating a potential threat to auditor independence

Certain non-audit services *potentially* pose a threat to the independence of the auditor. It may be possible to reduce such threats to an acceptable level by introducing specific measures to safeguard auditor independence. This requires a deeper and individualised analysis by the auditor and those charged with governance to understand if the provision of these services may and to what extent they could compromise the auditor's objectivity.

It is clear that, for example, assisting the client with a litigation on an *insignificant* matter does not affect the auditor's objectivity and independence as there will be no conflict of interest at the time of performing the audit and formulating conclusions. This would thus become an allowed service.

However, determining the value of an asset for an audit client will raise an independence issue when the value of such asset has a *significant* impact on the financial statements to be audited. This would thus become a prohibited service.

Certain other services like consultancy, advisory and some tax services also require an in-depth analysis. There are many different types of tax services like tax advice, tax planning, advocating the resolution of a tax matter before a public tribunal or court, etc. Therefore, the provision of such tax services by an auditor should be considered case by case as it will depend on the specific type of tax service, its dependence on an accounting treatment, the significance of its impact on the financial statement as well as the tax regime in a particular country whether the auditor can or cannot perform a certain tax service.

These assessments are not black or white in practice and will require a deep and objective assessment of the services on a case by case basis. This analysis is based on a solid rationale for applying criteria to determine which safeguards would be appropriate (or not) to mitigate the identified threats. In PIEs, the audit committee also often plays a determining role in the procurement of significant non-audit services from the auditor. This case by case analysis results in the auditor being prohibited or allowed to perform the service under consideration in that specific situation.

Allowed services

Some other non-audit services are audit-related, assurance, or advisory services. The performance of such services by the auditor may either be required due to legal, regulatory or contractual reasons, or the auditor is best placed to provide them to the audit client because the service is closely connected to the audit work.

A prohibition for the auditor to provide these types of non-audit services to an audit client would be unnecessary to preserve auditor independence. A ban would also seriously undermine the ability of companies and stakeholders to timely and cost-effectively enter into transactions where currently the assurance provided by the auditor on any element of the transaction is considered to be relevant. It would also affect part of the supervisory system in certain key sectors of the economy.

Some typical examples of these services are:

- Review of interim financial statements;
- Assurance provided to lenders on compliance with certain contractual agreements of a loan;
- Due diligence services on potential mergers and acquisitions;
- Assurance on corporate governance statements;
- Assurance on or attestation of regulatory reporting provided to regulators in certain sectors (i.e. bank regulators) beyond the scope of the audit and designed to assist regulators in fulfilling their role, such as on capital requirements or specific solvency-related ratios determining how likely a company will be to continue meeting its debt obligations;
- Providing comfort letters for investors in the context of the issuance of a company's securities;
- Assurance on a company's pro-forma financial information, anticipating the result of a planned transaction as a merger, an acquisition or a disposal;
- Assurance on Corporate Social Responsibility (CSR) matters;
- Tax compliance work, such as assistance in preparing tax returns.

The way forward: harmonised European independence requirements

Non-audit services provided by auditors should not be treated as a monolithic bloc endangering the auditor's independence and thus be prohibited as a whole. Certain services are not just permissible but are required to be performed by the auditor. The provision of other services to audit and especially non-audit clients may enhance the quality of the audit as well as its effectiveness and efficiency. Indeed, in performing auditing, advisory, assurance and even other non-audit services, members of the audit profession obtain complementary and specialised knowledge and competence. Also, it is a reality that this variety of work attracts talented young graduates and other highly skilled resources which is crucial for the provision of high quality audit services.

Further harmonisation of these matters at European level could be achieved if the adoption of relevant sections of the Code of Ethics for Professional Accountants issued by the International Ethics Standards Board of Accountants (IESBA) in July 2009 would be considered. Such common standards would also be a prerequisite for an EU passport for auditors.

Policy Statement

Standing for trust and integrity

July 2012



The Provision of Non-Audit Services to Audit Clients that are Public Interest Entities (PIEs)

FEE issued a Briefing Paper on the Provision of Non-Audit Services to Audit Clients in June 2011¹ further to the European Commission Green Paper on Audit.

Following the publication of the European Commission Proposal for a Regulation on specific requirements regarding Statutory Audit of Public-Interest Entities (PIEs)² in November 2011, FEE is supplementing its Briefing Paper with the present document by considering in further detail the prohibition of the provision of non-audit services to audit clients that are PIEs as proposed by the European Commission.

Non-audit services should not be dealt with by Regulation

As the representative organisation of the European accountancy profession, FEE is committed to advancing audit policy across the European Union (EU) and globally. This would require striking a proper balance between the need to provide consistent common principles and requirements while acknowledging the (sometimes significant) differences in size, structure, complexity and type of economies of EU Member States. While we recognise the importance of fostering harmonisation in accordance with the EU legal competences, we believe that EU intervention in these matters and especially as regards company law, needs to continue complying with the principles of subsidiarity and especially proportionality.

Therefore, FEE recommends the European Institutions to reassess the choice of a European Regulation as the legal instrument to change statutory audit of public interest entities. In line with the choice made regarding the current Statutory Audit Directive (2006/43/EC), it would be more appropriate and proportionate to continue dealing with the provision of statutory audit services to companies which are public interest entities in a European Directive. Furthermore, in view of the objective – that FEE supports – of enabling new entrants on the market of statutory audit services for public interest entities, it does not appear opportune to split the legislation of statutory audit in two different instruments, a Directive and a Regulation, as this may increase barriers to entry on the public interest entities audit market.

Our recommendations below are therefore not aimed at endorsing the legal instrument of a Regulation, but intend to encourage a common approach on non-audit services by other legislative and non-legislative means.

Independence rules are already in place in EU Member States

Article 22.4 of the 2006 Statutory Audit Directive (2006/43/EC) already created a legal basis for the European Commission to adopt implementing measures in relation to independence and objectivity. Many EU Member States have in the meantime implemented a robust system of independence rules without awaiting a European initiative.

International solutions for the provision of non-audit services are preferable

The application of the principles and requirements of the current Code of Ethics for Professional Accountants issued by the International Ethics Standards Board for Accountants (IESBA)³, in particular Section 290 of the Code dealing with Independence requirements, could facilitate further harmonisation in this area, especially if the provisions and the concept of materiality of the IESBA Code of Ethics⁴ would be brought in.

The IESBA is an independent standard-setting board of IFAC⁵ with at least half of its members being non-practitioners including public members. The Board follows a rigorous due process to ensure that a public interest perspective is taken into account. The views of stakeholders affected by its standards are thoroughly considered resulting in high quality global common standards, which are currently applied by many IESBA members – including in European Union Member States. On this basis FEE identifies a series of recommendations in order to better align the European Commission proposals with the global standards in the Independence Section 290 of the IESBA Code of Ethics.

The principle of objectivity is imposed on all auditors and in respect of all services they perform, which is the obligation not to compromise their professional or business judgment because of bias, conflict of interest or the undue influence of others. The concept of independence is a proxy to deal with objectivity in a regulatory, practical and measurable way.

Some non-audit services will compromise an auditor's independence and should be prohibited when combined with the audit. This is already the case in most EU Member States. Other services do not pose a threat to auditors' independence in many circumstances and should thus be allowed in such circumstances.

¹ See <http://www.fee.be/fileupload/upload/Briefing%20Paper%202002%20Provision%20of%20Non%20Audit%20Services%201106306201112257.pdf>

² See http://ec.europa.eu/internal_market/auditing/docs/reform/regulation_en.pdf

³ IESBA, the International Ethics Standards Board for Accountants, an independent board under the auspices of IFAC setting the global ethical and independence standards for professional accountants.

⁴ See <http://www.ifac.org/publications-resources/2010-handbook-code-ethics-professional-accountants>

⁵ IFAC is the International Federation of Accountants

In order to assess whether the provision of a particular non-audit service will, may, or will not compromise the auditor's independence, the non-audit services can be categorised as follows:

- To be generally prohibited;
- To be either prohibited or permitted depending on a case by case analysis; or
- Generally permitted.

Further explanation on the differences between the three types is given below. Most EU Member States have used a similar approach to regulate the provision of non-audit services by auditors and their network, although there are local differences as far as the categorisation of individual services is concerned.

Public interest entities versus non-public interest entities

Public interest entities are under heightened public scrutiny and are subject to additional governance, transparency and other requirements when compared with non-public interest entities. The independence requirements imposed on auditors of PIEs are more rigorous which results in more prohibitions of non-audit services for auditors auditing PIEs than for those auditing other companies.

The rigorous requirements for the prohibition or provision of non-audit services for PIEs are less justifiable or relevant for non-PIEs, including Small and Medium-Sized Entities (SMEs) as there is a reduced perception issue regarding auditor independence. The stricter PIE requirements should not result in additional burdens or unnecessary pressure for auditors of non-PIEs. This is especially important in an era where simplification, reduction of administrative burdens and deregulation for SMEs is a crucial objective within the EU.

Prohibited non-audit services to audited Public Interest Entities

Certain non-audit services would be seen to be such a significant threat to the independence of the auditor that the only possible solution is to prohibit the provision of such services to audit clients, if they have an impact on the

financial statements to be audited; in some cases even if the service has no such impact. These include the following⁶:

To be generally prohibited	
The EC Proposed Regulation intends to prohibit	IESBA Code of Ethics prohibits
<ul style="list-style-type: none"> • General management services 	<ul style="list-style-type: none"> • Assuming a management responsibility
<ul style="list-style-type: none"> • Legal services <p><i>Note: As provided for in the IESBA Code, it is recommended that legal services be generally prohibited if they relate to "Serving as General Counsel", "Negotiating for the audit client", or "Acting as an advocate for the audit client in case its outcome would have a material impact on the financial statements to be audited" (see below under case by case analysis in the IESBA list of prohibited services if material to the financial statements).</i></p>	<ul style="list-style-type: none"> • Serving as General Counsel • Negotiating for the audit client
<ul style="list-style-type: none"> • Broker or dealer, investment adviser, or investment banking services 	<ul style="list-style-type: none"> • Promoting, dealing in, or underwriting client shares
<ul style="list-style-type: none"> • Bookkeeping 	<ul style="list-style-type: none"> • Bookkeeping and accounting services
<ul style="list-style-type: none"> • Human resources services, including recruiting senior management⁷ <p><i>Note: As per the IESBA Code of Ethics, it is recommended that these services be generally prohibited if relating to recruiting senior management who would have significant influence over accounting records or financial statements.</i></p>	<ul style="list-style-type: none"> • Recruiting directors/officers, or senior management who will have significant influence over accounting records or financial statements
<ul style="list-style-type: none"> • Preparing accounting records and financial statements • Designing and implementing internal control or risk management procedure related to the preparation and/or control of financing information included in the financial statements 	<ul style="list-style-type: none"> • The preparation of financial statements and related financial information
	<ul style="list-style-type: none"> • Payroll services
<p>FEE Recommendation: To be generally prohibited as provided for in the IESBA Code of Ethics (Independence Section 290)</p>	

Case by case analysis - for non-audit services to audited Public Interest Entities creating a potential threat to auditor independence

Certain non-audit services *potentially* pose a threat to the independence of the auditor. It may be possible in many cases to reduce such threats to an acceptable level by introducing specific measures to safeguard auditor independence. This requires a deeper and individualised analysis by the auditor and those charged with governance, generally the audit committee, to understand if the provision of these services may and to what extent they could compromise the auditor's objectivity.

It is clear that, for example, assisting the client with a litigation on an *insignificant* matter does not affect the auditor's objectivity and independence as there will be no conflict of interest at the time of performing the audit and formulating conclusions. This would thus become an *allowed service*.

However, determining the value of an asset for an audit client will raise an independence issue when the value of such asset has a *significant* impact on the

⁶ Note that per the IESBA Code of Ethics the prohibition of the provision of some of these services applies for all audited entities and not only PIEs.

⁷ As per the European Commission Proposed Regulation on Audits of PIEs, these services may be provided by the statutory auditor or the audit firm subject to prior approval by the audit committee.

financial statements to be audited. This would thus become a *prohibited service*. Certain other services like consultancy, advisory and some tax services also require an in-depth analysis. There are many different types of such services. If they form part of the function of management they will be prohibited (see above). However, if they do not, the provision of such services by an auditor

should be considered case by case as it will depend on the specific type of service, its dependence on an accounting treatment, the significance of its impact on the financial statements as well as for example the tax regime in a particular country whether the auditor can or cannot perform a certain service.

Case by case analysis	
The EC Proposed Regulation intends to prohibit without regard to materiality	IESBA Code of Ethics: prohibited if material to the financial statements
• Resolution of litigation	• Estimating damages or other amounts as part of litigation support services
• Valuation services, providing fairness opinions ⁸ or contribution-in-kind reports ⁹	• Valuation services involving subjectivity
• Tax consultancy and other advisory services	• Tax or corporate finance advice that depends on a particular accounting treatment and financial statement presentation
	• Acting as an advocate before a public tribunal or court
• Actuarial services	• Certain actuarial services which are in effect valuation services
• Participating in the audit client's internal audit and the provision of services related to the internal audit function	• Internal audit services relating to internal controls over financial reporting or systems or financial statement amounts/disclosures
• Designing and implementing financial information technology systems for some public-interest entities (all except listed entities)	• Designing and implementing financial reporting IT systems
• Designing and implementing financial information technology systems for some public-interest entities (listed entities) ¹⁰	• Designing and implementing financial reporting IT systems
• Expert services unrelated to the audit ¹¹	
• Advice on risk	
FEE Recommendation: Depending on a case by case analysis, to be either • Generally prohibited if material to the financial statements as provided for in the IESBA Code of Ethics (Independence Section 290) or • Permitted only if, following rigorous analysis, appropriate safeguards are in place as well as appropriate audit committee involvement, to mitigate or even eliminate any threat to auditor independence to an acceptable level	

These assessments are not black or white in practice and will require a deep, objective and documented assessment of the services on a case by case basis. This analysis is based on a solid rationale for applying criteria to determine which safeguards would be appropriate (or not) to mitigate the identified threats.

In PIEs, the audit committee also often plays a determining role in the procurement of significant non-audit services from the auditor. A provision

Allowed services

Some other non-audit services are audit-related and other assurance services. The performance of such services by the auditor may either be required due to legal, regulatory or contractual reasons, or the auditor is best placed to provide them to the audit client because the service is closely connected to the audit work. Though apparently, in line with this understanding, the EC proposed Regulation intends to allow services referred to as "related financial audit services": however, FEE does not support an approach that would provide within legislation an exhaustive list of assurance and audit-related services which are permissible.

It should be noted that as far as the provision of assurance is concerned it is already a requirement for the auditor to be independent¹². This means that, as the statutory auditor has to be independent and is also subject to oversight, no other party would be better placed to perform these services from an independence perspective.

could be established that the auditor may not render other services to the PIE to be audited without audit committee involvement and/or approval. The audit committee should be able to predefine whether certain types and/or values of non-audit services can be awarded, or whether it wishes to award assignments individually, in particular in conjunction with its monitoring role.

The case by case analysis results in the auditor being prohibited or allowed to perform the service under consideration in that specific situation.

A prohibition for the auditor to provide these types of non-audit services to an audit client is not necessary to preserve auditor independence. A ban would also seriously undermine the ability of companies and stakeholders to timely and cost-effectively enter into transactions where currently the assurance provided by the auditor on any element of the transaction is considered to be relevant. It would also affect part of the supervisory system in certain key sectors of the economy. For these reasons, the IESBA Code of Ethics is consistent with the EC approach to permit this type of services within the overall requirement to address specific threats but without other limitations.

⁸ It should be noted that a "fairness opinion" is not a defined term in EU legislation but would fall under assurance services under the IESBA Code of Ethics and therefore be subject to independence requirements.

⁹ Certain types of "contribution-in-kind reports" are mandatory by EU law (2nd Company Law Directive) and are designed as assurance/attest services to protect minority shareholders and the public interest (i.e. squeeze out, merger situations, certain contractual relationships between companies, change of legal form). Though the EU legislation only requires these services to be performed by experts, many EU Member States require these services to be performed by the statutory auditor. Also, some EU Member States require the person providing such services to meet the same independence requirements as applicable for the statutory auditor.

¹⁰ As per the European Commission Proposed Regulation on Audits of PIEs, these services may be provided by the statutory auditor or the audit firm subject to prior approval by the competent authority.

¹¹ Note that it is presumed that these expert services relate to services not covered elsewhere in this Policy Statement.

¹² See IESBA Code of Ethics Section 290 for Review Engagements and Section 291 for Other Assurance Engagements

Generally permitted	
The EC Proposed Regulation intends to allow related financial audit services, but solely up to a limit of 10% of the fees paid for the statutory audit:	IESBA Code of Ethics Does not explicitly define permitted services, but some typical examples of these services which are implicitly permitted are:
• Audit or review of interim financial statements	• Review of interim financial statements
	• Assurance provided to lenders on compliance with certain contractual agreements of a loan
• Assurance on corporate governance statements	• Assurance on corporate governance statements
• Assurance on corporate social responsibility matters	• Assurance on Corporate Social Responsibility (CSR) matters
• Assurance on or attestation of regulatory reporting to regulators of financial institutions beyond the scope of the statutory audit and designed to assist regulators in fulfilling their role, such as on capital requirements or specific solvency ratios determining how likely an undertaking will be to continue meeting its debt obligations	• Assurance on or attestation of regulatory reporting provided to regulators in certain sectors (i.e. bank regulators) beyond the scope of the audit and designed to assist regulators in fulfilling their role, such as on capital requirements or specific solvency-related ratios determining how likely a company will be to continue meeting its debt obligations
	• Assurance on a company's pro-forma financial information, anticipating the result of a planned transaction as a merger, an acquisition or a disposal
• Certification on compliance with tax requirements where such attestation is required by national law	• Tax compliance work, such as assistance in preparing tax returns
• Any other statutory duty related to audit work imposed by [European] Union legislation to the statutory auditor or audit firm	
The EC Proposed Regulation would allow under certain circumstances	
• Due diligence services to the vendor or the buy side on potential mergers and acquisitions and providing assurance on the audited entity to other parties at a financial or corporate transaction ¹³	• Due diligence services on potential mergers and acquisitions
• Providing comfort letters for investors in the context of the issuance of an undertaking's securities ¹⁴	• Providing comfort letters for investors in the context of the issuance of a company's securities
The EC Proposed Regulation intends to prohibit without regard to materiality	
• Actuarial services	• Actuarial services which are not in effect valuation services
FEE Recommendation: The overall requirement to address specific threats shall apply without other limitations	

The way forward: harmonised European independence requirements

Non-audit services provided by auditors to their audit clients should not be treated as if every service endangers the auditor's independence in every circumstance. To prohibit provision as a whole would unnecessarily restrict the ability of business to choose the most appropriate adviser in circumstances when threats to independence would be absent or minimal or could be managed with safeguards. Certain services are not just permissible but are required to be performed by the auditor or can be best performed by the auditor. The provision of other services to audit and especially non-audit clients can enhance the quality of the audit as well as its effectiveness and efficiency. Indeed, in performing auditing, other assurance and even related

non-audit services, members of the audit profession obtain complementary and specialised knowledge and competence. Also, it is a reality that this variety of work attracts talented young graduates and other highly skilled resources which is crucial for the provision of high quality audit services.

Further harmonisation of these matters at European level could be achieved with the application of the principles and requirements of the relevant sections of the Code of Ethics for Professional Accountants issued by the International Ethics Standards Board of Accountants (IESBA). Such common standards would also be a prerequisite for an EU passport for auditors.

About FEE

FEE (Fédération des Experts-comptables Européens – Federation of European Accountants) represents 45 professional institutes of accountants and auditors from 33 European countries, including all of the 27 European Union (EU) Member States. In representing the European accountancy profession, FEE recognises the public interest. It has a combined membership of more than 700.000 professional accountants, working in different capacities in public practice, small and big firms, government and education, who all contribute to a more efficient, transparent and sustainable European economy.

¹³ As per the European Commission Proposed Regulation on Audits of PIEs, these services may be provided by the statutory auditor or the audit firm subject to prior approval by the competent authority.

¹⁴ As per the European Commission Proposed Regulation on Audits of PIEs, these services may be provided by the statutory auditor or the audit firm subject to prior approval by the audit committee.

Briefing Paper

Standing for trust and integrity

June 2011



Appointment of the Auditor

FEE believes that the independent external audit is fundamental to the efficiency of the global economy. The financial crisis has raised questions regarding the auditing profession and in particular, some commentators have raised concerns around the independence of the auditor and the length of the appointment of the auditor. FEE supports a global debate towards an even more valuable audit, meeting the needs of stakeholders.

The appointment of the auditor encompasses considerations for companies regarding the process of how the auditor is selected prior to commencing the audit work, how many auditors a company selects and how often the company would appoint and/or reappoint its auditor. These matters are further discussed in this FEE Briefing Paper.

The independence of the auditor is a fundamental prerequisite to the effectiveness of the audit, but independence alone cannot deliver a quality audit. It is therefore important to ensure that the quality of the audit is the paramount consideration in any decision to change the rules on auditor appointment.

Selection process for appointment of the auditor

The auditor is formally appointed by the shareholders of a company, usually on the recommendation of the board or the audit committee. While many audit firms do remain appointed for long periods of time due to having been reappointed a number of times, the audit appointment is subject to approval upon each reappointment, which in some countries takes place annually, but in other countries is done less frequently. The auditor is bound by ethical standards governing independence and, while the audit firm can remain appointed for some time, the key audit partners of public interest entities responsible for the audit engagement are already required at European level to rotate after a maximum period of seven years and cannot be reappointed again until two years later.

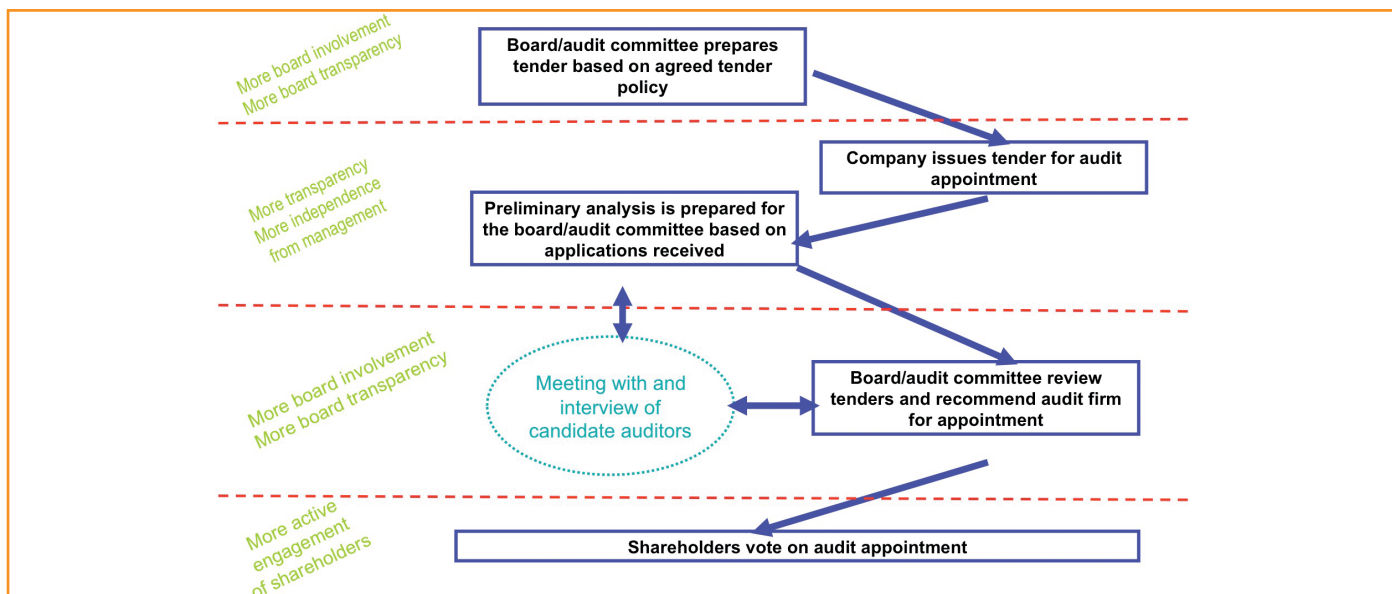
Different measures may be needed for companies of differing natures and sizes. In general, the process for selection and appointment of the auditor should be independent of management and the decision-making for auditor appointment should be with the governing bodies of the entity.

For *non-public interest entities*, the main parties involved in the appointment of the auditor are the board and the shareholders. Non-public interest entities are not a homogenous group. More involvement of independent members of the board, or the audit committee if so required at national level, could be relevant for entities where being independent of management would also be important. However, for smaller unlisted companies, including small and medium-sized entities (SMEs) and companies with an owner-manager structure, the current practice continues to appear appropriate.

In order to take account of some of the concerns expressed regarding the appointment of the auditor in *public interest entities* and having further harmonisation at European level in mind, FEE recommends the improvements as set out below for such entities:

- **Boards:** As is the case in some EU Member States, independent members of the Board, the supervisory board or the audit committee should be more involved in and be responsible for recommending the choice of audit firm. This would ensure that the appointment of the auditor is independent of management of the entity both in appearance and in mind.
- **Transparency:** There should be enhanced disclosure and transparency of the audit appointment process. In particular, the report of the board or the audit committee in the financial statements or annual report should include the rationale for selection of a new audit firm or the renewal of an incumbent audit firm's term.
- **Shareholders:** The board or the audit committee should seek to engage with the shareholders on the selection of the auditors, for instance by involving a "Shareholders Nominating Committee" in the appointment process.

The selection process and the proposed improvements can be explained as follows:



Following the appointment, the auditors engage with the board and/or the audit committee throughout the audit process over the year. In addition, the board and the audit committee review and monitor the effectiveness and the independence of the auditor on an ongoing basis throughout the year.

Appointment of the Auditor and Joint Audit or Audit Consortia

Having more than one statutory auditor is already an option that EU Member States and entities can adopt should they choose to do so. Whilst this is not widely adopted in practice and a minority of companies have chosen voluntarily to do so, it is recognised that certain jurisdictions see merit in this approach as a possible solution to the current levels of concentration in the audit market. How the concept of joint audit works in practice when two audit firms jointly carry out an audit at national and international level as well as the effect it can have on audit quality are to be considered as well.

Only few countries have experience with joint audit, and one example is France, where joint audits are mandatory for the audit of consolidated financial statements of all companies. There are no restrictions on the size of the audit firms which are involved in the joint audit. The auditors are required to take a balanced approach using quantitative as well as qualitative criteria, and to have a proportionate repartition of hours, experience and qualifications of the members of the audit teams. Even with these principles in mind, the concentration in the audit market for large listed entities is still relatively high. However, for smaller listed entities, more audits are carried out as a joint audit between a small and a large audit firm.

Another example, which originated from other concerns than the audit market, is Denmark. In Denmark, a mandatory joint audit requirement

was introduced at a time where the audit firms lacked the capacity to carry out audits of very large, complex and global companies. Joint audit was therefore used to ensure the sufficiency of audit resources for such companies. The concept of joint audit was abandoned as of 2005, as it was considered that the administration and financial burden placed on entities did not necessarily result in any tangible benefits for the business from an audit quality perspective. The original concerns with audits of large multinational companies are now addressed through independence requirements, review partner requirements, key audit partner rotation and effective internal and external quality control.

The main objective of using joint audits or audit consortia would be to decrease audit market concentration by building capacity for smaller audit firms in the audit market over a period of time and to enlarge their global reach. This could in due course change the dynamics of the audit market. Making audit consortia work in practice necessitates considering a number of issues like transitional measures in the initial years, how companies can coordinate and cooperate with two instead of one single audit firm, how the audit work can be divided, performed and reviewed, what the cost implications are for the audit firms and for the companies, etc. Further consideration should also be given to how differences of opinion between the auditors involved would be approached and how each signing auditor can take sole responsibility for the audit.

FEE notes that audit consortia could have an impact on helping to change the concentration in the audit market, although its impact on audit quality is unclear. Audit consortia will bring about some practical difficulties compared to having only one auditor carrying out the audit.

Appointment of the Auditor and Audit Firm Rotation

Mandatory or fixed duration audit firm rotation has been experimented with in a number of EU Member States and currently only one Member State (Italy) continues to apply mandatory rotation of audit firms for public interest entities.

The arguments for and against the mandatory rotation of audit firms have been debated by regulatory bodies and other interested parties for a number of years and have not changed much during this time.

Those in favour of mandatory audit firm rotation argue that a long-term relationship between an auditor and an audit client creates a risk of excessive familiarity that might impair the auditor's objectivity and independence.

Against this, those who are not in favour of mandatory audit firm rotation claim it might inadvertently threaten audit quality and that while there will undoubtedly be financial and time costs in making sure the "new" auditors get to know the business, sometimes against the backdrop of pressure on audit fees, the imposition of mandatory rotation has in the past increased market concentration in the larger audit firms.

There are legitimate concerns regarding independence and excessive client familiarity that mandatory audit firm rotation attempts to address. However, it can have the undesired effect of increasing audit market concentration.

Appointment of the Auditor and Retendering

Audit firm rotation has to be balanced with the growing trend in EU Member States for audit committees to opt for voluntary re-tendering of the audit.

Audit committees would seem to be well placed to undertake the task of assessing what the impact on audit quality will be should there be a change in auditor. A mandatory process of audit tendering, which would define a fixed term appointment for the auditor, would detract from the audit committee's ability to take any specific circumstances into account and exercise their judgment on whether the timing is right for such an appointment.

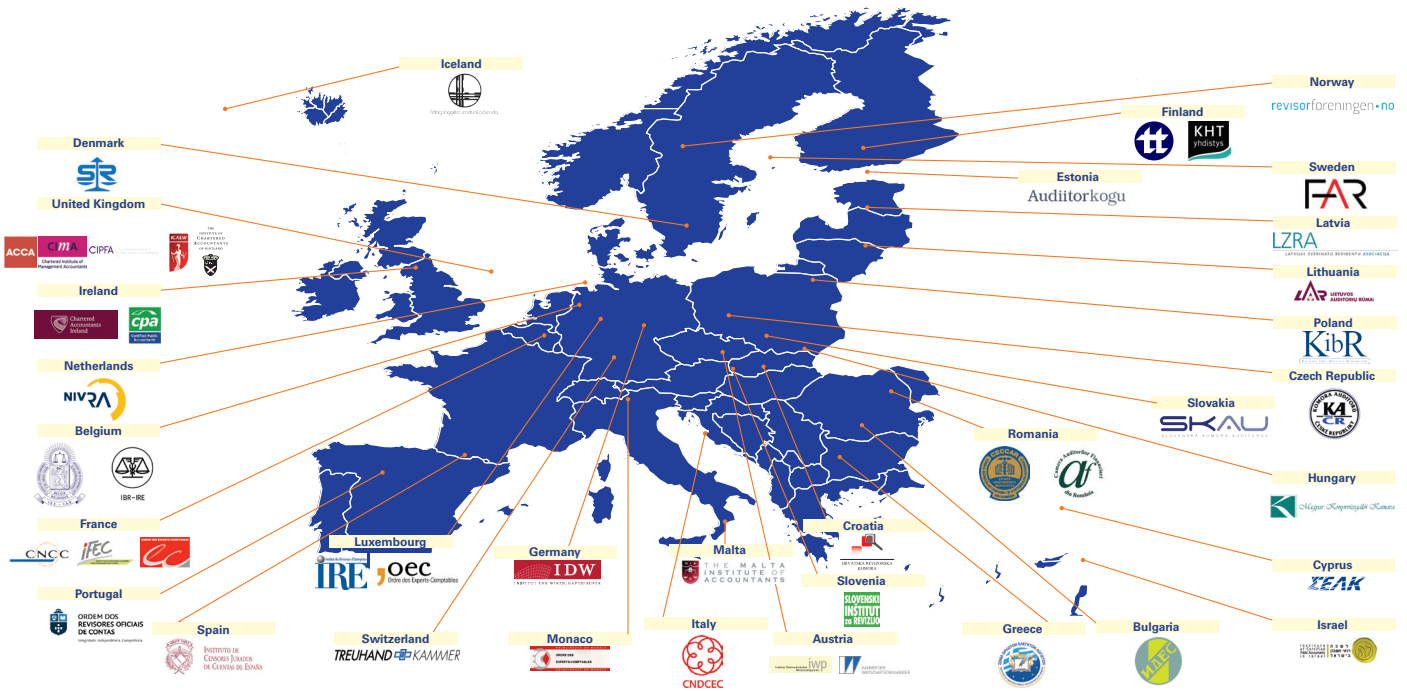
By opting for a system of voluntary retendering, the reappointment process could be effectively and efficiently managed by providing enhanced disclosure of the rationale behind the reappointment, which may be less expensive and disruptive and prove to be more conducive to gradual change in market dynamics. In this context, laws, regulations or general practices should not restrict the choice of an audit firm to a smaller selection of the market and "Big 4 clauses" or "covenants" should therefore be eliminated.

FEE believes that mandatory audit firm tendering will not meet the expectation of reducing concentration and that a move towards a system of voluntary tendering, with the provision of enhanced disclosures on the qualitative aspects of reappointment, would leave the decision in the hands of the audit committee who are ultimately better placed to make such a judgement.

Way Forward

FEE recognises that there is concern over the level of market concentration and independence in relation to the appointment of the auditor of the largest companies. FEE encourages the European Commission, in its deliberations following the Green Paper on Audit Policy, to ensure that any potential solutions do not impair the quality of the audit and we would be happy to assist the Commission in assessing any proposals when these have been formulated. FEE would also encourage policy makers to ensure that it fully engages with all stakeholders in this process and is conscious of what the implications of any proposals will mean in practice for all sizes of European businesses through a robust and transparent impact assessment.

FEE and its Members



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