



22 January 2009

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Ref.: CLC/HvD/SS/HB/SR

Dear Mr. Hodgkinson,

Re: FEE Comments on ICAEW/FRC Consultation Paper on Audit Firm Governance

- (1) FEE (the Federation of European Accountants) is pleased to provide its comments on the ICAEW/FRC Consultation Paper on Audit Firm Governance (the Consultation Paper).
- (2) We have noted the contents of the Consultation Paper with great interest. Even though the Consultation Paper is written within a UK context it includes many elements that may stimulate wider reflection in the profession both within other individual jurisdictions and at pan-European level. We commend the FRC and the ICAEW for initiating this debate.
- (3) We support the aim of the Consultation Paper to promote continuing confidence in, as well as choice amongst audit firms that command public trust in the market for the audit of public interest entities as set out in the Chairman's introduction.
- (4) The issues addressed in the Consultation Paper are fundamental and complex in nature. The debate in FEE and in some of its Member Bodies on these issues has just started and, consequently, it would be premature for FEE to express any detailed opinions or definitive positions. We will therefore not respond to the specific consultation questions. However, we would like to share with you at this stage some reflections and points that were raised in our initial discussions and which might be of interest.



Scope and level of application

- (5) Section 2.5 indicates that the planned UK Audit Firm Governance Code (the Code) only needs to apply to certain audit firms that audit public interest entities. The Paper recognises the possible need to introduce a size test in that the Code should apply, on the basis of “comply or explain”, to audit firms with public interest entity clients above a certain size or for audit firms with a certain number of public interest entity audits. Our discussions also referred to a further possibility of introducing a minimum size in relation to the audit firm itself above which there could be benefit from applying the Code. Small listed companies are sometimes audited by relatively small audit firms in a number of Member States (especially smaller Member States). For such firms compliance with such a Code or explaining why it is not complied with would not appear, at this stage in our thinking, to be useful and would be very burdensome; accordingly an appropriate cost-benefit balance would need to be struck.

- (6) Section 2.3 addresses the international structures of audit firms and refers to multi-jurisdiction structures. The section refers also to possible extra-territoriality implications were a UK originated code to be applied to audit firms in other jurisdictions. In our discussion, many potential complexities were raised, in light of the findings of the FEE study published in April 2008 on Trans-National Organisations and Practices within the Accountancy Profession¹. This Study identifies the different structural models of trans-national organisation and practice in the profession that have developed in response to the internationalisation of business. It also highlights the significantly different degrees of trans-national coordination and integration pursued by individual organisations within the profession. These findings indicate that the scope of application of any code would not be self-evident: should the Code be applied at the level of the trans-national structure or at the level of the individual firm? If it were to be the former the question arises as to whether the Code as developed in the UK would be appropriate and workable in other national environments or whether local codes would need to be developed (see also paragraph 10). One of the key issues concerns the functioning of the “comply or explain” principle. In our initial discussion it was noted that this principle is not well understood or widely employed in a number of EU Member States – at least where the operation of accounting and auditing firms is concerned.

¹ <http://www.fee.be/fileupload/upload/TOPs%20080409%20Clean195200826176.pdf>



- (7) The FEE Study identifies the most significant operational characteristics of trans-national organisations and practices in the profession, the most important of which relate to quality control, audit methodology and management of transnational assignments. In our initial discussion, the question was raised as to what additional benefit a code could provide in these operational areas and whether there are other mechanisms (existing or otherwise) which could more easily fulfil any desired public interest objectives. It was noted that the primary issues of public interest appear to revolve around independence and consistent quality and application of auditing standards (as per question 6 of the Consultation Paper). To our knowledge, this is where the focus of operational coordination of many trans-national organisations and practices already lies, driven to a considerable degree by existing regulatory requirements. Our discussions centered on the need for detailed consideration of whether a code (or codes) would be an effective and appropriate additional tool over and above existing regulatory measures for the furtherance of public interest objectives in relation to these operational characteristics of trans-national organisations and practices as they are predominantly structured today.
- (8) This discussion was undertaken in the knowledge that the overwhelming majority of trans-national organisations and practices operating in the EU today (and indeed globally) are international associations of independent member firms. In these cases, it is important to consider how any such code (whether a UK Code with extra-territorial implications or a code permitting or requiring local variation) could function in practice given the absence of direct control through ownership between individual firms. This is a very different context to the application of a code to an audit firm operating in a single jurisdiction and exercising a direct form of governance and control over its various activities.
- (9) It is recognised that there are changes within the profession among the major trans-national organisations and practices which are resulting in more integrated international partnerships which either operate on a stand-alone basis or, more commonly, within the context of a broader international association. This development could usefully be analysed further, also in the context of the potential need and benefit of a Code.
- (10) Our discussion also raised the further complexity which arises from the fact that corporate governance structures vary widely between countries (one tier vs two tier board systems) and the role. In addition, as noted in paragraph 6 above, the authority of corporate governance Codes are also different from one country to another. The UK Combined Code approach may not be easily understandable and translatable to situations in other countries in case of possible extra-territoriality implications were a UK originated Code to be applied to other national firms.

- (11) One of the main reasons for considering a code appears to be that of increasing transparency. In order to assess the potential benefits of any code in this respect, we believe that the transparency reports of audit firms auditing public interest entities (Article 40 of the Statutory Audit Directive) already provides for significant disclosures from audit firms. The level of disclosures already made by audit firms in this context will need to be considered in detail following the implementation in EU Member States. It should be recalled that this Article requires Member States to introduce very detailed transparency reporting at a national level for auditors of public interest entities, covering governance and operational matters and also, where a firm belongs to a network, a description of the legal and structural arrangements in the network. For instance, total turnover of the audit firm is to be disclosed in the transparency reports which begs the question whether the publication of complete financial statements, especially for partnerships, is to become best practice?

Independent Non-executive Directors and “tone at the top”

- (12) One of the issues which was prominent in our discussion is the potential position and role of independent non-executives on the board and important board committees covering audit, remuneration, and nomination matters of the audit firm. This would constitute a major change for many audit firms in many Member States. Again, the point raised in paragraph 6 above is pertinent: it is not immediately apparent where independent non-executive directors would fit in the legal and organisational structures of trans-national organisations and practices. The context of international associations of member firms across a number of countries is very different to that of a firm in one particular jurisdiction. FEE will continue to consider this issue, and more broadly other matters which would have an impact on the “tone at the top” in an audit firm, both in a single jurisdiction context and more broadly in trans-national audit organisations.
- (13) It should be noted that many firms have already implemented some forms of involvement of “non-executives” e.g. through “public boards” and seem to benefit from the experience. It may be helpful to survey the outcome of such experiences before committing to more specific undertakings in this respect.

For further information on this letter, please contact Saskia Slomp (Tel. + 32 (0) 2 285 40 74 – Email: saskia_slomp@fee.be) from the FEE Secretariat.

Yours sincerely,



Hans van Damme
President