



**Federation of European Accountants**  
**Fédération des Experts comptables Européens**

Mr. Greg Tanzer  
Secretary General  
IOSCO General Secretariat  
Calle Oquendo 12  
28006 Madrid  
Spain

12 January 2010

Ref.: AUD/HvD/HO/PW/MB

Dear Mr. Tanzer,

**Re: FEE Comments on the IOSCO Technical Committee Consultation on  
Exploration of Non-Professional Ownership Structures for Audit Firms**

FEE (the Federation of European Accountants) is pleased to provide you below with its comments on the Technical Committee of the International Organization of Securities Commissions (IOSCO) Consultation on Exploration of Non-Professional Ownership Structures for Audit Firms (the IOSCO Consultation Paper).

FEE is of the opinion that auditing is fundamentally underpinned by the ethics of professional services, the quest for quality and a commitment to the public interest.

FEE recognises that there is currently a debate about (i) choice in the audit market, (ii) sustainability of the audit profession in particular in the context of liability issues and (iii) the potential systemic impact of an involuntary withdrawal of one of the major existing audit providers.<sup>1</sup>

The European Commission organised recently a consultation on control structures in audit firms and their consequences on the audit market, which broadly addresses similar issues as these covered by the IOSCO consultation. It could be useful for IOSCO to consider answers to this consultation, which have been published on the European Commission's website<sup>2</sup>.

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<sup>1</sup> Study on the Economic Impact of Auditors' Liability Regimes, Final Report To EC DG Internal Market and Services By London Economics in association with Professor Ralf Ewert, Goethe University, Frankfurt am Main, Germany, September 2006

<sup>2</sup> 69 comment letters and a summary report prepared by the services of the European Commission – Directorate General for Internal Market and Services are available at:  
[http://ec.europa.eu/internal\\_market/auditing/market/index\\_en.htm](http://ec.europa.eu/internal_market/auditing/market/index_en.htm)



FEE would also recommend that IOSCO similarly publishes the responses received to its Consultation Paper, as well as a summary thereof to aid transparency towards all stakeholders concerned.

Our main comments to the IOSCO Consultation Paper are summarised below:

1. FEE is of the view that there is no single element which can create more choice and less concentration in general. These issues need to be addressed with great prudence, following a holistic approach and assessing the impact of any steps to be taken. In any instance, solving the liability issues both at individual country level and globally is an essential precondition.
2. The matter is complex and consideration should be given to potential impacts on capital markets, stakeholders' confidence and audit quality. This complexity mainly stems from the fact that:
  - There are different parts of the audit market, and only one where choice could be seen as a source of concern: that of larger multinationals active across the globe and sometimes with several listings;
  - This market situation has developed over a long period of time and will only evolve over the long term.
3. FEE is not convinced that lifting all bans on non-professional ownership in audit firms as suggested in the current consultation might result in more global players in the audit market.

Our detailed comments and responses to the questions raised in the consultation paper are provided in the appendix attached hereafter.

FEE would be pleased to discuss any of the points raised in further details. To this end, or for further information, please contact Henri Olivier ([henri.olivier@fee.be](mailto:henri.olivier@fee.be)) or Petra Weymüller ([petra.weymuller@fee.be](mailto:petra.weymuller@fee.be)) from the FEE Secretariat.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Hans van Damme', is written over a horizontal line. The signature is stylized and includes a long horizontal stroke extending to the right.

Hans van Damme  
President

## Appendix – Detailed comments

This appendix contains FEEs detailed comments and responses to the questions raised in the IOSCO Consultation Paper on Exploration of Non-Professional Ownership Structures for Audit Firms.

### **Q1. Should regulators and/or legislators address barriers to entry in the market for large public audit services? Why or why not? Please explain.**

- (1) In principle, it would be helpful if legislators created a context that facilitates access for medium-sized audit firms to the market of public audit services. Such measures would not only relate to entry but also encourage medium-sized firms to stay and develop in this market.

FEE doubts however that organic growth or mergers in the medium-sized audit market could in the short or medium terms close the gap between existing larger international audit firms and small and medium-sized audit firms and that concentration in the audit market would be reduced as a consequence.<sup>3</sup>

- (2) FEE would like to highlight that the current number of audit firms' networks is a result of market forces and history. It also depends on the size of the jurisdiction that can make it difficult for all audit firms' networks to be represented.

### **Q2. What are the most significant barriers to entry in the market for large public company audit services? How can legislators and/or regulators address these barriers? Are there ways aside from addressing audit firm ownership restrictions to address audit firm concentration and concerns about the availability of audit services to large public companies?**

- (3) FEE believes that market mechanisms should shape market structures and that historically regulatory intervention has already had an indirect impact on market structures and consequently on the number of market players.

Education, training, licensing, registration, quality control requirements, liability regimes and especially independence provisions, although necessary for audit quality, are still largely determined by national jurisdictions. This constitutes a barrier for all audit providers to operate across jurisdictions. As in other domains, for instance accounting and auditing standards, the application of international standards, would reduce these national barriers.

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<sup>3</sup>World Survey 2008, International Accounting Bulletin, 18 December 2008, page 6 to 14; also Final Report of the U.S. Treasury Advisory Committee on the Auditing Profession of 6 October 2008, Page VIII:4

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As demonstrated in a major FEE study on Trans-national Organisations and Practices (2008) the accountancy profession's trans-national evolution within Europe (and further afield) has been strongly moulded by the fragmented, jurisdiction-specific approach to regulation across the world and to the different legal systems and cultures. The profession has had to develop specific structures to make possible the servicing of trans-national client needs while also respecting national regulatory and legal requirements and related factors.

Other barriers, which were largely removed in Europe, can still exist in other part of the world, such as restrictions on multiple location, fees, advertising, and similar ethical restrictions.

- (4) FEE is convinced that ensuring the limitation of auditors' liability is a prerequisite to facilitate a broader access of audit firms to the market related to listed companies.<sup>4</sup> FEE would also like to point out that the international and in particular the US litigious environment resulting in the issue of potential extension of liability to networks, definitely inhibits the further development of current or new players. It is relevant to note that many indemnity insurance contracts in Europe exclude from coverage, all business activity involving a US client. It appears that certain mid-tier firms have recently been taking measures to reduce trans-national quality assurance programmes in light of concern over the implications for liability risk.
- (5) Companies, their external advisors (banks, lawyers) and regulators are often influenced by the "IBM effect" whereby they select a statutory auditor and often go to the larger firms without necessarily fully considering the real capabilities and competencies of other audit firms.
- (6) Regulators should turn their attention first to the demand side and the process for selecting statutory auditors and audit firms. The following measures which do not necessarily require regulatory intervention could be considered:
  - Stronger governance principles regarding the role of audit committees in selecting the external auditor;
  - Transparency of tendering procedures with a view to ensure that smaller firms are not prevented from competing. In this respect it should be noted that mandatory rotation of firms would be counterproductive and that experience has shown that it may well hinder audit quality.
- (7) Regulators should prohibit contractual clauses on the basis of "big 4 only" or requiring companies to disclose any provisions in the agreements that limit their choice of the auditor. (See EC Summary Report, p.19)

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<sup>4</sup> See Impact Assessment to the European Commission's Recommendation concerning the limitation of the civil liability of statutory auditors and audit firms, dated 5 June 2008, page 18 and 28

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(8) Regarding the supply side, FEE would like to suggest prioritising the following actions:

- Continue progress on auditors' liability reform;
- Enhance convergence of standards and adopting the clarified ISAs;
- Ensure convergence on independence requirements;
- Consider the impact of the scope of statutory auditing (including thresholds to exclude categories of companies) outside the audit market for listed entities on the capacity of smaller firm to gain experience and attract qualified staff;
- In Europe, ensure a consistent implementation of the Statutory Audit Directive and avoiding divergences such as with the network definition.

**Q3. Is increasing the availability of the sources of audit services to large public companies by addressing one of the barriers to entry into the market possible? If so, which one? If not, is addressing several or many of the barriers at one time necessary? If so, which ones?**

(9) As indicated in the answers to the previous questions, holistic approaches addressing all barriers to entry merits close attention. Actions could possibly be taken equally on the supply side and on the demand side.

### **Ownership Restrictions as a Barrier to Entry**

**Q4. Would expanding the scope of non-practitioner ownership create, alleviate, or remove any threats to the continuity of audit services? Please explain.**

(10) The concept of non-practitioner is unclear. FEE suggests making a clear difference between four groups:

- (registered) statutory auditors,
- Statutory auditors registered in another jurisdiction<sup>5</sup>,
- Professional accountants who are not registered as statutory auditor (whatever the reason) and professionals of another discipline employed by the (accounting) audit firm,
- Outside investors (in particular banks and other financial institutions) having only a financial interest in the audit firm.

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<sup>5</sup> Considering the provision of the Statutory Audit Directive, in this case, the EU Internal Market needs to be considered as a single jurisdiction.

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- (11) The outcome of possible discontinuity of audit services of one of the major players is unclear. It is not excluded that some partners and staff would join a smaller network which would then be able to provide services to larger listed companies. FEE suggests that before trying to address this question, regulators should first help providing an answer to the liability problem, which is the major if not the only threat to the continuity of audit services.

### **Q5. Could allowing audit firms the option of broader non-practitioner ownership, including through public sources, assist new competitors to enter the market for large public company audits? Please explain.**

- (12) Of course, audit providers need capital to:
- Set up structures to cover all the jurisdictions where there is client demand,
  - Recruit the necessary talent and
  - Develop systems to deliver and ensure the highest quality.

Nevertheless, as confirmed by IOSCO, FEE is not aware of any real difficulty in finding and maintaining such capital. Therefore, it is unclear whether new sources of finance would have any material effect on the decision to enter the market for public company audits. (See question 18)

- (13) The Consultation Report states that “Permitting broader ownership might increase the number of providers of audit services for large public companies. For example, permitting broader ownership might encourage new entrants to enter the market, including through expanded capital-raising in public market” (p7.)

FEE believes that financial capital may play a certain role but is not regarded as a key factor for increasing choice in the audit market. Auditing is not a capital-intensive activity, but a human capital intensive one.

- (14) In Europe, annual accounts and transparency reports published by the firms generally exhibit a low level of debt.<sup>6</sup>

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<sup>6</sup> see for example <http://annualreport.deloitte.co.uk/2008/financial-statements>,  
[http://www.kpmg.eu/docs/KPMG\\_AR\\_29.12.pdf](http://www.kpmg.eu/docs/KPMG_AR_29.12.pdf),  
[http://www.ey.com/Global/assets.nsf/UK/EY\\_annual\\_review\\_2007/\\$file/EY\\_Annual\\_Review\\_2007.pdf](http://www.ey.com/Global/assets.nsf/UK/EY_annual_review_2007/$file/EY_Annual_Review_2007.pdf),  
[http://www.pwc.co.uk/annualreport08/AR\\_2008.pdf](http://www.pwc.co.uk/annualreport08/AR_2008.pdf),  
[http://www.bdo.co.uk/BDOSH/SharedContent.nsf/i/4E0E9151164E9CC0802575080054C293/\\$file/bdo-figures-consolidated3.html](http://www.bdo.co.uk/BDOSH/SharedContent.nsf/i/4E0E9151164E9CC0802575080054C293/$file/bdo-figures-consolidated3.html),

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**Q6. Would allowing audit firms the option of broader non-practitioner ownership, allow for greater transitional flexibility to constitute a new firm or otherwise provide continuity of audit services in the event that one of the Big Four firms leaves the market?**

- (15) In the overall strategy to have more audit firms active in the segment of the audit market concerning listed companies, FEE believes that external capital is unlikely to be a key factor.

#### **Audit Firm Ownership Restrictions: Background**

**Q7. How important are the existing ownership restrictions to audit quality? How else do existing restrictions benefit investors and/or promote audit quality? How may audit quality be negatively affected by permitting alternative forms of audit firm ownership?**

- (16) It is important to recall that non-practitioner ownership has existed in certain countries before the European Eight Directive on the Approval of Statutory Auditors was enacted in 1984. At those times, audit firms could be owned by banks or by the state. The model was put into question because of its perceived risks for auditors' independence and was finally abandoned.
- (17) The perceived risks result in particular from the fact that non-practitioner ownership is characterised by the possibility of majority and thus controlling shareholders seeking short term gains.
- (18) In the European Union, the Statutory Audit Directive provides that a majority of the voting rights in an entity must be held by audit firms approved in any EU Member State or by natural persons who satisfy at least the conditions imposed by this Directive; accordingly it allows a minority to be held by non-auditors.

Since 2006, the criterion of "a majority" must be interpreted at the level of the EU, not within a single Member State. It is true to say that this provision of the European Directive has been transposed in such a way that diverging regimes continue to exist in some EU Member States, which is not conducive to the development of more audit providers operating with potential greater international capacity. It is however relevant to note that few audit firms use the maximum of this possibility when authorised by national law in Europe. (EC Summary Report p.12)

- (19) FEE is of the opinion that auditing is fundamentally underpinned by the ethics of professional services, the quest for quality and a commitment to the public interest.

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FEE fully subscribe to the statement in the Consultation Report (p.9): “Limiting majority ownership and control to individuals who meet acceptable licensing credentials arguably promotes competence and a culture of professionalism, and prevents non-practitioners from influencing, through management or control, the attestation practice without having the attendant competence, professional obligations and experience. The practitioner’s status as an accounting professional subject to attendant obligations is believed to temper the firm’s focus on its economic interests and provide assurance that management decisions are made with the benefit of professional knowledge and obligation to the public interest. In addition, the impact of an adverse judgment arising from a violation of professional standards could be greater for practitioners, increasing the deterrent effect of liability.”

### **Q8. What factors other than those set forth above should regulators consider in analyzing whether alternative forms of audit firm ownership and governance should be allowed?**

- (20) It is relevant to observe that accountants carry out services other than statutory audit and therefore do not necessarily need to be registered as statutory auditors, a fact which strengthens the need for multi-disciplinary structures. Furthermore, many professionals of other disciplines, e.g. lawyers, tax advisors, business and IT consultants are also working in audit firms and have ambitions of becoming a partner. However FEE maintains the view that it is beneficial to retain the majority ownership requirements established by the EU legislation.
- (21) Among other difficulties that should be addressed in alternative forms of audit firm ownership and governance, ethical rules can be highlighted, including confidentiality (professional secrecy) and indeed independence rules. Since ethical principles should apply to them, outside investors might create additional conflicts of interests and eventually reduce the choice in the audit market.

### **Q9. Would alternative forms of ownership that include boards of directors with independent members provide a useful reinforcement of auditing firms' public interest obligations and independence? Would other arrangements, such as compulsory charter provisions for audit firms that establish a requirement for partners or directors (licensed or unlicensed) to give due regard to the public interest, be useful?**

- (22) Alternative forms of ownership that include boards of directors with independent members might be a useful factor for reinforcing auditing firms' obligations and independence in the public interest but this is not directly related to the objective to facilitate market access. Furthermore it would not be a sufficient additional safeguard to avoid that non professional objective cause undue pressure on the work of statutory auditors.



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(23) ICAEW/FRC issued this year a Consultation Paper on Audit Firm Governance which addresses among others the issue of independent directors in audit firms<sup>7</sup>. Commenting on this consultation paper, FEE noted that the objective of the Code is to encourage firms to adopt governance arrangements, and to communicate information on those arrangements, so as to enhance the confidence of shareholders and others in the way that all the firms covered by the Code, i.e. not only the largest firms, are run and thereby enhancing choice. FEE however observed that there is a potential risk that the compliance costs associated with the Code will form a further barrier for smaller audit firms.

**Q10. Do audit firm non-practitioner employees have economic incentives more in line with practitioner owners than they would have with outside investors? Should ownership by firm employees who are not practitioners be treated differently from outside owners? Would more permissive non-practitioner employee ownership be likely to affect the firms' capital-raising capacity or otherwise affect barriers to entry for audit firms?**

(24) As mentioned above (paragraph 21) FEE believes that the removal of existing restrictions to the access to partnership for professionals employed by the audit firm is a possibility to facilitate the emergence of multi-disciplinary networks and therefore of new market players.

(25) Firm employees who are not practitioners should be treated differently from outside owners. A person working in the audit firm is directly interested in the quality of the professional service delivered by the firm. By contrast the risk of influence may be considered to be greater when the shares are held by persons whose only interest in the firm of statutory auditors would be capitalistic and, in particular, when the shares are held by financial companies. External shareholders are not necessarily as sensitive to the ethical and professional constraints as those who are professionally engaged in the firm of statutory auditors.<sup>8</sup>

(26) External perception might differ if external capital (and/or detention of the majority of voting rights) is owned by other professionals subject to the rules of their professional bodies working within the audit firm as opposed to financing organisations external to the firm.

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<sup>7</sup> The Consultation Paper and comment letters including the FEE comment letter can be downloaded from the ICAEW website:  
[http://www.icaew.com/index.cfm/route/161380/icaew\\_ga/en/Technical\\_and\\_Business\\_Topics/Topics/ICAEW\\_consultations/Governance\\_of\\_firms\\_that\\_audit\\_listed\\_companies](http://www.icaew.com/index.cfm/route/161380/icaew_ga/en/Technical_and_Business_Topics/Topics/ICAEW_consultations/Governance_of_firms_that_audit_listed_companies)

<sup>8</sup> FEE Discussion Paper on Free movement of Firms, October 2001, p.7

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**Q11. What benefits beyond avoiding additional conflicts of interest associated with non-professional or outside ownership and prohibiting non-qualified professionals from performing audits are realized by existing restrictions on firm ownership?**

- (27) As indicated in the introduction, FEE is of the opinion that auditing is fundamentally underpinned by the ethics, independence, the quest for quality and a commitment to the public interest.
- (28) There is a risk that outside shareholders would focus on the revenue from their investment rather than on ethics and quality of audit services. If they own the majority of votes, this could have an impact on the credibility of statutory auditors towards investors and ultimately on the audit profession as a whole.
- (29) Changing the existing model could also have an (negative) effect on other aspects, notably:
- The selection process of statutory auditors by companies and audit committees;
  - The recruitment of staff.

#### **Possibilities for Further Minimizing Risks and Improving Investor Protection**

**Q12. Could existing safeguards appropriately mitigate concerns regarding competence, professionalism, audit quality and independence if auditing firms were more broadly owned by non-practitioners?**

- (30) FEE acknowledges the importance of Article 24 of the EU Statutory Audit Directive stating: "Member States shall ensure that the owners or shareholders of an audit firm as well as the members of the administrative, management and supervisory bodies of such a firm, or of an affiliated firm, do not intervene in the execution of a statutory audit in any way which jeopardises the independence and objectivity of the statutory auditor who carries out the statutory audit on behalf of the audit firm."
- (31) FEE believes however that a majority of externally-owned capital and control would probably have an impact on the applicable independence rules, the consequences of which would require careful analysis, both in relation to the internal workings of audit firms and to external perceptions.
- (32) Internal quality control systems as required by the IAASB standard on quality control (ISQC 1) or national equivalent might potentially be affected by the intervention of non-practitioners (e.g. on cost grounds), although the performance of individual audit engagements could not be affected.

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**Q13. What level of non-practitioner ownership should concern regulators, and what level should be considered de minimis? Is a securities regulatory model for reporting beneficial ownership useful for this purpose?**

- (33) In the EU, the minimum required is that a majority of voting rights must be held by approved audit firms or natural persons who satisfy at least the qualification conditions imposed by the Statutory Audit Directive. However, some Member States have adopted a more restrictive approach, asking for more than just a simple majority of voting rights<sup>9</sup>. The same legal provision requires a majority – up to a maximum of 75% - of the members of the administrative or management body of the entity to have the same quality<sup>10</sup>.
- (34) An additional question relates to the possible limitation for certain categories of non-practitioners to be associated in an audit firm. For instance a distinction could be made between specialists of other disciplines employed in the firm and outside investors. It could be worthwhile investigating the potential for enabling multi-disciplinary practices where the majority of voting rights could not necessarily be in the hands of statutory auditors or audit firms. This leaves open however the definition of disciplines that can be associated in such multi-disciplinary partnerships.

**Q14. Could additional safeguards, or adjustments to existing safeguards, adequately ensure that auditing firms maintain their competence, professionalism, audit quality, and independence under broader non-practitioner ownership, including public ownership? If so, what safeguards or adjustments would be needed?**

- (35) In Europe, the Directive on Statutory Audit provides for adequate requirements on education, continuous professional development, independence and ethics, quality control.

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<sup>9</sup> It is noted that the Directive refers to voting rights, not to share capital, which can lead to different situations in Member States depending upon the legal rules applicable to companies.

<sup>10</sup> Art.3.4 of the EU Directive 2006/43/EC of 17 May 2006 on Statutory Audit

- (36) The reservation of the majority ownership to auditors is a safeguard in itself. Were such safeguard to be removed, another safeguard would most likely have to be found to close the gap. Additional safeguards, which could become necessary if outside investors have the majority of voting rights are however very difficult to identify. In its study for the European Commission, the consultant OXERA quoted in the IOSCO consultation, did not make any convincing proposal in that respect. It should also be noted that any additional regulatory measure(s), which would bring more complexity, would ultimately be an additional barrier to enter the market.
- (37) The suggestion of the IOSCO paper (p.14) of passive ownership might not be fully workable if for some important decisions, non-voting shares recover their voting right. Furthermore, non-voting shareholders could still have the indirect possibility to put pressure on the management of the audit firm to improve the profitability of their investment.

**Q15. What existing risks to any investors might be mitigated by public ownership and which might remain; which might be heightened? What, if any, additional safeguards could regulators implement to address sufficiently any remaining risks?**

- (38) FEE does not see any existing risks to any investors which might be mitigated by public ownership. FEE believes that the current model has proved very successful overall.

**Q16. Could new safeguards bring ancillary benefits to the audit process? If so, what are they?**

- (39) Under the current circumstances and legal regime, FEE believes that there are already ample safeguards to protect auditors' independence. For example Article 24 of the Statutory Audit Directive mentioned above.

**Q17. Could new safeguards bring ancillary detriments to the audit process? If so, what are they?**

- (40) Any new safeguard would most likely bring more complexity. In this way, such additional safeguards risk entrenching, rather than reducing, the concentration of firms in the audit market.

### **Impact on Audit Firms Concentration**

**Q18. What is the likelihood that potential new entrants would take advantage of opportunities for broader non-practitioner ownership, either in the near term or long term?**

- (41) FEE has in any case doubts that the non-practitioner ownership might result in more global players because financial capital is not regarded as a key factor for going global, neither for the emergence of new audit firms nor for the enlargement of existing networks.

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(42) As suggested in question 19, the major firms could also use the opportunity. Ultimately this could also strengthen their position in the audit market.

**Q19. What is the likelihood that one or more of the Big Four firms would take advantage of this option? Were one or more such firms to do so, would the access to additional capital potentially strengthen the firm's capital cushion, thus reducing the likelihood that the audit services market would be further concentrated? Conversely, could this increase concentration, as large firms solidified their market share?**

(43) FEE has no opinion on possible plan of the major audit firms in that respect

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### **About FEE**

FEE is the Fédération des Experts comptables Européens (Federation of European Accountants). It represents 43 professional institutes of accountants and auditors from 32 European countries, including all of the 27 EU Member States. In representing the European accountancy profession, FEE recognises the public interest. It has a combined membership of more than 500.000 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.

FEE's objectives are:

- To promote and advance the interests of the European accountancy profession in the broadest sense recognising the public interest in the work of the profession;
- To work towards the enhancement, harmonisation and liberalisation of the practice and regulation of accountancy, statutory audit and financial reporting in Europe in both the public and private sector, taking account of developments at a worldwide level and, where necessary, promoting and defending specific European interests;
- To promote co-operation among the professional accountancy bodies in Europe in relation to issues of common interest in both the public and private sector;
- To identify developments that may have an impact on the practice of accountancy, statutory audit and financial reporting at an early stage, to advise Member Bodies of such developments and, in conjunction with Member Bodies, to seek to influence the outcome;
- To be the sole representative and consultative organisation of the European accountancy profession in relation to the EU institutions;
- To represent the European accountancy profession at the international level