

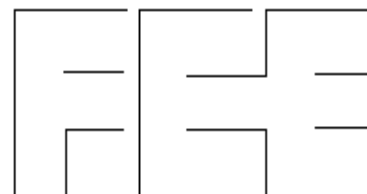
Date
4 December 2003

Le Président

Fédération
des Experts
Comptables
Européens
AISBL

Rue de la Loi 83
1040 Bruxelles
Tél. 32 (0) 2 285 40 85
Fax: 32 (0) 2 231 11 12
E-mail: secretariat@fee.be

Mr Karel Van Hulle
Head of Unit Accounting and Auditing
DG Internal Market
European Commission
Rue de la Loi 200
B-1049 BRUSSELS



Dear Karel,

Re: Principles to be included in the Eighth Directive

FEE (Fédération des Experts Comptables Européens – European Federation of Accountants), the representative organisation of the accountancy profession, is pleased to respond to your request in the meeting of the Committee on Auditing in Vienna to provide you with comments on the questions put forward in the note to the members of the Committee on Auditing regarding the modernisation of the Eighth Directive. Our remarks are based on the comments made in our previous letters regarding the modernisation of the Eighth Directive (see enclosed letters of 31 July and 14 October 2003).

Section I: Objective, Scope, Definitions

(1) Should we define a statutory audit for instance as an audit conducted in accordance with ISA (plus)? Should there be a separate definition of audit?

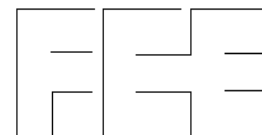
FEE supports the intention of the Commission to include a definition of a statutory audit in the Eighth Directive. However, instead of the definition proposed in the note to the members of the Committee on Auditing we would suggest a definition along the following lines:

“A statutory audit referred to in this directive is an audit that is required under EU legislation (e.g. under the Directive 78/660/EEC or under the Directive 83/349/EEC) and that is performed in accordance with the principles of this Directive [the Eighth Directive].”

The Eighth Directive only deals with statutory audits. Therefore, we do not see why it should include a separate definition of an audit. Such a definition would also apply to non-statutory, that is voluntarily performed audits, which are not within the scope of the Eighth Directive.

(2) Should the article dealing with definitions include a definition of other terms than those referred to above?

As a principles-based directive, the Eighth Directive should include only those definitions, which are necessary to make the Eighth Directive legally workable. Whether definitions of the terms mentioned in the note to the Committee on Auditing are necessary/sufficient depends on the precise text of the modernised Eighth Directive, and the possibility to make it more readable.



Apart from the question to which extent definitions are necessary, FEE doubts whether the term “public interest company” can be defined in a way appropriate for a legal text. In any case, the definition used in the glossary of the Independence Recommendation would not work in a Directive.

Other remarks:

a) Objective of the Eighth Directive

The note to the members of the Committee on Auditing states that the objective of the Eighth Directive is “to *enhance* the quality of statutory audits throughout the EU.” This phrase might lead to the (unfounded) impression that, at present, statutory audits are not conducted with high quality. Therefore, FEE recommends using the wording of the Commission’s Communication on statutory audits and referring to the objective of “underpinning” rather than of “enhancing” the quality of statutory audits (see also chapter 2.1. of the Communication).

b) Approval of natural and legal persons or other types of company, firm or partnership

According to Article 1 (2) of the existing Eighth Directive, it is within the responsibility of the Member States to decide whether only natural persons or also legal persons or other types of company, firm or partnership can be approved to carry out statutory audits.

However, as already pointed out in our letter of 14 October 2003, national rules prohibiting collective professional practice prevent de facto the free circulation of audit firms in those Member States, which have such rules. According to the preliminary results of the survey on audit firms that currently is carried out by FEE, almost all of the Member States allow not only natural persons but also audit firms to be appointed as statutory auditor. Therefore, FEE recommends amending Article 1 (2) of the Eighth Directive by deleting the Member State option, which allows for restricting the approval to carry out statutory audits to natural persons only.

If the European legislature, in addition, wishes to prevent any restriction on the legal form of audit firms, it should consider whether some principles should be introduced to safeguard in the public interest the substance of the obligations and responsibilities to the stakeholders (for further details see our letter of 14 October 2003).

Section II: Approval, Continuous Education and Mutual Recognition

(1) Should the curriculum of Article 6 be expanded to include other issues than those mentioned above? Or should existing subjects of the curriculum be updated or withdrawn?

FEE agrees that it is necessary to amend the curriculum of Article 6. However, the issue of how and to which extent the curriculum should be changed needs further discussion.

First of all, a principle should be developed setting out the general approach for amending the curriculum. As all other education requirements, the curriculum should guarantee high quality audits. Therefore, the curriculum should ensure that the persons allowed to perform statutory audits have a broad and deep knowledge in a wide range of areas paying attention to global standards. Which topics are to be covered in the amended curriculum in order to ensure that the auditor obtains the necessary knowledge requires further thorough discussion.

FEE has set up a subgroup of the Liberalisation/Qualification Working Party dealing with this issue. We will provide you with further input on this issue in due course.

Section III: Registration and Transparency

- (1) Do you agree that registration should be a condition sine qua non for the possibility to carry out statutory audits? In that case, should Article 2 be amended and the reference to "approval" be deleted or alternatively should we have a system of both approval and registration?**

FEE agrees that registration should be a condition sine qua non for the possibility to carry out statutory audits. However, the system of registration should not be put in place of the approval procedure but should be introduced in addition to the current approval system, which should be maintained.

To our understanding, registration is just a formality that goes hand in hand with approval. The positive effect of an additional registration requirement is that registration would enhance the publicly available information on the persons/firms allowed to perform statutory audits. The Eighth Directive should include a definition of those information to be disclosed in a public register (see also answer to questions 2 and 3).

- (2) What information should be included in the public register?**

Any requirement for providing information to the public should only focus on information which presents verifiable facts. No policy statement should be part of the fact sheets.

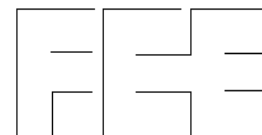
In addition to the information about the statutory auditor and the audit firms proposed in the Commission's note (legal form, main address, offices name and address of the authorities in charge of oversight and inspections) FEE suggests to require information for identification of the shareholders and the management of the registered audit firm as well.

- (3) Apart from the information listed above, what additional annual information, if any, do you believe would be meaningful for the purpose of demonstrating and maintaining audit quality?**

The current European framework does not require public annual reporting by statutory auditors and audit firms unless they are organised as limited liability companies with a filing obligation resulting from their legal form. This filing obligation, however, refers only to annual financial information. Therefore, if the Commission intends to introduce such reporting requirements as part of the on-going registration requirements, this would require further in-depth discussions on this issue and on the more general issue of increasing transparency of audit firms and networks. Special attention needs to be paid to the impact of such reporting requirements on confidentiality, liability and other legal issues.

After initial discussion of these issues, FEE is not supportive of the Commission's intention to require the statutory auditor or the audit firm to provide publicly available information, for example on the participation in continuous education, on the results of quality assurance or on the audit firm's governance and internal quality control policies. The reasons for this position are:

- Evidence of audit quality should be given by the audit infrastructure of the Eighth Directive including the requirement for maintaining national quality assurance and public oversight systems. If this audit infrastructure works well, additional disclosure requirements are not necessary to build public trust in statutory audits and audit firms.
- As already mentioned in the answer to question 2, information to be included in the public register or to be made publicly available in any other form should only cover such information which is clearly based on verifiable facts.
- The kind of information mentioned in the Commission's examples for annual reporting should be provided to the competent oversight body rather than to the public. Information of such kind would enable the oversight body to assess whether the statutory auditor or the audit firm has fulfilled its



ongoing registration requirements, such as the requirement for continuous education, taking part in a quality assurance program, etc.

Section IV: Ethics and Independence

(1) Should this section contain other issues?

No. As already mentioned in our letter of 31 July 2003 the Eighth Directive should deal with the professional requirements on a level of principles. Detailed guidance should be set out by reference to global standards: the IFAC Code of Ethics.

Therefore, FEE would support a proposal requiring Member States to adopt a code of ethics at Member States level based on the IFAC Code of Ethics. National standard setters and governments would indeed have the possibility to formulate national add-ons. To avoid the “export” of national add-ons, the national independence requirements should only apply to statutory auditors and audit firms located (and registered) in the respective Member State and not to take into account circumstances between foreign networks and foreign entities of a group (see also answer to question X. (1)).

With regard to the proposed content of the section on ethics and independence we would like to draw your attention to the following remarks:

- Access to documents necessary for supervision:

In the note to the members of the Committee on Auditing it is proposed to add a new article on confidentiality and professional secrecy which will protect the relationship between the statutory auditor and his client and will allow access to documents necessary for supervision. In addition, the Directive will deal with the exchange of information with other Member States in cross border (enforcement) cases.

It should be noted that requirements on the access to the auditor’s documents and on the exchange of information, will not only cause problems with regard to client confidentiality, but will also result in many other difficult legal issues, such the issue of self-incrimination or legal conflicts resulting from national data protection laws existing in most, if not all EU Member States.

These issues, which have been thoroughly discussed in the context of the registration requirements of the PCAOB, need also be taken into account when introducing European requirements on access to and exchange of information.

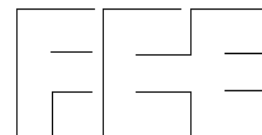
- Contingency of audit fees:

FEE welcomes the intention of the Commission to address the issue of audit fees. However, we propose to be more precise on the issue of contingency and clarify that audit fees must not be “contingent upon the results of the audit”.

In addition, the Eighth Directive should address the possibility of re-discussing audit fees: There needs to be some degree of flexibility to react on unexpected events arising in the performance of the audit, which should give rise to the possibility of re-discussing audit fees.

- Disclosure of audit fees:

In the note to the members of the Committee on Auditing it is proposed to require companies to disclose the amount for non-audit fees. We agree that fees received from an audit client by the statutory auditor for services provided during the client’s reporting period, must be publicly and appropriately disclosed. Whereas the Recommendation on Independence suggests disclosure of both non-audit and audit fees, the proposals made in the note to the members of the Committee on Auditing cover only disclosure of non-audit fees.



If both audit and non-audit fees should be disclosed, one needs to consider whether and to what extent there should be a classification of the disclosed fees. The Recommendation suggests a breakdown of fees for non audit services, distinguishing between categories of non audit fees. In our view, such regulation is too detailed to be included in a Directive. As already explained in our letter of 14 October 2003 FEE suggests categorising the fees into three parts:

- fees for the statutory audit;
- fees for audit related work (meaning work required to be done by the auditors by virtue of their position as auditor of the company or group, other than statutory audit work);
- fees for non-audit work.

We consider that such an analysis would correctly distinguish three types of work, with companies providing further analysis of the last category in line with the Recommendation on independence if such fees are particularly significant. This would strike an appropriate balance in legislation, allowing users of financial statements to assess this aspect of auditor independence without the need for excessively detailed legislation.

(2) Is using the general principle of the Recommendation on Auditor Independence complemented by disclosure and confirmation requirements a sufficient legal underpinning at EU level?

FEE strongly supports the principles-based ‘threats and safeguards approach’ as already applied in the Recommendation on Statutory Auditors’ Independence and welcomes the intention of the Commission to restrict the requirements of the Eighth Directive to a broad principle drawn from the Recommendation.

However, taking into account the different status of a Recommendation and of a Directive, we have doubts whether it is possible to include the principles of the Recommendation into the Eighth Directive without any changes of the wording. The “threats and safeguards approach” should not be affected by the legal status of the proposed principle. Will materiality-considerations also apply if the proposed text becomes part of European law? Or would any financial, business, employment or other relationship result in a prohibition to perform the statutory audit of the company under consideration?

In addition, the proposed wording of the principle takes a “negative-approach” (“A statutory auditor or an audit firm shall not ...”). FEE would favour a wording, explaining what the auditor is allowed or required to do rather than explaining what the auditor is not allowed to do.

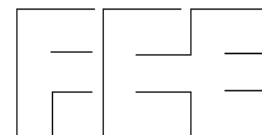
Taking both considerations into account, we would like to refer to the following proposal already made in our letter of 31 July 2003:

“Member States shall ensure that such persons [a statutory auditor or audit firm] when carrying out statutory audits shall be required to be independent from their audit client both in mind and in appearance and that such persons shall be required to identify, evaluate and respond to threats to objectivity including self-interest, self-review, advocacy, familiarity or trust and intimidation, and that they shall only carry out the audit if safeguards are in place to eliminate or reduce the threats to an acceptable level, such that objectivity is not compromised.”

Additionally, as suggested in the last meeting of the Committee on Auditing, FEE recommends to make an explicit reference to the European Commission’s recommendation in a recital of the modernised Eighth Directive.

Section V: Auditing Standards and Audit Reporting

(1) Do you agree with the proposed approach for introducing ISA's into the EU legal environment via comitology? Or do you see less burdensome but equally effective procedures to recognise ISAs as suitable standards for all statutory audits in the EU?



FEE supports the mandatory application of ISAs to all statutory audits in Europe.

Even if we would prefer application of ISAs without any endorsement mechanism, we can understand that some form of legal recognition is needed to give comfort to those that argue that standards established by an international private body cannot be enforceable without any legal action taken in the EU. However, as already pointed out in our previous letters, the endorsement mechanism to be introduced should not apply to every individual ISA. Instead, we suggest an endorsement system that requires recognition of the process of setting ISAs. Application of ISAs should be required in the EU on condition that IFAC and IAASB provide for a proper due process, oversight and transparency of the standard setting process in the public interest (for further details see our letter of 14 October 2003).

On this condition, we agree with the proposal made in the note to the members of the Committee on Auditing that the Commission in applying a comitology procedure should be entitled to recognise in secondary legislation ISAs for application in Europe.

With regard to the endorsement criteria, we deliberately do not recommend introducing criteria comparable to the criteria used in the IFRS-Regulation for endorsement of IFRS/IAS. First, recent developments have shown that the criterion of "European public good" has proved difficult to apply as there is no clear definition of what it means in terms of accounting. In addition, the criteria of understandability, relevance, reliability and comparability referred to in the IFRS-Regulation derive from the IASB's Framework. However, as the IAASB does not provide such a framework, there are no comparable criteria for endorsement of auditing standards.

Therefore, we favour introducing the criteria of proper due process, oversight and transparency of the standard setting process in the public interest. The process in the international standard setter should provide for sufficient European influence and a commitment to a principles-based approach to result in standards suitable for application in Europe. In addition, the Commission should be required to reassess its endorsement decision at regular intervals. Together, the proposed criteria and the regular reassessment of the endorsement decision by the Commission would increase the pressure for IAASB to carefully take into account European input in the setting of auditing standards and to work in the public interest towards the highest quality standards on auditing.

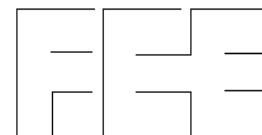
(2) Do you believe that the Directive should provide for the possibility to define a common audit report?

FEE believes that, if ISAs were to be recognised by the Commission for application in Europe, a separate European definition of a common audit report is neither necessary nor appropriate:

ISA 700, which is currently under revision within the IAASB, contains high quality principles and guidance on the form and content of the audit report. After the envisaged endorsement of ISAs ISA 700, which is fully in line with the requirements of the Fourth and Seventh Directive on the content of the audit report of European companies, has to be applied in every European statutory audit. Therefore, additional requirements on the form and content of an audit report are not necessary.

The envisaged endorsement process would ensure that European interests are appropriately taken into account in the standard setting process of IAASB. If the Commission is of the opinion, that the requirements of ISA 700 are not sufficient, it should actively contribute to the standard setting process within IAASB. Reserving powers to develop separate European audit requirements would undermine the whole idea of the endorsement process and would, therefore, be inappropriate.

With regard to the timetable scheduled for the modernisation of the Eighth Directive, we question whether the envisaged requirement to use ISAs for all statutory audits for 1 January 2005 onwards is feasible. In the last meeting of the Committee on Auditing the Commission announced its intention to publish a first draft of the Eighth Directive in February 2004. Due to the election of a new Parliament and the forthcoming personnel changes within the Commission in 2004, it is expected that the modernised Eighth Directive is unlikely to be enacted before the end of 2005. Given the proposed transitional period



of 18 months we doubt whether it is realistic to expect Member States to require the use of ISAs as from 1 January 2005.

One possibility to promote the use of ISAs from 2005 could be a separate Commission Recommendation dealing only with the application of ISAs as a temporary solution. Such an approach would reduce the time pressure for the modernisation of the Eighth Directive and would ensure that the legislative process for the modernisation of the Eighth Directive allows for an appropriate consultation in an open and transparent way with all parties concerned.

(3) Should a common audit report be limited to financial statements prepared on the basis of IAS?

See answer to question 2.

Other remarks:

In the note to the members of the Committee on Auditing it is stated that “additional audit requirements (“add-ons”) may be imposed on the condition that they specifically relate to legal requirements resulting from national and/or Community law.”

In light of a single European market, FEE supports having as few deviations as possible of ISAs in the form of the so-called “pluses” or “add-ons”. However, we do not agree that national add-ons should only be allowed if they relate to legal requirements resulting from national and/or Community law. Not every national peculiarity, that might have impacts on the scope of the audit or on reporting requirements, is necessarily laid down in law. For example, there are several additional national auditing and reporting requirements which are closely linked to corporate governance aspects. However, in many Member States corporate governance is a matter of codes rather than of law.

Therefore, the right of national standard setters and governments to add pluses should not be limited to legal issues. A certain degree of flexibility for national standard setters and governments would also contribute to innovation and, thereby, to improvement of auditing standards. In the end, the trend towards global harmonisation would result in a decreasing number of national pluses.

Section VI: Quality Assurance

(1) Do you think that the present requirements of the Quality Assurance Recommendation are sufficient?

The Recommendation on quality assurance has been published only three years ago. As already announced in the Recommendation, the Commission is now reviewing the situation in the Member States.

FEE is looking at this issue with great interest, especially as, at present, in many Member States changes to the national quality assurance systems are under way. It needs careful discussion whether the PCOAB requirements should have influence on the European requirements and on national systems.

We will provide you with further input on this issue with FEE’s comments on the questions put forward in your note to the members of the Committee on Auditing on the review of Member States’ quality assurance systems.

(2) Do you agree that some requirements could usefully be strengthened in order to ensure the independence of the reviewer from the reviewed statutory auditor or audit firm?

As observed in the note of the Commission to the members of the Committee on Auditing on the review of Member States' quality assurance systems (note of 29 October 2003) there is no clear preference for monitoring or peer review methodology and the peer review methodology is widely used within the EU.

There is no doubt that both monitoring and peer review systems need to be as robust as possible in order to ensure high quality audits and the public confidence in the quality assurance systems.

For quality assurance systems using the monitoring methodology, the expertise of the inspectors/staff performing the quality review and of its awareness of the professional developments is of utmost importance, since it can be difficult for full-time inspectors to maintain their knowledge of the professional developments and their understanding of the day-to-day business and audit techniques, especially with regard to issues which are very specific for certain types of companies or industries.

For quality assurance systems using the peer review methodology special attention needs to be paid to the independence in appearance of the peer. As already stated in the Recommendation on Quality Assurance the public oversight requirement is meant to ensure that the quality assurance is in reality and appearance an exercise with sufficient public integrity. This requires not only sufficient and appropriate public supervision of the administration and functioning of the quality assurance system and the presentation of its results. In addition it might be worth considering, for example, to improve the procedures for selecting and appointing of the peer. Under a peer review system, it is of utmost importance to have appropriate selection and appointment procedures in place to ensure not only, that the peer acts independently, but that he is also seen to be independent by the public. In this respect, it might be necessary to limit the choice of the peer by the audit firm under review, at least to a certain extent.

(3) In view of the recent developments in the US, is it still appropriate to use professionals (peers) for quality assurance reviews or would it be better to use inspectors for such tasks to ensure complete independence from the audit profession? Should in this regard be differentiated between those statutory auditors and audit firms that provide audit services to listed companies and those without such audit clients?

FEE recognises the need to work continuously to maintain the trust in the audit profession and to demonstrate to the public that the audit profession is committed to working in the public interest at the required highest level of quality and, therefore, supports the establishment of robust and effective national quality assurance systems.

When finalising discussions within the Committee on Auditing on the Recommendation on Quality Assurance, it was accepted that Member States should be able to choose between either a peer review or an external monitoring review methodology. Whilst both methodologies have their advantages and disadvantages, both methodologies meet the public interest objectives associated with the quality assurance process. The advantage of the peer review system is that it is performed by practitioners with up-to-date knowledge on auditing standards and quality control systems. Therefore, FEE does not support prohibiting the use of peers for quality assurance reviews. However, as already explained in our answer to question 2, it might be worth considering to improve the procedures for selecting and appointing the peer in order to ensure that the peer is both independent in mind and in appearance.

Like the Commission, FEE has always considered that all statutory audits should be conducted to the same standard – “an audit is an audit” (internal market approach). Therefore, all measures aiming at improving the quality of the services provided should apply to all kinds of audit engagements. Consequently, FEE would not be supportive of a wide-ranging differentiation between the requirements for statutory auditors performing audits of listed companies and the requirements for auditors without such audit clients. However, the internal market approach would allow for greater emphasis, for the purposes of public confidence, in quality assurance and oversight activities related to the audit of listed companies and other public interest entities.

Section VII: Investigations and Sanctions

(1) Should the new Directive be more detailed about sanctions?

FEE supports the intention of the European Commission to reinforce the existing requirement for appropriate disciplinary actions in the Eighth Directive by requiring all Member States to maintain an effective investigative and sanctioning system that includes deprivation of registration and approval.

Due to different legal systems and traditions in the Member States the national investigation and sanction systems differ widely within Europe. Diversity of the national systems needs to be recognised and accepted on the basis of the subsidiarity principle.

However, we would suggest that the Eighth Directive should be more precise on the general characteristics of the investigative and sanctioning system: investigations should be separated from the disciplinary systems. They should take place where there is reason for complaint or concern before any disciplinary action takes place. The investigative and sanctioning system should uphold principles of fairness and due process and should include a possibility for appeals.

With regard to a wording proposal for a new paragraph on investigations and sanctions please see our letter of 31 July 2003. In this letter FEE suggested requiring Member States to ensure “that there is a systematic link between significant findings from the quality review and initiating investigations and disciplinary proceedings.” The aim of this principle, which is taken from the Commission Recommendation on Quality Assurance, is to ensure that substantial negative outcomes of quality reviews are appropriately and effectively sanctioned. Only if there are appropriate and effective sanctions can the quality review add to the public credibility of audit and be seen as an effective proactive enforcement tool. However, the objectives of the quality review system in promoting continuous improvement in audits are different from the disciplinary oversight regime, where past offences against professional requirements are sanctioned. Consequently, the proposed principle should not require Member States to open investigations under a separate disciplinary oversight regime. This could lead professionals working within the audit firm under review to be defensive rather than open in cooperating with the reviewer and, thereby, could have a negative impact on the effectiveness of the quality review system. Therefore, some Member States have established a strict separation of the quality assurance system and the disciplinary oversight system. As long as such a separation still allows for appropriate and effective sanctioning of negative findings from quality reviews it should not be seen as counteracting the objectives of the quality review system.

(2) How far should disclosure of sanctions go?

There is no general valid answer to this question and we believe that the question should be approached with great caution. There needs to be some degree of discretion of the competent oversight body whether and to what extent sanctions are to be disclosed. In case of severe breaches of professional requirements and in cases of public interest or of suspension from the register publication of the sanctions might be an appropriate tool. However, applying the principle of fairness and proportionality, the oversight body should have the possibility to sanction violations of minor importance to the public without publication of the violation and the sanctions.

In addition, it needs to be taken into account that in some jurisdictions publication of violations itself is a form of sanction and that publication requires a court decision.

From a general point of view, we question whether it is appropriate at all to include details on disclosure of sanctions in the Eighth Directive, which should be developed as a principles-based directive.

Section VIII: Public Oversight

(1) Do you believe that the principles discussed in the Committee on Auditing should be included in the Directive?

FEE strongly supports the development of common EU principles (and essential features) for the organisation of robust national public oversight arrangements in Europe. In order to demonstrate its intention to contribute to the current debate, in September FEE has issued a Discussion Paper on “European Coordination of Public Oversight” considering how public oversight arrangements and an EU coordination mechanism could best be organised.

As already stated in our letter of 31 July 2003 the inclusion of common principles of public oversight in the Eighth Directive requires first of all, that a proper definition and description of “public oversight” is included either in the requirements of the Directive or at least in the recitals. For further details and for our detailed remarks on the principles on public oversight as proposed by the Commission in the last meeting of the Committee on Auditing we would like to refer to our letter of 31 July 2003.

(2) Should the co-ordinating mechanism of public oversight be organised by the Directive or be organised through a Commission decision?

The requirements of a single capital market demands a robust coordination of national systems of oversight in Europe. This requires that the co-ordination is not organised in a purely voluntary and relatively informal way. Co-ordination of EU public oversight can only be effective if it is visibly structured in the public interest and if it is legally established. Therefore, FEE strongly recommends organising the co-ordinating mechanism by means of a Directive.

In its Discussion Paper “European Co-ordination of Public Oversight” FEE expressed a preference for the establishment of a co-ordinating body which should be organised separately from government or the Commission and which should be vested with delegated powers to perform well-defined coordination functions on oversight activities. For a ‘possible wording of the Eighth Directive regarding the establishment of such a European coordination of national public oversight we refer to our letter of 14 October 2003.

Other remarks:

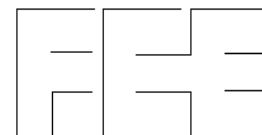
According to the note to the members of the Committee on Auditing the Commission intends to require Member States to identify one single entity that will be the contact for co-ordination of public oversight.

FEE is not supportive of such an approach. Member States are organised in a variety of ways resulting from various traditions and cultural approaches to oversight. In many countries, there is more than one oversight mechanism, addressing different aspects of the profession. Consequently, in those member states there might be more than one public oversight body. The diversity of national oversight systems is not an obstacle if the systems can be benchmarked against commonly agreed criteria and it can be demonstrated that the framework is robust and meets the needs of the users.

Section IX: Relationship of the auditor and the audit client

(1) Is it necessary to state the principle of independence of the statutory auditor from the executive management of the audited company?

FEE agrees with the principle of independence of the statutory auditor from the executive management of the audited company. However, we question whether it is necessary to state the principle explicitly or whether it does not already follow from the general principles on independence. If the principle



nevertheless should be included in the Eighth Directive we believe that it should be included in section IV on ethics and independence rather than in the section on corporate governance.

(2) Which instruments might contribute in the best way to establishing effective communication between auditor and audit client and, in this way, to ensuring that statutory auditors and the non-executive directors of the audited company are aware of significant developments, findings and events?

In discussing whether and to what extent the Eighth Directive should contain separate communication requirements it needs to be borne in mind that ISA 260 “Communication with those charged with governance” already contains several requirements on the communication between the auditor and the governance bodies of the audited company. Having passed the envisaged endorsement process, ISA 260 would have to be applied in every statutory audit of European companies.

ISA 260 is going to be revised by the IAASB. If the Commission is of the opinion, that the requirements of ISA 260 are not sufficient, it should actively contribute to the standard setting process within IAASB. Separate European communication requirements should be avoided to the extent possible (see also our comments on section V, questions (2) and (3)).

If, however, the Commission intends to introduce European communication requirements we would like to draw your attention to the proposals made in our letter of 31 July 2003 and in the FEE Discussion Paper on Financial Reporting and Auditing Aspects of Corporate Governance.

(3) Should the statutory auditor always be appointed by shareholder meeting?

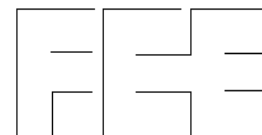
In principle, we agree with the appointment (election) of the statutory auditor by the shareholder meeting. However, the following issues need to be considered:

- The appointment of the statutory auditor in most Member States covers the election of the statutory auditor by the general shareholders meeting, but comprises also actions to be taken by the body charged with governance of the audited company, e.g. by the (supervisory) board or by the audit committee (hereinto referred as “governance body”): The board or the audit committee usually prepares a recommendation for the proposed selection and appointment of the statutory auditor and agrees and approves – usually in consultation with the Executive Management – the terms of engagement of the statutory auditors. The participation of the governance body in the appointment process, which is either common practice or, in some jurisdictions, even required by corporate governance codes or law, contributes to the overall aim of strengthening and ensuring auditors’ independence. Therefore, when using the term “appointment” instead of “election” (as suggested by FEE in its letter of 31 July 2003), it should at least be made clear that the current practice can be maintained.

Beyond this, a principle should be included in the Eighth Directive requiring that the governance body of the audited company shall both prepare the recommendation for the proposed selection and appointment of the statutory auditor and shall approve the detailed contractual terms of the audit (as laid down in the audit engagement letter).

- In addition, there might be situations, where the “normal” appointment process is not appropriate/applicable. Therefore, the draft Fifth Directive contained the following regulation (Art. 55):

“Where appointment by the general meeting has not been made in due time or where any of the persons appointed is unable to carry out his duties, the administrative, management or supervisory organ or any shareholder must have the right to apply to a judicial or administrative authority for appointment of one or more persons to audit the accounts.”



Further, the judicial or administrative authority must have power to dismiss, where there are proper grounds, any person appointed by the general meeting to audit the accounts, and must also have power to appoint some other person for that purpose if application is made by the administrative, management or supervisory organ or by one or more shareholders who satisfy the requirements of Article 16 (1). Such application shall be made within two weeks of the appointment by the general meeting.”

(4) Do you agree with the disclosure of the reasons for the dismissal of the statutory auditor to the public oversight institution?

FEE does not agree with a general requirement to disclose the reasons for the dismissal to the public oversight institution. Such disclosure should only be made if the audited company wishes to make a complaint on the statutory auditor or on request of the oversight body.

Instead of requiring disclosure of the dismissal to the oversight body, in its letter of 14 October 2003 FEE recommended to entitle the auditor to address the issues resulting in his dismissal or in his own decision to resign from the audit engagement either to the governance body or, if appropriate, to the shareholders of the audited company. This would help to prevent that the auditor is put under pressure by the audited company.

In addition, the Eighth Directive should not only address the issue of dismissal of the statutory auditor by the audit client, but should also deal with resignation of the statutory auditor, which is currently not addressed in the Commission’s proposals.

If the Commission intends to include in the Eighth Directive principles on dismissal and resignation of the statutory auditor, it should take into account the significant differences in the current national regimes on dismissal and resignation resulting from differences in the legal environment and corporate governance arrangements. Therefore, principles should not go into detail and should especially not deal with details on the conditions and procedure for dismissal and resignation, but should explain the overall purpose and objective of such procedures, which should then be enacted at Member State level.

For further remarks on the issue of dismissal and resignation we would like to draw your attention to our letter of 14 October 2003.

(5) Is it appropriate to introduce audit committee requirements for listed companies? What role should such a governance body play?

Although the Eighth Directive is not the best place to address audit committee requirements, we believe that certain audit committee issues need to be urgently addressed. Therefore, we understand the intention of the Commission to include some audit committee requirements in the Eighth Directive.

However, in defining the role of an audit committee one needs to remember that the role and responsibilities of audit committees differ widely within Europe and that the audit committee’s role is closely linked with the organisation of the various corporate governance systems (unitary and two-tier system). In addition, it needs to be taken into account that the audit committee is a preparatory committee – both in the unitary and in the two-tier system. As a preparatory committee of the (supervisory) board, the audit committee must undertake its work within the unitary/two-tier board system, avoiding the possibility of creating an additional “quasi (supervisory) board”. In a unitary system, financial statements and other financial information published by a company are the responsibility of the board as a whole, and the members of the board cannot be absolved from their responsibility for the financial statements just because the audit committee has undertaken detailed work on their behalf. The same applies in a two-tier system where the management board is responsible for the preparation of the financial statements and the supervisory board holds the responsibility for the approval of the financial statements which cannot be delegated to the audit committee. To fulfil its responsibilities in a proper way by taking into account the results of the work of the audit committee the (supervisory) board should ensure it is aware of the activities of its audit committee and receives and considers minutes of audit

committee meetings. In certain jurisdictions the supervisory board as a whole is legally liable, if it is not fulfilling the discussions on the financial statements and audit. In certain countries, such as Ireland, audit committees have a separate legal status and recognition.

Therefore, in-depth discussion and analysis of national systems is needed before the role and responsibility of an audit committee can be laid down in EU law.

For further remarks on this issue we would like to refer to the FEE Discussion Paper on Financial Reporting and Auditing Aspects of Corporate Governance as well as to our letter of 31 July 2003.

Other remarks:

a) Title of section IX:

The title of section IX is “Relationship of the auditor and the audit client”. FEE recommends rephrasing the title as follows: “Corporate governance in relation to statutory audits”. This title would avoid confusion on who the audit client is and would be in line with the Communication on Reinforcing the Statutory Audit in the EU (see chapter 3.3 of the Communication).

b) Immediately reporting on findings or events which may have a significant negative impact on the financial statements:

According to the note to the Committee on Auditing the Commission intends to require the auditor to immediately notify the audited company about findings or events which may have a significant negative impact on the financial statements. For the following reasons FEE is not supportive of this requirement:

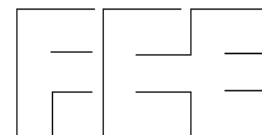
- It is the task of the management, but not of the auditor to inform the board of the audited company on any events that might have a significant negative impact on the economic position or on the financial statements of the audited company.
- The statutory audit is not directed towards the detection of events with possible negative impact on the audited company’s economic situation. The auditor is only obliged to assess whether and to what extent the financial statements comply with the applicable accounting standards and present a true and fair view of the financial situation of the audited company.
- It should be within the auditor’s judgement and decision, whether and when he informs the audited company’s board on his findings before having finalised the performance of the audit and before presenting the audit report. The same should apply to facts and events that come to the auditor’s attention in the course of the audit which may materially impair the company’s financial position.

c) Analysis of the financial position by the auditor:

The Commission intends requiring the auditor to “report to the audit committee including a written report that contains an analysis of the financial position and the accounting policies of the audited company.” This reporting requirement seems inappropriate insofar that the analysis of financial position is a management task. The responsibilities of the auditor should be limited to commenting on management’s analysis.

d) Fixing the remuneration of the statutory auditor by the general meeting:

FEE does not support inclusion of a principle in the Eighth Directive, that the general meeting should fix the remuneration of the statutory auditor. We are aware that such a requirement exists in certain Member States. However, we believe that such a principle is not appropriate and is difficult to work with in practice. In some Member States, where such a requirement exists, the shareholders’ resolution almost always is merely to authorise the board of directors to fix the remuneration of the statutory auditor.



Section X: International Aspects

(1) Do you agree with the "principle of home country control"? Is the modernised Directive a sufficient basis for mutual recognition of regulatory regimes within the EU?

We agree with the application of the principle of home country control with respect to oversight and inspections of an audit firm. However, it should be made clear that the home country is the Member State in which the individual audit firm is based regardless whether the audit firm is part of a multinational or international group or network of audit firms:

- If an audit firm located (and registered) in Member State A provides services in a global audit (for example, statutory audit of a local company's annual accounts which are consolidated in the consolidated accounts of a foreign company incorporated in Member State B, application of home country control would obviously result in inspections and oversight of the audit firm by the respective authorities of Member State A.
- If an audit firm located (and registered) in Member State A establishes a subsidiary in Member State B, the regulations and oversight of the Member State in which the subsidiary is located and allowed to perform statutory audits should apply, that is Member State B. Whether or not the audit firm is a subsidiary of another audit firm located in another Member State or not, should be irrelevant in this respect.

(2) Shall third country auditors be subject to EU oversight?

As explained in the answer to question 1, FEE favours the principle of home-country control. Therefore, except for political reasons, FEE does not see any merits of requiring third country auditors to be subject to EU oversight. However, we see good reasons for a regulatory cooperation on issues such as quality assurance in global audits. For more details especially on the legal issues which need to be raised before introducing a cooperation clause, see answer to question 2.

(3) What should a "cooperation clause" include?

FEE strongly supports cross-border cooperation in oversight of statutory auditors and audit firms. Any duplication of registration and quality assurance programmes should be reduced to a minimum, in order to make these programmes as effective as possible and to avoid inefficient use of resources.

However, certain legal issues, such as the issue of confidentiality and data protection, require further careful consideration. Conflicting regulations imposing incompatible requirements on practitioners need to be avoided.

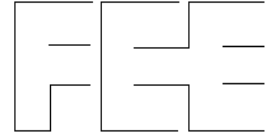
Section XI: Final provisions

(1) Are both committees' roles sufficiently clear?

FEE fully agrees that the roles of both committees need to be sufficiently clear. As discussed in the last meeting of the Committee on Auditing the impact of the future institutional arrangements and legislative procedures within the EU need to be taken into account in deciding on the tasks and responsibilities of the envisaged Auditing Regulatory Committee. We understand that under the new EU Constitution regulatory committees will no longer exist in their current form and function.

(2) For which areas in the Directive do you believe that implementing measures are useful?

With regard of the overall objective to promote global harmonisation of accounting and auditing standards, implementing measures resulting in separate European audit requirements should be avoided



as far as possible. The principles of the Eighth Directive should be interpreted by reference to internationally accepted standards, rather than by establishing separate European requirements implementing measures. Therefore, implementing measures should only be used to recognise those international standards. See also answers to question V. (1) on the endorsement of ISAs.

We would be pleased to discuss any aspects of this letter you may wish to raise with us.

Yours sincerely,

David Devlin
President

Encl.