

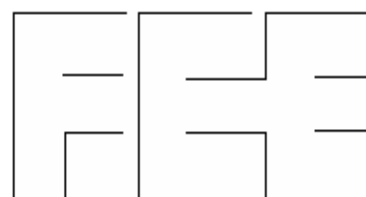
Date
11 October 2007

Le Président

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Ms. Jan Munro
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International Federation of Accountants
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Dear Ms. Munro,

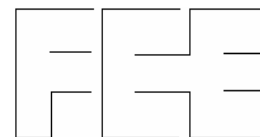
Re: Exposure Draft - July 2007 – Section 290 of the Code of Ethics – Independence – Audit and Review Engagements and Section 291 of the Code of Ethics – Independence – Other Assurance Engagements

FEE (Fédération des Experts Comptables Européens – European Federation of Accountants) is the representative organisation for the accountancy profession in Europe. FEE's membership consists of 44 professional institutes of accountants from 32 countries. FEE Member Bodies are present in all 27 Member States of the European Union and they represent more than 500,000 accountants in Europe.

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.

FEE is pleased to comment on the International Ethics and Standards Board for Accountants (IESBA) Exposure Draft (ED) of July 2007 on Section 290 of the Code of Ethics – Independence – Audit and Review Engagements and Section 291 of the Code of Ethics – Independence – Other Assurance Engagements. This letter includes a number of general comments on the ED and a number of specific comments on detailed aspects of the proposed Sections 290 and 291. In addition, we have summarised our responses to the questions set out in the Explanatory Memorandum at the end of this response.



Overall Comments

In general, FEE is pleased to note that the approach taken in respect of the items addressed in the ED remains the principles-based approach or the threats and safeguards approach.

FEE is committed to the principles-based approach as being the most robust because, inter alia, by focusing on the underlying aim rather than detailed prohibitions, the principles-based approach combines flexibility with rigour in a way that is unattainable with a rules-based approach. This has been recognised in Europe in the European Commission Recommendation on Independence¹, which follows this approach, and the recently, in the Statutory Audit Directive², which specifically endorses the approach in Article 22. We accept, however, that a Code containing nothing but a general discussion of principles, threats and safeguards is unlikely to completely meet the needs of the modern, complex profession and that examples of how these should be applied are necessary.

We, nevertheless, continue to be concerned about the increasing tendency of the IFAC Code of Ethics to become rules rather than principles-based. We believe that for instance the introduction of a particular fixed percentage into the relative size of fees discussion has moved the Code too close to a rules-based approach which can encourage a tick-box compliance with the form of the requirement rather than the spirit.

Comments on Specific Proposals

Internal audit services (revised paragraphs 290.186 to 290.191)

FEE agrees that an audit firm should not provide internal audit services to an audit client, if the services involve the firm in performing management functions. There are no safeguards to reduce the threats to an acceptable level in such situations.

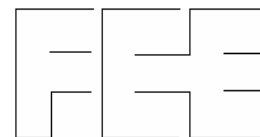
We also agree that the requirements should be similar for all audit clients, and not be dependent on whether the audit client is an entity of significant public interest or not.

We would like to note that paragraph 290.188 states that the firm's personnel will become part of the client's internal controls. However, it is not the individuals themselves, but the service provided by the firm's personnel that may become part of the client's internal controls. In more general terms, a clear distinction exists between internal audit and internal control within an audit client or entity and this should be made clear in the Code.

Internal Control is the process designed, implemented and maintained by those charged with governance, management and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. The internal audit function within an entity may be assigned specific responsibility for reviewing controls and any aspects of one or more of the components of internal control, monitoring their operation and recommending improvements thereto. The scope of the internal audit function's responsibilities in relation to the entity's internal control may, therefore, vary considerably from one entity to another.

¹ European Commission Recommendation on Statutory Auditor's Independence in the EU: A set of Fundamental Principles, May 2002

² Directive 2006/43/EC on Statutory Audits of Annual Accounts and Consolidated Accounts



Fees – relative size (revised paragraphs 290.213 to 290.215)

We welcome the retention of the principles-based or threats and safeguards approach to the issue of fee dependency. We consider that the new safeguards proposed to be required for audits of entities of significant public interest are reasonable.

However, paragraph 290.215 includes a fixed percentage or absolute limit that is to be considered by the auditor in determining the appropriate relative size of fees to be received from an entity of significant public interest.

FEE is in favour of a conceptual approach in relation to the relative size of fees for all audit clients, whether entities of significant public interest or other. Audit firms should, on a regular basis, review fees at different levels within the network, audit firm, office and also at partner level to determine whether objectivity is not compromised. The European Commission Recommendation on Independence recommends in Chapter 8.2 such approach by considering fees from one audit client making up an unduly high percentage of the total revenues.³ We also support as a general approach the approach taken in drafting paragraph 290.213 using terminology such as “large proportion of the total fees of the firm”.

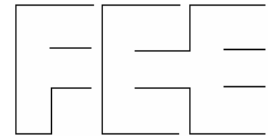
Therefore, we are of the opinion that it would be better not to include such fixed percentage or absolute limit in an international, principles-based code of ethics. The varying legal and cultural frameworks in different jurisdictions may result in very different influences on what levels of income and other factors would be likely to result in fee dependency. Additionally:

- A fixed percentage or absolute limit is arbitrary (i.e. 14.99% of total fees would be acceptable but 15.01% would not be acceptable) and does not take into account any particular circumstances;
- The basis and period for computing a fixed percentage or absolute limit might be interpreted in different ways, depending on the types of services provided, the cut-off of the period, etc;
- The imposition of a fixed percentage or absolute limit (rather than another appropriate fee limit) might have a disproportionate impact on smaller audit firms having one or very few significant public interest entities as an audit client;
- There is a risk that auditors of significant public interest entities would only consider whether the percentage rule applies and would not consider the whole concept (fees related to network, firm, office, partner) as described above.
- A fixed percentage might also impact on the concentration and choice in the audit market. A degree of flexibility is needed because stringent inflexible requirements relating to audits may further hinder small firms from becoming auditors of entities of significant public interest in some jurisdictions. Reference is made to the work currently being done by the UK Financial Reporting Council in this respect⁴.

³ Relationship between total fees and total revenue:

- The rendering of any (audit and non-audit) services by a statutory auditor, an audit firm or a network to one audit client or its affiliates should not be allowed to create a financial dependence on that audit client or client group, either in fact or in appearance.
- A financial dependency is considered to exist when the total (audit and non-audit) fees that an audit firm, or a network receives or will receive from one audit client and its affiliates make up an unduly high percentage of the total revenues in each year over a five-year period.
- The statutory auditor should also consider whether there are certain fee relationships with one audit client and its affiliates which may appear to create a financial dependency in respect of a person who is in a position to influence the outcome of the statutory audit.
- In any case, the statutory auditor, the audit firm or the network should be able to demonstrate that no financial dependency exists in relation to a particular audit client or its affiliates.

⁴ <http://www.frc.org.uk/images/uploaded/documents/Choice%20in%20the%20UK%20Audit%20Market%20Discussion%20Paper4.pdf>



We are also very concerned that the imposition of such a fixed percentage or absolute limit could be the first step towards a prohibition regardless of the circumstances. This might also set an unacceptable precedent for the introduction of other detailed rules and prohibitions within the code of ethics.

Therefore, if IESBA were to decide, after due consideration of the comments received on this specific aspect of the ED, that a fixed amount or absolute limit in relation to the determination of the appropriate relative size of fees to be received from an entity of significant public interest should be included in the code of ethics, guidance on application is needed.

Such guidance should focus on the use of different percentages depending on the varying circumstances in which they should apply. Examples should not only consider quantitative but also qualitative and contextual aspects of the clients under audit.

Additionally, if IESBA were to make reference to a fixed amount or absolute limit in relation to the determination of the appropriate relative size of fees to be received from an entity of significant public interest, an additional safeguard should be added as a valid alternative for the two safeguards already included in the ED: 'inspection by an independent quality assurance system under the responsibility of an public oversight system of an audit firm auditing public interest entities every three years'. Following implementation of Articles 29, 32 and 43 of the Statutory Audit Directive in all 27 European Union Member States, such system would be in place in Europe. This is especially important for smaller audit firms which could in such way avoid to involve a professional accountant who is not a member of the firm expressing the opinion as such involvement is invariably seen as commercially sensitive.

In section 290.216 the ED states that a self-interest threat may be created by overdue fees. We suggest:

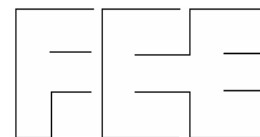
- The nature of the self interest threat be explained.
- Guidance be provided to clarify whether the significance (as in the last sentence) should be viewed from the perspective of the audit firm or, alternatively, the perspective of the client or possibly of both. In particular, to balance the treatment of overdue fees in the ED, we suggest the IESBA include text explaining that when such fees are insignificant to the firm but significant to the client, this would be likely to strengthen the firm's position and thus reduce the significance of any self-interest threat.

Contingent fees (revised paragraphs 290.217 to 290.220 and 291.151 to 291.154)

The guidance in the current IFAC Code of Ethics seems appropriate. However, we do not object to the substance of the proposed revision to this part of Section 290 as the requirements are similar.

As far as the proposals for Section 291 on other assurance services are concerned, they seem to be stricter than those in Section 290 for audit work, which does not appear to be logical. Paragraph 291.153 refers to whether the amount is dependent on the 'result' of the assurance engagement. However, this requirement does not appear to allow for any exception based on the materiality concept, unlike paragraph 290.219b. Furthermore, 'result' could be interpreted much more widely (for example if something is dependent on the mere fact that the report is signed off) than the equivalent requirement in paragraph 290.219b, where the term 'result' is no longer used.

We recommend that the requirements regarding contingent fees in Section 291 be brought in line with those in paragraph 290.219.



Comments on other matters

Special Considerations on Application in Audit of Small Entities

In the Explanatory Memorandum to the ED, views are requested on whether issues relating to the audit of small entities and application of the Code in developing nations have been taken into account appropriately.

In respect of both of these important areas we are of the view that interests are best served by adhering as closely as possible to the principles-based or threats and safeguards approach, which allows the right solutions in the varying circumstances often applicable to small audits and in developing nations. Guidance on application can, as proposed, be developed outside of the code of ethics, rather than adding to inflexible and often inappropriate absolute rules.

More specifically, we refer to our comments under 'Fees – Relative size' for our comments on the imposition of a fixed percentage or absolute limit in relation to the determination of the appropriate relative size of fees to be received from an entity of significant public interest. This might have a disproportionate impact on smaller audit firms and may further hinder small audit firms from becoming auditors of entities of significant public interest in some jurisdictions.

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

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Jacques Potdevin'. The signature is written in a cursive style with a long horizontal stroke at the end.

Jacques Potdevin
President

Ref: ETH/EF/HB/JP