TRANS-NATIONAL ORGANISATIONS AND PRACTICES WITHIN THE ACCOUNTANCY PROFESSION

April 2008

FEE would like to express its keen appreciation for the support provided by its Member Bodies, the Institute of Chartered Accountants in England and Wales (ICAEW) and the Instituut van de Bedrijfsrevisoren - Institut des Réviseurs d'Entreprises (IBR-IRE); we are particularly grateful to Martin Manuzi (ICAEW) and Sandrine Van Bellinghen (IBR-IRE) for the key contribution they made to this study.

FEE (Fédération des Experts Comptables Européens – Federation of European Accountants) represents 43 professional Institutes of accountants and auditors from 32 European countries, including all of the 27 EU Member States.

With a combined membership of more than 500.000 professional accountants, FEE works in the public interest to contribute to a more efficient, transparent, and sustainable European economy.

EXECUTIVE SUMMARY

This study has been prepared on the basis of a detailed survey of chief executives and senior staff members of 30 leading accountancy organisations and practices operating on a trans-national basis in Europe today.

Within the overall aim of promoting a wider understanding of the nature of the accountancy profession's development to serve the growing international needs of business, the study has the following objectives:

- To place the accountancy profession's development of trans-national organisations and practices in the relevant European regulatory and legal context;
- To identify the different models of trans-national organisation and practice employed by the profession in Europe;
- To provide a detailed empirical analysis of the structure, governance and operational arrangements of the different models as employed in Europe, with reference where relevant to global structures;
- To draw points of comparison and contrast between the various models and examine the growing interaction between them;
- To examine the views of survey respondents in relation to the network definition in the revised Statutory Audit Directive and related regulatory requirements.

Key findings and conclusions

1. The accountancy profession's development within Europe to meet international demand for a wide range of professional accountancy and related services has been strongly moulded by a fragmented, jurisdiction-specific approach to regulation of the profession and by the differences in national legal systems and cultures of each jurisdiction.

2. Among the many drivers which have shaped the profession's trans-national structures in Europe, the unevenness of liability regimes has been a key factor which has increased in importance over time. Differences in the legal regimes and cultures across jurisdictions within and outside Europe as well as the declining availability of professional indemnity insurance for large trans-national audit assignments have also had a very important bearing.

3. To date, there has been only modest trans-national coordination of regulatory policy at European level to allow for more simplified and integrated trans-national structures for accountancy organisations and practices.

4. Three distinct structural models of trans-national organisation and practice have been developed by the profession in response to the internationalisation of business: an international association of independent firms coordinated by a separate legal entity, an integrated international partnership and a national practice with subsidiaries in other jurisdictions.

5. The model of trans-national organisation and practice predominantly used in the profession in Europe today is that of an international association of independent firms coordinated by a separate legal entity.

6. Within the international association model, three discernible categories of associations – whose boundaries are not clear-cut – are identifiable in relation to the capacity to exercise governance

and control and in relation to operational policies and characteristics. The three categories fall within the framework of a broad correlation between, on the one hand, relevance and extent of trans-national activity and referrals and, on the other hand, size of association budget and shared resources and degree of interaction, coordination and integration between member firms. The majority of associations are at the lower end or middle range of the correlation.

7. Among the most significant operational characteristics which led to the identification of the three discernible categories of associations are policies on branding and external communication, quality control, audit methodology and overall management of trans-national assignments.

8. The dependency of some association member firms on income from referred assignments and technical resource-sharing is considerable in the most integrated associations and results in the highest degree of management and control possible in the association model consisting of legally independent firms.

9. The survey found that just one respondent describes itself in relation to its trans-national grouping as a whole as an integrated international partnership – the second of the three structural models of trans-national organisation and practice. However, the survey also found that the integrated international partnership model is used more extensively given that some international associations house such partnerships within their membership.

10. Evidence of the practical use of the integrated international partnership model in the profession confirms that while most theoretical features of this model – including profit and loss sharing – are employed, liability sharing across jurisdictions is not pursued given the unevenness of liability regimes across jurisdictions.

11. The third model of trans-national organisation and practice, consisting of a national practice operating through subsidiaries in other jurisdictions, is the least commonly used model at the present time. However, it represents an important model for the servicing of trans-national clients, particularly for professional accountancy services outside of statutory audit.

12. Interaction between the three models of trans-national organisation and practice is evolving, particularly between the international association model and that of integrated international partnerships. This evolution is being driven by increased trans-national business within the European Internal Market and further afield.

Network definition

13. There is a recognition across all those surveyed that the term “network” can no longer be used as a generic label, given the definition in the revised Statutory Audit Directive. The question of the application of the definition has received considerable attention.

14. For the most integrated international associations and the grouping which describes itself as an integrated international partnership, it is recognised that the network definition is applicable and systems already exist to meet the related regulatory requirements. However, concern was expressed by these survey respondents that EU Member States should avoid any gold plating of independence requirements which would increase the complexity and the costs of compliance which are already high.

15. Among trans-national organisations and practices with more modest degrees of coordination and integration, other views were recorded. In some cases, concerns predominate over the cost of installing new systems for regulatory compliance, in particular with regard to independence. Questions were also raised on the relevance of regulatory compliance for the public interest and over the potential for inconsistency in the application of the network definition across EU Member States. Consistency with regard to non-EU requirements and concerns over liability were also raised. In other cases, it is believed that compliance with the definition could have positive repercussions in the pursuit of audit quality and in attracting more and larger clients.

16. International associations with the lowest levels of trans-national work and integration do not consider their organisations to be networks as per the definition and do not believe that the benefits would outweigh the cost if they were to do so. In some cases, associations which hold this view have taken active steps to reduce operational coordination, for example in relation to quality control and common branding to further ensure that the definition is not applicable.

FEE policy conclusions

17. The study demonstrates that the announced policy of the European Commissioner for the Internal Market to publish a Recommendation on liability limitation is to be welcomed. This is due to the impact which the current unevenness of liability regimes in Europe has on trans-national structures within the profession. The European Commission Recommendation may also be a helpful point of reference for policy on liability in non-EU jurisdictions.

18. The new possibilities created by the revised Statutory Audit Directive in a number of areas – including ownership rules and auditing standards – should be capitalised on by EU Member States to facilitate the pursuit of high and consistent quality in audit services across jurisdictions.

19. Consistency of interpretation of the network definition across EU jurisdictions is critical to the successful implementation of the definition and to achieving even and consistent application of the related regulatory requirements. The use of IFAC guidance in this area by EU Member States is highly recommended.

20. The clarification of outstanding questions regarding the application of recent EU Internal Market legislation to the profession's wide scope of services and to establishment requirements could be highly relevant to the evolution of the profession's trans-national organisations and practices.

21. The empirical findings of the survey can provide an important point of reference for discussions of direct policy interest to the profession. A good understanding of existing trans-national organisations and practices is helpful to ensuring proportionate regulation and to considering issues such as the enhancement of choice in the listed entity audit market. It can also assist with broader public policy goals, such as the further development of the European Internal Market.

CONTENTS

1. INTRODUCTION

1.1. The accountancy profession and the internationalisation of business

The principle aim of the study is to facilitate a better understanding of the structural underpinnings of the main trans-national organisations and practices within the accountancy profession in Europe. It addresses how, in broad operational terms, the different organisational models function in practice to provide professional services trans-nationally, that is to say across jurisdictions[1]. The study also aims to demonstrate the very considerable diversity which exists within the different organisational models, and in particular within the most commonly employed model of trans-national organisation: an international association of legally independent firms.

Among the specific subjects covered in the illustrative analysis are the various legal forms of trans-national organisations and practices, including trans-national partnerships and holding and subsidiary practices across jurisdictions and, with regard to the model of international associations, the different vehicles and mechanisms for trans-national interaction, coordination and integration between nationally-based accounting practices.

As such, the study covers a wide range of "internal" management arrangements underpinning the organisations and practices, including those established for governance, quality control, transparency, insurance and liability purposes as well as for client and independence management. The study also addresses the external communication and branding of trans-national organisations and practices which has, in the last few years, also constituted an area of particular interest for the profession, regulators and other stakeholders.

To date, despite the growing degree of interest in these areas, there is a paucity of literature on the existing legal structures and the "internal" management arrangements of the different trans-national organisations and practices. In October 2007 the European Commission's Internal Market Directorate General published an independent study by Oxera on "Ownership rules of audit firms and their consequences for audit market concentration" which briefly addresses international structures[2]. The study states that its analysis of international structures is not a full assessment but rather an overview of issues relevant for access to capital. It provides some observations on the most commonly used model of trans-national organisation and structures – the international association of independent firms – although the terminology used by Oxera is "network" or "alliance". It should be noted that in this study, the use of the term "international association of independent firms" and various abbreviated versions of this term refers to the structural model itself, and not to a categorisation based on the application or not of regulatory requirements which are dealt with in 1.2. and chapter 6 of this study.

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1 It should be noted that the use of the term trans-national in this study is different to the Forum of Firms (FoF) terminology. The FoF uses trans-national when defining "trans-national audit" as "audit of financial statements which are or may be relied upon outside the audited entity's home jurisdiction for purposes of significant lending, investment or regulatory decisions: this will include audits of all financial statements of companies with listed equity or debt and other public interest entities which attract particular public attention because of their size, products or services provided." The use of the term trans-national in this study is in relation to a broader range of professional accountancy services where these are provided across jurisdictions.

2 "Ownership rules of audit firms and their consequences for audit market concentration", Oxera (October 2007), pp 103-106. On the subject of concentration, a further study has been published by the United States Government Accountability Office which is written from the US perspective. This also has some reflections on international structures. "Audits of Public Companies: Continued Concentration in Audit Market for Large Public Companies Does Not Call for Immediate Action", US GAO (January 2008).

The illustrative analysis in this study of the different types of existing organisations and practices is pursued against the backdrop of an analysis of regulatory and other factors which have historically greatly conditioned the evolution of organisational structures within the accountancy profession when operating in Europe and internationally. This backdrop outlines the very marked national perspective of regulation and the very limited relevance of European Internal Market provisions until a few years ago. It is hoped that the empirical findings of the study can provide a stimulus for considering regulatory frameworks which are more conducive to the needs of the European Internal Market, as well as to broader demands of globalisation, whilst continuing to protect the public interest.

1.2. Network definition

One aspect of the study is the collation of the views of the most important trans-national organisations and practices in Europe today as to whether in their perception they fall within or outside of the scope of the network definition in the revised Company Law Directive on Statutory Audit (2006/43) (henceforth referred to as the revised Statutory Audit Directive). This is the subject of chapter 6.

Observations have also been recorded in some cases in relation to the IFAC's Code of Ethics for Professional Accountants, Section 290 Independence-Assurance Engagements, introducing a new networks and network firms definition which is closely aligned with the revised Statutory Audit Directive definition.[3] The network definition in the revised Statutory Audit Directive is required to be transposed nationally by June 2008 (as will the majority of the revised Statutory Audit Directive's provisions). The effective date for compliance with the IFAC definition of networks and network firms is for reports issued on or after 31 December 2008.

Furthermore, the study summarises views on the scope and implications of the revised Statutory Audit Directive's network definition as perceived by the different trans-national organisations and practices. It also records, where relevant, their reactions both in relation to internal organisation as well as to external communication with regulators and clients, highlighting in particular where reactions appear to be the unintended impact of regulatory change.

It is important to clarify that many of the trans-national organisations and practices in existence today, which are the subject of this study, have traditionally attracted the label of "networks". However, this label has generally been used in a generic, as opposed to legal, sense. This was certainly the case at the time of the 2003 European Commission Communication on statutory audit which preceded the revised Statutory Audit Directive and first drew attention at EU level to "networks". The Communication referred to concerns regarding governance, control and transparency issues within the most visible of the profession's trans-national organisations[4]. In fact, the term "network" evolved as a broad description to convey a grouping of firms which "interacted" or "networked" between themselves for various purposes, and most particularly to help generate a capacity to provide services across different jurisdictions. Necessarily, therefore, the label "network" covered a wide range of different organisational structures and arrangements including international associations and the other types of trans-national arrangements in place today, which are discussed in this study.

[3] In July 2006, the International Ethics Standards Board for Accountants (IESBA) of IFAC issued revisions to its Code of Ethics for Professional Accountants, Section 290 Independence-Assurance Engagements.

[4] "Reinforcing the statutory audit in the European Union", Communication from the Commission to the Council and the European Parliament (21 05 2003), p 13.

The generic use of the term "network" is now changing on account of the legal definition in the revised Statutory Audit Directive and of the IFAC definition. As noted, this study focuses on describing existing organisational arrangements and structures and therefore does not seek to address which of the different types of trans-national organisations and practices fall under the EU network definition, nor that of IFAC and its related guidance. As an earlier FEE paper demonstrates, the network definition in the revised Statutory Audit Directive is still to be transposed in many Member States and therefore it is not at this stage possible to reach such a conclusion[5]. Nor is it possible at the current time to comment on the alignment between national transpositions of the EU network definition and the IFAC guidance: an alignment which FEE strongly supports[6]. This is because, as first highlighted in 2006 by the Institute of Chartered Accountants in England and Wales (ICAEW), the national transposition process with regard to the definition could result in an international organisation being viewed as a network in one EU jurisdiction, but not in another EU jurisdiction, if insufficient attention is given to the need for consistent transposition[7].

Consequently, this study summarises the views of the most important trans-national organisations and practices in Europe today with regard to the network definition in the revised Statutory Audit Directive and its regulatory consequences. All references to the network definition in the study are to the definition in the revised Statutory Audit Directive (also referred to in abbreviated form as "EU network definition"), unless specific reference is made to the IFAC definition. It should be noted that the study does not deal with the existence of definitions in legislation or regulation in non-EU jurisdictions.

1.3. Methodology

This study has been prepared on the basis of a survey of chief executives and senior staff members of a range of international accounting organisations and practices undertaken mainly between April and July 2007 through a detailed questionnaire and structured interviews. In addition, the study has drawn on an analysis of publicly available documentation such as annual reports and website information. The selection criteria for carrying out interviews was based primarily on the European survey in the International Accounting Bulletin of August 2006, and specifically the top 20 in the survey as listed by size of income. In addition, a further 10 interviews were carried out with international accounting organisations and practices outside of the top 20, in order to capture other structures of relevance to the European Internal Market. The full list of the international organisations and practices which have participated in the survey underpinning this study can be found in Annex I. The questionnaire on which the study is based can be found in Annex II.

During the course of the research for this study, important changes were witnessed in the sector both in terms of individual firms moving from one association to another as well as in the merging of associations and groupings. However, it was felt appropriate to include the findings of the interviews

5 "FEE Survey on the Network Firm definitions across Europe" (July 2007).

6 "The use of [the IFAC] guidance in European Member States would promote consistent application of the network firm definition internationally as a network definition is first and foremost a response to cross-border issues in relation to international associations of audit firms.
Therefore, FEE Member Bodies should discourage their national legislators or regulators from adding additional national requirements or guidance to the Directive's network definition and seek to persuade them to consider the IESBA guidance on the network definition for use in their jurisdiction." "FEE Survey on the Network Firm definitions across Europe" (July 2007), p 12. The situation regarding national transposition of the network definition will be the subject of an up-dated survey by FEE in the course of 2008.

7 "ICAEW Informal comments on practical implementation of "network definition" in the EU Statutory Audit Directive – and relation to IFAC definition" (August 2006).

with these organisations and practices in the study. It is also appropriate to observe that further changes in the sector may also be forthcoming, whether in response to market demand or regulatory changes or a combination of both. While the survey did not include direct questions in these respects, observations were made by a number of respondents and are recorded, as appropriate, in this study.

The study was undertaken in full recognition of the fact that the internationalisation involves Europe but also naturally goes far beyond Europe. Where possible, reference is made in the illustrative analysis to the relationship between the organisational arrangements in Europe and the global structures which exist. However, it is to be noted that the degree of analytical coverage with regard to global structures is necessarily lower than that afforded to organisational arrangements in Europe, which in itself cannot be said to be exhaustive.

In all cases, the illustrative analysis of the organisational structures and practices, as well as the references to the reactions to the network definition, are given in aggregate form without direct reference to any individual respondent. Broad and occasional reference is, however, made in the study to the so-called Big Four (Deloitte Touche Tohmatsu, Ernst & Young Global and KPMG International, PricewaterhouseCoopers International) where this assists the analysis, although again no direct reference to any individual respondent is made. As part of the final drafting process, this study has been shared with all the respondents to the survey. The results of the survey and this study have been reviewed by the persons interviewed and where needed, clarifications and amendments have been made on the basis of this review.

1.4. Structure of study

The study is structured as follows:

Chapter 2 sets out the primary legal and regulatory requirements, as well as other factors, which constitute the context in which the accountancy profession's trans-national structures have evolved and currently operate in response to the internationalisation of business.

Chapter 3 identifies the main models of trans-national organisations and practices, based on the self-description of respondents to the survey, which exist in Europe today.

Chapter 4 discusses the legal, structural and operational aspects of the most predominant form of trans-national organisation and practice evident in the profession today: the international association of independent firms. The chapter focuses both on common characteristics across all international associations as well as the defining features of three broad categories of associations, according to a categorisation identified in the course of the research.

Chapter 5 discusses the legal, structural and operational aspects of the other recorded forms of trans-national organisation and practice: the integrated international partnership and the national practice with subsidiaries in other jurisdictions. This chapter also considers the interaction of these two models with the model of an international association of independent firms.

Chapter 6 considers the network definition in the revised Statutory Audit Directive, on the basis of the perspectives and reactions of the trans-national organisations and practices.

Chapter 7 summarises the conclusions of the study.

2. LEGAL AND REGULATORY CONTEXT

2.1. Understanding the context of the accountancy profession's international development

This chapter sets out the primary regulatory, legal and other requirements and constraints which are relevant to the evolution of the accountancy profession's response, in structural, organisational terms, to the internationalisation of business. It is important to emphasise that, on account of these requirements and constraints, the accountancy profession is in a very different position to that of corporate entities. Without an understanding of this context, it is difficult to appreciate why the trans-national providers of accountancy services are structured as they are. This chapter then considers, drawing on the responses to the survey, the broad categories of structural models into which the most economically relevant important trans-national organisations and practices in Europe fall. In chapter 3, the main characteristics of the different models are discussed and in subsequent chapters the details of the different models are addressed.

In considering the various forms of trans-national organisations and practices in the accountancy profession, it is essential to bear in mind that statutory audit – one of the key activity areas of the profession where the public interest dimension is the most pronounced – is subject to very specific national legal requirements in practically all jurisdictions of the world. Furthermore, where accountancy and related services such as tax are concerned, many jurisdictions also employ comparable legal requirements. These requirements are justified by national authorities on public interest grounds and FEE and the accountancy profession as a whole fully recognise the importance of public interest consideration. Equally, the proportionality and fit-for-purpose nature of these requirements need to be constantly monitored: as chapter 7 suggests, some review in the interests of the Internal Market and the public interest more broadly could be beneficial.

Among the most relevant legal provisions to consider are those relating to ownership and control of audit firms, professional liability, education and training requirements and related approval procedures necessary to undertake statutory audit: provisions in these areas have had the most direct impact on shaping how the accountancy profession has responded to the demand for international professional services. However, these requirements should not be seen in isolation. It would be more appropriate to view them as reflecting in some cases and complementing in others, the myriad of other jurisdiction-specific constraints which, collectively, have had a very considerable bearing on the evolution of the particular structures which the accountancy profession has assumed when servicing international clients. Finally, consideration needs also to be given to the very nature of services provided by the accountancy profession – in themselves, these services are necessarily jurisdiction-specific to a far greater degree than many other professions and sectors, and the limited nature of the European Internal Market for services.

Taken together, these factors, which are elaborated upon below, have created a very different context for the pursuit of internationalisation by the accountancy profession to that experienced by corporate entities and other professions. It is perhaps on account of the complexity of this context that the understanding of the structures of the trans-national organisations and practices within the accountancy profession has been less well advanced than that of corporate entities and other professions.

2.2. Ownership and control rules and approval requirements

Within the European Union, ownership and control requirements in relation to audit firms have been in place since the adoption of the Eighth Company Law Directive in 1984 (84/253) (henceforth referred to as the Eighth Directive). The relevant provision in the Eighth Directive stipulated that the majority of voting rights in an audit firm and the majority of the management body must be held by statutory auditors approved in the Member State in question[8]. It should be added that, while the Eighth Directive only referred to "the majority", when transposing the Eighth Directive many Member States included requirements in the direction of 100% of voting rights and management composition by nationally approved statutory auditors in their national laws.

Furthermore, the Eighth Directive also required that the natural persons carrying out the statutory audit on behalf of audit firms should be nationally approved[9]. The revised Statutory Audit Directive re-defines ownership and control requirements. It has modified the requirements from their jurisdiction-specific nature towards a European approach. The revised Statutory Audit Directive introduces a set of EU-wide provisions which will require audit firms to be owned by a majority of registered auditors approved in *any* Member State. However, these provisions are in the process of being transposed in most Member States and it should be noted that the revised Statutory Audit Directive does not define specifically what constitutes a majority. Through the course of the study the views of some of the respondents in relation to the impact of these new provisions are conveyed. However, this subject was not pursued in depth through the current survey and merits more detailed attention. The relevant point for this study remains that the requirement in Europe has historically been that of "nationally owned" audit firms.

It should be noted that while the Eighth Directive did not address the freedom of movement of statutory auditors between EU Member States, EU legislation existed to permit this, through Directive 89/48 on the Recognition of Professional Qualifications. The revised Statutory Audit Directive addresses explicitly the freedom of movement of statutory auditors, although the nature of recognition arrangements between EU Member States remains unchanged from Directive 89/48 which in turn has been replaced by Directive 2005/36[10]. The arrangements therefore continue to be based on the completion of an aptitude test covering solely the differences between the education and training in the country of qualification and that required in the host country. Given that this issue relates to individual

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8 Article 2 of the Eighth Directive includes:
"(ii) a majority of the voting rights must be held by natural persons or firms of auditors who satisfy at least the conditions imposed in Articles 3 to 19 with the exception of Article 11 (1) (b) ; the Member States may provide that such natural persons or firms of auditors must also be approved. However, those Member States which do not impose such majority at the time of the adoption of this Directive need not impose it provided that all the shares in a firm of auditors are registered and can be transferred only with the agreement of the firm of auditors and/or, where the Member State so provides, with the approval of the competent authority;
(iii) a majority of the members of the administrative or management body of a firm of auditors must be natural persons or firms of auditors who satisfy at least the conditions imposed in Articles 3 to 19 ; the Member States may provide that such natural persons or firms of auditors must also be approved. Where such body has no more than two members, one of those members must satisfy at least those conditions."

9 Article 2 of the Eighth Directive states:
"(i) the natural persons who carry out statutory audits of the documents referred to in Article 1 on behalf of firms of auditors must satisfy at least the conditions imposed in Articles 3 to 19 ; the Member States may provide that such natural persons must also be approved."

10 Directive 2005/36 on the Recognition of Professional Qualifications which consolidates and in some cases modernises EU arrangements for freedom of establishment and freedom to provide services. Details of these provisions and their impact on the accountancy profession and their interaction with other EU legislation (including the revised Statutory Audit Directive) can be found in the recent FEE paper "Internal Market for Services and the Accountancy Profession: Qualifications and Recognition" (November 2007).

auditors (natural persons) – and not audit firms and organisational structures across borders – it is not addressed in this study.

FEE is naturally aware of the intention of the European Commission to undertake a public consultation on the issue of ownership requirements and the potential impact on choice and competition in the audit sphere. This area has assumed particular prominence on account of the publication in October 2007 of the Oxera report for the European Commission on "Ownership rules of audit firms and their consequences for audit market concentration"[11]. The UK oversight body – Financial Reporting Council – has also been a keen contributor to the debate in this sphere[12]. However, this study does not address these issues as the Oxera report was not published at the time of conducting the survey.

2.3. Differences in regulatory approach to service provision and market access

In addition to the above constraints concerning ownership and control on audit firms and approval requirements for auditors, consideration needs to be given to a number of other factors which add to the complexity of the context in which the accountancy profession has developed organisations and practices to serve trans-national clients. These include the substantial differences in the activities which professional accountants are permitted to undertake in different jurisdictions as well as the differences in Member States' market access rules in relation to the provision of accountancy services outside of statutory audit. In addition, there exist variations in Member States' rules regarding the range of non-audit services which can be offered by a statutory auditor to an audit client.

In all the above areas, there exists a considerable heterogeneity of national rules across EU jurisdictions, creating a context which has historically been and continues to be unconducive to promoting the uniformity of structures on the part of trans-national service providers. Most directly pertinent in this respect are the very considerable differences across EU jurisdictions in relation to rules concerning the provision of non-audit services to an audit client.

Internationally, as confirmed by the 2007 IOSCO survey, there is a low degree of commonality in the regulation of non-audit services and the approaches or models in place "are often reflective of the larger corporate governance and legal framework in a jurisdiction, as well as historical business custom and practice"[13]. Within the European Union, the situation is also characterised by sizeable differences. These are not addressed effectively by European Union legislation. The revised Statutory Audit Directive embeds in legislation the threats and safeguards approach to independence adopted in the 2002 European Commission Recommendation on Independence: however, it also permits use of the option to introduce additional independence rules and prohibitions.

Also of relevance is the diversity of regulatory approaches and of market access rules including qualification requirements at national level across the European Union in relation to services outside of statutory audit, including other assurance services. The extent of these differences is dealt with in

[11] "Ownership rules of audit firms and their consequences for audit market concentration", Oxera (October 2007).

[12] "Choice in the UK Audit Market. Final Report of the Market Participants Group", UK Financial Reporting Council (October 2007).

[13] "A Survey on the regulation of non-audit services provided by auditors to audited companies Technical Committee and Emerging Markets Committee of the International Organisation of Securities Commissions", IOSCO (January 2007).

detail in two important FEE studies[14]. Of most immediate interest for the purpose of this study are the differences in rules relating not only to other services in the accountancy sphere, including general accounting and tax, but also to other services such as legal advice and management consultancy. The revised Statutory Audit Directive does not address this matter, other than to support a principles-based approach to the provision of non-audit services in the framework of the provisions of independence (as noted above). This is also the approach of IFAC in the revised Code of Ethics. However, there is no mandatory harmonised approach set at European Union level (and less still at global level) thereby resulting in the existence of inconsistent rules between jurisdictions in the services which accounting firms can offer to the market. In turn, the national rules concerning permitted services interlock with the national rules on ownership and control.

Professional liability

Differences across jurisdictions in professional liability regimes also constitute an extremely important contextual factor. As has been recognised by the European Union both in the revised Statutory Audit Directive and in the subsequent independent studies undertaken by London Economics and Oxera at the request of the European Commission[15], there is a great diversity and unevenness of liability arrangements at national level in place today. More specifically, while there are indeed a growing number of Member States which have, through different means, limited the liability of auditors, there are still a significant number which leave auditors entirely exposed to unlimited joint and several liability. It should be recalled that statutory audit is the single most important common service provided by the accountancy profession internationally and that currently, both at European Union and at global level, there is no harmonisation, even on the basis of minimum criteria. Following the completion of the survey, the European Commissioner for the Internal Market and Services has confirmed in December 2007 his intention to issue a European Commission Recommendation on liability which would refer to the need to introduce a limitation, rather than indicate the precise form that this should take.

The views of respondents to the survey on the liability situation today as it relates to their trans-national organisations and structures are dealt with through the course of this study. Naturally, these views also refer to the situation regarding professional indemnity insurance. As noted by London Economics in their report for the European Commission, the availability of commercial insurance has fallen sharply and to such an extent that the available insurance would cover less than 5% of some of the large claims some firms face at the present time. Furthermore, insurance premiums have increased sharply[16].

Nature of demand for accountancy and related services

In considering the context in which the accountancy profession has developed trans-national organisations and practices, it is also important to bear in mind the nature of the demand for professional services from the profession. While the development of trans-national organisations and

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[14] "Admission to the Profession of Accountant and Auditor – A Comparative Study", FEE (December 2002) and "Provision of Accountancy, Audit and Related Services in Europe", FEE (December 2005).

[15] "Study on the Economic Impact of Auditors' Liability Regimes – Final report to EC-DG Internal Market and Services London Economics" (September 2006).
"Ownership rules of audit firms and their consequences for audit market concentration", Oxera (October 2007).

[16] "Study on the Economic Impact of Auditors' Liability Regimes – Final report to EC-DG Internal Market and Services London Economics" (September 2006), pp xxxiii/iv.

practices has evidently been in response to the internationalisation of business, such as the audit of subsidiaries across borders, the core nature of the services provided by the profession have remained jurisdiction-specific to a very great degree.

This is, of course, the case with regard to reporting by single jurisdiction entities but is also relevant in relation to group reporting and auditing of multi-national corporate entities. In the latter case, the parent undertaking and subsidiaries still need to prepare individual statutory accounts, often in accordance with national GAAP rather than international standards. This may take place in form of adapting the group reporting under group reporting standards (often international standards) to reporting under the applicable national GAAP. To a very high degree, therefore, the accountancy profession has been called upon to provide professional expertise to create a channel of communication and reporting between different rules specific to different jurisdictions.

It should be noted that it is only in very recent years that financial reporting has assumed an important international dimension in terms of standards, at least with regard to the consolidated accounts of listed entities. This has been achieved in the European Union through the International Accounting Standards Regulation (EC 1606/2002). Still, even in the European Union, for the overwhelming majority of companies (in terms of absolute numbers), financial reporting standards are set within individual jurisdictions and the process for the international harmonisation of auditing standards is still to be completed (as per the requirement in the revised Statutory Audit Directive).

The emphasis on jurisdiction-specific rules can also be explained by the fact that tax, company law and related matters have remained in all countries throughout the world the domain of national competence. Therefore, the depth of jurisdiction-specific knowledge required to service clients has remained considerable. As a consequence, the predominant mechanism to operate in such a context has proved to be the interaction of national experts in one jurisdiction to another, either through the referral of assignments or through ongoing collaborative arrangements between such experts, such as those required to undertake the audit of a multi-national corporate entity.

It is, therefore, important to recognise how national authorities have shaped the evolution of the accountancy profession's response to the internationalisation of business not only through the maintenance of national rules *vis-à-vis* the profession on matters such as ownership and control, approval procedures and the provision of services, but also indirectly through the continued development of national tax systems, company law, accounting standards (for individual accounts and for non-listed entities) and related requirements. In short, national authorities have ensured that the demand for professional services from the accountancy profession remains highly jurisdiction-specific, despite the considerable internationalisation of business.

European Internal Market for Services

As is well recognised, the creation of a European Internal Market for Services has proved challenging and a long-term assignment. The 2000 European Commission report on "The State of the Internal Market for Services"[17] referred to a huge gap between the vision of an integrated European Union economy and the reality as experienced by European citizens and service providers. This prompted a concerted political effort to review and improve existing EU legislation concerning freedom of establishment relating to individual members of a profession and to extend legislation beyond this to create a veritable European Internal Market for the modern service economy.

[17] COM(2002) 441

The specific legislative provisions of relevance to the accountancy profession, which are in part currently still at transposition stage, are examined in a recent FEE study, "Internal Market for services and the accountancy profession: qualification and recognition" FEE (November 2007). While this study provides commentary and illustrative guidance on the practical implications of many of these legislative provisions, it also highlights a number of important pending questions. In the latter areas, there is a need for further legal clarification on the interaction between the EU Directives and in some respects also on the actual content of a number of provisions and on the scope of Member State implementation. Among the most important questions are issues such as the practical interpretation of temporary and occasional service provision and the requirement to have a physical infrastructure in cases of establishment. All these questions could be highly relevant for the future evolution of the profession's structures in the European Internal Market context. For the purposes of the present study, however, it is sufficient to note that these provisions have not impacted on the profession's evolution to date and therefore have not had a bearing on the profession's existing trans-national structures.

In conclusion, the above factors, when considered together, create a very different context in which to pursue internationalisation to that experienced by corporate entities and other professions. It is perhaps on account of the complexity of the overall context that understanding of the structures of the trans-national organisations and practices within the accountancy profession may be less well advanced than is the case elsewhere.

3. UNDERLYING MODELS OF TRANS-NATIONAL ORGANISATIONS AND PRACTICES

3.1. Introduction

This chapter sets out the findings of the survey in relation to the underlying structural models used by the principal trans-national organisations and practices operating within the accountancy profession in Europe today. The findings refer to the number and type of different models, and the distribution of their use across survey respondents. They are based solely on the responses received to survey questions specifically directed at ascertaining the underlying model, encompassing broad legal and organisational characteristics, used by the trans-national organisations and practices which participated in the survey.

As noted in chapter 1, through the course of this study, branding and broader communication aspects are analysed drawing on both responses to specific survey questions in these areas and also on website information and annual reports. However, the findings in this chapter relate only to the underlying model used by respondents and it is helpful to reiterate this point, given the differences of interpretation which can arise in some instances on account of the diversified use of terminology across respondents in material for external communication.

3.2. Description of the organisations

In terms of specific methodology, respondents were asked to provide an overall description of their organisations and were prompted to do so by the following question and suggested answers:

"To which of the following descriptions does the grouping most closely correspond?

- *An integrated international partnership*
- *An international association of independent firms coordinated by a separate legal entity*
- *A mechanism for cross-border referrals"*

Respondents were also given the opportunity to provide a brief description of their organisation if none of the above was deemed applicable in their case.

International association of independent firms

The findings of the survey confirm that the trans-national development of the profession in Europe is based, in numerical terms, almost entirely on the use of a model of an international association of independent firms coordinated by a separate legal entity. Given the predominance of this model, the study affords particular attention to its structural aspects as well as to the wide range of different operational features which exist within this overall model. These matters are discussed extensively in chapter 4.

One respondent advanced the view that a different categorisation was appropriate in relation to an "international alliance of independent firms". However, as emerged from the individual respondent's answers to other survey questions, it appears that the grounds for differentiating this respondent from an international association coordinated by a separate legal entity are based on operational matters, and in particular on branding and communication. This is to say that, in terms of underlying structural model, there appear to be no distinguishing features. This is not to negate the importance of

differentiated operational approaches, in relation to this individual respondent and associations and also between the associations, as discussed in chapter 4. However, the survey did not find that this represents a different underlying structural model.

Integrated international partnership

Only one survey respondent indicated that, as a trans-national grouping as a whole, it was an integrated international partnership, that is to say a partnership encompassing partners from and based in different jurisdictions. However, in light of the answers of other respondents to other questions in the survey, it is clear that it would be inaccurate to regard this model as insignificant or isolated, which its minority status in the aggregate of responses to the question posed in the first part of the survey might appear to suggest.

As discussed in chapter 5, the survey found that integrated international partnerships exist as member firms of certain international associations, and in others the model is attracting growing attention with regard to its possible future adoption. It is important to emphasise that these trends are evolving and are still relatively modest when set against the overall context of organisational structures used in Europe.

As is also brought out in chapter 5, the survey found that the current interaction between the models can broadly be said to fall into two camps. The first denotes the emergence of a "hybrid" model where the integrated international partnership is "housed" within an international association of independent firms pursuing a high level of operational integration. The second is where there is a far looser interaction between the integrated international partnership and the international association, where the former has a significantly higher degree of operational integration and the latter serves solely to provide a liaison for potential referrals to and from jurisdictions outside those covered by the integrated international partnership.

Cross-border referral mechanism

None of the respondents replied that their organisation specifically falls into the category of a cross-border referral mechanism; that is to say a grouping which make referrals from one practice to another without recourse to the establishment of a separate legal entity to do so. However, one of the respondents described its structure as incorporating a mechanism for cross-border referrals within an entirely different underlying structure from any of the three suggested answers to the survey questions (see below).

This being said, in the case of a number of respondents which indicated that they are international associations of independent firms coordinated by a separate legal entity, there appear to be grounds to view them in operational terms, whatever their legal structure and commercial aspirations, as effectively being mechanisms for cross-border referrals. As discussed in further detail in chapter 4, this is due to the particularly limited role of coordination undertaken by the separate legal entity. In such cases, the use of the terminology "cross-border referral mechanism" would, however, be a descriptive one and not a categorisation based on legal and organisational characteristics. Hence the conclusion of the findings that none of the respondents is a cross-border referral mechanism in the legal and structural sense, with the exception of one respondent which, as noted, indicated that one aspect of its broader structure was based on this model.

National practice with subsidiaries

On the basis of the exception noted above and one further respondent's replies, the survey found that an additional underlying model is in use in Europe, albeit on a relatively limited scale. This model is centred around a large national practice based in one jurisdiction which, wherever possible, fully owns subsidiary practices in other jurisdictions. Where full ownership is not possible, the structure consists of subsidiaries of the national practice in other jurisdictions, with local share ownership as appropriate. From the answers of the respondents in this category to other survey questions, it is evident that this organisational structure can also interact with other models, notably through membership of an international association. These matters are also dealt with in chapter 5.

4. INTERNATIONAL ASSOCIATION OF INDEPENDENT FIRMS COORDINATED BY A SEPARATE LEGAL ENTITY

4.1. Introduction

As confirmed in chapter 3, trans-national organisation and practice in the accountancy profession today is almost completely dominated by the model of an international association of independent firms coordinated by a separate legal entity. This model is employed by the largest and most commonly known accountancy practices, including the Big Four. In this chapter, both the common characteristics as well as the distinguishing features across all the associations surveyed are considered in detail.

Following this introduction, the chapter is divided into the following sub-sections to clearly illustrate the common characteristics and distinguishing features recorded through the survey:

- Legal structure and characteristics: section 4.2.
- Governance arrangements: section 4.3.
- Operational matters: section 4.4.
- Summary of findings: section 4.5.

The focus on legal structure and characteristics is a key starting point to understand the functioning of the associations. Without an appreciation of this perspective, it is extremely difficult to address the issues of governance, decision-making, quality control and related matters within the associations which have been subjects of keen regulatory interest in recent years. As noted, it was observed in the 2003 European Commission Communication on statutory audit that: "international networks are often based upon rather loose agreements between separate and independent legal entities which do not allow decisive control over (and responsibility for): individual member firm's audit client and acceptance and retention procedures, audit procedures, partners decision making etc."[18].

This chapter explores from an empirical basis some of the areas raised by the European Commission Communication in relation to a wide range of different international associations. It should of course be reiterated that, in 2003, the term network was not based on a legal definition as is the case today and therefore it can be assumed that the reference in the Communication was more broadly to international associations of independent firms. It should also be underlined that the empirical analysis deals solely with the stated existence of set approaches to governance and operational matters drawing on the responses to the survey. The survey did not involve an assessment of their detailed implementation issues, as this lies beyond the scope of this study.

Of particular focus within the course of this chapter are the questions of governance, management and control, both in relation to the international association model as a whole and also to discernible categories of associations within this overall model to which reference is made below. This special focus is important as it can help correct misconceptions that may arise through the tendency to draw direct parallels with the exercise of governance, management and control within a corporate structure consisting of a holding company and subsidiaries. In reality, as this study bears out, the concepts of governance, management and control are exercised very differently in the context of international associations. For the sake of clarity, it should be underlined that the study deals only with matters at the international level – it does not cover arrangements and practices at the level of firms within individual jurisdictions.

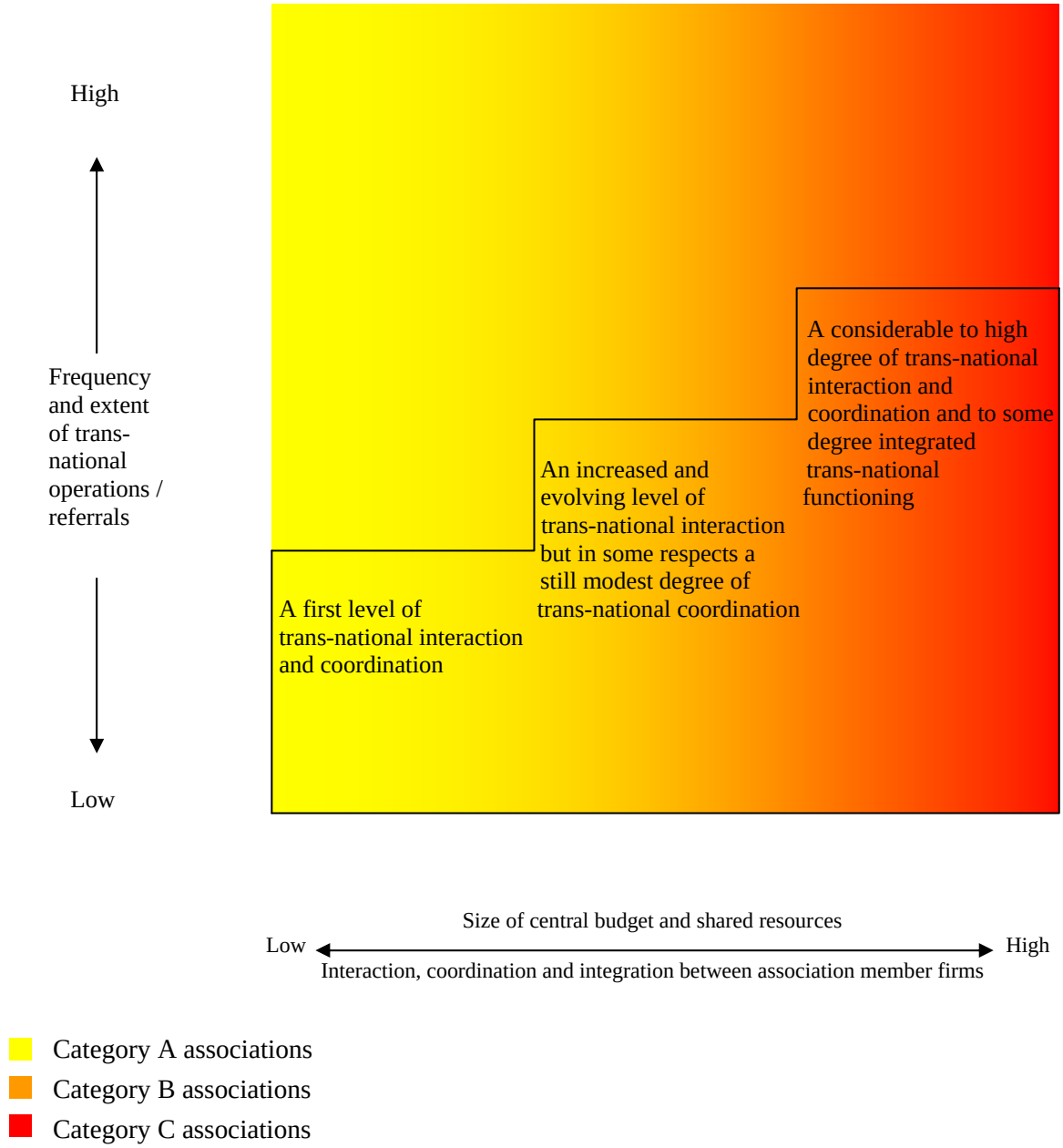
[18] "Reinforcing the statutory audit in the European Union, Communication from the Commission to the Council and the European Parliament" (21 05 2003), p 13.

Three discernible categories of associations – whose boundaries are far from clear-cut – were identified from the findings of the survey, on the basis of respondents' answers to questions concerning governance arrangements and operational functioning. These categories emerged in the framework of a broad correlation between, on the one hand, frequency and extent of trans-national operation and, on the other, investment in trans-national interaction, coordination and integration. The criteria of the three categories – A, B and C – are set out below:

- Category A associations denote a first level of trans-national interaction and coordination;
- Category B associations denote an increased and evolving level of trans-national interaction but in some respects a still modest degree of trans-national coordination;
- Category C associations denote a considerable to high degree of trans-national interaction and coordination and to some degree integrated trans-national functioning.

The criteria of the three categories and their relationship to the broad correlation are illustrated in Graphic 1 on page 25.

Graphic 1: Broad categories of associations and correlation to trans-national operations



As Graphic 1 shows, there are "blurred areas" between the categories, rather than clear-cut boundaries and it is the case that some individual respondents can be interpreted to fall between two categories. In fact, the reference to these categories is purely to assist in the interpretation of the detailed findings of the survey which are explored in sections 4.2. – 4.4.

Section 4.5., which summarises the survey findings in relation to associations, includes a more developed version of Graphic 1. This latter version illustrates the specific characteristics in the governance and operational spheres of the three broad categories of associations.

While the aim of the study is to create a general interpretative framework for associations operating in the profession today, rather than categorising individual firms, it is apparent that the Big Four firms are Category C associations. However, they should not be interpreted to exclusively populate this category. Clearly, as is widely recognised, the Big Four occupy a "domain" of their own in terms of aggregate fee income of member firms, such is the distance between the Big Four and the next largest trans-national accountancy organisations and practices in this regard. This being said, for the purposes of this study, with its focus on governance arrangements and operational functioning, a number of organisations outside the Big Four can also be regarded as Category C associations.

Overall, and in broad indicative terms, the survey found that Category C associations constituted the smallest number of survey respondents of the three different categories. The survey found therefore that the majority of respondents were either Category A or Category B associations. The distribution of respondents between these two categories was found to be broadly even.

4.2. Legal structure and characteristics

4.2.1. Underlying legal model

The findings of the survey reveal a high degree of commonality across all the associations surveyed in terms of underlying legal model. The most important elements of structural commonality lie in the distinct legal relationships between the constituent parts of the associations and the nature of the contractual interaction with clients.

On the basis of the survey findings, it is very clear that, among the many regulatory and legal factors which have shaped the evolution of the profession's trans-national structures, one of key drivers for the use of the association model is the consideration of liability. A recurrent observation made by respondents to the survey was that concern regarding possible litigation transfer over jurisdictions constituted one of the principal reasons for working through the organisational model of an association.

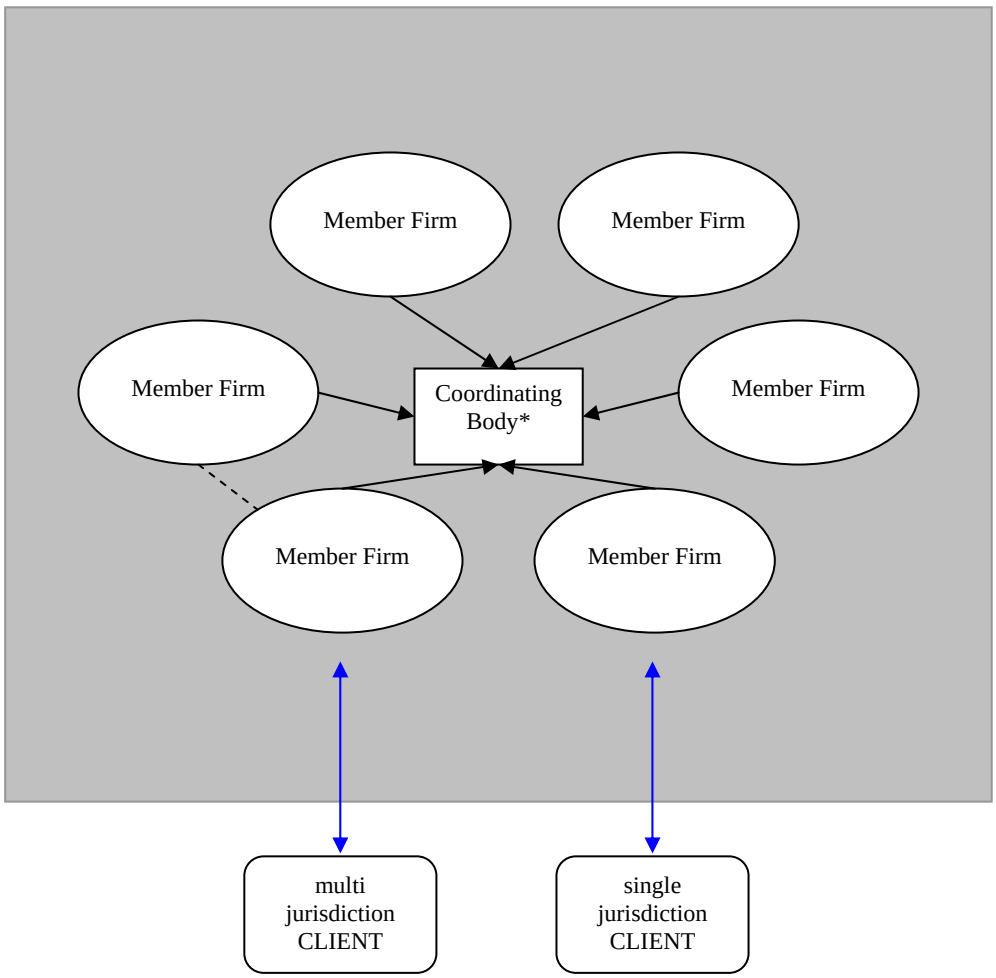
Reflecting liability concerns and other jurisdiction-specific regulatory requirements, the key legal structures and related characteristics of an association are as follows:

- An association consists of, on the one hand, legally separate firms (or groups of firms) based in or representing different jurisdictions and, on the other, a separate legal entity (or entities) for the facilitation of interaction and coordination on international matters between the separate firms themselves;
- Each firm (or group of firms) has a legal and functional relationship with the separate legal entity (or entities): the former is typically known as a "member firm" and the latter can be referred to as the "coordinating body";
- The coordinating body (or bodies) is not-for-profit organisation and either has a legal form which is specifically designed for not-for-profit organisations or is a legal form which is normally used or can be used in this way;
- The coordinating body (or bodies) provides services *only* to member firms: it does not provide services to clients of member firms, nor does it have any other direct clients;
- The association as a whole acts as (to varying degrees) as a "portal" *vis-à-vis* the market but does not enter directly into any contract relations with any clients in the market;
- The association has a set of bye-laws or rules which set out the obligations and rights of membership;

- All contractual agreements with clients for professional services are with the individual member firm in the relevant jurisdiction (and not with the coordinating body);
- Where specific member firms engage in joint-working to service a trans-national client, they do so by contractual agreement between themselves and in a manner which does not engage the coordinating body, other member firms who are not party to the contractual agreement or the association as a whole.

Graphic 2 on page 28 sets out in basic outline the architecture of the association model in terms of its interaction with the market. It highlights the important differentiations to be made between the overall association, coordinating body(ies), and member firms. The key feature which Graphic 2 illustrates is the separate legal status of each member firm and the fact that contractual arrangements with clients are signed by individual member firms, whether the assignment is single or multi-jurisdictional in nature.

Graphic 2: Basic architecture of the association model



* One or more separate legal structures

Contract between member firm that provides the service and head office of client

Sub contract between contracted member firm and another member firm

Association bye-laws / rules, constitution / member agreement

Financial contribution to central budget of the association

A review of the information on the association websites confirms that all the associations which participated in the survey provide a brief commentary or disclaimer to clarify the above structure. This information has very clearly been developed specifically to address liability questions and to protect against the transfer of liability from one member firm to another.

Among the key common elements in these commentaries are references to the separate legal nature of member firms, each of which provides services in its own rights and has no liability for the actions and omissions of other member firms, nor the authority to bind another member firm or the association as a whole. Some of the commentary is developed further to confirm that the association does not have

any authority to obligate or bind any member firm. Specific clarifications also exist with regard to branding, for example where it is noted that member firms may carry a common name but do not share common ownership or constitute a legal partnership. In addition, more detailed disclaimers and clarifications can be found in the increasing number of published annual reports/reviews. The substance, however, is unchanged.

Further details of the legal and structural characteristics of associations are given in the following sections which also record, within the broad framework of the model outlined above, notable specificities identified among the associations surveyed.

4.2.2. Coordinating body: role, legal status and legal seat

The existence of a separate coordinating body is in legal terms the lynchpin of the international association model. It is the legal vehicle through which interaction, coordination, and integration among member firms can be pursued while maintaining the legal independence of individual firms and fulfilling the liability objectives arising from the unevenness of liability regimes across jurisdictions. As is explored in subsequent sections, the role of the coordinating body differs very considerably in operational terms between the three identified categories of associations. In legal terms, however, there appear to be more similarities than differences.

Common characteristics of the coordinating body

Responses to the survey confirmed the existence of a defined set of characteristics and objectives in relation to the coordinating body which is common to all associations. The most important of these characteristics and objectives are as follows:

- The non-practising status of the coordinating body resulting in no direct relationships with clients;
- The not-for-profit nature of the coordinating body;
- The coordinating body's provision of a legal basis or a reference point for the establishment of governance structures and enforceable membership rules for the association in form of agreements or other contractual forms (dealt with in sections 4.3.1. and 4.3.2.);
- The coordinating body's provision of a legal basis for the sharing of costs across member firms for the delivery of services from the coordinating body to member firms.

Particularities relating to the coordinating body

The research demonstrates that a limited number of different legal forms are used to undertake the function of the separate coordinating body and a number of associations use more than one coordinating body in the form of a multi-tier structure. The specific legal form and legal seat of the coordinating body(ies) of the international associations surveyed are set out in Table 1 below.

However, it is helpful to first observe that respondents' replies to the survey indicate that there is not a close link between the choice of legal forms and legal seats with broader decisions regarding trans-national governance arrangements and the actual operational functioning of the coordinating body or of the association as a whole. This is to say, governance arrangements and operational objectives of the associations – which do differ (sections 4.3. and 4.4.) – can be pursued whichever specific legal forms are used to constitute the coordinating body. While the survey did not specifically request information in this regard, many respondents' replies indicate that the particular legal form and

location of the coordinating body owe much to the historical evolution of the association and in particular the national location of one or more of the founding member firms of the association.

Table 1: Legal form and legal seat

Total Number of firms	Legal entity	Legal seat
4	Limited Liability Company	UK (2) Netherlands France
12	Company limited by guarantee	UK
6	Not-for-profit organisation	US (2) Switzerland (2) Netherlands Belgium
5	Multi-tier legal structure	UK (2) Switzerland US Isle of Man and Guernsey

Seat of legal entity

As is evident from Table 1, the overwhelming majority of the legal seats of the coordinating bodies are based in the European Union, with some respondents recording their location in Switzerland, the Isle of Man and Guernsey and, in a number of cases, the US. The single most common location is the UK. One respondent indicated that the location of the coordinating legal entity is currently being reviewed, with the possibility of transferring it from the UK to a non-European country.

The survey found that the majority of associations also have their operational centre in the same location as the legal seat of coordinating body. However, it is by no means always the case or indeed necessary for the operational centre to be based in the same location. The single most common location for the operational centres is again the UK. The specific role of the operational centres is dealt with in section 4.4.

Status of legal entity

As confirmed in Table 1, just three different forms of legal entity, or combinations of two of the three forms, characterise the coordinating bodies across the whole sector of international associations surveyed. For the purpose of Table 1, different national variations of a not-for-profit organisation are regarded as a single legal form.

The most predominant form observed among the associations for the establishment of their coordinating body is a *company limited by guarantee*. Under UK company law, this vehicle is commonly used by not-for-profit organisations which require legal personality. In this form, there is no share capital and therefore no shareholders: the company has members – in this case accountancy firms - who as guarantors give an undertaking to contribute a nominal amount (such as £10 sterling)

towards the winding up of the company in the event of a shortfall upon the cessation of business. This form of company cannot distribute profits to its members and, given that the coordinating entity does not pursue profit making, it is therefore regarded as appropriate for use by many member-based associations where the sharing of costs for the provision of services to members is concerned. This legal form allows for multiple classes of members with separate voting constituencies.

Under UK legislation, a company limited by guarantee is required to abide by the applicable parts of the Companies Act, setting out, for instance, the responsibilities of boards and directors. This forms the basis of the governance arrangements of the associations, which is supplemented in turn by a membership (or accession) agreement or bye-laws signed by all member firms of the association. Among the issues dealt with in these documents is the possible distinction between different types of membership and the rights these give rise to in relation to governance of the association, as well as rights and obligations on more operational matters. These areas are dealt with in sections 4.3.1. and 4.4.

As Table 1 confirms, the use of a *limited liability company* is also a common legal form as the coordinating body among associations. Again, this legal form is subject to national legal requirements which can form the basis of governance arrangements which are also supplemented by association bye-laws. This company form, unlike that of a company limited by guarantee, can evidently be used for generating profit and indeed this is the most common practice in the market as a whole. However, in the case of all the associations surveyed, the coordinating body operates on a non-practising and not-for-profit basis.

The legal form of a limited liability company naturally requires the existence of shareholders. The associations surveyed displayed different approaches to share ownership of the coordinating body. For example, each member firm of the association can be a shareholder, in cases where entry to membership of the association carries with it the requirement to be shareholder in the company. In other cases, only a very limited number of members of the association are shareholders. This latter example forms part of a somewhat distinct association approach whereby all other (i.e. non-shareholders of the company) members of the association are regarded as "customers" who receive services from the coordinating body in order to enhance their market position and interaction with other members in order to undertake trans-national work.

The second most common form of legal entity is that of a specifically not-for-profit association, of which there are in turn a number of different types used in different jurisdictions: Switzerland, the US, Belgium and the Netherlands. The legal form of a not-for-profit organisation is used by associations with a very wide range of aggregate global revenues: this is to say by associations at both ends of the trans-national market for professional services, from the smallest to the largest.

The Swiss Verein is a frequently used legal form for a wide variety of organisations such as non-governmental organisations, political parties and multinational law firms. Its use is less frequent for accountancy associations. In relation to the US, Dutch and Belgian not-for-profit legal entities, there are no marked differences in the rationale of the legal entity although, naturally, registration procedures differ from jurisdiction to jurisdiction. In all cases, bye-laws or similar documents for the governance of the association are drawn up.

Table 1 also indicates that 5 associations have a multi-tier legal structure. The primary reason for the use of a multi-tier structure was cited as the practical convenience of having separate entities dedicated for governance issues and for operational matters regarding the rendering of services to member firms. This, however, does appear to be a major issue, given that many other respondents were found to be working with just one legal entity. Tax efficiency considerations were deemed the driver for a multi-

tier structure by one respondent. Significantly, a further reason cited by some respondents using the multi-tier legal structure was the utility of a "double-safety net" for liability purposes, which further reiterates the centrality of liability considerations in the maintenance of association structures.

Another form of multi-tier approach is whereby regional bodies exist as separate legal entities and are members of the worldwide coordinating body. Member firms are members of the regional coordinating bodies as well as of the worldwide bodies in most cases. Elsewhere, the regional bodies are members of the worldwide body. However, this form of multi-tier is not considered in Table 1. This refers only to situations where the worldwide central body itself is multi-tiered.

4.3. Governance, management and control

As noted, governance, management and control arrangements in the case of international accounting associations have attracted considerable interest in recent years from regulatory quarters. There has sometimes been a tendency to pursue this interest from an analytical reference point based on structures and practices in the corporate sector. This, however, can be misleading in some respects. The problem is that it overlooks the specific regulatory, legal and market factors which have historically strongly shaped and continue to shape the internationalisation of the accountancy profession.

As noted, the model of an association of independent firms is the most predominant one used by the profession in this internationalisation process: this section sets out the key elements of the governance, management and control arrangements of the associations. It identifies commonalities as well as differences between the categories of associations. It is important to reiterate that the study addresses governance, management and control solely in relation to the trans-national sphere, and not in relation to individual member firms within single jurisdictions.

4.3.1. Bye-laws, constitutions and other membership agreements

As noted, in the association model, the point of interaction for clients seeking and acquiring professional services is always with member firms, not the coordinating body nor the association as a whole. Neither of the latter two have the capacity, legal or otherwise, to interact with clients in this direct way. However, the coordinating body and in particular the association do seek to have a bearing – to a lesser or greater extent depending on the specific association in question – on the perception of individual clients and the market as a whole.

The overriding purpose of an association is to act as a market portal with regard to the availability of services as delivered by member firms (see section 4.4.6.). This objective can only be pursued if there is a formal agreement between member firms as to what the association stands for and what the conditions of association membership are. Formal understanding is, therefore, a critical element to the governance of the association model. The main contents of the agreements effectively constitute the operational basis of the associations and the reference point against which member firms' adherence is measured and governance is exercised.

The operational aspects of the agreements, as they apply across the three different categories of associations, are dealt with in section 4.4. In this section, some broad observations are made on the form of the agreements in relation to the different categories of associations. It should be emphasised that these observations are drawn on the basis of survey respondents' replies to questions regarding the relationship between member firms and the coordinating body and the organisation of the association.

No analysis was undertaken of the agreements themselves – which are not public documents in most cases.

Category A associations

Where Category A associations are concerned, the predominant approach is to work through a membership agreement setting out the rights and the obligations of membership. This can be linked directly to the legal form of coordinating body, where this form is a company limited by guarantee. Equally, this can also be separate and take the form of association bye-laws or a charter, which may be preceded by the signing of a membership agreement on entry to the association. The entry to an association may, as one respondent indicated, involve an exchange of letters rather than any other formal document.

Category B associations

In relation to Category B associations, the responses indicate broad similarities to the responses of Category A associations. Membership agreements exist, as do articles of associations with rules and bye-laws. In the case of one respondent reference was made to a "constitution" for which new members are required to sign a deed of adherence. Whatever their precise form, these documents set out the rights and obligations of membership and can, as noted above, be linked to the legal entity of the coordinating body.

The one notable additional element compared to Category A associations which was evident across a number of Category B respondents is the existence of licensing provisions for the use of a common name or other commonalities in branding. These provisions can be incorporated within a broader agreement or can be pursued separately. As a further point of differentiation, the agreements for Category B respondents generally include a greater proportion of additional conditions and also in many cases make reference to differentiated operational cooperation based on different membership categories. These additional elements are explored in section 4.4.

Category C associations

Where Category C associations are concerned, the findings reveal that, in broad structural terms, many of the elements observed in relation to Category A and B associations are also in place. As is explored in section 4.4., the recourse to detailed provisions and their impact on member firms is far greater. However, the fundamental basis of membership agreements setting out rights and obligations were also evident. Provisions on licensing agreements on the use of common names and materials were further enhanced in Category C associations which, as is also detailed in section 4.4., have the highest degree of commonality in these and other respects.

4.3.2. Governance and management and control structures

Overview and comparison with corporate entities

The survey requested specific information from respondents on governance arrangements and structures. The findings demonstrate the existence among all respondents of comparable governance structures showing similarities with the corporate sector, for example in the existence of boards and set channels for the delegation of implementation of board decisions. However, through the recorded observations of respondents which accompanied the description of governance structures, it is apparent that there are considerable differences between corporate entities and associations in the

degree of authority held by the boards and in the actual exercise of management and control. A formal comparative analysis with practices in the corporate sector has not been undertaken but the survey findings permit the drawing of a number of points of contrast based on general knowledge of practices within the corporate sector.

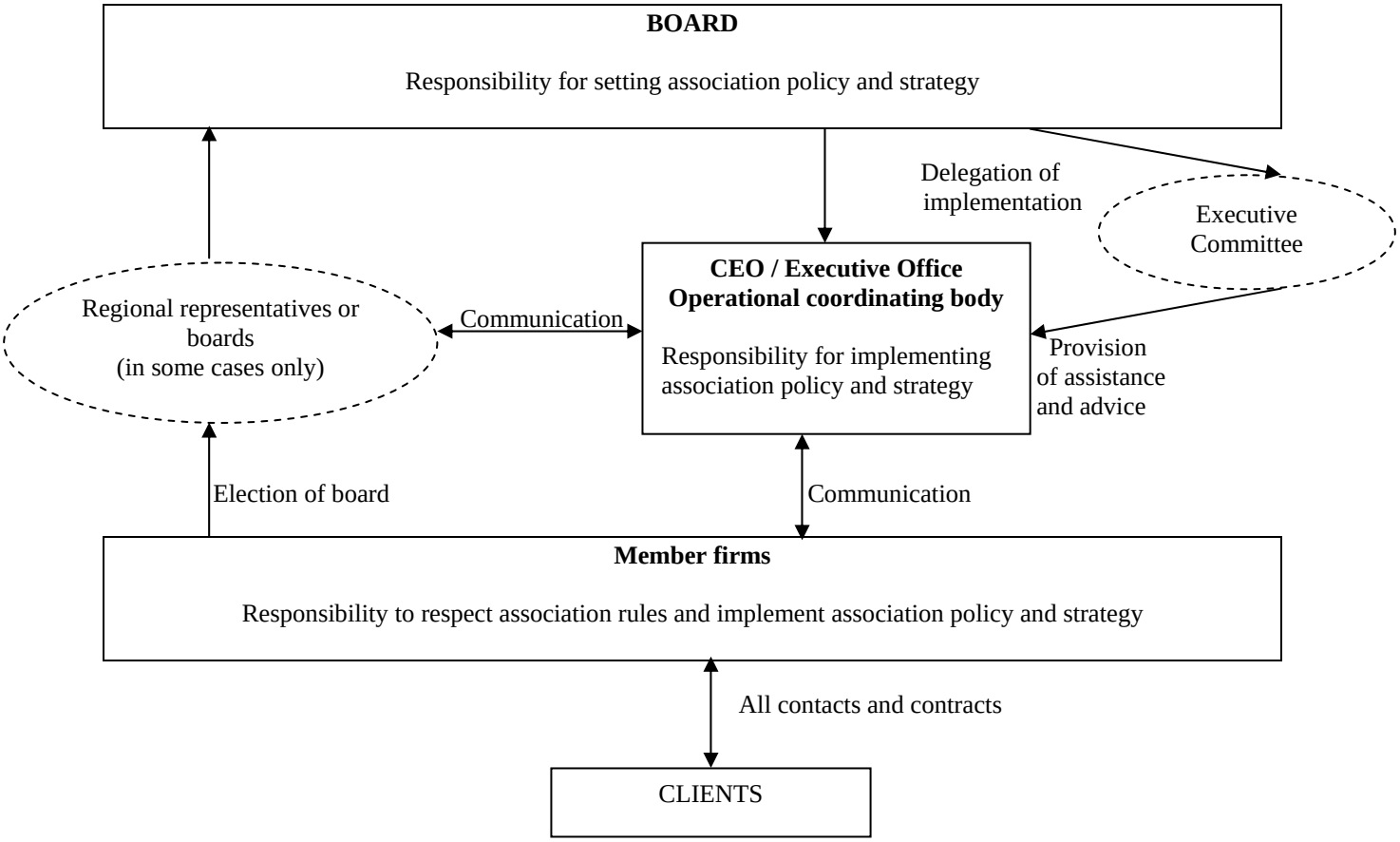
The survey results revealed that the differences are more pronounced where the degree of trans-national interaction and coordination is lowest, that is to say among Category A associations. However, the findings also drew out the consequences of the common characteristic of all respondents: an association is composed of legally independent firms with no common ownership (except in limited cases) and therefore there is no direct authority to exert control as is the case in corporate situations. Where associations are concerned, legally independent firms "voluntarily" agree to abide by membership rules and their governance arrangements are based on these "voluntary" foundations. Clearly, the concept of "voluntary" is markedly different across associations and is correlated to the degree of ongoing economic interest arising from trans-national assignments and member firm coordination and integration required to undertake such assignments.

Specifically, in terms of governance structures, the survey demonstrates that there are very considerable similarities between associations denoting the first and second levels of trans-national coordination and integration – Category A and Category B associations. The findings also demonstrate that the basic model is replicated where Category C associations are concerned, but in the latter cases the structures and arrangements are considerably more complex and engage more staff and other resources at the central coordinating body level.

Category A and B associations

Graphic 3 on page 35 sets out in broad outline the model of governance arrangements identified among Category A and B associations. It does not take into account all of the features of all of the relevant survey respondents and individual respondents will have differences between them and possibly also additional features to the graphic below.

Graphic 3: Outline of governance arrangements – Category A and B associations



The most significant features of the governance structures and arrangements for Category A and Category B associations are as follows:

- The existence of a worldwide board with overall strategic responsibilities for setting and monitoring adherence to association policy and rules, approval of association budget, final decision-making on geographical representation (particularly with regard to entry of new members and possible expulsion of existing members), marketing and conference schedules;
- The existence of regional boards (particularly in the case of Category B associations) or a system of regional representation on the worldwide board, typically based on geographical categorisations such as Europe, America(s), Asia Pacific, and Africa;
- The existence of formal arrangements for elections to the worldwide and other boards, either directly through member firm voting or through an Annual General Meeting at the association's international conference;
- Where direct elections are undertaken, typically, a weighting mechanism is used to ensure that practices from major economies have appropriate board representation;
- The delegation of responsibility for the implementation of association policy/strategy to a nominated Chief Executive Officer who typically either works alone or with a small Executive Office;
- The existence in some cases (Category B associations) of an Executive Committee between the board and the CEO / Executive Office.

The observations which accompanied respondent's descriptions of their structures indicate that the concepts of management and control as exercised through the above structures and arrangements are more nuanced in practice than may appear on paper, and especially so in relation to the Category A associations. For example, the operation of the boards of both Category A and B associations in relation to the development of overall strategy, involves a far greater degree of two-way interaction and search for consensus with member firms than is the case of a holding group and subsidiary in a corporate context. While the boards have ultimate responsibility for setting association policy and rules, and therefore, for setting the degree of coordination between member firms, the real authority to do so lies in the final analysis with the membership, that is to say the individual firms.

This observation appears particularly relevant to all Category A associations. It is borne out by the fact that in a number of cases, respondents from Category A associations expressed caution regarding the use of the term "coordination" when describing the role of the governance structures and of the Executive Officer or Office which is typically very limited in terms of resources.

In these cases, it was felt that this term overstated the strategic coordination and drive – less still the "control" – which the association as a whole could exert over member firms. At root, the reasons for this lie not in the governance structures themselves but in the nature of association rules and the obligations placed on member firms which member firms "voluntarily" sign up to. It is on this basis that respondents from Category A associations typically questioned the use of terminology such as management and control within their associations, preferring instead to refer to collaborative working between members to achieve shared goals.

The clearest example of this type of thinking was provided by one respondent which regarded the "members" of the association as being "customers" who "purchase" liaison, conference and "networking facilitation" services from the coordinating body. This constituted the "loosest" of all the Category A association operational arrangements but it encapsulates the membership focus and voluntarism which lies at the heart of Category A associations and shapes the approach to governance.

As noted, Category B associations operate with very similar board and other governance structures and arrangements to Category A associations. Again, this confirms the importance of the association rules which, in the case of Category B associations, grant greater pan-association authority and influence to governing bodies which in terms of structure are comparable to Category A associations. Equally, it should be reiterated, that this greater authority can only be achieved if member firms agree to it. Category B associations, therefore, denote a greater degree of self-imposed compulsion within a voluntary framework. This can be facilitated by enhanced mechanisms for member firm engagement to generate the required authority to introduce more mandatory requirements for member firms and systems for monitoring adherence. The existence of regional boards or arrangements for regional representation on the worldwide board are key mechanisms in these respects.

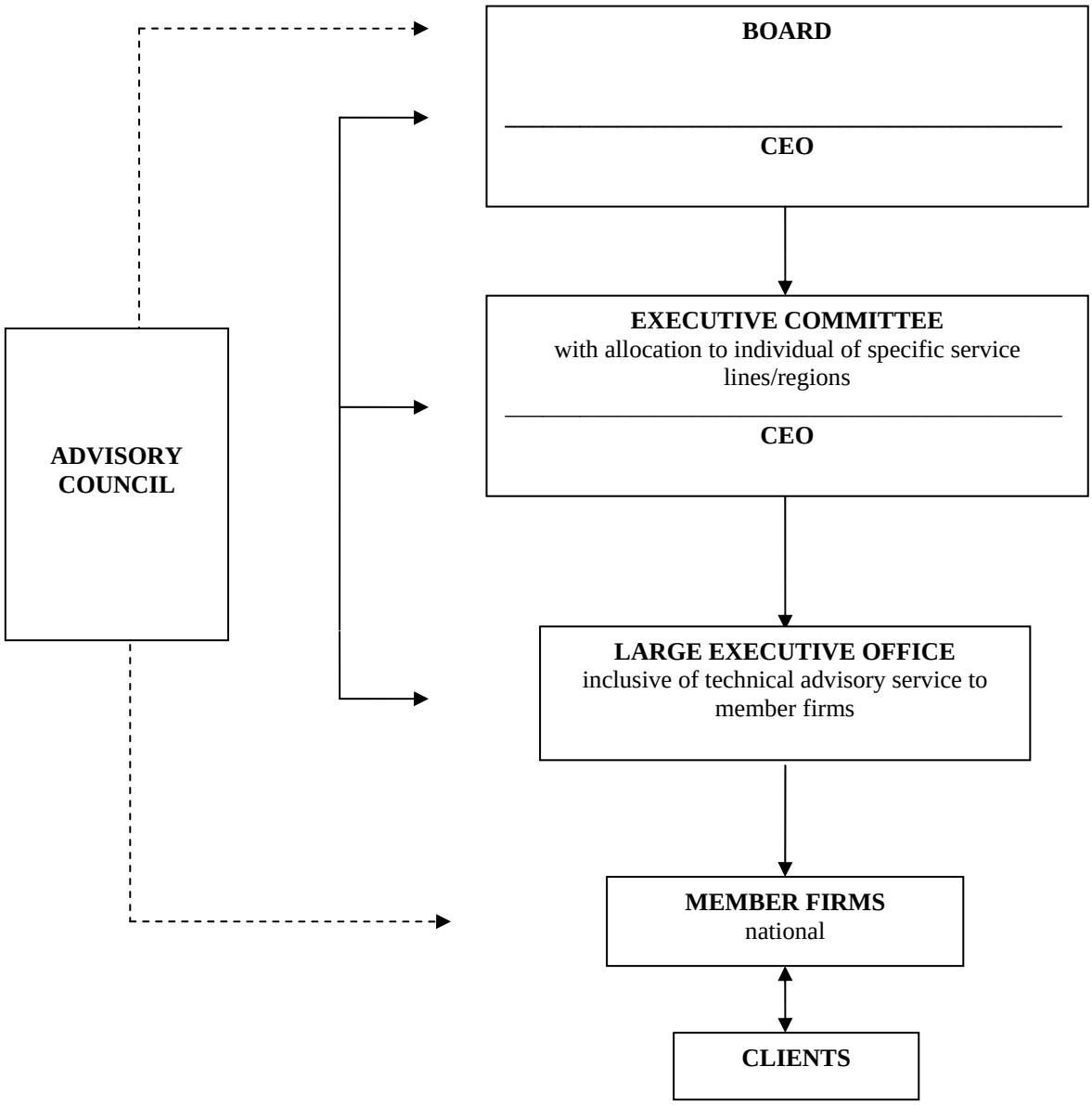
With regard to the monitoring of adherence by member firms, a particular feature of Category B associations is the existence of a larger executive office (directly or indirectly a part of the coordinating body). Whereas Category A associations are typically run by one individual Chief Executive Officer with one or two support staff, Category B associations have greater staffing to undertake the more sizeable task of implementing association policy and monitoring adherence to it. The role of the executive office is also to provide some technical and communication, marketing and other services to member firms. However, one of the most striking findings of the survey is in the still very modest dimensions of the executive offices of Category B associations. The average is still under 10 permanent staff.

Category C associations

As expected, Category C respondents demonstrated more developed and complex governance structures and arrangements. Also, as noted, these structures and arrangements have developed out of the basic model used by Category A and B associations where the allocations of responsibility for setting association policy and strategy and for implementing strategy and policy are effectively the same. However, the economic incentive for member firms to adhere to association policy and strategy is naturally far more enhanced than is the case for other associations given the size of trans-national activities. Furthermore, it is also appropriate to say that international regulatory interest has focused for some years on these associations and this too appears to have increased further the development of internal governance structures and arrangements. On account of both economic and regulatory interest, the degree of compulsion in the voluntary framework of the association is very considerably enhanced.

Graphic 4 on page 38 sets out in broad outline the additional or differentiating features of the model of arrangements used by Category C associations and these specific features are commented on below. It should be emphasised that the graphic and the subsequent commentary are designed to demonstrate the overall characteristics which emerged from the survey findings. Individual survey respondents will have differences between them, for example in the specific roles of Chief Executives and Board Chairmen as well as in other areas.

Graphic 4: Outline of governance arrangements – Category C associations



The significant additional or differentiating features of Category C governance and operational arrangements lie in the existence of large and well resourced association structures. Their role is to manage the more complex membership agreements characteristic of Category C associations, as well as to promote consistency in the servicing by member firms of both national and trans-national clients. Section 4.4. provides further details on operational matters in these regards. The focus here is on the structural elements.

The single most prominent distinguishing feature is indeed the resourcing and allocation of responsibilities to the central Executive Office. In the associations with the highest level of trans-national coordination and ongoing economic interests, the resourcing accounts for 2% to 3% of the

global aggregate revenue of all the association's members. Consequently, the staff allocation was many times larger than the average in Category B associations.

The worldwide board, which can have different titles such as "strategic international council", is the highest global governing body and as such has responsibility for strategy planning, management processes and ethical conduct. The board is assisted in various ways to fulfil its role. It can be assisted by an advisory council or a similarly constituted structure to enable the channelling of broader member firm views. It is generally supported by an executive committee, within which individual service lines or regions are identified, or by separate committees with allocated responsibilities. Among the typical service lines are advisory services, tax services, assurance services (including audit), although these are variously defined and organised across associations. This in turn reflects the fact that these associations have an enhanced central structure for the provision of technical advice and also of broader business support to member firms.

At the top end of the scale of Category C associations in terms of trans-national coordination and activities, the view was expressed by some respondents that the governance structures and arrangements denote a self-perception as an integrated international partnership which aspires to operate in an integrated fashion. On account of legal considerations – most notably vicarious liability – however, the respondents in question remain independent associations of independent firms.

4.4. Operational matters

As noted through the course of the preceding sections, there is a considerable deal of commonality in legal structure and, to a certain degree, in governance structure and arrangements across all the associations. However, as already anticipated, there are very considerable divergences in terms of operational matters, which are the focus of this section.

The operational functioning of an association is based on the association bye-laws or comparable rules and is partly geared towards and partly shaped by the existing client base of the associations. The findings discussed in this section are drawn on the basis solely of survey respondent replies to specific questions in the questionnaire on operational matters. On many occasions, respondents' replies included observations in relation to association rules, details of membership composition and client and market trends, as well as other considerations. The preparation of this survey did not in any way test these observations or research them in further detail (for example in relation to membership composition), as this lies outside the scope of the study.

The section draws points of comparison as well as of contrast between Categories A, B and C associations and concludes with an overview of the principal operational characteristics of the three different categories.

4.4.1. Entry criteria and procedures of membership of an association

Respondents to the survey were asked a number of questions regarding the existence of procedures and set criteria for the selection of new members. All the associations surveyed confirmed their existence to assess suitability for entry. As can be anticipated, these procedures and criteria were found to be more extensive where the size of the association's trans-national client base and general trans-national coordination were larger. The procedures and criteria also need to be considered in light of the policies of the associations in relation to categories of membership and conditions imposed on

members with regard to other associations and geographical remits. The latter are dealt with in section 4.4.2.

Category A and B associations

Category A and Category B associations typically have an application process for entry into the association which prospective members can initiate through a written request submitted on-line or through other means. The associations in Categories A and B generally observed that the number of such enquiries is considerable and that they are in the main receptive to considering such applications. The proportion of unsolicited enquiries which resulted in a successful entry to the association was, however, generally reported to be low.

Both Category A and B associations stated that they also pro-actively seek applications, either to cover gaps in international coverage within the association or to strengthen the existing membership. In the case of Category B associations, greater time and resource is generally allocated to the pro-active search for new members. Given that in many jurisdictions all sizeable accountancy practices which have an interest in cooperating internationally are already members of an association, the proactive search can lead to a practice being encouraged to leave one association in order to join another.

Among the information sought by the associations from applicants, whether unsolicited or pro-actively sought, are details such as size and location of firm, areas of professional service provision and existing client base as well as chargeable fee rates. Language capability also figured prominently in all cases: this is seen as essential with regard to at a least a key partner to enable effective communication across the association. In addition, all the associations confirmed that they seek information with regard to reports from regulatory and oversight bodies on quality assurance reviews and disciplinary procedures and measures.

In the case of all Category A and B associations, procedures exist for the initial vetting of applications, beginning with desktop research and followed by a more specialist review, undertaken either by the coordinating body or by a member firm. In many cases, the associations have some flexibility in their approach to criteria for entry such as size of firm and to some degree service lines, whereby the criteria are often regarded as preferences rather than strict requirements.

In relation to Category B associations, there is a general tendency to adopt a stricter approach to the application of set market criteria in the assessment of firms, such as the number of partners and service lines. This is driven by the desire to better match firms across jurisdictions and secure sufficient reliability in the timeliness of responses to referrals from other member firms. In this sense, particular emphasis was placed by one respondent on the motivation of applicants to join an association and on the likely ability and willingness to carry out referred work promptly.

There is a general recognition that the larger the member firm, the greater the likelihood of active participation in the activities of the association and of generating referral work for other member firms. As such, therefore, there appears to be an in-built general tendency in the application and assessment process relating to new membership for larger firms to gravitate towards associations populated by larger firms.

However, this should not be overstated, nor should it be assumed that, in terms of existing membership of Category A and B associations, there is a direct and uniform correlation between firm size and association type. Factors such as historical context appear to be important in this respect. The survey provides some evidence to suggest that the founding member firm of an association may prefer to remain with that association even if the composition of firms from other jurisdictions includes many

practices which differ in size. As noted, the study has not included an empirical analysis in this respect and the member firm composition of associations may merit further analysis.

All respondents confirmed that they adopt a rigorous approach concerning the assessment of professional practice on the part of the applicant. The manner in which this approach is implemented differs, however, between associations. All new entrants to a Category A association need to undergo a firm visit by a representative of the association but the nature of the visit varies across associations. In some cases, the visit consists of a verification of the information provided – rather than a quality review of auditing – and a focus on enhancing firm strategy and trans-national contacts overall. Also, in these and other cases, references given by clients are requested on occasions. It should be noted that in the case of some Category A associations, many member firms do not provide statutory audit: for this reason, alternative procedures for assessment are used. Where this is the case, and an association does seek to assess quality of statutory audit provision, the tendency is to check if there are any matters or procedures outstanding with the relevant national oversight or professional body.

In other cases of Category A associations, a practice review including quality assessment of statutory audit is undertaken. This is carried out either by the coordinating entity or by a practitioner from an existing member firm. If the latter, the practitioner is likely to be located in the same or nearby jurisdiction to the applicant firm. One Category A association indicated that the review on admission would likely be strengthened further as the association has decided not to pursue mandatory reviews for member firms thereafter, given broader considerations concerning the implications of the network definition in the revised Statutory Audit Directive (see chapter 6).

Among Category B respondents, there is a tendency to engage more directly in quality of auditing reviews with prospective firms, as opposed to more general interviews and visits. In Category B associations which provide greater resources to the coordinating body, specialist staff experienced in practice review procedures undertake the assessment and incorporate this into the ongoing quality control arrangements of the association as a whole (see section 4.4.5.).

In relation to the approval process for new entrants, all the Category A and Category B associations surveyed indicated that final decision making is a matter for the highest governing body of the association. Clearly, the specific procedures differ between the categories of associations, and between specific associations. In all cases, however, the views of the Executive Officer or the executive office are sought as part of the decision making process.

Category C associations

In the case of Category C associations, the situation regarding entry of new members is in the main notably different. This is due to the relative long-standing solidity in terms of membership and general adequacy of geographical coverage of these associations. Still, there are certainly cases of new firms, joining (and of course leaving) Category C associations where the situation is far from static. Consequently procedures for the assessment of suitability of new members do exist.

As is detailed in section 4.4.5., the key element consists of a quality review. This is to be expected given the importance of such reviews in quality control programmes which are central to permitting continuing membership of the association. In the main, however, there is far less proactive recruitment of new member firms. The assessment of applications for entry to an association is, therefore, far more commonly a matter for Category A and B associations. Where this does occur within a Category C association, it generally has significant impact on the market as a whole as it involves detaching the "acquired firm" from its existing association. There are also recent examples of individual firms in

European jurisdictions merging with individual firms which are member of a Category C association with the result that the former are detached from their original international associations.

In areas of Europe where the evolution of the profession has required particular additional investment and impetus in order to maintain pace with the service requirements of the market, Category C associations have also pooled resources from member firms in order to establish an entirely new practice. This has also been and in some cases still is the approach taken by Category C associations in developing economies.

4.4.2. Categories and conditions of membership of an association

Survey respondents were asked to describe the rules of their association with regard to ongoing membership of the association. Specifically, the survey questions focused on categories of membership, for example whether provision was made for different membership categories. They also focused on general conditions of membership where they relate, for example, to restrictions on involvement with other associations or groupings and the allocation of time to association activities. The purpose of these questions was to permit an assessment of the overall membership context of the different associations and degree of trans-national interaction and coordination. The answers are helpful to create a framework within which more detailed questions on operational matters can be interpreted in subsequent sections of this chapter.

Category A associations

Categories of membership

In relation to categories of membership, a diversified picture emerged across the associations concerned. This is in part attributable to the use of different terminology in relation to member firms, but also to more substantive issues. With regard to the existence of rules regarding involvement of member firms with other groupings, the survey revealed that practically all respondents of all categories expressed strong preference for member firms not to have any involvement with other groupings. However, the capacity of associations to achieve this was circumscribed, and most particularly so within Category A associations.

Category A associations demonstrated the greatest range of different situations regarding categories of members and, as anticipated, rules on the involvement of members in other groupings. In effect, every response to the survey from Category A associations had its own particularities. The commentary below, therefore, captures the most significant features of responses received, rather than presenting a comprehensive overview.

One association makes a distinction between full members, that is to say firms operating in the core areas of accounting, audit and tax, and commercial associates which have broader areas of activity, including a member firm operating in the banking sector. This is one of many examples where member firms are engaged in a wide range of professional services. In this particular case, concurrent membership with other associations and groupings is permitted. In the case of another respondent, only the category of full membership exists, but the worldwide association in question permits its regional boards to decide on whether member firms can have dual membership with another association or organisation.

Among other respondents, a distinction was made between full members and firms with looser ties to the association, referred to as affiliates, associates or representative offices. Different rules were said

to apply with regard to their membership of other groupings. Within the associations, various specific rules were identified, where the overall purpose is to allow only those firms which are not a part of another grouping to be full members. However, even in the case of the Category A respondents which had such exclusivity rules, the general sense was that the lack of availability of suitable practices in certain jurisdictions obliged all associations in this segment of the profession to be flexible in the application of their rules.

Conditions of membership

Of all the respondents, Category A associations demonstrated the most circumscribed conditions of membership outside of the common requirement throughout all the associations surveyed that member firms abide by the rules of the association. General membership conditions revolved around a policy of encouragement to participate in association activities. Chief among these are the annual conferences organised by all the associations. These meetings gather together partners and senior staff members of member firms and often coincide with meetings of the worldwide and regional boards.

Among other general membership conditions observed, are a commitment for member firms to nominate a contact partner who should be contactable by other member firms and the allocation of a set amount of time for association matters.

Category B associations

Responses from Category B associations demonstrated additional layers in terms of membership categories within a broad context of more rigorous requirements placed on full members (whatever the precise terminology used) in relation to exclusivity, branding and specific rules linking membership status and role in governance arrangements.

The survey also identified a discernible policy trend towards maintaining an overwhelming majority core of full members and, in relation to the minority, clearly identifying different categories of membership and the non-application of these rules. A further differentiating feature between Category A and B associations is the existence within the latter of specific procedures permitting the phasing of entry to the association, where deemed necessary, subject to the fulfilment of service quality enhancements. Furthermore, Category B associations have in a number of cases member firms which represent an entire jurisdiction, a characteristic which is the rule among Category C associations.

Within this framework, a number of specific responses merit further attention. They provide an important insight into the ongoing efforts of the associations to achieve global coverage while maintaining consistency of quality. For example, in one case, which constitutes the most “elaborate” mechanism for linking membership of the association with quality control concerns, four different categories of membership are used: full member, affiliate of full member, associate member, and correspondent member. A full member is subject to all the association rules, which do not permit membership of another association or grouping. The most important differentiation is between full member and associate member: the latter denotes a two-year “provisional” title given where practice shortcomings are identified which require resolution before full membership is granted. An associate member is not permitted to vote at an association meeting or to be elected to the board, until such time that its probation is deemed to be satisfactorily completed. Affiliate status is given to an affiliate of a member firm and all of the association’s requirements are to be met by this firm. The respondent in question indicated that it currently has no correspondent firms but this category is maintained in the event that the association requires coverage in a jurisdiction and is unable to find a firm which is deemed of sufficient quality to enter even the “provisional” category. The category of correspondent firms falls outside of the association’s rules on quality control.

The considerations underpinning the above respondent's categorisation of firms are evident through the responses of other Category B associations, even if the specific approaches employed differ from association to association and the terminology attributed to full members and other categories of membership vary. For example, one association distinguishes between principal members and representatives, while another respondent refers to full members, exclusive correspondents and correspondents. The substance and basic purpose of the distinctions are the same.

The findings of the study demonstrate that there is a common theme throughout this segment of the profession in that the associations differentiate the application of their operational rules regarding, for example, quality control and branding on such categorisations. The detailed aspects of these rules are elaborated upon in section 4.4.5. and 4.4.6. The associations also take into consideration these categorisations when considering the application of regulatory requirements, including those emanating from the EU network definition, as is evident from chapter 6. Overall, however, the survey also demonstrates a discernible trend among Category B respondents to extend as far as possible the majority of full members abiding by the entirety of association rules.

Category C associations

Where Category C associations are concerned, the situation regarding categories of membership is to a very large degree far clearer. The simple reason for this is that these associations have been able to pursue more actively the development trends evident among Category B associations and have also been better positioned to draw on economies of scale, given market factors, to achieve them. Typically, Category C associations are almost entirely composed of member firms representing single jurisdictions.

It was observed during the interviews that there is a trend, emerging also on the basis of the new pan-European ownership rules in the revised Statutory Audit Directive, for a member firm to cover more than one jurisdiction through the establishment of an integrated international partnership covering the relevant jurisdictions. For the time being, this is still a limited development within the associations but one which is regarded by many respondents as being of particular importance for further evolution of the profession. In one case, as is explored in chapter 5, the integrated international partnership covers over 20 jurisdictions, although this is attributable to other reasons rather than the revised Statutory Audit Directive. Elsewhere, the move towards the merging of member firms within the European context appears to have been directly encouraged by the revised Statutory Audit Directive, with the necessary organisational steps having been taken in anticipation of the Directive's transposition at Member State level.

It is the case that, in a small number of jurisdictions – the overwhelming majority of which lie outside the European Union – Category C associations have correspondent or other similarly named firms which are not full members of the association. In a manner similar to Category B associations, these are also subject to different arrangements regarding operational matters, notably quality control, branding and the like, which are detailed in sections 4.4.5. and 4.4.6.

4.4.3. Financial arrangements

As noted, the existence of a coordinating body is the legal lynchpin of the association model. One of its key functions is that of providing a legal basis for the sharing of costs across member firms for the delivery of services from the coordinating body to member firms and pursuit of related association matters.

Fixed annual budget

As also noted, the actual provision of services to member firms is pursued either through a Chief Executive Officer or through an executive office which draws on the resources pooled centrally. Whatever the precise form of the central source of service provision, the survey found that it generally operates with a fixed annual budget to which members of the association provide set contributions through fees. The fixed annual budget, which is decided at the highest governance level of the association, covers the costs of meeting the rights of membership in terms of access to services by member firms as well as of monitoring adherence to membership obligations, as set out in the association bye-laws or other such documents.

Where relevant, and as is particularly the case in relation to Category B and C associations, this central budget also covers the involvement of the associations in external representation activities. For example, this covers the participation of associations in the IFAC Forum of Firms (FoF) and other representative forums such as the European Contact Group (ECG) and EGIAN (European Group of International Accounting Networks).

Some associations are very transparent about fees paid by members of the association and publish the amounts on their website, but the majority do not make such fees public. Overall, the findings of the survey indicate a range of different practices to fund the central budget of the association. These variously involve entry fees paid on admittance to the association, annual fees for ongoing membership and fees based on the referral of assignments between member firms.

Category A associations

Entry fee

Only very few Category A associations apply an entry fee, which provides a first indication of the low financial hurdle for membership of a Category A association. One respondent referred to an entry fee of just over €1.500. In two cases where an entry fee as such is not applied, respondents do, however, use an application fee system and a mechanism based on a deposit payment. In both cases these are payable by the applicant prior to the association undertaking its full review of the firm's application. In the event of a satisfactory review and the completion of the approval process for the applicant's admittance, in one case the deposit is converted to payment of the first six months of membership fees, in the other case the application fee is returnable.

Annual membership fee

An annual membership fee is in fact the mainstay of the funding of all Category A respondents. These fees are often based on the number of partners of a member firm and one or more additional criteria such as the number of registered offices and branches.

The survey did not request the specific level of fees payable in the case of each association, however, a number of respondents provided details in these respects. The lowest recorded basic fee level was just over €500 to which a slightly lower figure would also be payable for each partner within the firm to complete the annual fee, with an upper limit established. It was also noted that there could be reductions to these amounts for members in countries where economic levels are lower, although this quite clearly refers to jurisdictions outside of the European Union.

As noted, the survey did not ascertain precise details for each respondent but the general sense from respondents' replies is that annual fees in other Category A associations are higher than the above figures but still represent modest amounts. For example, one respondent referred to a minimum amount of nearly €700 where there were four levels of fees and also a mechanism for referral-based contribution. The payment of annual fees naturally ceases on departure from the association, which in most cases requires a prior notice period (see section 4.4.9.). One of the associations surveyed used to have exit fees, that is to say a fee would be charged for leaving the association. However, this has been removed.

Fees based on referrals

Attitudes towards fees based on professional assignments referred from one member firm to another within an association differs widely across Category A associations and therefore merit particular attention. The economic importance attached to referral work is acknowledged by all Category A associations, and of course also by Category B and C associations: as noted, to a greater or lesser extent, it is an important ingredient in maintaining member firm participation in the association. However, policies on the part of the associations denote different interpretations of this how economic reality should relate to central budgeting.

On the one hand, approximately half of Category A associations apply fees based on a percentage of referrals. In these cases, referral fees constitute between 5% and 10% of the work referred, and are payable by the member firm that received the work to the coordinating body. Referral fees constitute between 10% and 30% of the total central budget in the case of associations using this mechanism, with the remainder being made up of annual fees.

On the other hand, the other half or so of Category A respondents confirmed that they do not have any referral based fees. In some of these cases, respondents' views indicated that they either did not see the need for any such system, given the adequacy of a system based on an annual fees, or that they believed that the referral based system was more difficult to manage, and possibly also counter-productive to the aims of the association. Some views were drawn on the basis of general observation, others on the basis of previous experience within the association. The policy of one association is to allow each of its regional boards to decide their own approach to funding, but it is expressly stipulated in the worldwide association rules that referral fees are not permitted. Each region then pays a "licence fee" to the worldwide association, in return for the central support it provides.

A recurrent point raised by Category A respondents – including those which have referral-based funding – was that reporting by member firms to the coordinating body on the actual amount of referral work was difficult to manage. There was a general sense that referrals were under reported, although as noted in section 4.4.4. the levels of referrals among respondents appear to be low or very low.

Overall, therefore, there does not appear to be a predominant trend among Category A associations with regard to policy on referral fees. It is the case that a number of associations have moved away from this system, but equally approximately half of Category A respondents retain this system and in the case of one association, the decision has only recently been taken to introduce it to support funding of regional groups within the worldwide association. The one common feature across all Category A associations is that fees based on referrals represent a minority proportion of the overall budget of the coordinating body.

Category B associations

Overall findings

When comparing the responses of Category B associations to those of Category A associations, a number of broad structural similarities appear. For example, the majority of funding for Category B respondents is also derived from annual membership fees. Equally, there are a number of distinguishing characteristics across Category B associations as a whole. Again, on the basis solely of "voluntary" disclosures by respondents, it appears that the financial obligation for membership of a Category B association is higher overall when compared to Category A associations. This is to cover the additional expenses related to enhanced member services and pan-association quality measures, both of which are considered in section 4.4.5.

Entry fees and annual fees

Overall, a higher number of Category B associations apply an entry fee indicating a higher entry hurdle than is the case for Category A associations. For example, one respondent indicated that its central budget is funded entirely by entry fees and a proportion payable on receipt of referral assignments. It was also observed, however, that in some circumstances, the entry fee can be waived, for example for prospective members in "difficult to get" countries or countries which have markedly lower levels of economic prosperity.

As noted, in the majority of cases, the bulk of the central budget is derived from annual fees. Most of Category B associations have annual fees based on turnover of the member firms or a different size measure, such as the number of partners. The annual fee in some associations consists of a fixed part and a variable part, related to size considerations or to a regional categorisation within the association. The formula for the annual fee can also vary according to category of membership, where different categories of membership are permitted. Again, the annual fees are sometimes reduced to reflect broader levels of economic prosperity in certain jurisdictions. While in some cases there are only modest differences in annual fees between Category A and B associations, at the higher end of the latter in terms of trans-national coordination and client base, the entry fee for membership of one respondent is at minimum €6.500 and at maximum €65.000 and the annual membership fee for a sizeable member firm can be around €200.000. In addition to which a proportion of received referral assignments is also payable to the centre.

Fees based on referrals

The percentage of Category B associations applying a referral fee is about the same as for Category A associations (60%) although it should be observed that the frequency of referrals appears higher in Category B associations. The precise form of the referral funding system differs between respondents. Some of the associations apply the same approach as that outlined in relation to some Category A associations. Others adopt a more complex system whereby a member firm carrying out work for a client or contact referred to it by another member firm pays a referral fee (percentage of client fee received) to the coordinating body. The coordinating body retains between 50% and 60% and pays the remaining part to the member firm which referred the assignment.

This system is seen by those associations which employ it as incentivising firms making the referrals to report this activity. The involvement of the coordinating body in these systems is also used in some instances to exert a monitoring role, both for general information purposes as well for quality control purposes, in the assignments referred between member firms. Some other associations ask both the receiving firm and the referring firm to report, and exercise their monitoring in this way. It is notable

that many Category B respondents also believed that the referral of assignments is underreported. One association currently applying referral fees intends to move away from the referral fee system in that it is expected that the system will be dropped in three to five years.

Category C associations

A similar proportion of Category C associations to Category B associations apply an entrance fee. Also in the case of Category C associations, the major part of the funding of the central budget is via annual fees. All associations in Category C base the annual contribution on the revenue of the member firms. In some cases, additional criteria are applied such as number of partners, use of external resources and referred work. Only two of the associations in this category apply a referral fee system, which is combined with an annual fee system. It should be noted that some Category C associations also placed financial obligations on member firms with regard to insurance: this is dealt with in section 4.4.7.

4.4.4. Arrangements for referrals and trans-national assignments

As noted at the outset of the study, the economic impetus and overall rationale for the profession's development of trans-national structures lie in the need to service trans-national client requirements. Broadly speaking, two different forms of trans-national requirements, or at least formats for meeting such requirements, can be identified.

The first arises from the identification by a client in one jurisdiction of new professional service requirements in another jurisdiction, for example for the establishment of a new branch. In this case, the accountancy practice advising the client in the first jurisdiction will seek to refer this assignment to a known practice in the jurisdiction where the client's new interests lie.

The second consists of, generally speaking, longer-term and larger scale trans-national assignments, such as tax planning for entities with interests in a number of jurisdictions, statutory audit of the consolidated accounts of a multinational and the audit (or carrying out of agreed-upon procedures) of publicly funded programmes over a number of jurisdictions. In the latter case, the funding provided by the European Union in the research and development sphere (Seventh Research Framework Programme FP7) would be an example.

Respondents to the survey were asked to describe the arrangements which they have in place to manage both types of assignments. Respondents were not asked to comment on the specific levels of activity of member firms within the association or on the proportion of such activity in relation to the overall fee income of the association. However, a number of respondents made comments in these regards when describing their arrangements and, where appropriate and pertinent, these are also recorded below.

Category A associations

Within Category A associations, the survey found that considerations regarding trans-national referrals constitute an important reason for firms to join and retain their membership of the association. However, this should not be taken to assume that the levels of referrals are high across the associations or that the associations generally have specific rules on referrals or mechanisms to organise how referred assignments are organised.

As a general observation arising from various respondents' comments, across the overwhelming majority of Category A respondents, the actual levels of referred work appear to be either low or very low, specially when compared to overall combined fee income of member firms. This is further borne out by the fact that there are, in the main, no set rules, processes or procedures within the Category A associations as to the organisation of the referral work. Significantly, in most cases, a member firm is not obliged to refer an assignment to another member firm: it is a further voluntaristic feature of the association model, and one which is particularly pronounced in Category A associations.

Where referrals are made, for the most part it is through member firms which agree bilateral arrangements between themselves without any involvement, less still direct control, of the coordinating body. Based on general comments made by some respondents when describing the market activity of their operations, it appears that such agreements are primarily in the area of non-statutory audit activity, for example in the area of tax advice. The highest degree of involvement by any of the coordinating bodies was found to be the management of records based on the completion of forms by member firms on referral work. As noted, a number of respondents organise funding partially through fees based on referrals and their record keeping is also designed with this in mind.

In the majority of cases, therefore, Category A associations appear to exist primarily to encourage "networking" between member firms, for example at annual conferences through other information sharing initiatives (see section 4.4.6.) so that there is sufficient familiarity between firms to encourage the referral from one member to another. This type of *modus operandi* tends also to account for the attitude of Category A associations to the EU network definition (as detailed in chapter 6).

It is also notable that in some cases, the findings of the survey indicate that membership of an association and attitudes to referrals are approached as a type of international "insurance policy". In these cases, a practice retains membership of the association in order to demonstrate to clients that, in the event that they might require additional services in another jurisdiction, the practice would be able to refer the assignment to a known service provider in the jurisdiction in question. The "insurance" element in these considerations consists of guarding against the possibility that the client would assume that it was necessary to find another and generally larger practice to service international needs.

Clearly, the "networking" carried out between firms within the association's events, are viewed in these contexts as being important for generating confidence regarding the services which the client could or will receive from the practice to which it has been referred. This is particularly important given the absence in Category A associations of coordinated or harmonised standards of service provision or quality control, as set out in section 4.4.5. Given also the general absence of set rules obliging a member firm to refer an assignment to another member firm, as well as the permitted dual membership of associations, developing bilateral channels of understanding between member firms assumes considerable importance.

Given the above findings relating to referrals, it is not surprising that Category A associations have a very low number of ongoing trans-national assignments in the multi-national statutory audit sphere and a generally low number of other types of ongoing trans-national assignments, as described above. Again, no involvement or control is exercised by the coordinating body in cross-border assignments and consequently bilateral arrangements between firms to establish consortia are the main channel for pursuing assignments in this way. As is also noted in chapter 6 dealing with the network definition, some associations have concerns regarding the interpretation of regulators with regard to these initiatives.

Category B associations

As a general observation, the findings reveal that referrals and ongoing trans-national assignments are more common and procedures for their monitoring are more enhanced across Category B associations, when compared to their Category A counterparts. In particular, there is some evidence that referred assignments represent a larger proportion against the combined income of all association member firms than is the case when compared to Category A associations. However, it is important not to over-estimate the size of referrals, which in the majority of cases appear to remain in modest proportion. It should also be emphasised that in structural terms, there are considerable similarities between Category A and B associations. This is not only because member firms ultimately have responsibility for carrying out assignments (which is also the case for Category C associations) but also because even within the largest of the Category B respondents, central resources are relatively limited. This has obvious implications for central procedures for monitoring, and for other aspects of the association's work, which are explained in the following sections.

A larger number of Category B associations have a formal procedure in place for providing guidance on and monitoring referred assignments, involving in some cases a computerised referral tracking system and a referral manual which includes reporting obligations. However, a number of respondents observed that monitoring of this type is very time consuming and brings limited benefits. It was noted that monitoring of referrals also emerged as an area covered through the association quality control programmes, a subject addressed in section 4.4.5. In all cases, the coordinating or central body has no authority or responsibility to intervene in any arrangement between member firms. Some Category B associations indicated, however, that their central offices could become involved in assisting coordination on behalf of member firms, in assisting, for example, with the choice of member firm to which the work is referred, where a jurisdiction has more than one member and where the competencies and service lines of the firms differ.

One Category B association indicated that it had obtained legal advice to ascertain whether assuming a more direct involvement in client work might be possible, but it was indicated that this was not possible. As is the case in the association model as a whole, individual member firms (or joint ventures of member firms) are the contracting parties. However, the responses also indicated that central offices did, in some cases, play a facilitation or coordination role on behalf of the member firms to assist in developing proposals and making presentations to clients and in selecting member firms that could participate in a consortium of member firms.

Category C associations

As already anticipated, the underlying structural model is the same across all the associations and therefore there are commonalities in the approach for dealing with trans-national referrals and assignments between Category C associations and Category A and B associations. However, it is also quite apparent from replies to the survey questions – and indeed from publicly available information – that Category C associations have the greatest involvement in larger scale trans-national work including, but not only, statutory audit assignments of major listed and other multi-nationals. Category C associations have put in place operational mechanisms and procedures to enhance the associations' capacities, through their individual member firms, to meet these demands. These mechanisms and procedures focus, on the one hand, on the enhancement of cooperation between member firms and, on the other, on the overall pursuit of consistency in quality of service provision.

As an overall observation, the survey shows that Category C associations, while evidently demonstrating some differences between them, have very considerably enhanced systems and procedures coordinated at central level when compared to their Category A and B counterparts. These

revolve around greater obligations to refer assignments to member firms, and also greater involvement of the central body to record and monitor the carrying out of referred work by member firms.

In relation to referrals, association rules or related documents either require that a member firm refers an assignment to another member firm, which appears to be the main route taken in practice, or that a decision should be made on the basis that a member firm is preferred.

Referral guidelines at a global level have existed for many years in some cases and in other cases are currently being streamlined. These also deal with matters such as the responsibilities of the member firm originating the work to follow up with the receiving member firm on issues regarding terms of engagement and service delivery. It should be recalled that a client can only enter into contract with a firm licensed in the jurisdiction in question to offer the particular service required: the ultimate decision on the terms of the contract for this service provision lie with the licensed firm, not the originator of the referral. For this reason, referral guidelines include the expectation that member firms undertake referred work competitively, where they are able to do so.

In one case, it was noted that member firms have the right to charge a percentage of the cost involved in taking on a client which has been referred to it by another member firm. This was described as being a rarely used provision.

In this overall framework, the role of the central body in Category C associations is primarily a monitoring one, to ensure respect of procedures and to assess feedback on the quality of the referred work. As noted in 4.4.3., only in a minority of cases are referrals important from the perspective of financing the central budget.

Where ongoing trans-national work is concerned, it is clear from the findings that there are differing levels of operational experience, structures and procedures within Category C associations. Broadly speaking two segments can be identified. The first, while already engaged in sizeable trans-national work, one segment appears to be currently embarking on an enhancement of operational structures and practices to promote greater coordination across member firms. The other segment appears to have undertaken this work some time ago. In terms of structural approach, the form which these developments have and are taking involve the establishment of global “heads of service” who act as the coordination point for specific sectors and facilitate the sharing of sector-specific knowledge across the association, assisted through the central body. It is important to reiterate that where individual assignments are concerned, however large, it is always either a single member firm or a consortia of member firms, who agree a contract with the client. In these cases, a “lead” partner for the provision of the trans-national services, whether a statutory audit or another service, is identified.

It should be noted that economic dependence on referral work varies across member firms and in some cases markedly so, in relation to the proportion of these fees to income generated domestically. It is quite apparent from the survey that this dependency is more pronounced in smaller jurisdictions where domestic work is more limited.

4.4.5. Audit practices, quality control and ethics

A major part of the survey focused on the approach of the associations in relation to the coordination of practices in the statutory audit sphere in particular, while also recording comments made in relation to professional practice in other spheres of accountancy services.

It is important to reiterate that associations (and indeed other forms of trans-national organisations in the profession) are far from being providers of statutory audit alone. However, it is also the case that the survey focused its questions primarily on statutory audit or on areas which raise questions regarding the management of ethics, independence and other quality issues for the statutory audit sphere. Within this framework, the survey included questions on the following key areas:

- Audit methodology,
- Ethics and trans-national independence,
- Quality control systems,
- Client acceptance procedures,
- Policy on working paper transfer.

Category A associations

Audit methodology

Where Category A associations are concerned, the overall position is one of maximum autonomy by member firms, and only limited trans-national coordination in certain areas based generally on encouragement to use association guidance. Significantly, none of the Category A associations surveyed has a common audit methodology. One association has a common audit guide but the use of this guide is not mandatory for member firms. Another association shares best practices between member firms, including examples of audit papers, tools and questionnaires on its internal website. The use of these tools and examples is, again, on a voluntary basis.

Ethics

None of the Category A associations has its own code of ethics. However, local codes as required by regulatory bodies or the IFAC Code of Ethics are referred to. Equally, none of the Category A associations currently records or has any other system for monitoring and managing trans-national independence matters. Category A respondents generally responded to the survey question in this area by commenting that responsibility for assessing any trans-national independence issues lies with the lead firm in the assignment concerned, and not with the coordinating body.

Quality control

In relation to quality control, none of the Category A associations has an internal quality control programme for the monitoring of the practice of statutory audit throughout the association. One respondent indicated that it had recently taken the decision to cease carrying out this quality control monitoring. For the purpose of the survey; therefore, its response is recorded on the basis of this decision.

One association has membership operating guidelines, several of which address quality control and are said to be ISQC1 compliant. However, also in this case, adherence to the guidelines is not monitored and therefore this has not been as a quality control programme. It should be noted that all Category A associations – as indeed is the case for all associations – confirmed that they require member firms are to comply with local standards as pursued by the relevant national oversight authorities and indicated that member firms are required to maintain proper registration status in their jurisdiction.

Client acceptance procedures

None of the Category A associations has common client acceptance procedures, either on a mandatory basis or on the basis of guidance.

Policy on working paper transfer

Procedures concerning professional secrecy are often not formalised. In one association, all inter-firm work is subject to a confidentiality agreement. Often the access to working papers is only for review purposes.

As is reported in chapter 6, Category A associations placed considerable importance on the above points when undertaking their assessment of the applicability of the criteria of the EU network definition.

Category B associations

In comparison to Category A respondents, Category B associations have an enhanced and in some cases significantly enhanced degree of coordination with regard to audit practice and quality control programmes across member firms and ethics and trans-national independence. However, it is important to emphasise that this is not uniform across all respondents. It is also the case that the coordination generally stops well short of harmonisation in a number of areas and denotes an overall lower degree of integration than that evident among Category C associations. It should also be noted that nearly all of the Category B associations are members of the IFAC Forum of Firms (FoF) and therefore are required to meet membership obligations which have a bearing in the areas covered by this section.

In these areas, the position of Category B respondents as a whole provides the clearest evidence of more advanced coordination when compared to Category A associations.

Quality control

In relation specifically to quality control, all of the respondents confirmed that they have a form of quality control system in place which is designed specifically to achieve consistency in audit quality across member firms. A number of respondents made reference to the requirements of the IFAC FoF, and specifically compliance with ISQC1, when describing their approach.

Summarising the overall findings, Category B associations generally base their quality control around the requirement for member firms to regularly complete a detailed questionnaire or information form which is submitted for monitoring by the central coordinating body. The main focus of quality control is the review (inspections) of member firms. The reviews are carried out, in the main, by reviewers from other member firms (peer reviewers). Generally speaking, the undertaking of firm reviews and visits is based on a cycle of around 3 years and is focused on all substantial audits.

Within individual responses, a number of observations of note were recorded. For example, one respondent indicated that it dedicates 40% of its annual central budget to its quality control programme. It is notable that this respondent has not developed a central audit methodology manual (see below) but is evidently dedicating very considerable part of its resources to quality control.

A number of respondents made reference to agreed procedures within the association whereby a member firm could receive notice on the need to improve quality. If this notice – which could have

various forms – was not satisfactorily enacted upon, the member firm would then be required to leave the association. The procedures in all cases foresaw the possibility of an appeal by the member firm in question and also the involvement of the highest governing body of the association to make a final decision.

Among other pertinent observations made in this sphere, some associations have recourse not only to reviewers from among member firms, but also draw, on occasion, on external assistance through the outsourcing of the review work. In one of these cases, reference was also made to centrally organised training of reviewers within the association to achieve consistency. The other respondent referred to the fact that its audit quality programme was encountering a certain degree of reluctance from a small number of member firms and it was possible that these members would be required to leave the association.

Ethics

With respect to ethics and trans-national independence, FoF membership obligations require members to have policies and methodologies in place which comply with the IFAC Code of Ethics. The majority of responses made reference to these obligations in providing their answers in relation to the requirements placed on individual member firms, although this should be taken to mean that FoF obligations are the sole reason why respondents have policies in place. Some associations reported that member firms with trans-national audit clients participate on a voluntary basis in a globally coordinated programme of annual self-assessment, which is designed to comply with the requirements of FoF membership. The monitoring of such policies and methodologies also figure prominent in respondents' description of their quality control arrangements.

In relation to the management of trans-national independence issues for association members as a whole, Category B respondents indicated that this is largely new terrain. None of the firms had any arrangements actually in place at the time of the initial survey. There were indications of varying levels of preparedness to make such arrangements, required in light of the regulatory implications of the EU network definition, and of the different attitude *vis-à-vis* the costs and benefits of doing so. (See also chapter 6.)

In the case of two associations, the general sense at the time of the initial survey was that further guidance or information was required before concrete steps could be taken. In the meantime member firms would be responsible for making the appropriate arrangements where individual assignments were concerned. Three associations expressed specific concern about the costs involved in establishing new procedures and observed that it was not entirely clear what arrangements would be needed. Other responses indicated a greater degree of certainty with regard to new procedures to be put in place. For example, two respondents were either developing directly or through outsourcing a computerised system which would permit all member firms to undertake the necessary checks with regard to identifying potential conflicts. A third association, whose response broadly fell into this type of response, indicated that it was formulating the necessary policies and procedures.

Client acceptance procedures

In respect of client acceptance procedures, Category B associations that are members of the FoF are required to comply with the acceptance and continuance of clients in accordance with ISQC1. Despite this, the picture which emerged from respondents' answers was somewhat varied. Just over half of the respondents indicated, at the time of the initial survey, that they did not have common client acceptance procedures across the association. Various responses were given within this broad framework. In some cases, it was indicated that specific guidelines were being prepared or that the

matter would be addressed through the association's broad quality control programme. In one case, no indication was given that a common procedure would be put into place.

Among the respondents which confirmed that they met the FoF requirement or had a procedure in place outside of the requirement of the FoF, the route taken to do so was either through the association rules or through specific guidelines or mandatory audit manuals. It is notable that many respondents, both among those which already had procedures in place and also those which were intending to introduce them, referred in their answers solely to statutory audit. They indicated that there were no procedures for non-audit assignments.

Audit methodology

The findings of the survey in relation to the coordination of audit methodology (or audit manual) reveal the largest number of different approaches between Category B respondents when compared to other operational characteristics. The findings of the survey in the area of audit methodology can help avoid any risk of over-stating the degree of overall coordination among Category B respondents which might emerge after considering the existence of quality control procedures. This being said, the survey certainly gave rise to some significant findings of existing investment in common audit methodology in some cases.

Summarising the findings, there is a discernible gradation amongst Category B respondents which fairly evenly distributes associations into three segments. These segments are: firstly, the existence and mandatory use of centrally developed audit methodology and manuals which are monitored; secondly, the existence of centrally developed methodology and manuals which are not mandatory but encouraged and to a certain extent monitored; thirdly, the absence of any centrally developed audit methodology or manual. In the paragraphs below, some comments are made in relation to individual findings within these three segments. Some references are also made with regard to quality control procedures, where these exist.

Among the respondents which indicated that they have a centrally developed audit methodology and manual for mandatory use, emphasis was placed on the considerable cost of developing, updating and monitoring this. One of the respondents, for example, estimated that its manual had been developed over a number of years at a cost of up to nearly €15 million. This appears to be the most highly developed of the Category B associations. The manual is updated on a monthly basis and a prominent part of the association's annual conferences is dedicated to discussing major changes and ensuring appropriate circulation and awareness. The manual is said to meet the requirements of ISAs and also provides examples of major additional requirements introduced by specific jurisdictions. The use of the manual also forms part of the association's overall quality control procedures.

As noted, a number of respondents indicated that they have developed a common audit methodology centrally which is not mandatory for member firms but whose use is strongly encouraged. The form of the methodology can differ, as can the degree of "encouragement" given. For example, one respondent referred to illustrative methodology prepared by the central office which is made available to member firms on the association intranet (see also section 4.4.6. dealing with internal communication). Firms which do not use this methodology are required, during the quality control programme, to demonstrate that their procedures are comparable to the illustrative methodology.

The third segment denotes in general a less coordinated overall policy on the part of the association. However, it is important not to assume immediately that this is always the case. As already noted, one association is investing a very considerable proportion of its central budget in its quality control

programme to enhance audit quality but it has chosen not to invest in a common audit methodology or manual.

Policy on working paper transfer

In relation to association policy on professional secrecy and access to working papers, the majority of the responses demonstrated high awareness of the restrictions emanating from national legislation. Respondents in general did not appear to have a formal policy to which all member firms are required to abide, in turn reflecting a recognition of differences between jurisdictions.

Category C associations

As anticipated, Category C associations demonstrated the highest degree of coordination and in some respects full harmonisation in the areas covered. In the case of all the respondents, the obligations noted above arising from membership of FoF apply.

Quality control

In relation to quality control, Category C associations demonstrated a further enhancement, when compared to their Category B counterparts, of coordination across the association and greater depth of intervention into individual firm practices arising from the requirement to abide by association policy. In practical terms, the most immediately apparent features of this coordination are the enhanced role of the central body (permitted by additional resource allocation), increased regularity of member firm reviews and the existence within the associations of quality control committee (or such like).

The frequency of, as well as the approach to, undertaking quality review do differ between associations. One respondent indicated that every member firm is subject to the association's audit review programme at least once every three years. However, this timeframe for reviews appears broadly typical across Category C associations. The source of the reviewers are either specialised staff from the central body or practitioners from member firms (peer reviewers), with the latter generally undertaking the bulk of the work.

As noted, the existence of standing committees with direct responsibility on behalf of the association for pursuing audit quality among member firms is a distinguishing feature of Category C associations. In some cases, the establishment or enhancement of the working of such a committee is part of relatively recent strategic changes designed to strengthen the coordination and integration of the association.

Ethics

Given that, as noted, Category C associations undertake the largest amount of trans-national ongoing assignments and referrals, the question in the survey concerning the management of trans-national independence assumed particular interest. All respondents confirmed that they have in place systems and procedures for addressing questions in this area.

In some cases, respondents referred to computer systems developed over a number of years and through significant investment which are in place to record existing assignments and thereby assist in the management of potential conflicts which may arise from new assignments. One respondent indicated that the development and ongoing running costs of these systems ran into millions of euros and this indeed appears to be a figure relevant for the largest of the associations. In some of these cases, an identified Global Director of Independence or similarly-titled individual is charged with

harmonising independence tracking across the entire association, with support from the central body. In other cases, investment is of a more recent nature and is ongoing both in developing computer systems and in enhancing of the work of audit committees within the association. Whatever the precise mechanism, these central coordination functions in the management of independence are designed to track existing assignments and facilitate the identification of independence where these might arise in relation to existing clients as well as new client acceptances. They also provide overall guidance to member firms and respond to specific questions in these areas. Finally, the systems also relate to financial interest restrictions on the part of individual partners for which regular information requests and monitoring is undertaken.

Client acceptance procedures

As can be anticipated, given the degree of attention which Category C respondents place on trans-national independence, there are procedures in place across all these associations to deal with the acceptance of new clients. These are not only generally more enhanced than is the case of Category B associations but also extend to cover acceptance of non-audit engagements. It is standard for Category C associations to require that international checks are undertaken between member firms and are approved by the central body. This can take different forms: for example, a "point-scoring" based assessment procedure can be used to mitigate risk.

Audit methodology

The trend towards greater coordination among Category C associations is most pronounced in the approach to audit methodology where full harmonisation is pursued. The survey recorded the existence of a common and mandatory audit methodology for all member firms in the case of all Category C respondents. Audit reports cannot be signed off by member firms unless the common audit methodology is followed. This audit methodology is supported by a standardised audit software application. This software includes checklists intended to provide guidance to engagement teams when reviewing clients' financial statements and drafting related audit reports. These checklists are updated periodically to address changes in standards.

Policy on working paper transfer

Category C respondents also demonstrated a high awareness of the restrictions emanating from national legislation relating to access to working papers. Respondents generally indicated that a common approval across the associations would be preferable. However, it was recognised that as far as professional secrecy is concerned, local and regional privacy laws and regulations are applicable.

4.4.6. Branding, External and Internal Communication

Branding and external communication constitute important elements in the liaison function which associations undertake between member firms and the market as a whole. The term branding in this respect is used to mean an organised and deliberate approach to convey a common identity which would be immediately recognisable as such by market participants. External communication refers to communication, through various means, with external parties. Together, branding and external communication are indicative of the degree of interaction, coordination and operational integration of an association, as brand and external communication strategy are necessarily linked to overall business strategy. The correlation between branding, external and internal communication reflects in turn the importance of the association as a market portal to individual member firms.

This section focuses in particular on the branding and external communication of associations from the perspective of the stated policies of the associations, as set out in their association bye-laws or rules. Clearly, an analysis of the branding of associations in terms of the implementation of marketing strategies lies beyond the scope of this study. However, a number of observations are made on some occasions in this broader area on the basis of overall comments made by respondents.

This section also discusses the general approach of respondents with regard to internal communication within the associations. It is written with the aim of complementing the findings of other sections in this chapter, rather than constituting an analysis of all aspects of communication within the associations.

Category A associations

Branding: overall observation

None of the Category A associations pursues a policy of common branding. Most notably, none of the Category A associations has a set and obligatory policy with regard to the use of a common name. Member firms retain their own individual names in the overwhelming majority of cases. Among respondents in this category, there is a small minority of associations which have a limited number of member firms using a common prefix/suffix in their name. In one case, the use of this prefix/suffix dates back three decades. As is explained in chapter 6, this has raised concerns within these associations with regard to the possible view of regulators concerning the application of the EU network definition.

As noted, this survey does not address implementation of marketing strategies, however, it is clear from the responses that Category A associations effectively do not have marketing strategies as such. This is to say they lack the budgetary resources, and ultimately consent of member firms, to actively promote the association as a whole through marketing initiatives such as advertising campaigns, or sponsorship arrangements. This is not to say that individual member firms do not undertake their own marketing, subject to the regulatory requirements of their individual jurisdictions.

External communication: association and membership

Notwithstanding the above, all the Category A respondents confirmed that they have a set communication policy to demonstrate the existence of the association and to denote the fact that a firm is a member of the association. Among the principal communication forms are the existence of an association website and the production of an association directory of firms (replicated on websites) listing all the firms which are members.

Complementing these initiatives are policies established by all but one of the Category A associations to ensure the use of a common logo and reference to association membership in member firm literature, stationery, business cards and the like. Typically, these state that the firm is a “member of X association”. They are particularly important in the everyday interaction of member firms with the market. The logo or other reference is often the most direct and externally visible indication that an individual firm is a member of an association.

The survey found that the rules of the associations on the precise references to the association membership varied, although from the survey responses there was a clear indication that member firms and the association governing bodies are all equally keen to ensure that there is clarity with regard to contracting parties and liability. The survey recorded considerable differences, however, in the degree of activity of the coordinating body in assisting firms with regard to sharing best practice

on the use of the logo or other reference to association membership, and of central monitoring in this regard.

One exception was noted in relation to the use of a common logo and merits a brief separate comment. The association in question forbids the use of a logo to denote association membership. This is pursued via the harmonisation of stationery formats alone.

External communication: labelling of associations

A particularly significant finding of the survey is the high degree of attention given by all Category A respondents to the "labelling" of the grouping as a whole. As is noted in further detail in chapter 6, among these respondents careful consideration has been given recently to the terminology used when describing the grouping in external communication on account of regulatory considerations. Most notably the use of the word "network" is being avoided.

It is also clear from the survey respondents that market perception issues are also deemed important in this regard. As noted in chapter 3, one respondent was keen to draw attention in its response to the initial survey to a new concept of "alliance" which lay outside the category represented by the EU network definition and also outside of the category of other non-network groupings. This label has also been assumed by a further two Category A respondents since the completion of the initial survey and appears also to be influenced by consideration of the network definition (see also chapter 6).

External communication: association activities

None of the Category A respondents publishes a voluntary annual report for the worldwide association as a whole. The main vehicles for external communication of the overall economic activities of a Category A association appear to be the regular surveys of the International Accounting Bulletin and other such surveys in the specialised press. These surveys merit a further comment as they constitute a type of voluntary ranking service to assess the relative sizes of the associations and other trans-national organisations and practices. The surveys constitute an opportunity to display the aggregate revenues of the associations' members and of other organisations and practices while also providing other broad information, such as number of partners, geographical location of member firms and overall fee data. It is on this basis alone that rankings of international groupings in the profession are generally based.

In turn, it can also be noted, on the basis of the survey findings, that Category A associations collect only very limited economic information from members on a yearly basis following their entry into the association. Some associations require that their members complete annual fact sheets but in the main the types of information requested are relatively limited and along the lines of those published in the external surveys.

Internal communication

In relation to internal communication within the associations, Category A respondents in the main have fairly low or very low levels of activity outside of an association newsletter or other such communication forms providing information on member firm assignments and membership changes. The low levels of activity are particularly notable in the case of pan-association communication on technical matters.

In the most developed cases, a Category A association has technical committees of members in defined areas, for example accounting, auditing and tax. However, the role of such committees is

somewhat limited. Principally, their role is to discuss important updates and to act, on virtual basis, as an occasional point of reference for member firm queries. Contributions of a technical nature are also included in newsletters. A further role for such technical committees, where they exist, is to prepare input and present at association conferences.

Association conferences appear to be the most important tool used by Category A associations for internal communication and are generally attended by partners from member firms and also senior staff members. Conferences tend to be organised on both a regional basis (where regional structures exist) and also at a global level and are often scheduled to coincide with the meeting of the governing bodies of the association.

In addition to providing the opportunity to discuss technical updates, as noted above, association conferences also constitute forums for communicating association strategy and policies to member firms. Many of the associations use such conferences as a "barometer" to gauge reaction to possible future modifications to association strategy, as well as of member firm involvement in the activities of the association. For example, some associations include a specific requirement that member firms send representatives to a minimum number of conferences in a given time frame. It should also be noted that attendance at such conferences is generally subject to separate charges from contributions to the central budget of the association. Member firms, therefore, have to finance their own participation, which covers both travel and accommodation and also, generally speaking, a conference fee.

Category B associations

Branding: overall observations

When compared to their Category A counterparts, Category B associations tend to have a more defined policy on the branding of member firms. Still, this should not be overstated as considerable divergences in approach are evident across respondents.

Where marketing strategies as such exist, it is the case that additional budgetary resources, when compared to Category A associations, are generally available. However, again it is important to note that there are significant differences between individual Category B respondents in this regard. Overall, the associations in themselves do not appear to engage in marketing initiatives and sponsorship arrangements, although member firms can and do so. Given that member firms have, to a far greater degree than is the case in Category A associations, commonality of names and prefixes/suffixes (see below), Category B associations are more visible in the marketplace as whole. However, this is generally speaking considerably more modest than is the case with Category C associations, and the most integrated of Category C associations in particular.

External communication: association and membership

All Category B associations confirmed the existence of set communication policies to demonstrate the existence of the association and to denote the fact that a firm is a member of the association. As is the case with Category A associations, an association website and directory of member firms exist in all cases. In addition, Category B associations generally produce additional literature on the association, for use by member firms.

Common logos and other references to association membership are the minimum requirements within Category B associations. More frequent is the use of a common prefix/suffix or a common name. The general approach observed across Category B associations is to pursue this commonality as far as possible, subject to the agreement of members and to legal restrictions in individual jurisdictions. To a

degree, Category B associations have a "franchise" type policy with regard to the use of the association brand. Such policies are, however, most advanced at Category C association level.

Most category B associations provide some form of marketing support to member firms. This can be in the form of common tools, common brochures, assistance in website development and the provision of formats and guidelines for office stationery. The larger Category B associations report to have already or to be developing broader corporate identity guidelines for branding, strategies for joint marketing initiatives between member firms, assistance in coordination of joint tenders and marketing related workshops at conferences.

External communication: labelling of association and activities

The majority of Category B associations, at the time of the publication of this study, include the term network in self-descriptions on their websites. This appears to represent a continuation of past policy, rather than a specific decision to refer to the network definition in the revised Statutory Audit Directive.

Only one Category B association currently produces an annual review and this has been initiated very recently. For the most part, Category B associations use the regular surveys of the International Accounting Bulletin and other such publications to communicate externally on their economic activities. This, of course, is in addition to general literature on the associations produced for marketing purposes.

Internal communication

Compared to Category A associations, there is more technical support provided centrally and more member firm pooling of technical expertise in Category B associations. This can take various forms, for example the development of intranet and regular association newsletters; the identification of experts in member firms, the use of virtual or formal helpdesks; the existence of committees addressing technical questions and the development of databases of key technical information.

Category C associations

Branding: overall observations

Category C associations have the most advanced and integrated approaches to branding across all respondents. In the most developed cases, these have evolved over many years and through considerable investment and have resulted in a high degree of market recognition.

External communication: association and membership

All Category C respondents confirmed the existence of set communication policies to demonstrate the existence of the association and to denote the fact that a firm is a member.

Category C association member firms are required to use the association name, either directly and in full or as a prefix/suffix as a minimum requirement, unless this is prohibited by national legislation in a particular jurisdiction. It would be inaccurate, however, to convey this commonality of branding as being solely the result of a mandatory requirement: in these cases, member firms derive considerable benefit from the use of the common name. In effect, there is, to varying degrees, economic dependency based on the common name. This is the case to such an extent that it would be more

accurate to regard the predominant approach to common branding within Category C associations as more akin to "franchise" agreements.

Category C associations have developed detailed corporate identity manuals to provide guidance to member firms on the use of the brand, logo and name. In addition, Category C associations have global or central marketing support services to assist member firms and share best practice in a variety of marketing areas, including brand management and communications. Advertising and sponsorship decisions are generally the initiative of individual member firms.

As noted, correspondent members are usually not allowed to use the brand name directly, but are able to demonstrate their status as correspondent members of the association.

External communication: labelling of association and activities

As noted, Category C associations recognise that the network definition in the revised Statutory Audit Directive is applicable in their regard. Most use the term network in their website description which again reflects a continuation of past policy.

Category C associations provide information for the International Accounting Bulletin survey and other such publications but there are also many other channels for communicating details on the economic activities of the associations. Most Category C associations produce an annual review, summarising activities of the international association and providing broad details on governance arrangements and related matters. It was noted by respondents that the transparency report requirements in the revised Statutory Audit Directive would require the provision of some additional information, but this was not deemed to be significantly more than that which is already made publicly available.

Category C associations also invest a considerable amount of resources in marketing literature on international association activity, along with the publication of international surveys and enquiries on matters of professional interest.

Internal communication

A large series of internal communication functions are organised at central level in the Category C associations, including well resourced technical support functions such as helpdesks on financial reporting, auditing and standards, drawing on the work of technical committees, and also industry expertise centres to provide support on specific industry sectors. In addition, these associations also have an office of General Counsel. These functions usually exist at different levels in the association: international, regional (European) and national. In these respects, most Category C associations have considerably more enhanced arrangements in place than Category B associations on account of the more sizeable central budgets and staffing.

4.4.7. Professional Indemnity Insurance

The situation regarding liability for statutory audits and the availability of insurance differs, and in some cases markedly so, across EU jurisdictions and indeed across the world. This subject is now better understood at European and international level given recent high-level debates. An important contribution in enhancing understanding has been provided through the study undertaken for the

European Commission by London Economics[19] which has demonstrated that there is no insurance commercially available for a significant part of the overall audit market.

It should also be clarified that the survey posed questions solely on the set policy of associations but did not seek to examine issues arising from the practical implementation of these policies.

Category A associations

In Category A associations, individual member firms are required under membership rules to have a liability insurance in their jurisdictions, where this is available. Some associations seek to assist their member firms in obtaining an insurance elsewhere, if there is no indemnity insurance available in their own jurisdiction. However, it should be stressed that the degree of assistance is of a practical nature rather than one where risk is shared.

In all cross-border referrals, disclosure is usually required as to whether the member firm has professional indemnity insurance. The member firm making the referrals has then to decide if it wants to refer to uninsured firms. This in fact applies to all categories of associations.

Only one Category A association indicated that it currently has a "vicarious liability" policy to cover claims brought against the association in the US. It should be emphasised, however, that this is an isolated example among Category A associations and that the coverage is for a modest amount ($250,000) when compared to litigation cases and legal costs. Furthermore, the liability arrangements of the association in question are in all other respects the same as for other respondents: that is to say that individual member firms carry liability for their own actions alone and professional indemnity insurance is arranged accordingly.

Category B associations

Category B associations also require their member firms to have an appropriate level of professional indemnity insurance cover for their jurisdiction where this is available. The survey found that Category B associations do not have group insurance for the association as a whole. Within this framework, a number of additional features and considerations arose through survey responses which merit comment.

A small number of associations reported they had in the past a broad international professional indemnity insurance covering all international referral work but this insurance was discontinued. It was commented that the insurance sector is now unwilling to consider providing coverage for an association as a whole. One of the other comments was that professional indemnity insurance on an individual firm basis is less expensive than a central professional indemnity insurance.

A small number of respondents indicated that they have a limited amount of professional indemnity insurance in place or are organising "legal defence" cover for the association in order to be able to defend against potential allegations of "vicarious liability" arising from the actions of member firms. Again, in the few cases where this exists, it is important to emphasise that the amount of coverage involved is minimal and does not alter the overall approach whereby professional indemnity insurance is a matter for individual member firms.

[19] Study on the Economic Impact of Auditors' Liability Regimes – Final report to EC-DG Internal Market and Services London Economics (September 2006).

Category C associations

The situation regarding professional indemnity insurance with regard to the largest international providers of audit services, all of which are associations in terms of underlying structural model, is covered in detail in the London Economics' Study[20]. It is not necessary to replicate all the findings of the report here but it is appropriate to reiterate the impact of the decline in the availability of commercial insurance.

While Category C associations also require individual member firms to take out insurance coverage in their individual jurisdictions, this is unavailable in many cases: large segments of the client base of Category C associations are currently "uninsurable". As noted in the London Economics study, the availability of commercial insurance has fallen to such an extent that the available insurance would cover less than 5% of some of the large claims some firms face at the present time. As is also brought out by the London Economics study, the very largest and most integrated associations have as a consequence developed their own programmes for the coverage of professional liability. These are known as "captives": mutuals owned by member firms of the associations which mutualise risk across member firms. However, it is important to emphasise that these can provide only a limited amount of cover for professional indemnity, as is also acknowledged by the London Economics study.

Outside of the very largest and most integrated respondents, there are no such arrangements in place, or other policies taken out on behalf of an association as a whole. One respondent indicated that it takes out insurance centrally to cover referred assignments between member firms. However, this does not constitute coverage for the association as a whole.

4.4.8. Professional Education, Human Resources and IT

The survey posed specific questions concerning the existence of association policies in relation to professional education in the areas of professional activity (outside of initial education and training for qualifications of professional Institutes) and to the promotion of individuals working within member firms and other relevant human resource measures. The survey also asked specifically about the existence of harmonised Information Technology.

Professional Education

Some Category A associations conduct a programme of education through meetings and conferences which in some cases can be registered for the purpose of fulfilling national or professional Institute Continuing Professional Education (CPE) requirements. Aside from these initiatives, Category A associations do not have any significant engagement in the professional education sphere.

A not entirely dissimilar picture can be drawn for many Category B associations. However, as noted, there is a greater degree of association-wide investment among Category B associations in technical coordination and dissemination. This provides a platform for greater fulfilment of CPE obligations via the association than is the case in Category A associations.

Across Category C associations, the survey recorded some divergences of approach in this sphere which are not always correlated to the size of the associations, based on the aggregate income of all member firms. In some cases, there are no arrangements in place at association level for CPE, while in

[20] "Study on the Economic Impact of Auditors' Liability Regimes – Final report to EC-DG Internal Market and Services London Economics" (September 2006). See Part II, and in particular pp 91-107.

others, prescribed programmes have been developed at the central level. These stipulate areas where member firms are obliged to take initiatives and areas where member firms are recommended to do so. Also in some cases, centrally organised courses are delivered to member firms.

Human Resources

All Category A and B associations reported that there are no common human resources policies in place and it is up to the individual member firm to decide on promotions and related personnel matters. Some Category B associations, on account of the membership of the Forum of Firms, indicate that they are following the guidelines on Personnel Advancement in accordance with ISQC1. It is also notable that some Category B associations encourage secondments amongst member firms, which is generally not evident within Category A associations.

The transfer of staff, through secondments and other initiatives, is more developed still within Category C associations and in particular within those with the highest aggregate income of member firms. There is also a discernible higher degree of coordination in approach to human resources. However, the overall findings of the survey are that coordination – less still integration – is very limited. Category C associations have some common characteristics in their evaluation and promotion systems but national requirements and circumstances appear predominant.

Information Technology

Outside of harmonised audit software, which exists to some degree in Category B but most particularly in Category C associations, there is no harmonisation of IT in any of the associations.

4.4.9. Withdrawals and expulsion from an association

The procedures for a member firm leaving or being required to leave an association are covered, in all three categories of associations, in association bye-laws or comparable documents. They are sometimes further elaborated upon in an association's operational rules.

Member firms may leave voluntarily, subject to resignation provisions, which generally include a specified notice period. Member firms may also be required to leave – i.e. they are expelled from the association. Reasons for expulsion include failure to pay fees and other charges. They can also include failure to adhere to membership quality requirements. In expulsion cases, the highest governing bodies of the associations are always involved.

The licence to use the association's name or logo or other reference of membership of the association is terminated immediately upon withdrawal or expulsion. In the case of withdrawal from the association, it is possible that arrangements can be agreed for the continued use of the association's name, logo or other reference of membership for a defined period. However, this does not appear to be common.

The survey did not ask specifically with regard to the frequency of withdrawals and expulsions. However, many survey respondents commented on this. The general sense from these comments is that withdrawals by firms leaving to join another association are not so uncommon. Expulsion appears to be less frequent, but by no means rare. Quality control concerns appear to be the main reason where this does occur. It is also the case that Category C associations have experience of expelling members.

4.5. Summary of overall findings

The survey demonstrates that, where the overall legal model is concerned, there is very considerable commonality across all international associations surveyed. The same basic underlying legal model is used in the profession today for associations with widely differing dimensions of trans-national work and combined figure of income from all member firms. With regard to the latter, the extent of the differences among those surveyed range from less than €1 billion to over €20 billion annual aggregate global fee income.

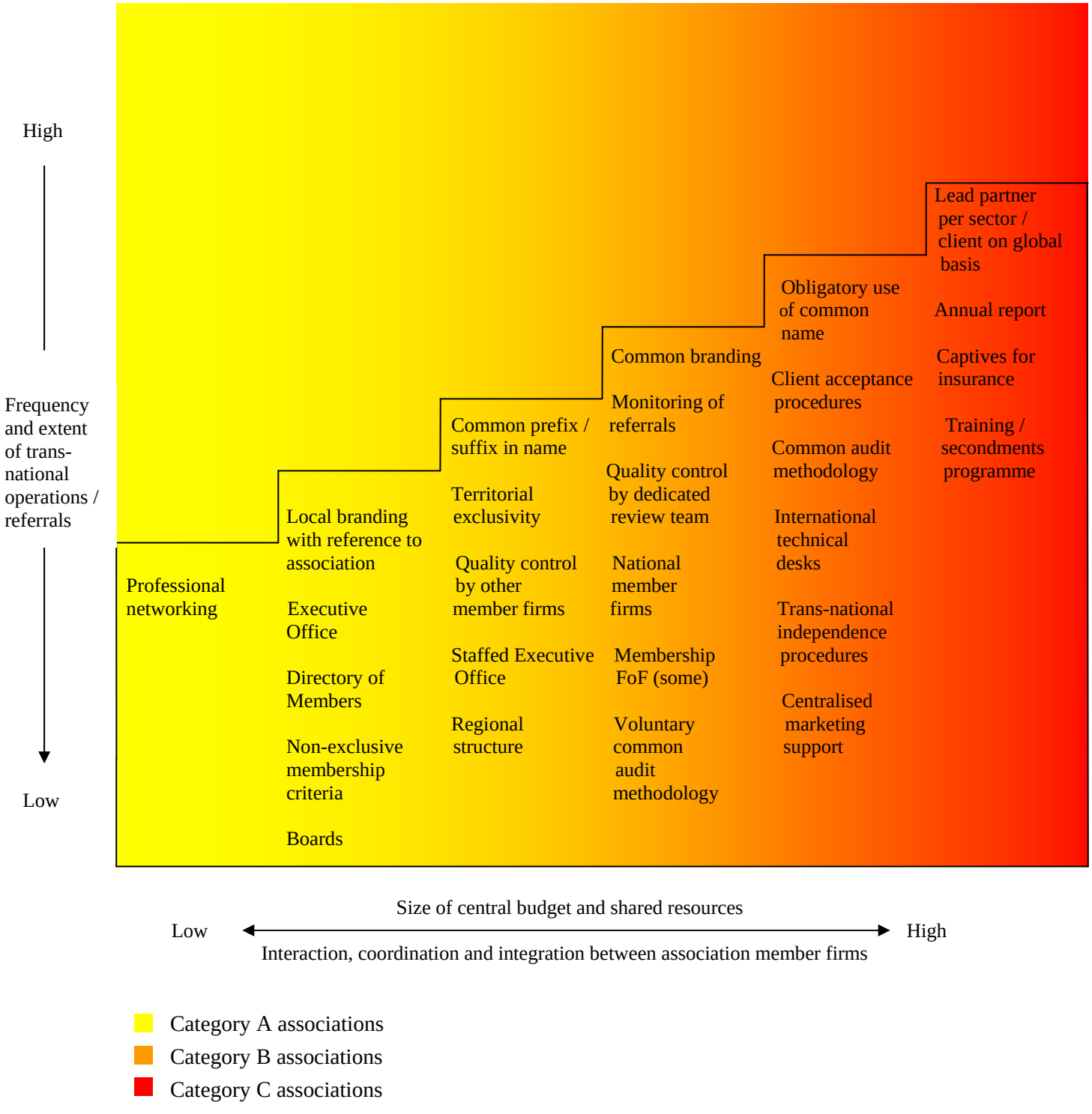
On the basis of the survey findings, it is very clear that among the many current jurisdiction-specific regulatory and legal drivers which have shaped the evolution of international associations, liability has been a key factor and has increased in importance over time. The uneven playing field in relation to liability regimes, particularly in light of the fact that many jurisdictions apply unlimited joint and several liability, as well as the intense litigation cultures in certain jurisdictions have heightened concern regarding liability transfer across jurisdictions. The use of a coordinating body (or bodies) is the lynchpin in the association model, as this permits necessary interaction, coordination and integration between legally independent member firms while protecting against liability transfer over jurisdictions.

A further key element in the overall structural model consists of agreed obligations of membership which take the form of association bye-laws, rules or other such regulations.

The obligations of membership effectively constitute the agreed parameters of operational functioning which are the key distinguishing features between individual associations. As noted through the course of this chapter, three discernible categories within the associations (A, B and C) were identified through the survey which are correlated to an ascending degree of interaction, coordination and integration along operational lines.

Graphic 5 on page 67 illustrates the ascending governance and operational features of the three categories. It should be emphasised that these categories are not clear-cut and therefore have blurred areas between them into which some individual respondents can and do fall. The categories are designed solely to assist interpretation of the survey findings. They also constitute a useful reference point for comparing the most integrated of the associations with the model of an integrated international partnership and that of the national firms with subsidiaries in other jurisdictions. These models are the subjects of chapter 5.

Graphic 5: Main operational characteristics of associations



In interpreting Graphic 5, it is also important to consider the findings of the survey in relation to governance, management and control.

While the survey demonstrates the existence of some similarities in governance structures between the profession and the corporate sector, for example the existence of boards, it also shows large differences in the degree of authority held by the boards and even more marked differences in the actual exercise of governance, management and control. These are most pronounced in relation to Category A and Category B associations. However, also with reference to Category C associations, the survey findings would indicate that a more "nuanced" concept of governance, management and control exists to that which is exercised in the case of corporate entities.

A further common and related feature across all the associations is that the relationship between member firm decision making and board decisions at international level appears to involve far greater "bottom-up influence" as opposed to "top-down interaction" which is often predominant in the case of a corporate scenario involving holding company and subsidiaries. This is clearly most evident in the case of Category A associations. In this regard, the fact that it is the member firms which have the relationships with the client rather than the coordinating body is a highly influential factor.

The fundamental defining factor for all associations is that there is no common ownership across firms: the firms are all (with limited exceptions) independently-owned legal entities. To varying degrees, they are bound together on a "voluntary" basis. Where member firms are less dependent on the commonalities provided through the association – for example, reputation developed on the basis of common pan-association audit procedures and branding – this voluntary characteristic is most pronounced. In the case of the associations where the dependency is highest, the degree of compulsion, as exercised by the association's governance, management and control systems, is greatest. However, there remains a degree of voluntarism at the core of the association model based on agreed adherence to association rules. In the final analysis, the main vehicle for the exercise of control in the association model for all three categories is the monitoring of adherence to these rules: direct control across jurisdictions to implement these rules is not possible without an ownership stake.

5. INTEGRATED INTERNATIONAL PARTNERSHIP AND NATIONAL PRACTICES WITH SUBSIDIARIES IN OTHER JURISDICTIONS

5.1. Introduction

As set out in chapter 3, the survey found that two further models of trans-national organisation and practice are employed within the accountancy profession in Europe in addition to that of the international association of independent firms. The two models are: an integrated international partnership and a national practice with subsidiaries in other jurisdictions.

The main purpose of this chapter is to provide a detailed overview of the legal structure and characteristics, governance arrangements and operational functioning of the two models as they are employed in the profession today. Given the greater predominance of the integrated international partnership model, far more attention is given to the empirical analysis of this model in the course of the chapter. The chapter also considers the nature of the interaction of these models with the international association model.

Following this introduction, this chapter is divided into the following sub-sections:

- Integrated international partnerships: section 5.2.
  Defining characteristics and legal and regulatory context: section 5.2.1.
  Legal structure and related matters: section 5.2.2.
  Governance, management and control: section 5.2.3.
  Operational matters: section 5.2.4.

- National practices with subsidiaries in other jurisdictions: section 5.3.

- Summary of interaction of organisational models: section 5.4.

As is noted in chapter 3, in pure numerical terms, both models are currently very much in the minority in relation to the distribution of organisational models used by respondents in relation to their organisations as a whole. However, as also noted in chapter 3, and as is confirmed through the course of this chapter, it would be inaccurate to regard these models as insignificant or isolated. This point is especially relevant in relation to the integrated international partnership model.

This particular relevance is not only due to the market position of the one individual respondent which describes itself in relation to its trans-national grouping as a whole as an integrated international partnership. It is also due to the fact that significant aspects of this structural model can either be directly observed in or are attracting growing attention from respondents at the larger end of the market using the international association model.

It is important to emphasise that the analysis of the defining characteristics and legal structure of the integrated international partnership model (sections 5.2.1. and 5.2.2.) draws in many instances from this broader pool of experience of using the model as well as from the one individual respondent which describes its whole grouping as an integrated international partnership. The other sections in this chapter dealing with governance arrangements and operational matters (sections 5.2.3. and 5.2.4.) draw solely from the latter.

Where appropriate to the analysis, points of comparison and contrast with the international association model are made during the course of this chapter and in particular to the most operationally integrated

associations, referred to in chapter 4 as Category C associations. It should be underlined, however, that all such observations are made on the basis of comparing and contrasting only the stated approaches of respondents. In a number of areas observations are also made on the basis of theoretical considerations regarding, for example, the exercise of governance and control. In no way should such observations be deemed to denote superiority or inferiority of one model over the other.

Also where appropriate to the analysis and to ease interpretation of practical market implementation, reference is made to the interaction observed through the survey between the two models which are the focus of this chapter and the model of an international association. The findings of the survey in this respect are summarised in section 5.4.

5.2. Integrated international partnerships

5.2.1. Defining characteristics and legal and regulatory context

A. International partnership: theory and practice

The definition of a partnership is a form of business entity in which partners share with each other the profits or losses of the business undertaking in which all have invested. By definition the key characteristics of an integrated international partnership must be precisely its integrated and international features. More specifically, this means a business model based on integrated operations and the sharing of profits or losses - and also, therefore, business risk and liability – among partners from and based in different jurisdictions.

The findings of the survey show that many, but not all, of the theoretical aspects of the model are employed in practice by the profession today where integrated international partnerships are said to exist. From the answers of the individual respondent whose organisation as a whole was described as an integrated international partnership, as well as of respondents constituting the broader pool of experience in this area, it is apparent that national regulatory and legal considerations are decisive in shaping divergence in practice from the theoretical norm. This divergence is evident in a number of areas and is most notable in respect of liability. It is also clear that such considerations are important in determining the geographical coverage of the partnership.

With regard to regulatory and legal considerations, in the first place it should be recalled that it is currently still not possible to establish an international partnership to operate in the accountancy sphere in the European Union in the same way as it is to establish a partnership in a single jurisdiction. The revised and "Europeanised" ownership rules in the revised Statutory Audit Directive are still to be implemented across all Member States. As noted in chapter 2, the registration requirements have historically been for nationally-approved individuals and are still of this nature in some cases, pending full transposition of the Directive.

All respondents to the survey who had experience of the international partnership model attached particular importance to the unevenness of liability regimes across jurisdictions and also to intense litigation cultures in certain jurisdictions. None of the respondents which either regard themselves as an integrated international partnership as a whole or house such a partnership within an international association shares liability risk across jurisdictions.

It is significant to note that the individual international partnership respondent indicated that it intends to study the possibility of modifying its structures as soon as possible after the revised Statutory Audit Directive's provisions in the ownership area are transposed across the EU. Equally, however, the

respondent observed that liability issues would also have to be considered and these could represent a significant brake on this development. A number of other respondents to the survey, specifically within Category C associations, made similar observations when referring to the evolution of existing international partnerships within their associations and the possibility of existing member firms of the association in different jurisdictions merging together.

Against this background it is not surprising, therefore, that the survey revealed that specific legal structures and other mechanisms, which are not entirely dissimilar from those used in the international association model, are used in order for international partnerships in the profession to operate internationally in an integrated way while abiding by the national regulatory and legal requirements in each jurisdiction. The precise nature of these legal structures and other mechanisms are dealt with in section 5.2.3.

B. Geographical coverage

The survey found that, in relation to the individual respondent described specifically as an integrated international partnership, the number of jurisdictions covered by the partnership was considerable – over 40 jurisdictions with the majority in the European Union but also with many non-EU jurisdictions outside of Europe. Clearly, however, the coverage of the partnership could not be said to be near-global, as is the case with many of the international associations.

In the case of other survey respondents which house an integrated international partnership within an association, the number of jurisdictions covered can vary very widely, from as low as two or three to a maximum number of over 20 jurisdictions. In the case of the respondent with a partnership covering the highest number of jurisdictions, the countries concerned are primarily in the emerging markets of Central and Eastern Europe and in the recent EU accession states.

None of the partnerships encompasses firms from the US directly and on the basis of the full sharing of profit and loss. International cooperation with the US is always through other mechanisms, in order to further safeguard the partnerships and individual practices from the possibility of liability transfer from the US and vice-versa.

Additional reasons outside of concerns regarding liability for the geographically more limited employment of the integrated international partnership merit brief comment. The historical context and the jurisdiction-specific nature of regulatory and legal requirements which have impacted on the accountancy profession as a whole provide a very important backdrop. It is after all from this broad canvas of jurisdiction-specific regulation and diversified business practices and structures that international partnerships have had to be fashioned.

The influence of existing business practices and structures certainly should not be under-estimated: it is not a given that it is always possible to find partners and practices in different jurisdictions which share the same business approach and strategy and with whom agreement can be found to share profits and losses. It can be observed that in regions of Central and Eastern Europe and elsewhere, the absence of existing business practices and to some degree of jurisdiction-specific regulations in the early 1990s created a less obstructive context for the evolution of international partnerships, as well as other forms of trans-national service provision.

Considerations pertaining to both regulatory and legal matters and also broader business issues have resulted in the one respondent which describes its entire grouping as an integrated international partnership pursuing different legal and structural channels to secure an operating presence in

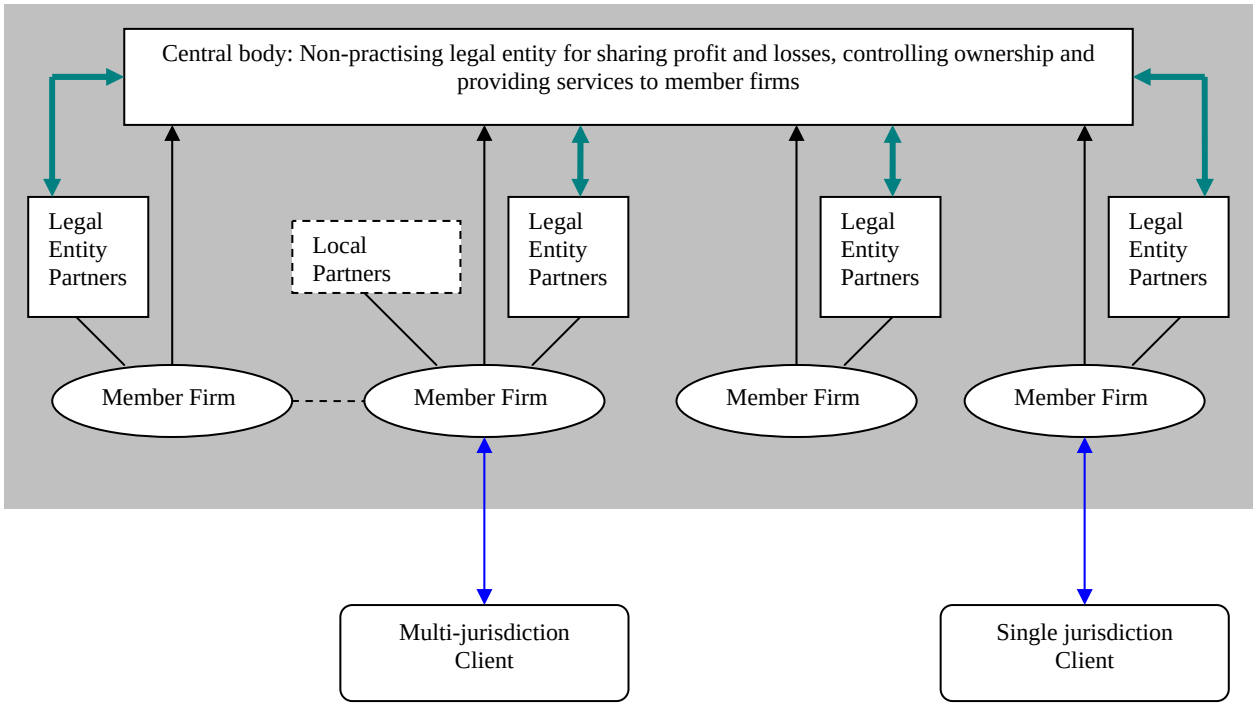
jurisdictions outside of those covered by the partnership itself. These include membership by the partnership of an association. This point is examined separately in section 5.4., through discussion of the combination of structural models of trans-national organisation and practices observed through the survey. Other channels include the establishment of joint ventures which lies outside the scope of this study.

5.2.2. Legal structure and related matters

A. Underlying legal model

The underlying legal structure of the integrated international partnership model as it is currently employed in the profession is set out in Graphic 6 on page 73. It is followed by explanatory text describing the nature of the legal and operational relationships between the various components and also the points of comparison and contrast with the international association model. Both the graphic and the commentary have been developed from a broader pool of experience than that alone of the single survey respondent which describes its entire grouping as an integrated international partnership: however, they necessarily draw very considerably from the latter's experience.

Graphic 6: Underlying legal structure as implemented of the integrated international partnership model



Contract between member firm that provides the service and head office of client

Sub contract between contracted member firm and another member firm

Constitutional documents (and/or other agreements) binding on all partners and member firms

Contribution to central budget of association

The shares of the central non-practising legal entity are owned by the partners of the member firms

Local partners can exist who are partners of member firms but do not own shares in the central non-practising legal entity

Ownership

The key legal structures and related characteristics illustrated in Graphic 6 can be summarised as follows:

- The existence of a central, non-practising legal entity as a vehicle for partners based in different jurisdictions to share profits and losses and to control ownership;
- The existence of individual member firms in each separate jurisdiction which are the points of service provision to, and contract liaison with, clients;
- The possibility to distinguish, if needed or chosen, between different categories of partners: those with an equity stake in both the non-practising legal entity and a member firm and those which only have equity shares in the latter;
- The use of the central non-practising separate legal entity to provide a basis for governing bodies of the partnership;

- The use of the central non-practising separate legal entity as a basis to share costs for the provision of services to promote and pursue operational integration across member firms (the provision of these services need not be provided through the legal entity itself);
- The existence of a constitutional document or other agreements for the international partnership as a whole, setting out rights and obligations relevant for all partners and member firms.

In relation to the respondent which describes its grouping as an integrated international partnership, the survey found that the central non-practising legal entity is a limited liability cooperative registered in Belgium (SCRL). In the case of the respondent which houses an integrated international partnership within an association of independent firms covering the largest number of jurisdictions, there is a two tier legal structure encompassing a foundation (Dutch Stichting) and a Dutch private limited liability company (BV). In both cases, the member firms of the partnership have a range of legal forms as permitted under the legislation of each jurisdiction. For example, some are general partnerships, some are limited liability partnerships and others are limited liability companies.

B. Role of central legal entity

The capital base of the central legal entity is at the heart of the structure and constitutes a very important aspect of the model. This is in direct contrast to the negligible role of the capital base of the separate legal entity in the international association model. In the latter, the central body serves only to share costs among member firms in the provision of services to the association as a whole which can, of course, involve very sizeable tasks and budgets as is the case with some Category B and C associations. However, in the case of international associations, the model is constructed in a way which does not involve the sharing of profits and losses nor the sharing of risk via the capital base of the separate legal entity.

In the case of the integrated international partnership the central body is the main vehicle for the enhanced economic integration of partners and member firms. It is effectively the vehicle through which the sharing of profit and loss is channelled. This, in the final analysis, constitutes the most significant difference between the integrated international partnership and the international association models. As noted, in neither the association model nor in the integrated international partnership model as employed by the profession today is there sharing of liability risk across jurisdictions.

Given its importance, considerable attention is understandably given to the rules surrounding the capital base of the central body in the integrated international partnership model. The rules form part of the constitutional arrangements of the partnership which can be set out in various different documents. In the case of the single respondent which describes itself as assuming this model, the capital of the non-practising legal entity is individually owned by partners of the member firms in proportion to their shares in the latter. The number of local partners is limited and very much in the minority. Among the rules governing the capital is a requirement that shareholders may only transfer their shares to parties approved or designated by the central legal entity, *i.e.* in practice other partners who hold shares in the central legal entity. It was also noted that no goodwill may be taken into account in the transfer of shares between partners.

The assumption of shared profit and loss is not, of course, pursued solely on the basis of a set of rules regarding the capital base of the central structure. These rules are complemented by the use of set structures and mechanisms in the governance, management and control and operational spheres. The ultimate objective of all these features is to enhance the quality and consistency of service provision and the sharing of profit.

The existence of set structures and mechanisms in these two spheres are dealt with in the following sections. It should be reiterated that the following sections are written on the basis of the survey answers of the respondent which describes its grouping as an integrated international partnership. The approaches of the other respondents which house an integrated international partnership within an association are effectively those agreed by the association as a whole. As such, the latter are, therefore, considered in chapter 4.

5.2.3. Governance management and control

A. Partnership's constitutional documents

In a manner not entirely dissimilar to the model of an international association, the survey found that the integrated international partnership model also uses a set of "constitutional" documents setting out the basic principles and main objectives of the partnership, the responsibilities and rights of partners and member firms, and the general operating parameters. Also covered are membership, governance and operational aspects of the central legal entity.

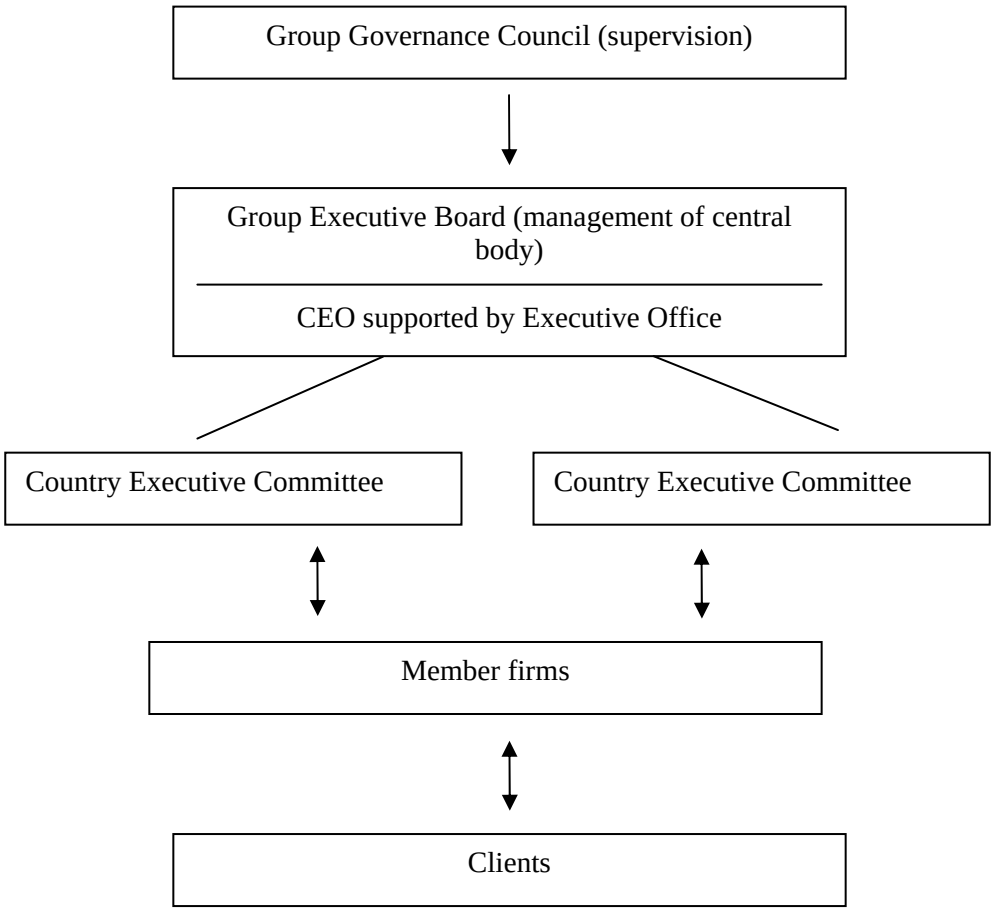
As is the case with associations, these documents constitute the reference point against which partner and member firm adherence is measured and governance is exercised. However, from the survey answers, it is clear that governance, management and control is pursued in a different way to that of an international association. In the first place, this is because the very concept of a member firm is – at least in theory – different between the two models. On account of the shared ownership, governance, management and control appear to be more direct and "less nuanced" than in the association model where there is no liaison through the capital base.

The relationship between member firms and also between member firms and the central legal entity is more integrated given the shared assumption of profit and loss. Equally, and again on at least a theoretical basis, the in-built structural incentives to proactively encourage adherence to the articles of association is greater in the integrated international partnership model than in the international association model. In both, it would appear that significant reliance is placed on ongoing monitoring of quality control through various operational measures (see 5.2.4.E.) However, the dependence on such monitoring appears greater in the international association model, when viewed purely from the theoretical perspective. These considerations appear particularly relevant when using as a point of comparison Category A and B associations.

B. Governance, Management and Control Structures

Graphic 7 on page 76 sets out the findings of the survey in relation to the governance structure of the integrated international partnership model. It is followed by a brief commentary on the key features of the structure and points of comparison and contrast with international associations.

Graphic 7: Governance structure of an integrated international partnership



The respective responsibilities and roles of the various component parts of the governance structure are as follows:

- The central pivot of the governance and decision-making of the international partnership is the General Meeting which gathers all the central legal entity partners at least once a year. It deals with the approval of strategic decisions, election of the Group Executive Board and Governance Council, nomination of new partners and approval of the Group's consolidated accounts;
- The Group Executive Board is responsible for the definition and implementation of strategy, the promotion of brand, quality control and financial control policy, preparation of financial statements and merger and acquisition negotiations. It periodically reports to the Governance Council and to the General Meeting;
- The Governance Council monitors the way the partnership is run by the Group Executive Board and the performance of member firms;
- The Chief Executive Officer of the partnership is a member of the Group Executive Board and is supported by the Executive Office which is responsible for provision of services to member firms;

- The management of member firms, of which there can be a number in a single jurisdiction, is the responsibility of their respective country Executives which are elected by the partners of each member firm, their candidacy being subject to the agreement of the Group Executive Board.

There are clearly many points of similarity with the international association model, in terms of the delegation of responsibilities through the various tiers of governance. The key difference, however, is the nature of the relationship of the partners to the central organs arising from the common ownership of the central body and its role in the sharing of profit and loss. As noted above, the partnership produces consolidated accounts – as opposed to information on the annual aggregate revenue of all member firms.

5.2.4. Operational matters

A. Admittance of new members

As noted, decisions on the admittance of new partners and members is a question for the Annual General Meeting of partners. As is the case with an international association, set rules regarding entry criteria exist in the case of an integrated international partnership. The degree of attention afforded to candidates for admittance appear to be at least as great as those used by Category B associations and probably nearer those of Category C associations. The reason lies in the fact that entry to membership ultimately involves a decision by existing partners on potential impact on profit or loss by the partnership as a whole.

Candidates for membership may be proposed by the national executive of a member firm, or the Group Executive Board. There are two distinct procedures: for individual candidates and for collective candidates (external firms with more than three candidates). All candidates must be formally approved by the Group Executive Board and the Group Governance Council before going to the Annual General Meeting of partners. The latter votes on the admission of partners.

B. Categories and conditions of membership

The survey found that only one category of membership exists within the international partnership, that of a full member. Full members are bound by the membership conditions stipulated in the partnership's constitutional documents. As already noted, some member firms can have a minority of local partners who do not share in the central profits or losses although the incidence of this is said to be very low. Also as noted, while local partners are not partners of the central legal entity, the partnership's constitutional documents are also binding in their regard.

Forms of representation other than through member firms, for example correspondent firms and joint ventures, are used in order to secure a degree of geographical coverage for referral of assignments or the undertaking of ongoing trans-national work. These are dealt with in section 5.2.4.D. and are distinct from member firms of the partnership as well as from the relationship which the integrated partnership has with an international association, which is considered in section 5.4.

C. Financial arrangements and financial reporting

i) Distribution of profits (or losses)

The financial arrangements of the partnership are channelled, as noted, through the central legal entity, in the first place for the international distribution of profits (or losses) among partners, as is noted in section 5.2.2.B.

Partners of the central legal entity are rewarded, in equal proportion, according to performance of the national member firm they contribute to, and the performance of the international partnership overall. (As noted, there is a small minority of partners who are not rewarded on the basis of the international partnership). Profits are divided between partners in proportion to the shares (base points) they have been allocated according to their country's collective performance, and the individual performance of each partner. In addition, in several countries a bonus system is used based on individual performance.

Due to differences across jurisdictions in the legal form of member firms as well as the differences in tax regimes in different countries, the sums which are payable to international partners for each financial year may take different forms. For example, they can consist of the payment of salaries, bonuses and social charges, contributions to pension schemes, dividends, partnership profits, fees and benefits in kind. As was also noted from other survey respondents outside of the individual integrated international partnership, calculating an equitable distribution of remuneration across jurisdictions is extremely complex: some associations in the past operated in this way but chose to discontinue on account of, among other factors, the complexities involved.

ii) Financing of central services

While the central legal entity does not carry out any professional operations directly to clients – in a manner similar to the role performed by the coordinating body in an international association – it is important for the provision of central services to member firms. Its first role in this regard is to provide the legal basis for the sharing of costs for these services. These costs, which are agreed as a fixed annual budget, are payable by member firms via a proportion of their overall fees. The actual provision of services is through the executive office which also supports the Chief Executive Officer, the staffing of which is dispersed through a limited number of member firms. Details on the various central services provided to member firms are addressed through the course of sections 5.2.4.F. to 5.2.4.I.

iii) Financial reporting

For financial information purposes, the central legal entity is the consolidating entity of the integrated international partnership. While international associations publish through various sources information on the combined revenues of all members of the association, the integrated international partnership produces consolidated financial statements in accordance with IFRS. These comprise the accounts of the central legal entity as well as those of the entities in which international partners carry out their professional activities and companies which are majority owned. They also comprise the results of joint ventures, but not of the activities of correspondent firms (see section 5.2.4.D.). The consolidated financial statements are audited, according to regulatory requirements.

D. Arrangements for referrals, trans-national assignments and other forms of representation

The same underlying economic rationale in relation to referrals and trans-national assignments observed in relation to the associations is naturally also evident in the case of the respondent which describes its grouping as an integrated international partnership.

Arrangements for referrals are set out in partnership's constitutional documents which define the territorial exclusivity which each member firm must respect. Member firms are required to refer work in another territory to the relevant member firm except where there is a specific request from the client or because of special circumstances of the assignment.

With regard to cross-border assignments, each global or international assignment is managed and carried out by an integrated team, coordinated by the partner in charge who takes final responsibility for reporting to the client group. The arrangements in place appear quite similar to those employed by Category C associations and some Category B associations.

As noted, forms of representation other than through member firms exist in order to secure a degree of geographical coverage for the referral of assignments or the undertaking of ongoing trans-national work. These include the use of correspondent firms to which assignments can be referred, following the signing of a correspondent agreement, but over which no management control can be exercised by the partnership. They also include joint ventures with individual firms in order to service clients in specific markets. In these cases, the integrated international partnership negotiates specific terms on the sharing of resources and other issues, such as co-branding.

E. Audit Practices, Quality Control and Ethics

The survey posed a number of questions in the areas of audit methodology, ethics and trans-national independence, quality control systems and client acceptance procedures as well as on the transfer of or access to working papers. The findings in relation to the respondent which describes its grouping as an integrated international partnership indicate that a parallel can largely be drawn with Category C associations as far as the degree of coordination and harmonisation is concerned.

It was confirmed that the respondent has a common audit methodology in the form of an audit manual whose use is mandatory and is supported by specifically designed audit software. Through specific partnership policy, and also with reference to the membership requirements of the FoF, the international partnership maintains appropriate quality control standards in accordance with ISQC1. This is pursued via centrally organised quality control procedures which regularly monitor partner firms.

Also on account of partnership policy and with reference to FoF membership, the international partnership obliges member firms to respect the IFAC Code of Ethics. The respondent also referred to its compliance in relation with the 2002 European Commission Recommendation on Auditors' Independence in the EU and observed that each member firm has to respect national requirements where these are more restrictive.

The survey also confirmed that policies and procedures have been put in place to mitigate threats to independence on a trans-national as well as a national basis. These include engagement acceptance and continuance procedures, the maintenance of a listed audit client database and an annual declaration of independence by partners and staff. In addition, an ethics coordination committee,

composed of the head of ethics in the larger member firms, exists to assist with and investigate, where necessary, independence issues. The international partnership's quality control department regularly reviews compliance with procedures in respect of independence as part of its regular cycle of member firm monitoring.

As far as professional secrecy is concerned, the respondent confirmed that national regulations are applicable.

F. Branding, External and Internal Communication

As noted in chapter 4, branding and external communication constitute important elements in the liaison function with the market and are in themselves indicative of the degree of interaction, coordination and operational integration of a trans-national organisation. Brand and external communication strategy are necessarily linked to overall business strategy.

Given this context, it is not surprising to find that there is a very high degree of commonality of branding in the respondent which describes its grouping as an integrated international partnership. Under the respondent's constitutional documents, member firms are granted a licence to use the partnership's name and trademarks. Through specific agreements on joint ventures and with firms to act as correspondents, the use of the common name and other trademarks extend well beyond the member firms of the integrated international partnership. In some cases, the use of the common name is as a prefix/suffix, and this appears especially to be the case in relation to correspondent firms.

Marketing support services, educational tools and coaching are provided to member firms. In addition, internal communication functions such as technical support and exchange of information are undertaken by the partnership.

G. Professional Indemnity Insurance

As noted, the respondent which describes its grouping as an integrated international partnership does not share liability risk on an international basis in the same way that profits and losses from ongoing economic activity are shared. Member firms in the partnership are required, through the partnership's constitutional documents, to take out a professional indemnity insurance policy appropriate to the risks incurred by professional activities carried out in their country. The amount of cover required to be taken out in each country depends in part on the national regulatory and requirements – which as noted in chapter 4 vary considerably across EU members states and further afield. They also depend on other factors, including the nature of client base of the member firm and its service lines as well as the capacity of insurance providers.

While there is no cross-jurisdiction sharing of liability, the integrated international partnership does also subscribe to additional group level insurance. This is distinct from the captive system used by the most integrated associations. Its purpose is to provide a form of economic "backup" in the event that an individual member firm may require assistance in a litigation procedure. This backup forms part of a broader policy of the partnership to assess and mitigate risk through initiatives in the audit practice, quality control and ethics sphere, as outlined in section 5.2.4.E.

H. Withdrawal and expulsion from the partnership

Withdrawal from the partnership – that is to say from membership of the central legal entity – can be pursued through resignation or retirement from a member firm. It is also possible for a member firm to be expelled from the partnership. Decision-making in the case of an expulsion lies with the Group Executive Board. Grounds for doing so include where a partner or a member firm is subject to a temporary or permanent professional practice prohibition from its professional regulator, files for bankruptcy or commits a substantial violation of the partnership's constitutional document. Any member may request the Group Executive Board to expel a defaulting member stating the grounds for expulsion.

In the event of the departure of a member firm, a penalty is payable, based on a percentage of gross fees.

I. Professional education, Human Resources and IT

The respondent which describes its grouping as an integrated international partnership operates an internal training programme which is complemented by external seminars that respond to the specific requirements of staff members arising from the environment and businesses of their clients. Each audit partner must complete a minimum number of hours training per year. Other personnel are required to undergo Continuing Professional Education in accordance with national legislation or requirements of national professional Institutes.

An evaluation and promotion system is in place throughout the international partnership.

As noted, IT harmonisation exists to a certain extent across the partnership through specifically designed software to facilitate the use of the mandatory audit manual.

5.3. National practice with subsidiaries in other jurisdictions

5.3.1. Context and service activities

As is noted in chapter 3, on the basis of two survey respondents' replies, it is clear that one further underlying structural model is in use in Europe for trans-national servicing of clients, albeit employed on a very limited scale. The model is centred around a large national practice based in one jurisdiction which, wherever possible, fully owns subsidiary practices in other jurisdictions. While outside the scope of this survey, it is also recognised that this model also has relevance for non-European practices, for example from the US, which have subsidiaries in Europe (as well as elsewhere).

It is particularly important when considering the use of this model to bear in mind that the provision of non-statutory audit services often represents a very considerable proportion of the services provided by subsidiary practices. Other services in the accountancy sphere, and especially the provision of general accountancy services, international tax advice and the carrying out of due diligence work as well as broader business advice are prominent.

As noted through the course of this study, the areas of service activity of the profession are very broad and the activities of international associations and integrated international partnerships are certainly not restricted to statutory audit. In the case of a national practice with subsidiaries, however, the importance of services outside of statutory audit as a proportion of overall activity appears higher still.

This has facilitated the establishment of subsidiaries in jurisdictions outside the one in which the national practice is registered. It has also made it possible for subsidiaries to be established in European jurisdictions by non-EU practices. The reason is that the ownership criteria for audit firms as laid down in the Eighth Directive (and now modified by the revised Statutory Audit Directive) have been less applicable or not applicable.

One of the two respondents described its organisation specifically as encompassing features of a national practice with subsidiaries in other jurisdictions as well as those of an integrated international partnership. In fact, the model of a national practice with subsidiaries does not appear to be used entirely as a standalone model. This was also confirmed by the second respondent through answers to the survey regarding its membership of an international association of independent firms. The model is therefore, to varying degrees, used in conjunction with the other two models of trans-national organisation and practice analysed in this study. Section 5.4. summarises the degree and form of interaction of these models.

5.3.2. Defining characteristics

From the findings of the survey, the model of a national practice with subsidiaries can be said to have the following characteristics:

- The existence of a sizeable national practice, fully registered for statutory audit and other professional accountancy services in the home jurisdiction;
- The existence of subsidiary practices established in other jurisdictions which are, wherever possible, 100% owned by the national practice in the home jurisdiction;
- The development of subsidiary practices, at least in the first instance, to cater for the professional service needs of existing clients of the national practice;
- The existence of subsidiary practice which need not always be registered for the provision of statutory audit;
- The development of governance, organisational structures and operational arrangements by the national practice to manage subsidiaries;
- The use of other mechanisms for trans-national work where the required coverage cannot be achieved through subsidiaries.

From the respondents' answers to the survey, the largest geographic coverage achieved under this model is just over 30 jurisdictions, half of which are in the European Union. Among the non-European jurisdictions covered by two respondents are the United States, Australia, China and countries in South Asia and Africa.

5.3.3. Governance and operational matters

Governance

As noted, the governance, organisational structure and operational arrangements of the trans-national organisations are driven by the national practice, which is possible due to the direct ownership stake. In the case of one of the respondents, the management board of the practice has a majority presence of national partners and a minority number of partners from the subsidiaries. The latter are selected by the former. In the case of the second respondent, the management board is composed solely of members from the national practice.

Quality control in statutory audit and other services

In relation to operational matters, it appears that the inherent policy in the model is to extend national arrangements to subsidiaries in order to achieve quality and consistency of service provision. For example, a common audit manual, as developed by the national practice, is mandatory for subsidiaries carrying out statutory audit. Programmes of quality control involving visits to major subsidiaries are carried out. The quality control is undertaken generally by a mixed team, involving reviewers from the national practice and from another subsidiary. Given the direct control which the national practice has over subsidiaries, any remedial action can be pursued directly.

For both respondents, the existing client acceptance procedures of the national practice are also made mandatory throughout the practice and subsidiaries.

An audit steering committee exists in the case of one respondent to assist with issues arising in relation to the completion of statutory audits by subsidiaries. The role of the audit steering committee of this respondent merits further comment specifically in relation to structural model. The committee also functions as a mechanism for achieving consistency of statutory audit quality in subsidiaries which are not fully owned or where a partner of the national practice has not acquired audit signing rights through the relevant recognition procedures. In the latter case, an audit partner in the subsidiary who is not a partner of the national practice will sign the audit report, but under the supervision of the risk committee.

It is important to reiterate, however, that statutory audit is not a service provided through all subsidiaries. Indeed, the respondent referred to in the above paragraph observed that statutory audit is generally the last service to be offered by a subsidiary. Subsidiaries are generally created in the first place to offer other accountancy services, and also often legal advice, to clients based in the same jurisdiction as the national practice who are pursuing business interests in other jurisdictions.

Specifically in relation to the management of independence, both respondents referred to the IFAC Code of Ethics and the codes of the relevant professional body or oversight structure in the jurisdiction of the national practice. One of the two respondents also indicated that a pragmatic approach was taken by the national practice in full respect of the ethical code of the profession in the home jurisdiction. An assessment is made as to the economic value of the services required by clients when statutory audit and other services are both requested and a decision is made on this basis. Assistance, if needed, is provided by the respondent's audit steering committee.

Referrals and cross-border assignments

When compared to other models, and in particular to Category A associations, the national practice with subsidiaries have a much more developed and interventionist approach to referrals and cross-border assignments. The whole model is based on "client push", as subsidiaries have historically been established in jurisdictions where clients based in the home jurisdiction of the national practice have internationalised their commercial interests. The organisation of ongoing cross-border assignments is coordinated centrally according to where the largest subsidiary of the clients is based.

The survey also revealed that national practices could also develop agreements with third party firms to be correspondents who are not subsidiaries and may or may not be a fellow member of an association. In these cases, the purpose of such agreements is to deal with referrals in a certain jurisdiction according to the nature of the specific agreement.

Branding, external and internal communication

The respondents confirmed that the name of the national practice is used either directly or as a prefix/suffix in virtually all subsidiaries and is only omitted where legal requirements in a national jurisdiction oblige this to be the case. The marketing is coordinated by the national practice, as are training and internal communication between subsidiaries.

In addition, in the case of one respondent, the provision of technical support is channelled through the audit steering committee and through web-based tools. The sharing of best practice is pursued through the quality control programme and also through an annual international conference for subsidiaries.

Professional indemnity insurance

Both respondents confirmed that a dual system of professional indemnity insurance is in place. This is based on each subsidiary acquiring cover in their jurisdiction of activity, where available, and this is supplemented by a centralised insurance cover. It was observed by one respondent that acquiring insurance cover at the centralised level has not raised any issues and that insurers have looked favourably at the direct control relationship over subsidiaries.

Professional education and IT

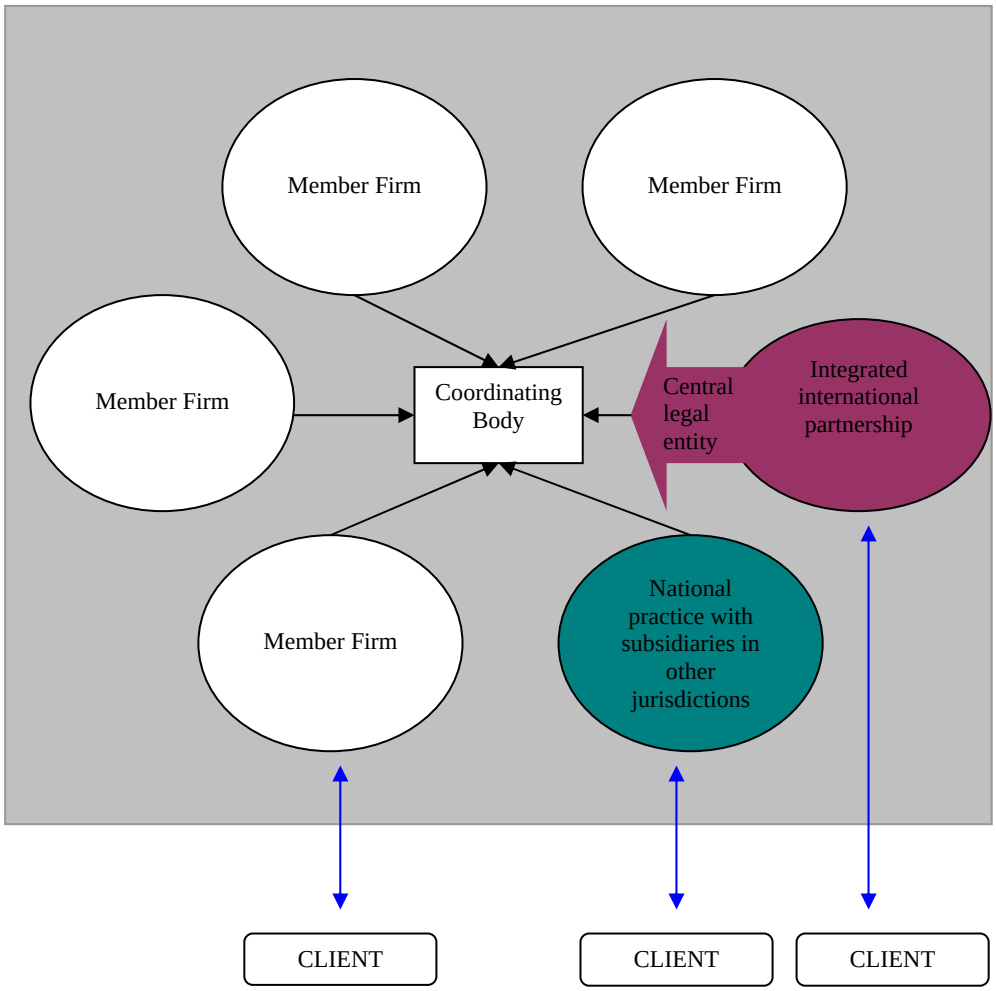
One respondent indicated that it has web-based provision of continuing professional education for staff within the national practice and subsidiaries, while partners are required to fulfil their obligations of the respective professional Institutes. The second respondent indicated that it provides continuing professional education through seminars for directors of subsidiaries. Only a limited degree of IT harmonisation is pursued across subsidiaries, but only where this is economically viable.

5.4. Interaction between models of trans-national organisation and practice

As noted briefly through the course of this chapter, both the integrated international partnership model and the national practice with subsidiaries can and do interact with each other. More commonly, and of greatest relevance for the market today, these models also interact with the international association model. This interaction is separate to any type of direct contractual arrangements which either an integrated international partnership or a national practice with subsidiaries may pursue directly with third parties in the form of a joint venture or another contractual relationship to service a specific client.

The reasons for the interaction with the international association model can be numerous but invariably also include the desire to achieve a wider geographical coverage of trans-national client servicing. Graphic 8 on page 85 illustrates how this interaction with the association model is pursued in structural terms. It is followed by a number of observations made on the basis of various survey respondents' replies on how this interaction functions in practice in the market today.

Graphic 8: Interaction between an integrated international partnership and national practice with subsidiaries with an international association



Association bye-laws

Profit and risk sharing

Direct control exercised by national practice over subsidiaries

Contract between member firm that provides the service and head office of client

Contribution to central budget of association

As is illustrated in Graphic 8, both an integrated international partnership and a national practice with subsidiaries can interact with an international association by assuming membership of the association, subject to satisfying the applicable entry criteria. In the case of the integrated international partnership, it is through the central legal entity of the partnership that membership of the association is pursued. Once membership of the association is assumed, the bye-laws are applicable to all members of the association, whether they are individual firms, which have direct membership, or an integrated

international partnership or a national practice with subsidiaries in which cases their individual firms are indirectly members of the association.

From various respondents' replies to the survey, it is clear that the interaction between the three models of trans-national organisation and practice effectively falls into two broad camps.

The first is where the international association and its bye-laws, governance and operational arrangements are predominant. In these cases, it can be said that an integrated international partnership or a national firm with subsidiaries (more commonly the former) are effectively "housed" within an association. These structural models exist within the association to facilitate the pursuit of the association's policies and strategies across given jurisdictions, rather than to pursue strategic policies which are distinct from those of the association. This is not to say that, within such an integrated international partnership, enhanced cooperation between jurisdictions cannot be pursued, for example in relation to profit and risk sharing. However, this is confined to the partnership itself and does not modify the overall policy of the association.

The second is where the international association and its bye-laws are of a distinctly less integrated and coordinated nature than the forms of governance and operational practices of the integrated partnership or national practice with subsidiaries. In these cases, the association type in which membership is sought and maintained is a Category A association where the emphasis is primarily in establishing points of contact for potential referrals. The association will invariably have a wider coverage than that of the integrated international partnership or national practice with subsidiaries and will also in most cases have another member firm in jurisdictions which are covered by the partnership or national practice through subsidiaries. In these cases, the relatively loose ongoing membership obligations, particular in relation to non-exclusivity, do not interfere with the more binding referral requirements and other operational characteristics of the integrated partnership and national practice with subsidiaries.

6. NETWORK DEFINITION

6.1. Introduction

This chapter explores the views of respondents to the survey concerning the decision at European Union level to afford legal status through the revised Statutory Audit Directive to the term "network" and to introduce regulatory requirements which are linked either directly or indirectly to the network definition in the Directive. It should be reiterated that all references to the network definition in this chapter are to the definition in the revised Statutory Audit Directive (also referred to in abbreviated form as "EU network definition"), unless specific reference is made to the IFAC network definition.

It was anticipated in the 2005 European Commission Communication on statutory audit that the issue of networks would be addressed in legislation. The revised Statutory Audit Directive introduces for the first time in European legislation a legal definition of the term network. The specific wording of Article 2 (7) of the Directive is as follows:

"'Network' means the larger structure:
- *Which is aimed at cooperation and to which a statutory auditor or an audit firm belongs, and*
- *Which is clearly aimed at profit– or cost-sharing or shares common ownership, control or management, common quality-control policies and procedures, a common business strategy, the use of a common brand-name or a significant part of professional resources."*

A FEE survey of 2007 demonstrated that only 4 Member States had implemented the above network definition at the time of the initial interviews for the current survey[21]. As underlined in an earlier paper by the ICAEW, there is considerable scope for uncertainty and inconsistency in the transposition of the definition without Member State coordination[22]. Furthermore, the paper noted the possibility of potential unanticipated consequences arising from the definition outside of the context of independence and transparency. In particular, this latter reference was to the broader evolution of liability and case law.

The revised Statutory Audit Directive refers to networks specifically in relation to independence and transparency and also to registration requirements. This is to ensure that the specific provisions of the Directive in these areas apply to networks as well as to individual practices. It should be noted that in the area of independence, while the Directive reconfirms the EU's "threats and safeguards" approach based on principles, it also allows Member States to introduce additional requirements and prohibitions. Such additions by Member States beyond the requirements of any Directive are often referred to as "gold plating" and can have detrimental impacts on the European Internal Market. The European Commission announced in October 2007 that it had sent a reasoned opinion to a Member State to amend its independence rules in relation to international networks of audit firms precisely on these grounds. These considerations, along with the uncertainties regarding the transposition of the EU network definition provide an important backdrop to the survey responses.

In relation to transparency, the revised Statutory Audit Directive includes a mandatory requirement for annual transparency reports by auditors which carry out statutory audits of public interest entities. The transparency report may include additional details as required by any Member States, but must meet a number of minimum information requirements across all EU Member States. These include a description of the network and its legal and structural arrangements, where an audit firm belongs to the

21 "FEE Survey on the Network Firm Definitions Across Europe", p 7.

22 "ICAEW Informal comments on practical implementation of "network definition" in the EU Statutory Audit Directive – and relation to IFAC definition" (August 2006).

network. The Directive's requirements with regard to the registration of audit firms also include details of network membership, although these requirements are generally not regarded to be burdensome and are therefore not considered through the course of this chapter.

This chapter has two primary objectives. Firstly, it records the views of respondents of the survey as to whether they believe that they fall under the scope of the EU network definition, as well as recording pertinent remarks with regard to the IFAC Code, where raised. Specifically, respondents were first asked to comment on whether in their opinion their organisation meets the network definition in the revised Statutory Audit Directive. As is brought out in the text, however, efforts at self-assessment led in many cases to respondents referring to the anticipated or potential interpretation of regulators. Therefore, in recording the views of many respondents as to their own self-assessment, views are also recorded on their opinion of the position regulators would or could take.

Secondly, the chapter records the views of all respondents with regard to their interpretation of the impact of the EU network definition in practical terms. This also includes conveying the observations made by respondents as to their proposed or ongoing responses to the implications, in terms of management measures within their organisations.

To facilitate the interpretation of the results, this chapter deals first with the detailed findings of the survey in relation to the three models of trans-national organisation and practices identified in the report. In relation to the associations – the largest constituency of trans-national organisations and practices – reference is made to the three categories of associations identified in chapter 4. It should be stressed, however, that the basis of the categorisation of the associations was undertaken with regard to the observed organisational structure and operational practices, as elaborated in chapter 4, and not on the basis of their views on the network definition. It should also be reiterated that the categories are not rigidly defined and that there exists "blurred" areas, particularly between Category A and Category B associations. The chapter concludes with a brief summary of the findings from all survey respondents.

6.2. Detailed findings

Category A associations

Overall observations

From the responses of Category A associations as a whole, a number of important initial observations can be drawn. The first relates to the high degree of awareness regarding the existence of the definition and the fact that it was no longer appropriate to use the term "network" in a generic way, as had been the case until the present time. Specific knowledge of the definition's criteria varied, as is illustrated below, but among all Category A respondents, the question of its application or not to their organisation had been given extensive consideration. It was in all cases a matter for the highest level governing bodies in the association to consider. It is also clear that a number of associations have sought legal advice, have considered the IFAC guidance and have interacted with national professional Institutes. There also appears to have been some discussion among the associations with regard to the analysis of the definition and its implications. In short, the topic of the network definition has been afforded much attention.

All of the Category A associations surveyed indicated that, on the basis of their own assessments, they do not consider their associations as a whole to be networks as per the definition. It is significant to note that at the time of conducting the initial questionnaire-based survey, three of the respondents were

equivocal in their responses and consultation following the initial questionnaire-based survey was required to finalise their views. These responses, therefore, merit particular attention.

One of the associations indicated at the time of the survey that its position was uncertain due to the need for its international board to make a final assessment in this regard. However, it appeared from the majority of its other responses to be moving towards considering itself to be a "non-network". This has now been confirmed as the respondent's final assessment.

The second association indicated at the time of the survey that it was actually likely to accept that it fell under the definition, most particularly because the word "network" had appeared in its name for many years.

However, subsequent to the interview, this organisation has now removed the term network from its name and it has been clarified that this decision has been taken to avoid any external perception that it meets the EU network definition. It also appears that this decision was encouraged by the fact that acceptance of the network definition would raise questions regarding a large proportion of its membership which are law firms.

The third respondent believed that it did not meet any of the definition criteria except the common name which was used by a significant number of its member firms. At the time of the initial survey it had consulted the IFAC guidance and was considering the possibility that its case study on a network existing within the association might be applicable. The final assessment of the respondent is that the association as a whole does not meet the network criteria but that a limited number of firms within the association might do so, on account of the use of a common name which is employed either as a common prefix or as a suffix. This is examined in further detail below.

The overall findings demonstrate a considerable if not high degree of "confidence" among all the respondents that their self-assessments would be in line with the views of regulators. However, this should not be taken to mean that there was not a degree of uncertainty – more pronounced among certain respondents than others – with regard to the precise policy which regulators would take in some important detailed aspects which are considered below.

This being said, in the main the observations of the Category A respondents as a whole were based on the premise that the application of the regulatory requirements associated with the network definition would be inappropriate and disproportionate in their regard. At best, the requirements are viewed as not bringing any advantages to the functioning of the associations. At worst, they are seen as entailing costly regulatory compliance which would actually discourage trans-national activities, as well as potentially increasing exposure to liability claims.

Significantly, there was no case of a Category A respondent indicating a desire to fall under the definition or indicating that active steps would be taken to do so at the current time. On the contrary, the survey also found that a number of Category A associations which already believe they fall outside the scope of the definition are taking active steps to "further ensure" that they are not considered to be networks. These steps are being taken to address any uncertainty which might exist among external parties, and most particularly regulators, as to their position.

Only one of the Category A associations surveyed expressed the view that it could become a network over the medium term. With regard to the intervening period, this particular respondent expressed concern about the possible departure of internationally-minded member firms which could gravitate to larger groupings or networks. There was a realisation among other Category A associations that this risk also exists but it was not seen as significant enough to lead to a review of overall policy. One

further respondent commented that there may be a market disadvantage for "associations" *vis-à-vis* "networks" but on balance the status of an "association" was the preferred one given regulatory considerations. This appears to reflect the overall views of Category A associations as a whole and raises the issue of external communication of Category A respondents which is dealt with below.

Common name, branding and external communication

In relation to the analysis by respondents of the specific criteria of the definition, the question of common name and branding received the greatest degree of attention, while the issues of overall control and coordination and common quality control procedures also figured prominently. Consequently, their own self assessments focused in these areas, as did the anticipated or ongoing "active" steps to ensure avoiding falling under the network definition, in the case of the associations who were reacting in this way.

In relation to branding, for example, a number of the Category A associations observed that the commonality of a name – in all these cases a prefix/suffix to a name – would probably be deemed by regulators as sufficient grounds in themselves for considering that the network definition is met. In this regard, reference was also made on a number of occasions to the IFAC guidance.

As noted in chapter 4, only a minority of Category A associations have member firms which use a prefix/suffix and none of the associations has a mandatory policy in this regard. This fact constituted a key point in determining the relevant respondents views that their association does not fall under the definition. It was not the only point (see below), but in respondents' eyes, it was regarded as a key factor.

Among the minority of Category A associations which have member firms sharing a common prefix/suffix, concerns were expressed regarding the consequences of this. The respondent referred to above which has a significant proportion of member firms using a common prefix/suffix, in which they have invested for over three decades, accepts that these members may be deemed to be a network. It also recognises that meeting the regulatory requirements emanating directly and indirectly from the network requirement is preferable to re-branding all the firms.

Among the other Category A associations which have member firms using a common prefix/suffix a number of different reactions were being considered and in some cases actively pursued. In some cases, the policy of the association has been modified and the use of the prefix/suffix has been or is in the process of being withdrawn. In the remaining cases, the same concerns exist but a "wait and see" approach is being taken. The associations in question recognise the possibility that regulators may regard member firms with a common name or prefix/suffix to constitute a network within an association. The respondents contested whether this would be a proportionate decision given the absence of other criteria deemed necessary for a network.

Among Category A associations, careful attention is not only being given to branding of individual firms but also of the association as a whole. In the case of all Category A respondents, there has been a general vetting of communication materials and website references to ensure that the term "network" is avoided. When describing their organisations, the majority now use the term "association" while one uses "affiliation" and three use "alliance". In one specific case, it was noted that the organisation had recently modified its website to state specifically that it is an "association" and does not fall under the network definition of the revised Statutory Audit Directive or of the IFAC Code of Ethics.

All respondents except one indicated that the use of a common logo denoting membership of the association would be continued. The one exception has never, through all its previous activity, used a

common logo in this way but has demonstrated membership of the association through different means. Significantly, no respondent indicated that they would withdraw their website or discontinue their directory of firms which are evidently considered a form of branding and external communication which is distinct from the use of a common-name.

Broader considerations in the operation of associations also figured prominently in survey respondents' statements that they did not constitute a network. For example, one association which has a strongly regional governance structure, permits each region to introduce additional criteria with regard to the entry of new firms and to the standards and bye-laws governing the operation of firms within the regional association, on top of the minimum standards established by the worldwide associations. However, the worldwide association stipulates that these additional criteria cannot endanger the association's stated intention of being considered an "association" rather than a "network".

Quality assurance

Quality assurance considerations also figured prominently in answers from Category A respondents; their absence being used to justify or add to the justification that a respondent was not a network in the overwhelming majority of cases.

Notably, in the case of one respondent which is also reviewing its use of a common prefix/suffix, the decision has been taken to cease the monitoring of quality assurance for statutory audit across member firms. It will, however, strengthen the process of vetting and reviewing applicants seeking to enter the association, a procedure which is believed to lie outside the network definition. The association will continue to recommend a commonality of approach in quality assurance but will cease the monitoring specifically on account of this criteria being included in the network definition. The association in question indicated that a more general practice review would also be maintained – of the type used by other respondents to the survey and focused on relations with clients, development of business opportunities and marketing.

For those respondents which have such a programme of practice review in place, the main concern was to ensure that this was not interpreted as quality assurance in the audit area. This was seen, in the majority of cases, as being a criteria which could in itself lead to the assumption that the network definition is met. Category A respondents were unanimous in their affirmations that they did not qualify in respect.

Among the other responses was the observation made by one respondent that it is seeking to enhance quality of service provision across member firms but is considering approaching this in a different way on account of the need to avoid disproportionate regulation arising from the network definition. The view was expressed that the requirements in the revised Statutory Audit Directive in this area are therefore somewhat counter-productive for smaller groupings.

Control, business strategy and joint ventures

The fact that one member firm could not influence the audit work of another member firm was noted by one respondent as being a critical issue in affirming that the network definition is not met, whatever the policy of the association with regard to common names or branding. This comment reflects the situation in Category A respondents as a whole where the absence of such influence – not to mention broader control – was interpreted as being a convincing indication that they fall outside the network definition.

The criteria in the definition to common business strategy raised some concerns given the very broad nature of these criteria. For example, one Category A association expressed a degree of uncertainty as to how regulators might view a degree of operational coordination between member firms within specific regions of the association which led to the establishment of consortia structures based on joint and several liability in order to service specific clients. In this particular case, the view was expressed that this response to specific client needs on a regional basis should not lead to the global association being considered as a network.

In a further case, one respondent indicated that a consortia composed of a limited number of member firms pursues public tenders with a view to involving other member firms where possible in the carrying out of contracted work.

Liability

As noted, liability concerns were expressed by respondents. A common observation made by Category A associations in this area referred to the possibility of liability transfer across jurisdictions. Three respondents conveyed the concern felt in particular among US member firms that they could be exposed to a large risk outside the US. It should be recalled that the weighting of US member firms in the associations is generally high in proportion to the aggregate global revenue of all member firms.

Transparency

The issue of transparency requirements did not attract major attention among the Category A respondents: it appears not to have been considered in any great detail largely because it would represent a new requirement arising out of the network definition. Only one respondent indicated that it had already begun preparing such a statement as it believed that it would be a helpful vehicle for clarifying the nature of the association, as well as its liability arrangements.

Category B associations

The findings of the survey in relation to Category B associations are more complex. While they demonstrate some commonalities across those surveyed, they also convey a degree of differentiation between associations which is far higher than that observed among Category A respondents. It is also far higher than in relation to Category C associations whose position is much clearer, as is demonstrated in the following section. The complexity of the responses is also determined by the fact that the organisational and operational structures of the Category B respondents, and their service offerings and client bases, are far more similar to Category A respondents than to Category C respondents. This appears to have impacted the manner in which at least some of the Category B respondents have addressed the network issue. In some cases it has resulted in comparisons with Category A respondents' interpretations and actions while in other cases it has prompted questions regarding the actual intentions and objectives of regulators.

Overall observations

As a common feature, all of the Category B respondents indicated in their answers to the survey that they believe, on the basis of their own assessments, that their associations meet the EU network definition or, significantly, could be interpreted by regulators as doing so. The findings also indicate an overall sense on the part of respondents that their associations were probably not the intended focus of regulatory interest when the network definition was being adopted, most notably on account of the non-public interest nature of the majority of clients which Category B associations currently service.

This being said, Category B respondents demonstrated ample recognition of the relevance or very likely potential relevance of regulatory interest in their regard. This contrasts with Category A associations as a whole, where the basic premise, founded on self-assessments, is that they fall outside the scope of the definition. A further distinguishing feature of the responses from Category B associations was a keen awareness of the distinction to be drawn between self assessments and the binding views which regulators would take.

Given the above, it is not surprising that the survey found that Category B respondents have dedicated considerable attention to the definition and to its regulatory implications. The question has, across all Category B associations, been a matter for consideration and final assessment or decision making at the highest level worldwide governing bodies. Across a number of Category B associations there had been recourse to external legal advice while in other cases reliance was placed on internal expertise.

It also appears that a considerable degree of dialogue and cross-referencing between like-minded associations had taken place, in addition to, as noted, consideration of the reactions of other segments of the profession. It should also be noted that the question of the network definition has been discussed within the forum of EGIAN – European Group of International Accounting Networks – to which the overwhelming majority of Category B associations belong. Furthermore, there has been careful analysis of the IFAC Code and interaction with professional Institutes to enhance understanding not only among individuals with governance responsibilities within the associations but also among member firms. A particular channel for the latter has been the partner and senior staff conferences of the associations.

One of the overall conclusions which emerge from Category B respondents is that the regulatory requirements relating to the network definition constitute a serious professional challenge which in turn requires significant investment or at least a significantly modified approach to the management of the association. The specific reaction to this challenge, however, appears to differ between Category B associations. It appears that these differences are determined not only by the particular membership and market position of the association in question but also by the perceived policy of other organisations in the profession, and most particularly Category A associations.

The views recorded by the survey range from the identification of the network requirements primarily as new burdens to be managed, to the consideration of the network definition as a type of a "hallmark" with some or considerable potential market advantages which outweigh the regulatory implications. Within this range, many different views were recorded in relation to the readiness to meet the cost of managing compliance with the regulatory requirements arising from the definition. The following paragraphs set out the main views expressed by respondents in these respects as well as the detailed analysis of the respondents in relation to the specific criteria in the definition. Points of comparison and contrast are drawn out between Category B associations as well as between the answers given by Category A respondents.

Interpretation of the application of the definition

The starting point of the respondents when considering directly the applicability of the definition was generally the reference to the existence of a common name. This is not surprising given the greater degree of commonality of names and prefixes/suffixes among Category B association member firms as compared to their Category A counterparts. A number of respondents expressed the view that branding and the use of a common name or prefix/suffix appeared to be or would be the first or key reference point in the regulators' interpretation of what constituted a network. This is to say, there was a sense that regulators would use this as a short-cut route to interpreting whether the definition was met. On the basis of this factor alone, therefore, these respondents believed that they would in any case

be deemed a network. Having said this, it was also believed that other criteria in the definition were also met, among which references to common quality control featured prominently.

Categories of membership

The responses of Category B associations as a whole provide evidence of remaining questions and, in approximately half of the respondents more enhanced ongoing concern, with regard to how regulators will conclude that an organisation falls under the definition. These questions and concerns certainly emanated in part from the desire for clarity in their own particular cases, with regard, for example, to the precise application of the definition over different types of membership. It was also noted that national authorities were required to transpose the definition in their own legislation and there was a serious risk of inconsistency in these types of areas. The overall view of respondents was that, where different categories of members are permitted within an association, only full member firms should fall under the definition. This position was based on the view that the most substantial part of the association would be covered and that those members who were not fully under the remit of the association's practices, for example in relation to branding or quality control, should be considered separately.

Consistent application of definition

The views of a small number of Category B respondents also denoted a broader concern regarding the potential uneven application across all organisations in the profession. For example, particular emphasis was placed by one respondent on the need to ensure a level playing field. The comment was clearly directed to organisations in the profession which are publicly describing themselves as an "association" or another similar label which is distinct from "network" and thereby devoid of any direct regulatory consequences for the manner in which the organisation as a whole operates. In the view of this particular respondent, no plausible distinction can be drawn between a "network" and an "association" or "alliance". Furthermore, the continued use of a logo and a publicly accessible directory or website of member firms constitutes a form of common branding which should qualify the organisation in question as a network. In expressing this view, emphasis was placed on the fact that the definition refers to the "larger structure" to which a firm belongs and not just an individual firm which is a member of this larger structure.

Considerations regarding the compliance burden and the impact on existing memberships also underpinned this view. The respondent identified a risk that the extra costs and management time required to meet the network requirements could encourage member firms (in particular the smaller practices) to terminate their membership. It was perceived that they could leave to seek a less-intrusive, as well as less costly, association from which to pursue more generalised trans-national interaction and referral work. From this perspective, the network definition would act as a disadvantage, not an advantage, and a disincentive rather than an incentive for practices in different jurisdictions to join.

A similar point was made by a further Category B association which had taken the decision to actively pursue network status. It observed that other organisations which were ostensibly larger in terms of number of member firms and aggregate income of member firms as well as more integrated in relation to branding, had "opted" for the status of an association. This raised questions and uncertainties in the respondent's mind on whether the investment required to meet the definition was worthwhile and indeed needed at all. In this context, consistency in the approach of regulators to implementation of the definition was seen as especially important.

Independence and quality control

References to the management of trans-national independence as well as to quality control figured prominently in the responses provided by Category B associations. In relation to quality control, it was recognised that the existence of quality control procedures would definitively confirm the applicability of the definition, should confirmation be needed.

For all Category B respondents, the need to manage trans-national independence arrangements was cited as the biggest practical impact of falling under the definition. The recurrent references to independence are attributable not only to the associated compliance costs but also potential implications for existing and potential future client bases. In all of the Category B associations surveyed, there was a high level of awareness of the regulatory impact of the EU definition on independence, although there were some differing interpretations of the specific requirements and effects.

The considerable degree of attention afforded to independence issues is not surprising as none of the Category B associations had – at the time of the survey – arrangements in place to deal with trans-national matters (see section 4.4.5. for further details). Only one respondent indicated at the time of the survey that it had not yet assessed the detailed implications, while one further association demonstrated just a very broad appreciation that its present arrangements would need to be modified. The latter indicated that it would welcome guidance on this. For the majority of respondents, however, consideration of the implications was very much more developed. This should not be taken to imply that there was a uniformity of views as to the precise nature of the requirements, although there was a general consensus that the implementation challenge was sizeable.

The precise assessment of the challenge depended in turn on the particular interpretation of the requirement and the nature of ongoing work across member firms in the association. Some respondents made clear that they were currently interpreting the independence requirements to relate to all assignments taken on by member firms and not solely those of a trans-national nature. Consequently, they believed that the management of independence across the association would require considerable infrastructure and resources. Among other respondents, however, a greater emphasis was placed on the time-consuming nature of this exercise while the costs involved were estimated to be more reasonable.

Category B respondents with the highest level of trans-national referrals and ongoing activity – in the tax, general accountancy and other service areas as well as in auditing – had the highest estimates of the costs associated with meeting the new regulatory requirements. In conveying views on this particular subject, one of the associations expressed concern regarding the absence of a de minimis level of override with regard to the activity to be covered in the independence requirements.

Having said this, in these cases where the level of trans-national referrals and ongoing activity were higher than the average for Category B associations (and certainly markedly higher than Category A associations), there was a greater acceptance of regulation of independence. The network definition and its regulatory consequences were seen as a necessary price for operating in a certain segment of the international market. Consequently, there was an acceptance that there would be some changes to the client base but overall the benefits were seen to outweigh the costs.

Among other points raised by respondents in this area were a number of uncertainties concerning the rolling out of independences programmes on a world-wide, as opposed to European, basis. In this regard, questions were also raised concerning the applicability of EU requirements in non-EU jurisdictions such as the US. Again, it should be noted that US firms constitute in many if not most

associations, the largest fee earners and therefore a large proportion of the aggregate revenue of the association as a whole.

Transparency

The issue of transparency requirements was also raised by a number of Category B associations, although it appears to have been given less attention than questions regarding the management of independence. The majority of respondents appeared to be broadly informed as to the new requirements but had not as yet prepared their responses. Views varied, however, on the precise nature of the requirement and its benefits and as well as on the practical steps to be taken.

Among the comments were calls for additional guidance, criticisms regarding the additional cost burden and also, in one case, an enthusiastic welcome of the initiative as it corresponded to the respondent's own initiative to launch an annual review. In the latter case, the transparency requirement was seen as a catalyst to and as an integral part of the marketing literature of the association. Significantly, the respondent also observed that the annual review was "littered" with references clarifying that member firms were independent of one another and that it is the member firms which undertake client work. Liability considerations were central to this and the respondent in question had invested significantly in obtaining legal advice and disseminating this among member firms, as well as incorporating it into literature for external use.

Liability

As already noted above and in earlier sections of this study, the survey of Category B associations revealed the very considerable concern regarding the need to avoid liability transfer across jurisdictions. The majority of Category B associations did not add specifically to these comments when discussing the network definition. However, one respondent did highlight liability as one of a series of significant issues raised by the definition. In doing so reference was made to the concerns held by US member firms within that particular association with regard to potential liability arising from member firms in other jurisdictions.

Category C associations

Overall observations

Among Category C respondents, there was a unanimity of replies that they all considered, on the basis of their self assessments, that they meet the EU network definition. There was also a unanimous sense among all respondents that they would be regarded by regulators as networks: there were no points of contention in this regard. The degree of awareness regarding the implications of the definition was also very high. Such responses were to be expected given not only the organisational structures of these associations but also the close monitoring of regulatory issues which is regularly undertaken by these associations.

The survey provided an opportunity to discuss the manner in which the definition could be interpreted and applied with regard to immediate regulatory implications. It also permitted an elaboration of the views of the respondents in relation to broader considerations, including the potential view of third parties in liability cases.

Application of definition and categories of members

While, as noted, there was an acceptance of application of the definition in this regard, there was a general sense among respondents that the definition is overly broad and generic. As such, it was noted that it could be interpreted to encompass a very wide range of organisations. One respondent referred to the national transposition in a large Member State which had exacerbated further the potential for overly wide application by including within its legislation the term "common economic interest". However, despite other comments to this effect, there was acknowledgement by Category C associations that they fall under the scope of the definition.

There appears to be just one proviso in this respect: references were made by the respondents to the existence of a small number of correspondent or affiliate firms (i.e. not full members) which it was believed should not be considered to be included in the scope of the definition. As noted in section 4.4.2., there is a general tendency across all the associations surveyed – and not only Category C associations – to have recourse to correspondent firms in jurisdictions where the availability of suitable practices is lower than desired. Correspondent firms are also generally permitted to act as correspondents for more than one organisation, which also accounts for the attitude of Category C associations in respect of the network definition. It should be reiterated that the number of correspondent firms within Category C associations is very low.

Independence

Category C associations, as noted in section 4.4.5. of this study, have already established systems for the management of independence, nationally and trans-nationally, and have invested considerably in their development. As a consequence, respondents indicated that the relevant regulatory requirements in this area emanating from the revised Statutory Audit Directive would not necessitate any changes in policy or infrastructure for the associations. The full independence requirements as laid down in the principles of the revised Statutory Audit Directive are accepted. However, it was noted that complexities arise on account of the additional independence requirements introduced by individual Member States. There was a general sense that regulators should avoid "gold plating" EU requirements as this would add to the already very considerable costs of the systems for managing independence.

Transparency

With regard to the transparency requirements in relation to the network definition, Category C respondents also indicated that they do not see major challenges. Again, this is largely the case due to existing experience in this area: external reporting by Category C associations has developed considerably in recent years through the publication of annual reviews. All Category C associations now publish an annual review. The question of transparency was, therefore, noted mainly as an issue for individual member firms given that the revised Statutory Audit Directive also introduces requirements at national level which are new for many EU Member States.

Liability

The network definition also gave rise to observations by respondents on the subject of liability. There was a unanimity of views that the introduction of the definition does not impact on the legal structure of the associations and therefore there is no legal basis for it to have any repercussions for liability.

It was acknowledged by the majority of respondents that plaintiffs may well seek to include references to the definition in cases taken against the associations but they would not have a legal basis. As one

respondent observed, while the definition could "give ammunition to plaintiffs" there is no cross-border liability within an association unless two independent member firms agree in contractual terms to joint working. It was also acknowledged by other respondents that litigation as a whole remained a major concern, which had heightened over the last few years. It constitutes a challenge for firms using the same software and name which also attract the attention of plaintiffs, although the Courts continue to up-hold the legal independence of member firms.

Other trans-national organisations and practices

Integrated international partnership

The one respondent to the survey which describes its grouping as an integrated international partnership replied that it believes that all the regulatory requirements associated with the network definition are applicable to it, and indeed have already been complied with for many years. The view was expressed that the integrated international partnership model not only meets but extends beyond the criteria of the network definition. Given the extension of the partnership arrangements across borders, regulatory provisions on the management of independence, for example, have been complied with on a trans-national basis. The public reporting of this respondent was also deemed to be at the very least in line with the transparency provisions in the revised Statutory Audit Directive.

As commented upon in detail in chapter 5, none of the respondents with operational experience of the integrated international partnership model – that is to say the single respondent which operates as a whole in this way and associations which house such a partnership within their membership - shares liability risk over jurisdictions. In all these cases, the view was expressed that the network definition would not have any impact on their liability arrangements.

National practice with subsidiaries in other jurisdictions

The two respondents to the survey which operate wholly or in part as a structure of a national practice with subsidiaries in other jurisdictions expressed the view that their structures would be interpreted to meet the criteria of the network definition.

In the case of one of the respondents, the implications of falling under the definition are still to be considered in detail. On the basis of its initial assessment, concerns were expressed that the regulatory implications could generate disproportionate burdens and a loss of clients. This concern was based on an assessment of the possible independence provisions and also on the respondents' existing client basis which was characterised by a high number of relatively small clients. The general sense was that the network definition would bring no benefits and could potentially hinder further expansion of the organisation into new countries.

6.3. Summary of findings

The findings of the survey in relation to the EU network definition and its regulatory implications provide a number of clear conclusions. Overall, the survey demonstrates that these subjects have generated a very high degree of interest and reflection across the profession as a whole, and among certain segments of the profession in particular. Respondents were in the main also aware of the revision of the IFAC Code introducing a new networks and network firm definition. Among all those surveyed, there was a recognition that the term "network" is no longer a generic label but has legal consequence, and it is essential for organisations to know whether they fall either under or outside the

scope of these definitions. There is recognition of the distinction between self-assessment and the final assessment of regulators, which is particularly keenly felt in some quarters.

Category A associations

Among all Category A associations, the self-assessments against the criteria of the definition reach an unanimous conclusion that the criteria of the network definition are not met. However, in some cases, there is either a broad recognition, or ongoing concern, that the network definition might apply to a number of member firms within the association which have a common prefix/ suffix or name. In some instances, the survey found specific steps have been taken by associations to modify member firm and pan-association coordination, as well as external branding and communication. Overall, Category A associations believe that the network definition and related requirements are not appropriate in their regard and would constitute, in any event, disproportionate burdens. Notably, in all cases, the word "network" has been removed from the website self-description of these organisations.

Category B associations

In relation to Category B associations, the conclusions are more complex. While all the respondents believe that they fall under the definition, or would be deemed by regulators to do so, there is not a uniformity of views on the regulatory implications. There are different degrees of "appetite" to meet the costs of the implications and there are also differing assessments of the advantages in the market place of doing so. It appears that even among the Category B associations with the highest levels of trans-national activity and referrals, there is still concern over the extent of the costs of compliance and over whether these costs will bring benefits to the associations themselves, as well as to the wider public interest. References were also made in some cases to the need for a level-playing field as far as the application of the definition across the whole profession is concerned. For this reason, there is a pronounced sense among some respondents that greater regulatory certainty and consistency would be beneficial.

Category C associations

In relation to Category C associations, it is clear that, but for a number of relatively minor points regarding correspondent or affiliate firms, they fully accept the application of the definition in their regard. They also accept the regulatory implications of the definition, and specifically the independence and transparency provisions, although there is concern about potential "gold plating" by individual Member States which could lead to further complexities and costs in the management of independence which are already high. The position of the Category C associations in respect of trans-national liability is unchanged by the network definition, although it is recognised that plaintiffs may seek to refer to the definition in future cases.

Other survey participants

In relation to the other survey participants, the implications are still to be fully assessed by one of the respondents with an organisational structure of a national firm with subsidiaries. Meanwhile, the regulatory implications of the network definition are regarded as already fully met by the respondent which describes its grouping as an integrated international partnership. This is on the understanding that the definition does not alter the liability arrangements of the respondent.

7. CONCLUSIONS

Overall conclusions

The main overall conclusion to emerge from the survey is that the accountancy profession's trans-national evolution within Europe, and indeed globally, 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. This context explains why the internationalisation of the accountancy profession has been markedly different to that of corporate entities and why the structures of the profession may seem less readily apparent and comprehensible to the external observer.

The survey found that three distinct underlying structural models of trans-national organisation and practice have been developed by the profession in response to the internationalisation of business and that by far the most predominant model employed today is the international association of independent member firms coordinated by a separate legal entity. This is not to say that the other two models are insignificant or isolated: in fact, the survey reveals that they are not only important in their own rights but they also interact with the international association model.

Despite the growing degree of attention from regulators on the international activities of the profession, there has to date been only a very modest trans-national coordination of regulatory policy to allow, less still encourage, the emergence of more integrated and simplified international structures. While the profession has, through its existing structures, provided a significant input to the development of business in the European Internal Market, a European Internal Market approach to operating structures and service provision in the accounting sphere (the latter through horizontal policy measures) has only just been legislated for at EU level. The practical impact is still to be seen.

From the responses of the survey, it is clear that among the many current jurisdiction-specific regulatory and legal drivers which have shaped the evolution of trans-national structures, liability has been a key factor and has increased in importance over time. The profession has developed structures and arrangements to operate in the face of a very uneven playing field in relation to liability regimes and litigation cultures as well as the declining availability of professional indemnity insurance. Concern was frequently expressed by survey respondents about the need to avoid liability transfer over jurisdictions given that unlimited liability exists in many countries.

International association of independent firms

The survey reveals that the international associations which exist in the profession today have a very high degree of commonality in terms of underlying structural model. The fact that they are practically identical in terms of legal structure may be unexpected to external observers given the very different sizes of the associations in terms of annual aggregate revenue of member firms, which range from under €1 billion to over €20 billion. In addition, the associations share in many cases the same governance structure. However, in terms of the actual exercise of management and control, and most particularly in the management of operational matters, the survey found very substantial differences across the associations.

At one end of the scale, an international association is a vehicle for limited interaction between member firms for the purposes of referring assignments with low levels of association–driven commonality in operational terms and governance and control influence. At the other end of scale, an

association has a high degree of association-driven commonality and integration in operational matters including quality control, pooling of technical expertise, coordination of client relations and service provision and branding and external communication. However, there is a very important common feature concerning legal structure across all international associations. The survey found that liability concerns arising from the uneven nature of liability regimes and litigation cultures across jurisdictions currently preclude the sharing of liability risk across jurisdictions by all association respondents, including the most operationally integrated associations.

The differences observed among the associations reflect the differing degrees of investment and involvement in the association as a whole by the member firms and the degree of trans-national work they undertake. In order to convey the overall differences between the associations which emerged from the survey findings, reference can be made to three discernible categories of associations which represent different levels of interaction, coordination and integration on trans-national matters.

The three categories – A, B, and C – are not intended in any way to constitute rigid categories and there are certainly "blurred areas" in many cases where a particular respondent could fall into one of two categories, most notably into either Category A or B. The findings of the survey confirm that the large majority of associations are Category A and Category B associations with a relatively even distribution between the two.

It is also clear from the findings of the survey, however, that there are considerable differences in terms of central resourcing, pooling of technical expertise and integration of trans-national service delivery between Category B and C associations and certain Category C associations in particular where the differences are extremely large. This finding is particularly relevant to the ongoing debate regarding competition and choice for the largest public interest entity audits. Central resourcing, pooling of technical expertise and trans-national services are features which cannot be developed in a short time frame but grow over an extended period of time through enhanced coordination between and investment from individual firms which are engaged with trans-national clients.

Specifically in relation to governance, management and control, the association model represents a different set of challenges to a corporate structure. Governance, management and control are necessarily more "nuanced" in the case of associations as a whole, given the absence of direct control arising from ownership. However, they are at their most developed within associations where dependency on the receipt of client referrals and central technical and other resources is greatest.

Broadly speaking, the survey found that the smaller the proportion of the purely domestic revenue of a member firm in relation to internationally derived assignments, the greater the degree of economic dependency on the association and thus also on its governance, management and control arrangements. However, it is also important not to overstate the correlation. There always remains a degree of voluntarism at the core of the association model and in the final analysis the main vehicle for the exercise of control in the association model is the monitoring of adherence to association rules: direct control across jurisdictions to implement these rules is not possible without an ownership stake.

Integrated international partnerships and national firms with subsidiaries

The survey found that two other models of trans-national organisation and practice are employed in the profession today, albeit with a far lower degree of use than the international association model. The two models are: an integrated international partnership and a national firm with subsidiaries in other jurisdictions.

The survey sheds considerable light on the integrated international partnership model, which hitherto has attracted modest attention. It demonstrates that while its use may be relatively confined at the present time in terms of its use by an entire trans-national grouping, key elements of the model are either evolving within certain international associations or are generating growing interest from them.

The survey found that, where used in the profession, this model results in additional elements of commonality, integration and management and control when compared to even the most advanced international association. Notably, this also includes the sharing of profit and loss across jurisdictions - an element entirely absent across independent firms in the association model.

However, the survey also demonstrated that some of the key theoretical characteristics of the partnership model are modified when employed in practice, on account of national regulatory and legal considerations. To begin with, it is currently still not possible to establish an international partnership in the same way as it is to establish a partnership in a single jurisdiction: consequently, integrated international partnerships where the profession is concerned still require the establishment of a separate central legal entity.

More significant still is the fact that the partnerships do not encompass the trans-national sharing of liability risk - as distinct from profit and loss sharing. The reason given by respondents is, again, the unevenness in liability regimes across jurisdictions. The partnerships observed through the survey can be described as the most highly integrated structures which are deemed feasible in the current legal and regulatory context. Notably, the modified ownership requirements in the revised Statutory Audit Directive are seen by various respondents as providing an opportunity to move further still towards a fully integrated international partnership but the degree to which liability concerns might act as a brake on this development are still considered significant.

An enhanced integrated approach to governance, management and control was also found in the third model of trans-national organisation and practice: a national firm with subsidiaries and branches in other jurisdictions. In statistical terms, this model is the least commonly used in the profession at the present time. The model derives its structure from a desire to respond directly to existing clients' new business service requirements in new jurisdictions. Rather than make referrals to a legally separate entity, the respondents which have adopted this model service these clients needs directly by establishing subsidiaries. The trans-national coverage of these respondents was the most geographically limited of all the models. It remains to be seen whether the revised Statutory Audit Directive and other recently adopted EU Internal Market legislative measures in the services sphere will encourage these respondents to increase their coverage.

Evolution of "hybrid" trans-national models and possible future trends

An important finding of the survey is the growing interaction of the three models of trans-national organisation and practice in the profession. As noted, the international association model is by far the most extensively used but there is certainly evidence of a growing interaction between the different models.

The most significant trend observed through the survey is the interaction between the international association model and that of integrated international partnerships. It appears likely from the survey responses that more integrated international partnerships will emerge among existing member firms within associations. The modified ownership provisions in the revised Statutory Audit Directive are important in this respect. There are also broader drivers such as the overall development of the European Internal Market and opportunities to take advantage of more efficient service-delivery

structures. All these raise considerable professional issues which legally independent firms have to take into account when considering the possibility of integration. In addition, there is also the question of liability. It would appear from overall survey respondents that the announced policy of the European Commissioner for the Internal Market on recommending the limitation of liability will have an important bearing on future trends.

Network definition

The survey found that the EU network definition and its regulatory implications have generated a very high degree of interest and reflection across the profession as a whole and among certain segments of the profession in particular.

In the case of the most integrated international associations and the grouping which describes itself as an integrated international partnership there is an acceptance that the network definition in the revised Statutory Audit Directive is applicable. There is also an acceptance of the regulatory requirements emanating from the definition. However, these respondents also stressed the importance of Member States avoiding gold plating the independence requirements as this would increase the already considerable complexity and cost of such systems.

Among other respondents, however, the findings of the survey are more complex given the variety of replies from respondents with low to modest degrees of trans-national coordination and integration. The complexity arises from the different observations recorded relating to the perceived scope of application of the definition and the question of regulatory consistency in this regard, the compliance costs of related regulatory requirements and the broader market and legal implications and repercussions of meeting the definition. Specifically with regard to compliance costs, the management of independence on a trans-national basis generated the greatest concern.

International associations with the lowest levels of trans-national work and integration do not consider their organisations to be networks as per the definition. In some cases, associations which hold this view have taken active steps to reduce operational coordination, for example in relation to quality control and common branding, to further ensure that the definition is not applicable.

In these cases the survey recorded concerns regarding the costs of the regulatory implications of the definition and the potential implications with regard to the capacity to retain membership of the associations. It should be reiterated that associations do not encompass solely member firms providing statutory audit but a wide range of professional services in the accountancy and related spheres as well as, in some cases, further areas such as legal services.

Among other respondents, there is a recognition that their associations either fall under the definition or would be deemed by regulators to do so. Among these respondents the survey found evidence of differing degrees of appetite to meet the costs of compliance and differing interpretations of the benefits to the associations, as well as to the wider public interest. The latter point was made in particular in light of the client base of these associations in which non public interest clients predominate. Also from among some of these respondents concerns were expressed regarding liability, the potential uneven application across the profession and the potential disproportionate nature of the regulatory implications which might not be counter-balanced by market recognition of “network” status. It is also important to note, however, that some respondents outside of the most integrated respondents expressed the view that meeting the network definition, and being clearly seen to meet the definition, could have positive repercussions in the pursuit of audit quality and also in terms of attracting more and larger clients.

FEE policy conclusions

The study demonstrates the impact which the current unevenness of liability regimes in Europe has on trans-national structures within the profession. FEE therefore welcomes the announced policy of the European Commissioner for the Internal Market to publish a Recommendation on auditor liability, which will call for the limitation of liability in a way which is best suited to the legal environment of each Member State. The European Commission Recommendation can have a positive impact on the development of trans-national structures in the profession in Europe as well as further afield given the potential for the European Commission Recommendation to be a reference point for liability regimes across the rest of the world.

FEE supports the various initiatives currently being undertaken within the profession's trans-national structures to pursue quality and consistency in the statutory audit sphere (and other service areas) across jurisdictions to seek to mitigate liability risk. FEE encourages regulators to consider ways in which regulatory requirements emanating from the revised Statutory Audit Directive can be implemented to further facilitate and enhance the pursuit of consistent quality across borders, including for example through the adoption of harmonised international auditing standards (ISAs). FEE also believes that the ownership rules in the revised Statutory Audit Directive should also be considered in this light during national transposition.

The findings of this survey can usefully be read in conjunction with the FEE study published in November 2007 on "Internal Market for Services and the Accountancy Profession: Qualifications and Recognition", FEE believes[23]. FEE believes that providing clarity in relation to the pending questions in the latter study on implementing the EU Internal Market legislation could be highly relevant to the profession's trans-national organisations and practices.

Overall, the detailed picture generated by the survey of the trans-national organisations and practices which are operating today provides an empirical basis which can be an important point of reference both for discussions regarding regulatory issues directly of relevance to the profession, and also to broader public policy issues. For example, it can assist regulators and all other stakeholders, including the profession itself, in the discussion of regulatory approaches to assist the pursuit of quality and consistency of statutory audit and other accountancy services across jurisdictions and also to meet other objectives, such as enhancing choice of statutory auditors for major entities. Furthermore, it can provide the basis for broader public policy discussion, including the enhanced contribution which more simplified structures in the profession for trans-national service provision could give to the development of the European Internal Market as a whole.

[23] "Internal Market for Services and the Accountancy Profession: Qualifications and Recognition", FEE (November 2007).

ANNEX I - ORGANISATIONS WHICH PARTICIPATED IN THE SURVEY

AGN International
Alliott Group International
Baker Tilly International
BDO International
CPA Associates
Constantin
Deloitte Touche Tohmatsu
DFK International
Ernst & Young Global
Grant Thornton International Ltd
HLB International
Horwath International
IAPA*
IGAF
JPA International
KPMG International
Kreston International
Mazars
Moore Stephens International
Morison International
MSI Global Alliance
Nexia International
PKF International
Polaris International
Praxity**
PricewaterhouseCoopers International
Rödl & Partner International
RSM International
Russell Bedford
UHY International

* In addition, helpful information was provided by the UK200 Group, a national grouping of practices.

** Moores Rowland International (MRI), which was listed in the International Accounting Bulletin Europe Survey of August 2006, has been wound up. A large number of former MRI members have become members of Praxity.

ANNEX II - QUESTIONNAIRE ADDRESSED TO SURVEY PARTICIPANTS

This questionnaire seeks to understand the structures which accounting/auditing groupings have in place in Europe but respondents are also invited, where possible and appropriate, to comment on links to wider structures outside of Europe.

A: Details and description of the grouping

1) To which one of the following descriptions does the grouping most closely correspond?
- *An integrated international partnership*
- *An international association of independent firms coordinated by a separate legal entity*
- *A mechanism for cross-border referrals*

If none of the above is applicable, please provide a brief description of the grouping:

2) Do you think that your grouping falls into the network definition referred to in article 2 (7) of the Statutory Audit Directive 2006/43/EEC?

B: European (or wider international) coordinating body

1) If the international grouping functions with a coordinating organisation, what is its legal status?
- A limited liability company
- A company limited by guarantee
- A partnership
- A trust/foundation
- Other (please describe)

(If the grouping does not have a coordinating organisation, please go to Section C)

2) Where is the legal seat of the coordinating structure?

3) Is the coordinating structure:
- A practising organisation
- A non-practising organisation. For example, is it a holding?

4) How do individual firms belong or relate to the coordinating body? For example, are the individual firms separate and independent legal entities?

Please provide any further relevant details with regard to legal form of the coordinating organisation and of the relationship with member firms of grouping.

C: Organisational structure

1) How is the grouping organisation structured? *(Please provide an organisational chart if available, address governance procedures as far as possible, for example, what boards are there and describe their allocated authority.)*

2) Is the grouping organised on a regional basis within Europe or, where relevant, what is the connection with other parts of the world?
(Please provide any relevant details)

D: Entry requirements and Membership conditions

1) What procedures exist for the selection of new Members? (for example, entry tests, interviews)

2) Are potential new members assessed against set admission criteria? (for example, quality, minimum turnover, market position, language capabilities)

3) Does the grouping permit different categories of membership? For example, are the following distinctions made:

- Full member
- Correspondent member

(If there are any further categories, please specify)

4) Does the grouping impose conditions on its members with regard to:

- Membership of other groupings – (please specify)
- Geographical remit (of individual firms) – (please specify)

5) By way of general obligations, are members required to:

- Appoint an individual to act as the correspondent with the grouping
- Allocate a minimum of time for grouping activities
- Attend international meetings

(Please specify any other requirements)

6) Which of the following financial obligations are applied to member firms?

- Entry fee
- Fixed annual fee:
- Contribution based on a) members turnover
  b) number of partners
  c) other
- Percentage based on referrals
- Other

7) What financial matters (costs, fees, etc.) are shared or dealt with by the grouping?

8) As far as quality control is concerned, does the grouping share one internal quality control system? (ISQC 1) If not, what are the procedures relating to quality control in place?

9) Does the grouping have a common code of ethics?

If yes, which one (e.g. IFAC) is used and how is it monitored?

10) How does the grouping deal with trans-national independence issues?

11) Does the grouping have a common audit methodology (harmonised audit programme, including ISAs, audit report, national standards)?
If yes, how is it monitored? If not, how are the methodologies in use monitored?

12) Does the grouping provide a programme of continuing professional education? If yes, please describe

13) Are there specific rules for promoting persons belonging to the grouping and on what basis: i.e. the increase of the quality of the work carried out or the commercial achievements?

14) Complaints and malpractice
Does the grouping have established procedures to deal with complaints and malpractice (for example sanctions)?

15) Are there common client acceptance procedures within the grouping for audit clients and non-audit clients?

16) Are the members of the grouping subject to the same rules relating to the calculation of fees?

17) What procedures and circumstances are involved in a member firm leaving and being required to leave the group?

E: Transparency and Communication

1) What disclosure of information does the grouping make/or require of its individual member firms? For example, does this disclosure cover information solely relating to partners or other staff?

2) In relation to branding and external communications, how do member firms demonstrate that they belong to the international grouping?
For example, are individual firms required or encouraged to use the same name/prefix/logo?

3) To what extent does the grouping assist member firms with marketing?
For example, does the grouping provide marketing support services, educational tools, coaching?

4) What internal communication functions are undertaken or supported by the grouping?
Are any of the following included?
- Technical support
- Exchange of information
- Sharing of best practices
- Other (please specify)

5) What is the policy of the grouping with regard to professional secrecy in the case of a group audit? Is access given to the working papers?

6) Is there a harmonised IT-system within the grouping for the drafting of the final audit report? Has the IT-system been changed recently and if yes, when? Is the IT-system in line with the amendments made to the international standards?

F: Management of cross-border assignments

1) How does the referral system operate within the grouping? Does the grouping have established procedures to follow-up on referred engagements?
If yes, what are the major elements?

2) Does the grouping have in place professional indemnity insurance arrangements where they are not locally available? How does the grouping deal with liability issues?

3) Does your grouping regularly undertake cross-border assignments and how are they managed?

G: Any other comments

1) ***Have you assessed the implication of the network definition set out in article 2, 7) of the Statutory Audit Directive 2006/43/EEC?***

2) ***Please include any additional information relevant to the establishment and operation of the grouping, which has not been addressed in the above questions.***