Federation of European Accountants
Fédération des Experts comptables Européens

Mr. Greg Tanzer
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Ref.: AUD/HvD/LA/SH

Dear Mr. Tanzer,

Re: FEE Comments on the IOSCO Technical Committee Consultation on the Transparency of Firms that Audit Public Companies

FEE (the Federation of European Accountants) is pleased to provide you below with its comments on the Technical Committee of the International Organization of Securities Commissions (IOSCO) Consultation on Transparency of Firms that Audit Public Companies (the IOSCO Consultation Paper or the Consultation Paper).

FEE welcomes the debate on transparency of firms that audit public companies which has attracted the attention of a variety of stakeholders around the globe. The IOSCO Consultation Paper is one of the contributions to this global debate, in addition to the views of investors, issuers, preparers, regulators, legislators and auditors. FEE strongly believes that all these stakeholders should work together to improve communication to investors without any particular stakeholder taking this debate forward unilaterally. FEE would therefore recommend that IOSCO publishes the responses received to this Consultation Paper, as well as a summary thereof to aid transparency towards all stakeholders concerned.

Audits of financial statements are carried out in the public interest. In order for users of financial statements to understand this contribution to the public interest, transparency of those charged with audits is desirable. FEE is therefore supportive of transparency of audit firms as this should contribute to ensuring that audits of financial statements are carried out in the public interest.

As representatives of the European audit profession, FEE constantly contributes to promoting high quality audits. FEE is therefore supportive of public oversight of the audit profession and audit firms as FEE believes that public oversight contributes to enhancing audit quality.

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

(1) In the European Union, the requirements in respect of transparency of auditors of public interest entities are set out in the Statutory Audit Directive[1] as implemented in the European Union .

(2) FEE refers to Article 40 on 'Transparency reports' of the Statutory Audit Directive which requires for auditors of public interest entities that an annual transparency report is published which includes comprehensive information related to governance of the audit firm. The disclosures required in Article 40 are mainly a description of the legal structure, the ownership and the governance structure of the audit firm, a description of any network that the audit firm belongs to and a description of the internal quality control system of the audit firm. FEE believes that the information provided in such transparency reports ensures a high level of transparency for audit firms of public interest entities.

(3) The Statutory Audit Directive strives to achieve high quality audits and therefore Article 26 of the Statutory Audit Directive requires audits to be carried out on the basis of international auditing standards.

(4) Article 26 of the Statutory Audit Directive on 'Auditing standards' gives authority to the European Commission to adopt international auditing standards for all statutory audits in the European Union. International Standards on Auditing (ISAs) as issued by the International Auditing and Assurance Standards Board (IAASB) are already commonly used to perform audits in European Union Member States[2]. In June 2009, the European Commission issued a Consultation Paper proposing to adopt the ISAs. It is expected that such adoption will effectively be announced and take place in the near future.

(5) This demonstrates that the Statutory Audit Directive is a legal instrument which deals with and links both transparency of audit firms, auditing public interest entities and audit quality. FEE is of the view that the requirements, experiences and results of the European regulation regarding transparency and audit quality are relevant for consideration at an international level.

Our detailed comments and responses to the questions set out in the IOSCO Consultation Paper are included in the Appendix attached hereafter and centre on matters of principle that are of relevance to the European accountancy profession as a whole and are not formed from the viewpoint of investors.

[1] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2006:157:0087:0107:EN:PDF
[2] http://ec.europa.eu/internal_market/consultations/docs/2009/isa/consultation_ISAs_en.doc

For further information on this FEE[3] letter, please contact Mrs. Hilde Blomme at +32 2 285 40 77 or via email at hilde.blomme@fee.be from the FEE Secretariat.

Yours sincerely,

Hans van Damme
President

[3] FEE is the Fédération des Experts comptables Européens (Federation of European Accountants). It represents 43 professional institutes of accountants and auditors from 32 European countries, including all of the 27 European Union (EU) Member States. In representing the European accountancy profession, FEE recognises the public interest. It has a combined membership of more than 500.000 professional accountants, working in different capacities in public practice, small and big firms, government and education, who all contribute to a more efficient, transparent and sustainable European economy.

FEE's objectives are:

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

Appendix – Detailed comments

This appendix contains FEEs detailed comments and responses to the questions set out in the IOSCO Consultation Paper.

1. Is a definition of audit quality necessary to evaluate audit quality or can audit quality be evaluated from an understanding of the attributes, behaviors, and indicators of audit quality?

Measurability of audit quality

(1) FEE welcomes the debate in relation to audit quality as addressed by IOSCO. FEE would like to caution that defining and measuring audit quality might not be straightforward or even possible. Some organisations have invested significant resources to identify indicators, characteristics or features of audit quality, like the UK Audit Quality Forum[4]. However, such indicators are not considered to be comprehensive enough to form the basis for a common set of indicators to compare audit quality or for a definition of audit quality as judgement will have to be used when considering audit quality.

(2) Additionally, depending on the legal, regulatory, professional, regional, cultural and other circumstances, assessments of audit quality might differ. That is why a workable definition of audit quality seems to be extremely challenging, if not impossible to achieve. Additionally, the evaluation of audit quality is likely to differ depending on the perspective from which audit quality is assessed because regulators and investors may have different perception of, and thus criteria for, such an evaluation.

Statutory Audit Directive

(3) The European Union Statutory Audit Directive aims at ensuring consistently high quality in all statutory audits required by European Community law. This is achieved by regulating all aspects of an audit including as most important ones the education of auditors, their ethics and independence, auditing standards to be used as well as audit reporting, quality assurance of auditors, investigations and penalties for auditors and the public oversight of auditors.

(4) No common definition for audit quality is included in the Statutory Audit Directive as all aspects pertaining to an audit as indicated above are believed to contribute to high quality auditing.

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[4] http://www.icaew.com/index.cfm/route/155421/icaew_ga/en/Technical_and_Business_Topics/Thought_leadership/Audit_Quality_Forum/Audit_Quality_Forum

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(5) FEE is therefore of the view that the effects for European audits and audit firms of the requirements, experiences and results of the implementation of the Statutory Audit Directive in the European Union should be analysed before deciding on any further initiatives on international level.

IAASB

(6) The IAASB has initiated a project on 'Addressing the Expectation Gap on Audit Quality' as announced in the IAASB Strategy and Work Program 2009-2011. This project has commenced and a first discussion took place in the IAASB Board meeting in December 2009[5]. FEE welcomes this initiative taken by the IAASB and would therefore recommend to await the results of the IAASB project before considering any further initiatives in respect of defining audit quality.

(7) Currently, the ISAs do not include any definition of audit quality. ISAs are currently applied in the majority of the European countries and in well over one hundred countries worldwide as it is widely accepted that applying ISAs results in high quality audits.

2. In addition to competence and industry expertise of the audit personnel, firm culture that promotes audit quality, firm-wide quality control systems, and auditor oversight, are there other examples of attributes, behavior, and indicators of audit quality that should be considered?

(8) The indicators selected in question 2 are competence, culture, quality control and oversight, but depending on the sources consulted, there are other indicators or attributes of audit quality which could have been identified and selected.

(9) The legal, regulatory and professional environment in which professional accountants work include amongst other things ethical and quality requirements which follow from the code of ethics for professional accountants, the Statutory Audit and Transparency Directives, the International Standard on Quality Control (ISQC) 1 and internal and external quality assurance systems.

[5] http://www.ifac.org/IAASB/Meeting-BGPapers.php?MID=0169&ViewCat=1196

(10) The following should also be considered:

(a) There are five fundamental principles (integrity, objectivity, professional competence and due care, confidentiality, professional behaviour) set out in the International Ethics Standards Board for Accountants (IESBA) Code of Ethics for Professional Accountants[6] and partly in the Statutory Audit Directive. All these fundamental principles should be applied and ethics covered in the consultation paper as competence, culture, quality control and oversight is therefore not the only fundamental principle that is relevant for professional accountants.

(b) Other elements of a system of quality control (leadership, relevant ethical requirements, acceptance and continuance of client relationships, human resources, engagement performance, monitoring) of International Standard on Quality Control 1[7] (ISQC 1) could also be considered.

(c) The Statutory Audit Directive contains other aspects that could also be considered. These other aspects could be approval of statutory auditors, continuing education and mutual recognition; registration; professional secrecy: auditing standards and audit reporting; (external) quality assurance; investigations and penalties; public oversight; public interest entities, etc.

(11) FEE would therefore recommend that the aspects addressed in this question are broadened out to cover these additional aspects of ethics for professional accountants.

3. Are there other areas of governance for which additional transparency should be considered?

(12) Reference is made to Article 40 of the Statutory Audit Directive on 'Transparency reports' which requires for auditors of public interest entities that an annual transparency report is published[8]. FEE is of the view that the information

[6] http://www.ifac.org/Members/DownLoads/code-of-ethics-for-professi-2.pdf
[7] http://web.ifac.org/download/2009_Auditing_Handbook_A007_ISQC_1.pdf
[8] Article 40 requires that a transparency report includes at least
(a) A description of the legal structure and ownership;
(b) Where the audit firm belongs to a network, a description of the network and the legal and structural arrangements in the network;
(c) A description of the governance structure of the audit firm;
(d) A description of the internal quality control system of the audit firm and a statement by the administrative or management body on the effectiveness of its functioning;
(e) An indication of when the last quality assurance review referred to in Article 29 took place;
(f) A list of public-interest entities for which the audit firm has carried out statutory audits during the preceding financial year;
(g) A statement concerning the audit firm's independence practices which also confirms that an internal review of independence compliance has been conducted;
(h) A statement on the policy followed by the audit firm concerning the continuing education of statutory auditors referred to in Article 13;

provided in such transparency reports ensures a high level of transparency for audit firms of public interest entities and does therefore not see a need to add further disclosures.

(13) The disclosures required in Article 40 are mainly a description of the legal structure, the ownership and the governance structure of the audit firm, a description of any network that the audit firm belongs to and a description of the internal quality control system of the audit firm.

(14) Article 40 forms the basis of transparency disclosures for EU audit firms auditing public interest entities which are entities governed by the law of a Member State whose transferable securities are admitted to trading on a regulated market of any Member State.

(15) As the scope of Article 40 of the Statutory Audit Directive and the IOSCO Consultation Paper is the same, FEE believes that the information provided in such transparency reports in accordance with Article 40 of the Statutory Audit Directive ensures a high level of transparency for audit firms auditing public interest entities.

(16) As far as external quality assurance or inspections are concerned, the 2008 European Commission Recommendation on Quality Assurance requires certain disclosures related to the outcome of inspections, like the public disclosure of major deficiencies in internal quality control systems and of disciplinary actions taken or penalties imposed, apart from other disclosures to the audit firm under inspection.

(17) It should also be noted that Article 41 of the Statutory Audit Directive on 'audit committees' assigns certain monitoring and review responsibilities to the audit committee of public interest entities, which results in a number of areas of governance for which no public transparency but transparency to those charged with governance is considered appropriate.

(i) Financial information showing the importance of the audit firm, such as the total turnover divided into fees from the statutory audit of annual and consolidated accounts, and fees charged for other assurance services, tax advisory services and other non-audit services;
(j) Information concerning the basis for the partners' remuneration.

4. Would the proposed disclosures mentioned above be useful in improving audit quality and availability and delivery of audit services to public companies?

(18) It is perceived that audit quality is already at a high level although further improvements in certain aspects of audit quality could be considered which is also under consideration by the IAASB in relation to its current project on Audit Quality as mentioned in our response to question 1.

(19) The Statutory Audit Directive had to be implemented in EU Member States by mid 2008. The assessment of the effectiveness of the transparency disclosures required in article 40 of the Statutory Audit Directive is therefore limited and further experience should be awaited. At this stage, FEE is of the view that the Articles 40 and 41 requirements in the Statutory Audit Directive regarding transparency disclosures and audit committees ensure a high level of transparency for audit firms of public interest entities as mentioned in the response to question 3.

5. Could other limitations arise if such disclosures were required?

(20) Item (f) of Article 40 in the Statutory Audit Directive states that *"a list of public-interest entities for which the audit firm has carried out statutory audits during the preceding financial year".*

(21) Additionally, Article 40 of the Statutory Audit Directive permits EU Member States not to apply the requirements of Article 40 (f) in exceptional circumstances if necessary to mitigate an imminent and significant threat to the personal security of any person. Any information which forms such or a similar threat like to personal or commercial privacy of information should be limited for disclosure purposes following the 'comply or explain' approach.

(22) Given the level of detail proposed, comparability is likely to be impaired and, furthermore, there is a risk for a significant information overload in case all information discussed in the Consultation Paper were disclosed publicly.

6. Can audit quality indicators provide objective information when evaluating a firm's audit quality. If so, do the ones identified in this report accomplish that goal?

(23) As mentioned in the responses to questions 1 and 2 FEE is of the view that other audit quality indicators should be taken into consideration and that all indicators together can not be considered to be comprehensive enough to form the basis for a common set of indicators to compare audit quality or for a definition of audit quality. Reference is made to our responses to these questions.

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(24) In addition, FEE would like to highlight that the use of professional judgement is crucial in performing audits and in assessing audit quality. Professional judgement has to be applied to respond to inherent limitations to obtaining objective information when evaluating audit quality. It is clear that objectivity should be part of the assessment of the effectiveness of quality control systems but judgement will have to be used when performing such an assessment.

7. In addition to the indicators identified in this report, are there any other audit quality indicators that should be considered for disclosure? Would disclosure of the audit quality indicator described above be helpful in evaluating audit quality?

(25) As mentioned in the responses to questions 1 and 2 FEE is of the view that other audit quality indicators should be taken into consideration. Reference is made to our responses to these questions.

(26) We would however like to comment on a few particular disclosure proposals made in the IOSCO Consultation Paper:

(a) In section C on page 16, disclosures on insurance coverage are referred to as information that may improve both audit quality and the availability and delivery of audit services. Such information is currently not explicitly required to be disclosed under the Statutory Audit Directive.

FEE is of the view that if disclosures on insurance coverage would ever be required, only a clear statement that the audit firm has insurance coverage would be relevant. Information about the premium of the insurance coverage is in FEE's view not relevant for the transparency of audit firms regarding audit quality.

(b) In section D on page 16, restatements of financial statements are referred to as an indicator of audit quality. FEE would like to highlight that legislation in various jurisdictions restricts the ability to restate financial statements. Therefore, the number of restatements can hardly be a relevant indicator of audit quality which contributes to increased transparency about audit quality.

(c) In section E on page 17, client acceptance and dismissal information is referred to as an indicator of audit quality. Article 38 of the Statutory Audit Directive does not require public disclosure of dismissals and resignations of audit firms but that public oversight authorities are informed about dismissals or resignations during the term of appointment and are given an adequate explanation of the reasons therefore. FEE is of the opinion that further public disclosures might go too far and might violate privacy laws and regulations in a number of jurisdictions.

Appendix – Detailed comments

8. ***In addition to the benefits or limitations identified in this report, are there any other benefits or limitations about disclosing audit quality indicators that need to be considered?***

(27) FEE does not have any further comments in this regard.

9. ***Can audited financial statements of audit firms provide useful or objective information regarding audit quality? If so, how?***

(28) Audited financial statements are usually considered as a measure to enhance transparency of the audited entity and as a sign of good governance. This will apply regardless of whether the audited entity is an audit firm or not. Whether or not the financial statements, in case the audited entity is an audit firm, provide useful and/or objective information regarding the quality of the audits performed by the audit firm is not necessarily clear-cut and is not necessarily the purpose of the financial statements of an audit firm.

(29) The financial statements for an audit firm, like for any other company, can demonstrate whether the business itself is financially sound. For audit firms, in particular, financial statements are a means to demonstrate whether the audit firm has a proper and sound financing structure as financial stability is a prerequisite, but only a prerequisite, for the 'business model' of an audit firm.

10. ***If disclosure to the public or regulators of an audit firm's own audited financial statements is warranted, who should audit the auditors? Are firms other than the Big Four equipped to audit the Big Four? If not, does having the Big Four firms audit each other raise concerns? If so, how could any such concerns be addressed?***

(30) In general, the audit of an audit firm is not excessively complicated and the financial statements of an audit firm can thus be audited by any audit firm. The complexity of an audit firm appears mainly in the consultancy departments of an audit firm where longer term projects and assessment of work in progress are important. The auditor of an audit firm will need to carry out risk assessment procedures and assess the professional competence and knowledge of the business model in the same way as for any audit client in any line of business.

(31) The practice of whether big four audit firms audit each other varies across Europe as in some countries big four audit firms are audited by another big four audit firm whilst this is not the case in other countries. As for any other audit client an audit firm accepts, it has to assess the threats to its independence in accordance with the independence requirements in the Statutory Audit Directive. If independence is threatened, safeguards have to be applied and if no safeguards can eliminate or reduce the threats to an insignificant level, the auditor should not carry out the audit. These principles apply in all situations

where audits are carried out and therefore also in a situation where the audited entity is an audit firm. FEE is of the view that these principles are sufficient for the auditors to assess the threats and the safeguards that need to be in place when auditing an audit firm.

(32) Because of independence requirements and conflicts of interest, it can be difficult for big four audit firms to audit each other. Indeed, because of prohibitions on the provision of non-audit services to audit clients, different big four audit firms often have the same public interest entities as clients, one as an audit client and others as clients for the provision of non-audit services. In practice, it appears that smaller audit firms are more likely to have no such independence conflicts.

11. Can disclosing certain financial information instead of audited financial statements achieve the same objective of improving audit quality and the availability and delivery of audit services? If so, what financial information should be disclosed?

(33) We refer to our response to question 9. FEE is of the view that financial information included in audited financial statements for audit firms, prepared in accordance with the legislative requirements for financial statements, together with the financial information in the transparency report following Article 40 of the Statutory Audit Directive, ensure a high level of transparency for audit firms of public interest entities. Therefore, no additional requirements setting out new disclosures for audit firms should be introduced.

12. Are there other parameters that should be considered?

(34) FEE is of the view no other parameters would be relevant to consider.

13. Should certain disclosures not be publicly available and if so, what criteria should be considered when determining what disclosures should be publicly available?

(35) FEE agrees that different stakeholders have different information needs. Not all information about an audit firm is relevant for all users of financial statements. For instance, under the Statutory Audit Directive comprehensive information is submitted by the audit firms to the audit public oversight authorities. Such information is submitted as part of the inspection process or external quality assurance reviews of the audit firm in question. This information is relevant to the public oversight authorities, but not necessarily to users of financial statements audited by the audit firm in question.

(36) FEE also agrees that the role of a securities regulator is to protect investors and to ensure that investors are provided with all relevant and necessary information in order to make informed investment decisions. Other regulators have other roles. Audit regulators have to ensure the quality of the audits carried out. This entails that information submitted to the audit public oversight authorities would not necessarily have the same level of relevance to the securities regulator in their role of investor protection as it has for the audit regulator in its role of protecting audit quality. Information about audit inspections should therefore not necessarily be shared with securities regulators although the information has relevance for the audit public oversight authorities.

(37) Another example of different information needs could be the role of audit committees. In accordance with Article 41 of the Statutory Audit Directive, audit committees are provided with information that would not necessarily be relevant for investors in a broader context.

(38) FEE is therefore of the view that situations could occur where certain disclosures would and should not be publicly available.

14. Should certain disclosures be made at the network, firm, and/or, engagement level?

(39) In general, the level at which information is disclosed, whether it is network, firm, office or engagement levels, will depend on the type of information considered for disclosure on a case-by-case basis. In addition, with the aim of increasing transparency of the audit firm some networks provide additional information about the network on their websites.

(40) However, as mentioned in the response to question 3, Article 40 of the Statutory Audit Directive requires that comprehensive information be disclosed by audit firms of public interest entities. FEE believes that these transparency reports strike a good balance as far as disclosing information which is relevant for users of financial statements. Therefore, FEE does not see a need for additional disclosures made at network, firm or engagement level.

15. Should there be different disclosure requirements for large, mid-size, and small audit firms?

(41) In line with Article 40 of the Statutory Audit Directive, disclosure requirements set out in the transparency report appear most appropriate for audit firms auditing public interest entities regardless of whether the audit firm is a large, mid-size or small audit firm.

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(42) Additional disclosures related to the size of the audit firm should be carefully considered and a thorough cost-benefit analysis should be conducted prior to introducing additional disclosures along these lines. It should also be taken into consideration that being a large, mid-size and small audit firm can vary from one country to another, even if the national audit firms belongs to the same network at international level.

(43) Introduction of additional governance initiatives could create obstacles for mid-size or smaller audit firms to enter the audit market of public interest entities thereby furthering concentration in the audit market. FEE is of the view that striving to increase transparency of audit firms should not result in perpetuating market concentration.

16. Should the disclosures be mandatory and if so, should they be subject to regulatory oversight? Would a similar impact to the markets occur if the disclosures were encouraged instead of being mandatory? Should consideration be given to a framework of audit quality and allow for flexibility in the types of disclosures?

(44) In line with our previous responses, we believe that disclosure similar to the ones required by Article 40 of the Statutory Audit Directive could be made mandatory for audit firms auditing public interest entities. The public oversight of Article 40 on transparency reports is to be assumed by national audit oversight authorities. Although we are not of the opinion that there is currently a need for additional disclosures, any such additional disclosures should preferably be provided on a voluntary basis, following the 'comply or explain' principle.

(45) In this respect, reference is made to the FEE Comments on the Second ICAEW/FRC Consultation Paper on Audit Firm Governance[9], which commented on the following:

We see a risk of overregulation and an increase of bureaucratic burdens in Europe if further disclosure requirements beyond the Statutory Audit Directive and the EC Recommendations are considered, given the public oversight systems already in place. We think there would be benefits in understanding how the different current requirements are being implemented in European Union Member States, particularly with regard to transparency reports and independence before considering additional regulatory measures.

[9] http://www.fee.be/fileupload/upload/Hodgkinson%20091010%202nd%20Consultation%20Paper%20Audit%20Firm%20Governance1210200951620.pdf

In general the expected benefits of disclosures brought by a further improvement of governance practices are for example related to enhanced dialogue between auditors and the shareholders and other stakeholders of listed companies. There is a potential risk that the compliance costs associated with additional disclosures will form a further barrier, in addition to the requirements imposed by the Statutory Audit Directive, especially for smaller audit firms. Therefore, we recommend including the size of the audit firm itself as an additional criterion if disclosures were to be mandatory.

17. Would transparency of audit firms improve audit quality and the availability and delivery of audit services? What negative effects, including costs, of increased transparency should regulators consider?

(46) As mentioned in the response to question 15 and 16 in the IOSCO Consultation Paper FEE is of the view that the benefits of additional transparency disclosures, especially for smaller audit firms, is not likely to outweigh the costs of providing them and the risk of increasing market concentration for audit firms.

18. Would investors have increased confidence in financial reporting as a result of increased audit firm transparency?

(47) Not applicable.

19. Are there significant benefits to investors of increased audit firm transparency, since they invest in companies and not audit firms?

(48) Not applicable.

20. Should regulators consider areas outside of audit firms' governance, audit quality indicators, and financial statements for potential disclosures?

(49) As mentioned in the response to question 3, Article 40 of the Statutory Audit Directive requires comprehensive information disclosed by audit firms of public interest entities. FEE believes that these transparency reports in accordance with Article 40 of the Statutory Audit Directive strike a good balance as far as disclosing information. Therefore, FEE does not see a need for additional disclosures made at network, firm or engagement level.