

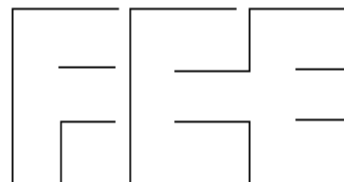
Date  
31 July 2003

Le Président

Fédération  
des Experts  
Comptables  
Européens  
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Mr Karel Van Hulle  
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DG Internal Market  
European Commission  
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Dear Karel,

Re: Principles to be included in the Eighth Directive

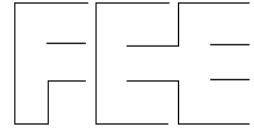
FEE (Fédération des Experts Comptables Européens – European Federation of Accountants) is pleased, as representative organisation of the accountancy profession, to respond to your request in the Committee on Auditing meeting in Athens to provide input to the modernisation of the Eighth Directive and notably on the principles to be included by the end of this month. Below we are setting out thoughts on the main issues, which we intend to detail further in a submission to the Commission in the middle of October.

We realise that as a result of the US-EC regulatory discussions further requirements may need to be included in the Directive. These considerations are not included in this letter.

In the Communication on Statutory Audit also a number of mid-term priorities are indicated such as the transparency of firms and their networks. We welcome that the Commission will exempt the provision of audit services from its proposal on the recognition of professional qualifications by amending the Eighth Directive to include a principle for mutual recognition. These mid-term priorities are not addressed in this letter. FEE will give further consideration to these issues and will develop its position for discussion with the Commission at a later stage.

There are corporate governance matters which will probably not be dealt with in the Eighth Directive but will presumably be dealt with in other Company Law or Capital Market Directives, notably in relation to responsibilities and tasks of non-executive directors and in particular of audit committees. Nevertheless we believe that a certain minimum needs to be urgently addressed, such as arrangements for the appointment of the auditors, and we suggest incorporation in the Eighth Directive although we realise this may not be the best place.

In addition we include below some ideas that could be addressed in dealing with those corporate governance issues announced as a mid-term priority in the Communication on Statutory Audit. These thoughts are mainly extracted from the FEE Discussion Paper on Financial Reporting and Auditing Aspects of Corporate Governance (advance copy enclosed). FEE would be glad to participate in the further European debate and would be prepared to assist the Commission in their future work regarding these matters which should be taken up with high priority.



## **I. PROPOSALS FOR THE REVISED STRUCTURE OF THE EIGHTH DIRECTIVE**

The revised Eighth Directive could be structured as follows:

- Sect. I: Scope [*current Art. 1*]
- Sect. II: Rules on approval [*current Art. 2-22 with removal of superseded articles*]
- Sect. III: Publicity (Registration of the approved persons) [*current Art. 28*]
- Sect. IV: Election [*new article*]
- Sect. V: Ethics and Independence  
[*new articles including current Art. 22-25 and 27*]
- Sect. VI: Auditing Standards [*new article*]
- Sect. VII: Quality assurance [*new articles*]
- Sect. VIII: Investigation and Disciplinary actions [*amended Art. 26 and new article*]
- Sect. IX: Public Oversight [*new articles*]
- Sect. X: Final provisions [*current Art. 29-31*]

A separate section may need to be included on the Audit Regulatory Committee depending on its role and responsibility (see also discussion of section VI “Auditing Standards” below).

In the appendix to this letter, we have made a comparison between the existing text of the Eighth Directive and our proposals for the principles to be included in the Eighth Directive.

## **II. PROPOSAL FOR PRINCIPLES TO BE INCLUDED IN THE EIGHTH DIRECTIVE**

### **Section I: Scope**

Current Art. 1 to be maintained.

### **Section II: Rules on approval**

This section would contain the current Articles 2-22, but the superseded articles need to be removed. Many of these articles were transitional provisions to accommodate national situations at the time.

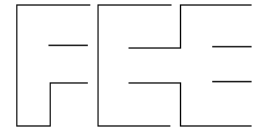
Article 6 lists the subjects which must be covered in an auditor's curriculum. FEE through its Liberalisation/Qualification Working Party and its Education Subgroup is currently considering the need for an update of the current text in light of the examination announced in the Communication of the relevance of the current EU curriculum requirements in the context of new developments. Any update of the curriculum should preferably be based on the IFAC standards given the global nature of these standards.

In this section we believe that also continuing education needs to be addressed. We suggest a separate article to be included after Article 6 along the following lines:

*“Member States shall ensure that persons approved for the statutory auditing of documents referred to in Article 1 (1) are subject to continuing education requirements in order to maintain professional knowledge and skill at the level required to carry out statutory audits.”*

### **Section III: Publicity (Registration of the approved persons)**

Current Art. 28 to be maintained.



## Section IV: Election

As indicated above the Eighth Directive may not be the ideal place to address the appointment of the statutory auditor, but it seems important that the appointment of the statutory auditor is addressed in EU legislation (the draft Fifth Directive never saw daylight). Moreover, all Member States have legislation on the appointment of the statutory auditor. National legislation requires that the statutory auditor is elected by a general meeting of shareholders and, for certain companies in many Member States, subsequent to the election, is engaged by the (supervisory) board or the audit committee to perform the audit. Only in some cases are there exceptions or further requirements for specialised industries.

The procedure and responsibility for electing and appointing the statutory auditor should contribute to the overall aim of strengthening and ensuring auditors' independence. Therefore, FEE supports the general principle that neither the election itself nor the proposal for election should be within the responsibility of the management of the audited company.

Following this principle, for listed companies FEE proposes in its Discussion Paper on Financial Reporting and Auditing Aspects of Corporate Governance that all listed companies should have an audit committee function and that the audit committee would play a key role in the proposed selection of external auditors, agreeing and approving the terms and conditions of the audit. The audit committee should recommend the selected auditor to the (supervisory) board which, in its turn, proposes the auditor to the annual shareholders meeting which takes the final decisions. FEE strongly agrees with the Commission that the role of the audit committee and the communication between the statutory auditor and the audit committee is crucial, as a fully functioning audit committee helps to improve the quality of financial reporting. However, since it is at this stage unsure whether the audit committee will be dealt with in the Eighth Directive, we have decided not to make proposals on the principles for recommendation for the appointment of the auditor at this stage but only for the election by a general meeting of shareholders itself. More detailed European election legislation would also require a detailed analysis of the corporate governance structures established in the Member States in order to ensure that the European solution results in appropriate solutions in the different governance systems in existence around Europe.

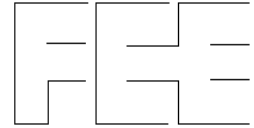
We believe, therefore, that the Eighth Directive at this time should only contain a high level article on the election of the statutory auditor.

Possible wording of the Eighth Directive with regard to the election of the auditor:

*"Member States shall prescribe that in case of statutory audits of companies referred to in Article (1) of Directive 78/660/EEC a general meeting of shareholders as a whole is responsible for the election of the statutory auditor."*

In the further work on European legislation on the election and dismissal of the statutory auditor, a distinction may need to be made between the dismissal of the statutory auditor and the voluntary resignation of a statutory auditor:

- For the dismissal of a statutory auditor, the same principle would apply that those responsible for the preparation of financial information should not take the final decision on dismissal. Dismissal should at least require agreement of the shareholders meeting. Special protection should be afforded to the statutory auditor to protect his independence.
- The voluntary resignation of a statutory auditor is under national company law and contractual law and is accordingly particularly complex to regulate in a Directive. There may be issues of concern, which the resigning auditor may wish to place on record with the audit committee, the (supervisory) board or even the shareholders meeting. Public reporting of such issues is required in some countries but is often confidential in others.



Details and further requirements on dismissal (and resignation) and remuneration could only be added once the governance issues are further addressed, notably on non-executive directors and audit committees.

## **Section V: Ethics and Independence**

Replacing the current articles 23-27 section IV should deal with the professional requirements including requirements on auditors' independence.

The requirements of the Eighth Directive should follow the principles-based 'threats and safeguards approach' as already applied in the EU Recommendation on auditors' independence. Therefore, the requirements of the Eighth Directive should be restricted to broad principles which should be drawn from the "IFAC Code of Ethics for Professional Accountants" (approved as exposure draft by the IFAC Board in Quebec 9-11 July) and from the EU Recommendation on auditors' independence.

Detailed guidance should be set out by reference to global standards: the IFAC Code of Ethics. We acknowledge that the Recommendation on auditor's independence provides such guidance in respect of independence.

Possible wording of the Eighth Directive with regard to professional requirements:

*"Member States shall prescribe that persons approved for the statutory auditing of documents referred to in Article 1 (1) shall carry out such audits with professional integrity, objectivity, professional competence and due care, respecting the confidentiality of information acquired as a result of professional and business relationships.*

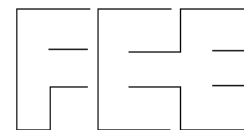
*Member States shall ensure that such persons when carrying out statutory audits shall be required to be independent from their audit client both in mind and in appearance and that such persons shall be required to identify, evaluate and respond to threats to objectivity including self-interest, self-review,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

The IFAC Code of Ethics refers also to the principle of "professional behaviour". We have not included this principle in the proposed article since it requires discretion and judgement being affected by evolving social norms and professional behaviour and may therefore not be suitable to be included in legislation. However FEE strongly supports the principle of professional behaviour.

## **Section VI: Auditing Standards**

FEE supports the mandatory application of International Standards on Auditing (ISAs) to all statutory audits in Europe. In November 2001, FEE proposed that by 2005 EU national auditing standard setters should require statutory auditors to perform audit procedures that comply with ISAs and to report on financial statements in accordance with the same international standards.

FEE supports direct application of ISAs without any endorsement mechanism in order to ensure a uniform and complete application of the global auditing standards in the EU. However, we can understand that some form of legal recognition would be needed to give comfort to those that argue that standards established by an international private body cannot be enforceable without any legal action taken in the EU. Therefore, ISAs should be required in the EU, provided that IFAC and IAASB provide for a proper due process, oversight and transparency of the standard setting process in the public interest. The current developments in IAASB and IFAC and the encouraging progress on proper public oversight of the IAASB standard setting process give comfort that this is the case. Under the condition that these issues are sufficiently dealt with, the Commission in applying the comitology



procedures should be entitled to recognise in secondary legislation ISAs for direct application in Europe.

Proposal for a new article to be included in the Eighth Directive:

*The Commission shall require (in secondary legislation under comitology procedures) that auditors perform statutory audits at least in accordance with a defined set of auditing standards that is generally accepted internationally and developed in accordance with requirements for proper due process, public oversight and transparency.*

In light of a single European market, FEE supports having as few deviations as possible of ISAs in form of the so-called pluses. We hope over time that the need for pluses will diminish. We recognise, however, the right of national standard setters and governments to add pluses, especially in areas of innovation and in order to address specific national features of company law.

With regard to the “pluses”, FEE has also recommended a new format of the audit report which would allow European auditors to demonstrate clear compliance with ISAs whilst providing additional information (“pluses”) as required by national laws and standards. However, as the form and content of the audit report is currently addressed in the Fourth and the Seventh Directives, such a new format would be subject to requirements of those directives rather than of the Eighth Directive.

Irrespective of whether the audit report issue will be dealt with in the Accounting Directives or in the Eighth Directive, it needs to be avoided that the division of the audit report into two parts leads to the wrong impression that the additional audit requirements (“pluses”) could be dealt with in a separate phase of the audit process. Rather, due to the interdependencies between the ISA-requirements and the “pluses” the additional audit procedures necessary to fulfil the “plus“-requirements have to be integrated in the whole audit approach and process as required by the ISAs.

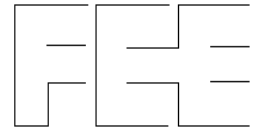
## **Section VII: Quality Assurance**

FEE supports the European Commission’s proposal to incorporate some key elements of the EU Recommendation on “Quality Assurance for the Statutory Auditor in the EU” into the Eighth Directive. This will help to guarantee that oversight of the auditing profession and the quality assurance systems are seen to be carried out in accordance with common European benchmarks, thus supporting the single market and also the dialogue with regulators in other jurisdictions, notably the US.

The Quality Assurance Recommendation identifies the following principal issues which should be included in the Eighth Directive:

- appropriate review methodology
- review coverage (adequate selection and adequate cycles)
- public oversight (addressed in section IX)
- independence and objectivity of the reviewer
- quality of the reviewer
- transparency (public quality review report)
- assessment internal quality control systems
- scope and extent of testing
- link between significant outcomes from the quality review and initiating investigations and disciplinary proceedings (addressed in section VIII).

When finalising discussions within the EU Committee on Auditing on the Recommendation on Quality Assurance, it was accepted that Member States should be able to choose between either a “peer review” or an “external monitoring” review methodology. Whilst both methodologies have their



advantages and disadvantages, there is general recognition at an EU level that both methodologies will meet the public interest objectives associated with the quality assurance process.

Moreover, monitoring should not be a wholly mechanical process but should, within the context of a six year cycle, be based on appropriate risk-profiling. Some firms might be visited with shorter cycles such as listed and public interest companies.

Proposal for a new article to be included in the Eighth Directive:

*Member States shall ensure that all persons approved for the statutory auditing of documents referred to in Article 1 (1) which perform such audits are subject to an appropriate and effective quality assurance system.*

*Member States shall ensure that the selection of the statutory auditors for a quality review is made on a consistent basis so as to ensure coverage of all statutory auditors over a predetermined period and that the cycle to achieve full coverage of all statutory auditors is a maximum of six years.*

*Member States shall ensure that the quality assurance relates to statutory audits of documents referred to in Article 1 (1) and that the scope of the quality review includes an assessment of the internal quality control system of an audit firm with sufficient compliance testing of procedures and audit files to verify its adequate functioning.*

*Member States shall ensure that the persons, either peers or employees of a monitoring organisation, who carry out quality reviews should have appropriate professional education and relevant experience combined with specific training on quality assurance reviews.*

*Member States shall ensure that for the selection of reviewers for individual review assignments possible conflicts of interest are adequately taken into account and that the reviewers are subject to the requirements of Section IV of this Directive.*

*Member States shall ensure that the aggregated results of quality assurance are adequately published and that reporting includes recommendations for professional and/or regulatory actions.*

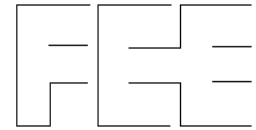
## **Section VIII: Investigation and Disciplinary Actions**

FEE supports the intention of the European Commission to reinforce the existing requirement for appropriate disciplinary actions in the Eighth Directive by requiring all Member States to have an appropriate and effective system of investigation and disciplinary actions. Investigation should be separate from the disciplinary systems. Investigation should take place where there is cause for complaint or concern before any disciplinary action takes place.

Proposal for new articles to be included in the Eighth Directive:

*Member States shall ensure that persons approved for the statutory auditing of documents referred to in Article 1 (1) are liable to appropriate and effective investigation and disciplinary systems when they do not carry out audits in accordance with Articles ...[number of articles on ethics, independence and applicable auditing standards to be added]. The disciplinary system shall include the possibility of removal of the approved person from the audit register. The system should uphold principles of fairness and due process and should include a possibility for appeals.*

*Member States shall ensure that there is a systematic link between significant findings from the quality review and initiating investigations and disciplinary proceedings.*



## Section IX: Public Oversight

FEE recognises the need to work continuously to maintain the trust in the audit profession and to demonstrate to the public that the audit profession is committed to working in the public interest at the required highest level of quality and, therefore, supports the proposed organisation of a robust oversight of the audit profession in the public interest.

FEE agrees with the European Commission that due to differences in legislation in the EU Member States the regulation of the profession and public oversight structures are better organised at national rather than at European level and that instead of building up a separate European public oversight structure a robust European coordination of national oversight systems is needed in order to ensure a harmonized level of audit quality and to encourage convergence of the national systems.

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

We have used the principles for national public oversight as presented in the Committee on Auditing meeting in Athens and our Discussion Paper as basis for first proposals on principles to be included in the Eighth Directive, including how to establish a European coordination mechanism.

### a) Common principles for national public oversight:

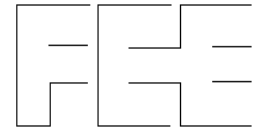
We suggest that the principles as proposed by the Commission to the Committee on Auditing could be elaborated as followed. For more details behind our thoughts we refer to our Discussion Paper European Coordination of Public Oversight.

1. ***All statutory auditors must be subject to adequate public oversight to ensure that they consistently achieve the goal of maintaining standards at the level the public has a right to expect. Public oversight should be fair, balanced and conducted in the public interest.***

FEE supports the principle of public oversight over the profession. The role of statutory audit in listed companies and other entities which are of significant public interest because of their business, their size, their number of employees or their corporate status may be specific but the fundamental justification for a statutory requirement is not different. FEE has always considered that all statutory audits should be conducted to the same standard – “an audit is an audit”. Therefore, all measures aiming at improving the quality of the services provided should apply to all kinds of audit engagements. This approach allows for greater emphasis, for the purposes of confidence, in quality assurance and oversight activities related to the audit of listed companies and other public interest entities.

The principles need to include a proper description of “public oversight”. The objective of “public oversight” is to ensure that the profession is consistently achieving the goal of maintaining technical, educational and ethics standards at the level the public has a right to expect. Public oversight arrangements can then involve third parties which are especially interested in some activities of the professional organisation. Their role can be twofold. Either they can contribute directly to the development of standards or to the enforcement process, or they can supervise the process and give assurance of the public that the professional authorities are acting in the public interest. Both possibilities are referred to as “public oversight”.

Diversity of oversight mechanisms needs to be recognised and accepted on the basis of the subsidiarity principle. However, it is crucial that arrangements in the Member States have common



features. FEE has a preference for a mechanism which combines the benefits of significant auditing expertise with the benefits in terms of public confidence of independent non-practitioners.

Monitored self-regulations is a preferable system because it provides technical expertise and professional knowledge. Other systems could also achieve the same results but they will often face the risk of developing an expensive bureaucracy.

2. *Public oversight requires a majority of non-practitioners. Persons involved in public oversight should be selected under an independent and transparent nomination procedure.*

FEE supports this principle. This approach should enable oversight mechanisms to adopt a wide view of their responsibilities in order to balance the stakeholders' interests that comprise public interest. The representation of stakeholder interests could be through the involvement of public authority. The public oversight should not be dominated by one single group of stakeholders. FEE believes that oversight bodies, to be effective, also need significant auditing expertise. This provides the oversight mechanism with a better insight into the working of the environment of the auditing profession. It is important that oversight mechanisms can be confident that proposals they make or decisions they implement will represent practical solutions to improve audit quality.

3. *Public oversight comprises the responsibility for **supervision of the organisation of licensing and registration of statutory auditors as well as for standard setting on ethics and auditing, continuous education, quality assurance, investigation and disciplinary systems.***

FEE believes that oversight arrangements should cover standards on education, auditing and ethics. The framework for setting auditing and related standards should be distinguished from the mechanisms to ensure that these rules and standards are properly applied and enforced. In relation to application and enforcement, registration of statutory auditors, quality control systems and disciplinary schemes and sanctions can be identified as the main aspects.

As already discussed in the meeting of the Committee on Auditing in Athens the term "ultimate responsibility for" should be changed into "responsibility for supervision of".

4. *Public oversight must include the exercise of investigative and disciplinary powers over statutory auditors.*

FEE supports this principle. In addition to other safeguards built into the system of investigation and discipline, such as the involvement of judges or independent persons and appropriate transparency of the process, adequate public oversight arrangements are useful to demonstrate to the public that the profession take seriously the respect of rules and standards by all its members.

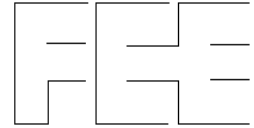
5. *Public oversight mechanisms must be transparent. This should include the publication of annual work programmes and activity reports.*

FEE supports this principle.

6. *Public oversight must be adequately funded. It should not be **primarily** funded by the audit profession. There must be an adequate level of funding by other sources.*

FEE agrees with the idea behind this principle that the audit profession may not influence the scope and intensity of public oversight by deciding on the level of funding. Funding should not only be from the profession since this would undermine the credibility of the oversight of the audit profession. The reality of public relations and public perceptions should not be underestimated. The perception will be in whatever system that is in majority funded by the profession that the profession funds its own oversight.





## **b) Establishment of a European coordination mechanism**

FEE agrees with the Commission that there is a need for a EU-coordination mechanism to bring together national systems into a cohesive, efficient pan-European network. “The Commission sees its role as encouraging convergence of principles and practice in the committee which it will chair.” Such a coordination mechanism should presumably already be referred to in the modernisation of the Eighth Directive. FEE would advocate a more robust coordination mechanism as suggested in our discussion paper on European Coordination of Public Oversight.

Provided it is not just a further layer of oversight at EU level, FEE supports co-ordination of national public oversight mechanisms because it is in the interest of the Member States and also because it could help to:

- Build trust in the effectiveness of audit;
- Explain how EU principles of oversight are implemented by member states and the profession;
- Support quality assurance at equivalent level for the single market;
- Co-ordinate Member States and Commission response to topical issues;
- Assist in review of cross-border audits requiring investigation;
- Explain EU arrangements in global regulatory dialogue.

FEE considers that in the medium term, such co-ordination of national public oversight mechanisms can only be fully effective if legally established. The co-ordination should be credible to other oversight bodies in the world and be able to explain the quality of oversight arrangements in Europe. The coordination would include the quality control of national oversight systems.

National oversight systems need to have the legal power to participate in coordination of activities at European level and with similar bodies elsewhere which have reached cooperation agreements with the Commission. This would include the participation in the discussion of specific cross-border issues and individual cases without inappropriate legal impediments.

FEE recommends the establishment of a privately organised body with delegated powers to perform well-defined co-ordination functions on oversight activities. The European Coordination would have the following tasks:

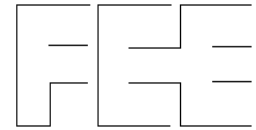
- On the basis of self assessment initially, establish and report on how EU principles of oversight have been implemented by Member States and the profession
- If necessary, develop recommendations to the Commission on interpretation of oversight principles
- At regular intervals, review the effectiveness of quality assurance and oversight systems and recommend any necessary improvements
- Encourage convergence of best practice
- Provide a forum where Member State oversight mechanisms, the Commission, the profession (and other stakeholders) can co-ordinate and develop their activities
- Provide a formal mechanism for exchange of information and co-ordination of oversight in cross border cases.

Possible wording of the Eighth Directive on coordination of oversight:

*Member States shall ensure that national oversight systems are empowered to participate in European coordination.*

## **Section IX: Final provisions**

Current Articles 29-31 with amendments with regard to the transitional provisions and the date by which the directive needs to be transformed into national law by the Member States.



### **III. PROPOSAL FOR POTENTIAL REQUIREMENTS REGARDING AUDITING ASPECTS OF CORPORATE GOVERNANCE**

Based on our Discussion Paper on Financial Reporting and Auditing Aspects of Corporate Governance, we would like to suggest some proposals for potential requirements regarding the auditing aspects of corporate governance. Although the Eighth Directive is not the appropriate place, it may be important to address in the preambles some governance matters related to the audit. Actually, addressing these governance aspects is announced by the Commission in the Committee on Auditing as a mid-term priority.

Furthermore, some of governance principles set out below will not be relevant for SMEs, especially since they usually cannot have separate audit committees given their size. The ideas below mainly apply to listed companies since our discussion paper focuses on listed companies. Some of them can be made more generally applicable by referring to non-executive directors or supervisory boards instead of audit committees.

In the interest of audit quality, we also wish to raise the point that directors and management should be under some form of legal obligation to disclose to auditors any information which may be specifically relevant to the audit, such as perhaps instances of fraud and earnings management issues, without the auditors specifically enquiring (since they may be unaware of such issues arising).

#### **a) Communication with governance body:**

- Statutory auditors should be entitled to meet at least one time a year with the audit committee without presence of other directors
- Statutory auditors should report in writing on the audit at least once a year to the audit committee
- Statutory auditors should communicate with the audit committee regarding the company's significant accounting policies and practices including alternatives

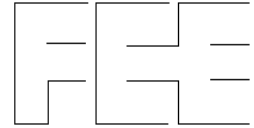
#### **b) Right to attend meetings:**

- Statutory auditors should have the right to attend (supervisory) board meetings in which financial statements and related audit issues are discussed in order to convey their views in person to the full board
- Statutory auditors should have the right to ask for full (supervisory) board consideration of audit issues, after discussion in the audit committee

#### **c) Audit committee:**

FEE recommends that all listed companies should have an audit committee function. Such a requirement should ideally not be introduced in the Eighth Directive, but in another Company Law or even Capital Market Directive.

- Audit committee should monitor relationship of the statutory auditors with the company and its management to confirm that the auditors' independence satisfies the requirements of this Directive and the Recommendation on Statutory Auditor's Independence
- Audit committee prepares a recommendation for the proposed selection and appointment of statutory auditors and agrees and approves the terms of engagement of the statutory auditors



- Audit committee should review the financial reporting arrangements, including the review of the interim and annual financial statements, the other financial information published by the company, including related party disclosures, and internal control related to financial reporting to ensure overall balance and transparency. The audit committee should consider the auditors' report and communicate with the statutory auditor

**d) Characteristics of audit committee members and disclosure:**

- At minimum the majority of the audit committee members must be independent. An audit committee member is not independent if there are any financial, business or other relationships between him and the company, that a reasonable and informed third party would conclude compromise his independence. Independence can be affected by different types of threats. Different types of safeguards – including prohibitions, restrictions, other policies and procedures and disclosures – have to be established in order to mitigate or eliminate threats to the audit committee member's independence
- The reasons for considering an audit committee member to be independent should be disclosed in the corporate governance statement

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

Yours sincerely,

David Devlin  
President

Encl.

EIGHTH DIRECTIVE (1984) – CURRENT TEXT	EIGHTH DIRECTIVE – TEXT SO FAR PROPOSED BY FEE
<p><b>SECTION I Scope</b></p> <p>Article 1:</p> <p>1. The coordination measures prescribed in this Directive shall apply to the laws, regulations and administrative provisions of the Member States concerning persons responsible for:</p> <p>(a) carrying out statutory audits of the annual accounts of companies and firms and verifying that the annual reports are consistent with those annual accounts in so far as such audits and such verification are required by Community law;</p> <p>(b) carrying out statutory audits of the consolidated accounts of bodies of undertakings and verifying that the consolidated annual reports are consistent with those consolidated accounts in so far as such audits and such verification are required by Community law.</p> <p>2. The persons referred to in paragraph 1 may, depending on the legislation of each Member State, be natural or legal persons or other types of company, firm or partnership (firms of auditors as defined in this Directive).</p>	<p><b>SECTION I Scope</b></p> <p>Article 1: UNCHANGED</p>
<p><b>SECTION II Rules on approval</b></p> <p>Article 2:</p> <p>1. Statutory audits of the documents referred to in Article 1 (1) shall be carried out only by approved persons. The authorities of the Member States may approve only:</p> <p>(a) natural persons who satisfy at least the conditions laid down in Articles 3 to 19;</p> <p>(b) firms of auditors which satisfy at least the following conditions:</p> <p>(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;</p> <p>(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</p>	<p><b>SECTION II Rules on approval</b></p> <p>The superseded articles need to be removed. Many of these articles were transitional provisions to accommodate national situations at the time. An examination by the Commission on the implementation of the Eighth Directive should indicate which articles are no longer needed.</p>

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<p>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;</p> <p>(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.</p> <p>Without prejudice to Article 14 (2), the approval of a firm of auditors must be withdrawn when any of the conditions imposed in (b) is no longer fulfilled. The Member States may, however, provide for a period of grace of not more than two years for the purpose of meeting the requirements imposed in (b) (ii) and (iii).</p> <p>2. For the purposes of this Directive, the authorities of the Member States may be professional associations provided that they are authorized by national law to grant approval as defined in this Directive.</p>	
<p><b>Article 3:</b> The authorities of a Member State shall grant approval only to persons of good repute who are not carrying on any activity which is incompatible, under the law of that Member State, with the statutory auditing of the documents referred to in Article 1 (1).</p>	<p>Article 3: UNCHANGED</p>
<p><b>Article 4:</b> A natural person may be approved to carry out statutory audits of the documents referred to in Article 1 (1) only after having attained university entrance level, then completed a course of theoretical instruction, undergone practical training and passed an examination of professional competence of university, final examination level organized or recognized by the State.</p>	<p>Article 4: UNCHANGED</p>
<p><b>Article 5:</b> The examination of professional competence referred to in Article 4 must guarantee the necessary level of theoretical knowledge of subjects relevant to the statutory auditing of the documents referred to in Article 1 (1) and the ability to</p>	<p>Article 5: UNCHANGED</p>

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<p>apply such knowledge in practice. Part at least of that examination must be written.</p> <p>Article 6: The text of theoretical knowledge included in the examination must cover the following subjects in particular:</p> <ul style="list-style-type: none"> <li>(a) - auditing,</li> <li>- analysis and critical assessment of annual accounts,</li> <li>- general accounting,</li> <li>- consolidated accounts,</li> <li>- cost and management accounting,</li> <li>- internal audit,</li> <li>- standards relating to the preparation of annual and consolidated accounts and to methods of valuing balance sheet items and of computing profits and losses,</li> <li>- legal and professional standards relating to the statutory auditing of accounting documents and to those carrying out such audits;</li> <li>(b) in so far as they are relevant to auditing: - company law,</li> <li>- the law of insolvency and similar procedures,</li> <li>- tax law,</li> <li>- civil and commercial law,</li> <li>- social-security law and law of employment,</li> <li>- information and computer systems,</li> <li>- business, general and financial economics,</li> <li>- mathematics and statistics,</li> <li>- basic principles of the financial management of undertakings.</li> </ul>	<p>Article 6: TO BE REVISITED</p>
<p>Article 7: 1. By way of derogation from Articles 5 and 6, a Member State may provide that a person who has passed a university or equivalent examination or holds a university degree or equivalent qualification in one or more of the subjects referred to in Article 6 may be exempted from the test of theoretical knowledge in the subjects covered by that examination or degree.</p>	<p><i>Article 6a</i> <i>Member States shall ensure that persons approved for the statutory auditing of documents referred to in Article 1 (1) are subject to continuing education requirements in order to maintain professional knowledge and skill at the level required to carry out statutory audits</i></p>

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<p>2. By way of derogation from Article 5, a Member State may provide that a holder of a university degree or equivalent qualification in one or more of the subjects referred to in Article 6 may be exempted from the test of the ability to apply in practice his theoretical knowledge of such subjects when he has received practical training in them attested by an examination or diploma recognized by the State.</p>	
<p><b>Article 8:</b></p> <p>1. In order to ensure the ability to apply theoretical knowledge in practice, a test of which is included in the examination, a trainee must complete a minimum of three years' practical training in <i>inter alia</i> the auditing of annual accounts, consolidated accounts or similar financial statements. At least two-thirds of such practical training must be completed under a person approved under the law of the Member State in accordance with this Directive ; the Member State may, however, permit practical training to be carried out under a person approved by the law of another Member State in accordance with this Directive.</p> <p>2. Member States shall ensure that all training is carried out under persons providing adequate guarantees regarding training.</p>	
<p><b>Article 9:</b></p> <p>Member States may approve persons to carry out statutory audits of the documents referred to in Article 1 (1) even if they do not fulfil the conditions imposed in Article 4, if they can show either:</p> <p>(a) that they have, for 15 years, engaged in professional activities which have enabled them to acquire sufficient experience in the fields of finance, law and accountancy and have passed the examination of professional competence referred to in Article 4, or</p> <p>(b) that they have, for seven years, engaged in professional activities in those fields and have, in addition, undergone the practical training referred to in Article 8 and passed the examination of professional competence referred to in Article 4.</p>	
<p><b>Article 10:</b></p> <p>1. Member States may deduct periods of theoretical instruction in the fields referred to in Article 6 from the years of professional activity referred to in Article 9, provided that such instruction is attested by an examination recognized by the State. Such instruction must last not less than one year, nor may it reduce</p>	

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<p>the period of professional activity by more than four years.                      2. The period of professional activity as well as the practical training must not be shorter than the programme of theoretical instruction and the practical training required by Article 4.</p>	
<p>Article 11:                      1. The authorities of a Member State may approve persons who have obtained all or part of their qualifications in another State provided they fulfil the following two conditions:                      (a) the competent authorities must consider their qualifications equivalent to those required under the law of that Member State in accordance with this Directive ; and                      (b) they must have furnished proof of the legal knowledge required in that Member State for purposes of the statutory auditing of the documents referred to in Article 1 (1). The authorities of that Member State need not, however, require such proof where they consider legal knowledge obtained in another State sufficient.                      2. Article 3 shall apply.</p>	
<p>Article 12:                      1. A Member State may consider to be approved, in accordance with this Directive, those professional persons who were approved by individual acts of that Member State's competent authorities before the application of the provisions referred to in Article 30 (2).                      2. The admission of a natural person to a professional association recognized by the State where, according to the law of that State, such admission confers on the members of that association the right to carry out statutory audits of the documents referred to in Article 1 (1), may be considered as approval by individual act for the purposes of paragraph 1 of this Article.</p>	
<p>Article 13:                      Until the application of the provisions referred to in Article 30 (2), a Member State may consider approved, in accordance with this Directive, those professional persons who have not been approved by individual acts of the competent authorities but who have nevertheless the same qualifications in that Member State as persons approved by individual acts who on the date of approval are carrying out statutory audits of the documents referred to in Article</p>	



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<p>1 (1) on behalf of such approved persons.</p>	
<p>Article 14:                      1. A Member State may consider to be approved in accordance with this Directive those firms of auditors which have been approved by individual acts of that Member State's competent authorities before the application of the provisions referred to in Article 30 (2).                      2. The conditions imposed in Article 2 (1) (b) (ii) and (iii) must be complied with no later than the end of a period which may not be fixed at more than five years from the date of application of the provisions referred to in Article 30 (2).                      3. Those natural persons who, until the application of the provisions referred to in Article 30 (2), carried out statutory audits of the documents referred to in Article 1 (1) in the name of a firm of auditors may, after that date, be authorized to continue to do so even if they do not fulfil all the conditions imposed by this Directive.</p>	
<p>Article 15:                      Until one year after the application of the provisions referred to in Article 30 (2), those professional persons who have not been approved by individual acts of the competent authorities but who are nevertheless qualified in a Member State to carry out statutory audits of the documents referred to in Article 1 (1) and have in fact carried on such activities until that date may be approved by that Member State in accordance with this Directive.</p>	
<p>Article 16:                      For one year after the application of the provisions referred to in Article 30 (2), Member States may apply transitional measures in respect of professional persons who, after that date, maintain the right to audit the annual accounting documents of certain types of company or firm not subject to statutory audit but who will no longer be able to carry out such audits upon the introduction of new statutory audits unless special measures are enacted for their benefit.</p>	
<p>Article 17:                      Article 3 shall apply to Articles 15 and 16.</p>	
<p>Article 18:                      1. For six years after the application of the provisions referred to in Article 30</p>	

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<p>(2), Member States may apply transitional measures in respect of persons already undergoing professional or practical training when those provisions are applied who, on completion of their training, would not fulfil the conditions imposed by this Directive and would therefore be unable to carry out statutory audits of the documents referred to in Article 1 (1) for which they had been trained. 2. Article 3 shall apply.</p>	
<p>Article 19: None of the professional persons referred to in Articles 15 and 16 or of those persons referred to in Article 18 may be approved by way of derogation from Article 4 unless the competent authorities consider that they are fit to carry out statutory audits of the documents referred to in Article 1 (1) and have qualifications equivalent to those of persons approved under Article 4.</p>	
<p>Article 20: A Member State which does not make use of the possibility provided for in Article 51 (2) of Directive 78/660/EEC and in which, at the time of the adoption of this Directive, several categories of natural persons may, under national legislation, carry out statutory audits of the documents referred to in Article 1 (1) (a) of this Directive, may, until subsequent coordination of the statutory auditing of accounting documents, specially approve, for the purpose of carrying out statutory audits of the documents referred to in Article 1 (1) (a) in the case of a company which does not exceed the limits of two of the three criteria established in Article 27 of Directive 78/660/EEC, natural persons acting in their own names who: (a) fulfil the conditions imposed in Articles 3 to 19 of this Directive save that the level of the examination of professional competence may be lower than that required in Article 4 of this Directive ; and (b) have already carried out the statutory audit of the company in question before it exceeded the limits of two of the three criteria established in Article 11 of Directive 78/660/EEC. However, if a company forms part of a body of undertakings to be consolidated which exceeds the limits of two of the three criteria established in Article 27 of Directive 78/660/EEC, such persons may not carry out the statutory audit of the documents referred to in Article 1 (1) (a) of this Directive in the case of that company.</p>	

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<p>Article 21:                      A Member State which does not make use of the possibility provided for in Article 6 (1) of Directive 83/349/EEC and in which, when this Directive is adopted, several categories of natural persons may, under national legislation, carry out statutory audits of the documents referred to in Article 1 (1) (b) of this Directive may, until subsequent coordination of the statutory auditing of accounting documents, specially approve, for the purpose of carrying out statutory audits of the documents referred to in Article 1 (1) (b), a person approved pursuant to Article 20 of this Directive if on the parent undertaking's balance sheet date, the body of undertakings to be consolidated does not, on the basis of those undertakings' latest annual accounts, exceed the limits of two of the three criteria established in Article 27 of Directive 78/660/EEC, provided that he is empowered to carry out the statutory audit, of the documents referred to in Article 1 (1) (a) of this Directive, of all the undertakings included in the consolidation.</p>	
<p>Article 22:                      A Member State which makes use of Article 20 may allow the practical training of the persons concerned as referred to in Article 8 to be completed under a person who has been approved under the law of that Member State to carry out the statutory audits referred to in Article 20.</p>	
<p><i>[old article 28]</i></p>	<p>SECTION III Publicity (Registration of Approved Persons)</p> <p>Article 22a:                      1. Member States shall ensure that the names and addresses of all natural persons and firms of auditors approved by them to carry out statutory audits of the documents referred to in Article 1 (1) are made available to the public.                      2. In addition, the following must be made available to the public in respect of each approved firm of auditors: (a) the names and addresses of the natural persons referred to in Article 2 (1) (b) (i) ; and                      (b) the names and addresses of the members or shareholders of the firm of auditors;                      (c) the names and addresses of the members of the administrative or management body of the firm of auditors.                      3. Where a natural person is permitted to carry out statutory audits of the documents referred to in Article 1 (1) in the case of a company according to the conditions referred to in Articles 20, 21 and 22, paragraph 1 of this Article shall</p>

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	<p>apply. The category of company or firm or the bodies of undertakings in respect of which such an audit is permitted must, however, be indicated.</p> <p>[Article 28.3 may no longer be necessary.]</p>
<p>[new]</p>	<p>SECTION IV Appointment</p> <p>Article 22b: <i>Member States shall prescribe that in case of statutory audits of companies referred to in Article (1) of Directive 78/660/EEC a general meeting of shareholders as a whole is responsible for the election of the statutory auditor.</i></p>
<p>SECTION III Professional integrity and independence</p> <p>Article 23: Member States shall prescribe that persons approved for the statutory auditing of the documents referred to in Article 1 (1) shall carry out such audits with professional integrity.</p>	<p>SECTION V Ethics and independence</p> <p>Article 23: Member States shall prescribe that persons approved for the statutory auditing of documents referred to in Article 1 (1) shall carry out such audits with professional integrity, objectivity, professional competence and due care, respecting the confidentiality of information acquired as a result of professional and business relationships.</p>
<p>Article 24: Member States shall prescribe that such persons shall not carry out statutory audits which they have required if such persons are not independent in accordance with the law of the Member State which requires the audit.</p>	<p>Article 24: <i>Member States shall ensure that such persons when carrying out statutory audits shall be required to be independent from their audit client both in mind and in appearance and that such persons shall be required to identify, evaluate and respond to threats to objectivity including self-interest, self-review, advocacy, familiarity or trust and intimidation, and that they shall only carry out the audit if safeguards are in place to eliminate or reduce the threats to an acceptable level, such that objectivity is not compromised</i></p> <p>Article 25: UNCHANGED</p>
<p>Article 25: Articles 23 and 24 shall also apply to natural persons who satisfy the conditions imposed in Articles 3 to 19 and carry out the statutory audit of the documents referred to in Article 1 (1) on behalf of a firm of auditors.</p>	
<p>Article 26: Member States shall ensure that approved persons are liable to appropriate sanctions when they do not carry out audits in accordance with Articles 23, 24 and 25.</p>	<p>(See Section VIII, Disciplinary Actions)</p>
<p>Article 27:</p>	<p>Article 27: UNCHANGED</p>

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<p>Member States shall ensure at least that the members and shareholders of approved firms of auditors and the members of the administrative, management and supervisory bodies of such firms who do not personally satisfy the conditions laid down in Articles 3 to 19 in a particular Member State do not intervene in the execution of audits in any way which jeopardizes the independence of the natural persons auditing the documents referred to in Article 1 (1) on behalf of such firms of auditors.</p>	<p>[Depending on changes to Articles 3 to 9, this article may need to be changed.]</p>
<p>[new]</p>	<p><b>SECTION VI Auditing Standards</b>  <i>Article 27a:</i>  <i>The Commission shall require (in secondary legislation under comitology procedures) that auditors perform statutory audits at least in accordance with a defined set of auditing standards that is generally accepted internationally and developed in accordance with requirements for proper due process, public oversight and transparency</i></p>
<p>[new]</p>	<p><b>SECTION VII Quality Assurance</b>  <i>Article 27b:</i>  <ol style="list-style-type: none"> <li>1. Member States shall ensure that all persons approved for the statutory auditing of documents referred to in Article 1 (1) which perform such audits are subject to an appropriate and effective quality assurance system.</li> <li>2. Member States shall ensure that the selection of the statutory auditors for a quality review is made on a consistent basis so as to ensure coverage of all statutory auditors over a predetermined period and that the cycle to achieve full coverage of all statutory auditors is a maximum of six years.</li> <li>3. Member States shall ensure that the quality assurance relates to statutory audits of documents referred to in Article 1 (1) and that the scope of the quality review includes an assessment of the internal quality control system of an audit firm with sufficient compliance testing of procedures and audit files to verify its adequate functioning.</li> <li>4. Member States shall ensure that the persons, either peers or employees of a monitoring organisation, who carry out quality reviews should have appropriate professional education and relevant experience combined with specific training on quality assurance reviews.</li> <li>5. Member States shall ensure that for the selection of reviewers for individual review assignments possible conflicts of interest are adequately taken into account and that the reviewers are subject to the requirements of Section IV of this Directive.</li> </ol></p>

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	<p>6. Member States shall ensure that the aggregated results of quality assurance are adequately published and that reporting includes recommendations for professional and/or regulatory actions.</p>
<p>[See old Article 26 and new.]</p>	<p>SECTION VIII Investigation and Disciplinary Actions</p> <p>Article 27c:</p> <p>1. Member States shall ensure that persons approved for the statutory auditing of documents referred to in Article 1 (1) are liable to appropriate and effective investigation and disciplinary systems when they do not carry out audits in accordance with Articles ...[number of articles on ethics, independence and applicable auditing standards to be added]. The disciplinary system shall include the possibility of removal of the approved person from the audit register. The system should uphold principles of fairness and due process and should include a possibility for appeals.</p> <p>2. Member States shall ensure that there is a systematic link between significant findings from the quality review and initiating investigations and disciplinary proceedings.</p>
<p>[new]</p>	<p>SECTION IX Public Oversight</p> <p>Article 27d:</p> <p>1. All statutory auditors must be subject to adequate public oversight to ensure that they consistently achieve the goal of maintaining standards at the level the public has a right to expect. Public oversight should be fair, balanced and conducted in the public interest.</p> <p>2. Public oversight requires a majority of non-practitioners. Persons involved in public oversight should be selected under an independent and transparent nomination procedure.</p> <p>3. Public oversight comprises the responsibility for supervision of the organisation of licensing and registration of statutory auditors as well as for standard setting on ethics and auditing, continuous education, quality assurance, investigation and disciplinary systems.</p> <p>4. Public oversight must include the exercise of investigative and disciplinary powers over statutory auditors.</p> <p>5. Public oversight mechanisms must be transparent. This should include the publication of annual work programmes and activity reports.</p> <p>6. Public oversight must be adequately funded. It should not be primarily funded by the audit profession. There must be an adequate level of funding by other sources.</p> <p>7. Member States shall ensure that national oversight systems are empowered to</p>

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<p><b>SECTION IV Publicity</b></p> <p>Article 28:</p> <ol style="list-style-type: none"> <li>1. Member States shall ensure that the names and addresses of all natural persons and firms of auditors approved by them to carry out statutory audits of the documents referred to in Article 1 (1) are made available to the public.</li> <li>2. In addition, the following must be made available to the public in respect of each approved firm of auditors:               <ol style="list-style-type: none"> <li>(a) the names and addresses of the natural persons referred to in Article 2 (1) (b) (i) ; and</li> <li>(b) the names and addresses of the members or shareholders of the firm of auditors;</li> <li>(c) the names and addresses of the members of the administrative or management body of the firm of auditors.</li> </ol> </li> <li>3. Where a natural person is permitted to carry out statutory audits of the documents referred to in Article 1 (1) in the case of a company according to the conditions referred to in Articles 20, 21 and 22, paragraph 1 of this Article shall apply. The category of company or firm or the bodies of undertakings in respect of which such an audit is permitted must, however, be indicated.</li> </ol>	<p><i>[See Section III.]</i></p>
<p><b>SECTION V Final provisions</b></p> <p>Article 29:</p> <p>The Contact Committee set up by Article 52 of Directive 78/660/EEC shall also:</p> <ol style="list-style-type: none"> <li>(a) facilitate, without prejudice to Articles 169 and 170 of the Treaty, harmonized application of this Directive through regular meetings dealing, in particular, with practical problems arising in connection with its application;</li> <li>(b) advise the Commission, if necessary, on additions or amendments to this Directive.</li> </ol>	<p><b>SECTION V Final provisions</b></p> <p>Article 29. [To be revised for ARC.]</p>
<p>Article 30:</p> <ol style="list-style-type: none"> <li>1. Member States shall bring into force before 1 January 1988 the laws, regulations and administrative provisions necessary for them to comply with this Directive. They shall forthwith inform the Commission thereof.</li> <li>2. Member States may provide that the provisions referred to in paragraph 1 shall not apply until 1 January 1990.</li> <li>3. Member States shall ensure that they communicate to the Commission the texts of the main provisions of national law which they adopt in the field covered</li> </ol>	<p>Article 30:</p> <ol style="list-style-type: none"> <li>1. Member States shall bring into force before <i>1 January 200X</i> the laws, regulations and administrative provisions necessary for them to comply with this Directive. They shall forthwith inform the Commission thereof.</li> <li>2. Member States may provide that the provisions referred to in paragraph 1 shall not apply until <i>1 January 200X</i>.</li> <li>3. Member States shall ensure that they communicate to the Commission the texts of the main provisions of national law which they adopt in the field covered</li> </ol>

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<p>by this Directive.                      4. Member States shall also ensure that they communicate, to the Commission, lists of the examinations organized or recognized pursuant to Article 4.</p>	<p>by this Directive.                      4. Member States shall also ensure that they communicate, to the Commission, lists of the examinations organized or recognized pursuant to Article 4.</p>
<p>Article 31                      This Directive is addressed to the Member States.</p>	<p>Article 31: UNCHANGED</p>