Date

18 April 2007

Le Président

Fédération des Experts Comptables Européens AISBL

Avenue d'Auderghem 22-28/8
1040 Bruxelles
Tél. 32 (0) 2 285 40 85
Fax: 32 (0) 2 231 11 12
E-mail: secretariat@fee.be

Ms. Jan Munro
Senior Technical Manager
International Ethics Standards Board for Accountants
International Federation of Accountants
545 Fifth Avenue, 14th Floor
New York, New York 10017
USA

Edcomments@ifac.org

Dear Ms. Munro,

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

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

FEE's objectives are:

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

FEE is pleased to comment on:

- The International Ethics and Standards Board for Accountants (IESBA) Exposure Draft (ED) on Section 290 of the Code of Ethics – Independence – Audit and Review Engagements (Proposed Section 290); and
- The IESBA ED on Section 291 of the Code of Ethics – Independence – Other Assurance Engagements (Proposed Section 291).

This letter includes a number of general comments on the ED and a number of specific comments on detailed aspects of the proposed Sections 290 and 291. In addition, we have summarised our responses to the questions set out in the Explanatory Memorandum at the end of this response.

1. General Comments

1.1 Overview

FEE welcomes the retention of the principles-based threats and safeguards approach as the base of the revised Sections 290 and 291. As noted below, there are certain aspects of the proposed new Sections that we also welcome, as we consider them to be an improvement on the existing Code. However, we are deeply concerned that the introduction of yet more absolute prohibitions into Section 290 moves that Section further away from the principles-based approach, with a number of no doubt unintended consequences:

a. FEE is committed to the principles-based approach as being the most robust because, inter alia, by focusing on the underlying aim rather than detailed prohibitions, the principles-based approach combines flexibility with rigour in a way that is unattainable with a rules-based approach. This has been recognised in Europe by the European Commission Recommendation on Independence[1], which follows this approach, and the recently revised Statutory Audit Directive[2], which specifically endorses the approach in Article 22. We accept that a Code containing nothing but a general discussion of principles, threats and safeguards is unlikely to completely meet the needs of the modern, complex profession and that examples of how these should be applied are necessary. We believe that the requirements now included in Section 290, particularly for the audits of entities of significant public interest, have moved too close to a rules-based approach which can encourage a tick-box compliance with the form of the requirement rather than the spirit.

b. We note from the Explanatory Memorandum accompanying the ED that the IESBA has applied benchmarking in a number of jurisdictions. This will inevitably indicate additional restrictions but does not of itself provide evidence of a need for these restrictions in an international code. The fact that a restriction is considered necessary in one jurisdiction because of particular circumstances does not necessarily indicate that it is appropriate on a global basis.

c. The introduction of additional absolute prohibitions even in circumstances when acceptable safeguards could be applied does not seem justified either in terms of enhanced independence (see (a) above) or evidence of a need to restrict further the ability of businesses to have access to and obtain their professional service needs cost effectively. There are a number of matters that need to be considered when proposing additional prohibitions, particularly for smaller entities. For example, cost and management time is often greater when non-audit services are obtained from a provider other than the auditor. In addition, in audits of smaller entities, the additional information acquired when providing other services enhances audit quality.

1.2 Interaction of examples and underlying approach

We have expressed concern above that the examples will be seen as a rule-book and applied in form rather than substance. The IFAC Code will be applied globally in a wide variety of circumstances and we believe that it is imperative that the purpose and context of the examples be stressed, as well as the link between independence and the principle of objectivity. Accordingly, we propose that 290.3 be put at the beginning of Section 290 and that both 290.8 and 290.100 (neither of which mention principles) be expanded to remind the user of the key requirements of the framework and how the examples derive from them.

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

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

1.3 Split of Existing Section 290

We support the division of the existing section into separate sections covering audit and other assurance engagements.

1.4 Scope of Proposed Section 290

We note that the proposed Section 290 on audit engagements has been extended in 290.1 to cover review engagements conducted in accordance with International Standards on Review Engagements (ISREs) 'or equivalent', as well as financial information ranging from general purpose financial statements to individual elements of a financial statement.

As regards the extension to review engagements, it is important that it be clear what type of engagements Section 290 is intended to apply to:

a. Despite the description of the level of assurance in ISRE2400, we note that the public expectation of whether a review engagement opinion should be regarded as similar in nature to an audit opinion, or giving a very much lower level of assurance, varies from country to country;
b. In particular we do not believe that review engagements for restricted use should fall within the scope of Section 290 as they are unlikely to be similar in nature to audits;
c. We note that ISRE2400 states: "This ISRE is directed towards the review of financial statements. However, it is to be applied *to the extent practicable* to engagements to review financial or other information..." It is unclear therefore whether a review of other financial information would (or even could) fall within the scope of Section 290.

As regards audit engagements, we note that the proposed new ISA800 changes the wording used to describe special purpose financial statements and it may be necessary to amend 290.1 to align with ISA800 when finalised.

1.5 Restricted Use

The key requirement for any restricted use engagement where different independence provisions have been applied is that the intended users are aware of and agree to the terms applied. While the ED requires this, it does not specify that the report should contain this information. FEE believes that 290.501 should specify that the terms be made clear in the restricted use report. In this case, it should be possible for the terms to be agreed between the auditor and users and the ED does not need to specify in 290.504 onwards, which terms may or may not be varied.

Paragraph 290.503 could be interpreted to mean that the auditor can apply different requirements to the restricted use engagement than to the audit engagement. We do not believe that this is intended, but the intent could be made clearer by deleting the words "to that audit engagement" at the end of the paragraph.

1.6 Definitions

We note a slight change in the definition (and in 290.7) of independence from that in the existing Code. We hope that this is a matter of tidying up wording: we would be very concerned if the removal of the reference to knowledge of all relevant information including safeguards applied were intended to be a change of substance. Any change of wording is likely to lead to an assumption by some readers that a change of meaning has been intended and we believe the previous wording should be reverted to or the position clarified.

We understand that the definition of engagement team has been changed with the intention of distinguishing between individuals who carry out audit work (including experts) and experts who are consulted in their capacity as experts. We support the intention but believe "that might otherwise be provided by a partner or staff of the firm" remains capable of misinterpretation. FEE proposes "All partners and staff of the firm and any individuals contracted by the firm that perform the assurance engagement" as an alternative definition. This may benefit from brief guidance on what 'performing an assurance engagement' encompasses.

The definition of key audit partner could be enhanced by setting it in the plural, to emphasise that more than one partner on an engagement can be considered to be key.

1.7 Language and clarity

We are supportive of the work undertaken to use more direct language. However, it is important not to take this too far as it is important that directness does not of itself result in more rules and for the user to realise that merely complying with the specific example set out is insufficient. As noted in 1.2 above, it is vital that it be clear how the examples are to be applied within the context of the conceptual framework.

2. Comments on Specific Aspects

2.1 Entities of significant public interest

We agree with the extension of specific listed entity requirements to other entities of significant public interest (ESPIs). We also agree that it would be inappropriate for the IESBA to provide a detailed definition of what sort of entity should be regarded as an ESPI, to any greater extent than is included in the ED.

2.2 Documentation

We agree with the enhanced discussion on this subject in 290.27. Documentation is not an indicator of independence but is a key aspect for the credibility and effectiveness of the threats and safeguards approach.

2.3 Close business relationships

The EC Recommendation on Independence and the Statutory Audit Directive refer to the need for owners of audit firms not to interfere in the audits and for auditors not to audit those who own the firm. Although not specifically addressed in Section 290, the close business relationship provisions could be considered to address these matters. It would be helpful to include ownership of a significant proportion of the audit firm in the list of examples of the types of relationship that may pose a threat, in 290.121.

2.4 Employment with an audit client

It should be clarified in 290.135(a) that what are generally known as 'cooling off' provisions are only applicable in respect of partners joining the client in a position to influence the accounting records or financial statements *at the group level*. It follows that 290.135(b) should be changed to clarify that the appointment as director and officer applies only to such positions with the parent company.

There is a similar potential confusion with the phrase "financial statements on which the firm will express an opinion" as used in, for example, 290.131, which could be interpreted, in the case of ESPIs, to refer to the group level only or to the group and any affiliate levels. The intent should be clarified.

We also have a concern about the phraseology in 290.137: "is not considered unacceptable if…" First, this seems to imply a carve-out from the normal requirement for threats and safeguards, whereas it is a carve-out only from the absolute prohibition. In addition, "is not considered unacceptable" sits uneasily in a principles-based threats and safeguards framework which places the onus on the professional accountant to assess the threats and safeguards. The paragraph should be rephrased as a requirement to apply safeguards including at least those items specified.

2.5 Provision of non-assurance services

2.5.1 Valuation services

FEE does not believe that there is any evidence to support a need for the tightening of the requirements in this area, which were in line with those advocated by the European Commission Recommendation on Statutory Auditor Independence. Accordingly, we do not support the change in requirements for ESPIs such that material valuations are prohibited even if they are not subjective in nature. The self-review threat arises as a result of the auditor having to audit his or her own work but, if there is no significant element of judgement included in that work, the degree of threat is very much reduced.

2.5.2 Taxation services

We agree that the provision of taxation services by auditors, like any other non-audit service, could create threats to independence and these need to be assessed and necessary safeguards applied, or the service not provided. Accordingly, it is appropriate to introduce a discussion on potential threats and examples of safeguards. We note that the IOSCO Survey on Non-Audit Services[3], in its comments on tax services, observes that taxation services are in many jurisdictions seen as unique as a result of certain inherent safeguards, but there is agreement with the need to consider threats.

However we believe that the section proposed is in far greater detail than necessary and seems to support a presumption of threats which cannot be mitigated by safeguards in many cases. It introduces a number of absolute prohibitions which go beyond those applied in a number of other cases and for which no evidence has been produced that there is a public interest need. Indeed, from the perspective of the users of professional tax services, the inevitable additional costs of sourcing tax assistance and potential issues of choice and audit quality (see 1.1(c) above) indicate that these additional restrictions are likely to be against the public interest.

Should the IESBA nevertheless decide that the proposed structure of a detailed analysis is to be retained, we set out below a number of specific points on the proposed tax section.

In particular, we do not believe that the prohibition in 290.178 on material tax calculations by auditors for their ESPI clients, irrespective of whether safeguards can be applied, is necessary or justifiable in the public interest. At the absolute minimum the prohibition, if applied, should apply to material *and* subjective calculations as we believe the degree of threat is otherwise less significant. See our comments on valuation services under item 2.5.1 above.

We commented above on the lack of clarity of what is meant by “financial statements on which the firm will express an opinion”. The same phrase is used in 290.178. We believe that the prohibition, to the extent that it stands, should apply only to the group financial statements.

It would be useful to clarify that advising the client on new tax legislation is clearly a duty for a tax advisor as it is in the interest of the client. This would help to remove the implication that could be read into 290.179 (which we assume is intended to be a neutral introductory paragraph) that the services mentioned are a potential threat.

We note that the discussion in 290.181 refers to three possible safeguards. These safeguards are mentioned as examples (“might include”). In many countries, small businesses source their tax assistance from sole practitioners. However, of the examples mentioned in 290.181, the only possibility for such practitioners is the last example: obtaining advice on the service from an external tax professional. This is likely to add to the cost to the client. Indeed it might render the provision of tax services to audit and review clients unviable for this part of the profession, presenting the client with the need to find another source, if available. It would be helpful to add additional examples, such as obtaining pre-clearance or advice from the tax authorities, where available, and extending periodic quality control reviews to tax services.

[3] A Survey on the Regulation of Non-Audit Services Provided by the Auditors to Audited Companies, IOSCO, January 2007

We are concerned that the phrase “reasonable doubt as to the appropriateness of the accounting treatment” in 290.182(a) is unhelpful and request that this be rephrased. See comments on a similar statement in the Corporate Finance section, under item 2.5.5 below.

Paragraphs 290.184 and 185 prohibit the audit firm from acting as an advocate for the client in the resolution of a tax matter in certain circumstances. While threats should clearly be considered, the degree of threat will vary. The EU Recommendation on Independence notes (at Section 7.2.5) “Even when taking a relatively active role on behalf of the client, there can be other specific situations which are generally not seen to compromise a Statutory Auditor's independence. Such situations could include the representation of an Audit Client before the court or the tax administration in a case of tax litigation. They could also include advising the client and defending a particular accounting treatment in a situation where a Member State's authority, securities regulator or review panel, or any other similar European or international body investigates the Audit Client's financial statements.” It is at the very least important to distinguish between merely representing a client position and the audit firm defending its own opinion, where it has already opined on a certain treatment (this is implied in the second item in the list in 290.183 but “on which the firm *will* express an opinion” is not repeated in 290.184). In this latter case, there is no advocacy threat to a future opinion and there should be no prohibition.

2.5.3 IT systems services

We note that the scope of this example has been changed from covering "design and implementation” circumstances to a wider set of circumstances covering "design or implementation". We do not believe that there is any evidence of a need to additionally introduce the wholesale prohibition in 290.197 on the provision of such services for ESPI audits. The safeguards discussed in paragraph 290.195 for audit clients that are not ESPIs should still be possible to apply for all audits, since the threats will not always be of such significance that they cannot be reduced to an acceptable level.

2.5.4 Recruiting senior management

It is unclear to us whether all of 290.206 is intended to apply to the audit of ESPIs as the second paragraph within 290.206 is not wholly consistent with 290.207, which clearly does apply to such audits. It should be clarified which requirements apply to all types of audits and which to audit clients that are not ESPIs.

In addition, the last paragraph within 290.206 is written in a ‘permissive’ style which sits uneasily with the general stance of a principles-based Code that activities are permitted provided safeguards can be applied to address any threats, unless specifically prohibited. The paragraph could more helpfully be rephrased in terms of giving examples of activities where there is likely to be little or no threat to independence.

2.5.5 Corporate finance

This section has been extended significantly by comparison with the existing Code. However, we do not believe it has added much useful discussion and the need for the additional wording should be revisited. In particular the reference in 290.211(a) to “reasonable doubt as to the appropriateness of the accounting treatment” is unhelpful. It is a wholly reasonable safeguard to ensure that the auditor can accept any proposed accounting treatment but it needs to be clarified that management is responsible for the accounting treatment and the requirement is therefore to ensure, if material, that the proposed accounting treatment is acceptable under applicable GAAP before supplying the service.

2.6 Fees and compensation and evaluation policies

We support the inclusion of a section on compensation or remuneration and evaluation policies. This takes a sensible threats and safeguards approach to a potentially important issue.

2.7 Section 291 Independence – Other assurance engagements

FEE recognises that it is necessary to continue to tie the discussion on assurance engagements in with the IAASB Assurance Framework. However, as we have commented before, that discussion remains difficult to understand and apply in Section 291. The Code should ideally be readable as a stand-alone document and be self-explanatory with relevant definitions or footnotes being imported from the framework.

2.8 Effective Date

The timetable is clearly ambitious as it needs to include time for translation, implementation and education. If the revision to the Code is not approved and publicised in the time anticipated, it will be important that the effective date be moved sufficiently to accommodate such translation, implementation and education.

We note that it is intended that "firms will have six months after the effective date to complete any ongoing services that were contracted for before the effective date". We do not believe that six months is sufficient time to allow contractual undertakings to be adhered to. The period should be at least one year.

3. Request by IESBA for specific comments (questions 1 – 4)

Question 1: Is it appropriate to extend all of the listed entity provisions to entities of significant public interest? If not why not and which specific provisions should not be extended? Is it appropriate that, depending on the facts and circumstances, regulated financial institutions would normally be entities of significant public interest and pension funds, government-agencies, government owned entities and not-for-profit entities may be entities of significant public interest?

Yes (though see our comments above on whether all of those provisions should apply even to listed entities). See comments under item 2.1 above.

Question 2: Is it appropriate to eliminate the flexibility for small firms to apply alternative safeguards to partner rotation? If such flexibility is appropriate, what alternative safeguards will eliminate the familiarity threat or reduce it to an acceptable level?

As a result of provisions included in the Statutory Audit Directive, this flexibility has been withdrawn for public interest audits within the European Union already. However, we note that, as a result of the withdrawal of the exemption from rotation from the requirement for the engagement and review partners on the audits of ESPIs, firms now effectively need to have at least four suitably skilled audit partners in order to undertake such engagements. This could have a significant effect on the availability of auditors in a number of other locations around the world, particularly where the client is operating in a specialised or remote area. This could result in a significant problem with choice of auditor or extra cost. It is unclear to us that it can be shown that this is justifiable in the public interest and we believe the IESBA should carry out research into the effects before removing the exemption.

The impact is further exacerbated by the inclusion of key audit partners within the rotation requirements. As with the 'cooling off' provisions (see 2.4 above), we believe that the rotation requirements should be applied only to partners *at the group level* and this should be clarified.

Question 3: Is the revised guidance related to the provision of non-audit services appropriate?

No. See our comments under items 1.1 and 2.5 above.

Question 4: The primary objective of the strengthening of the independence provisions of the Code is to enhance both the perceived and actual objectivity of those performing assurance engagements, thereby enhancing audit quality. Implementation of the new provisions will likely entail some additional costs to stakeholders which are particularly difficult to measure in the context of a global standard. The IESBA is, however, of the view that the benefits of the proposals are proportionate to the costs and therefore the proposals strike the appropriate balance between the differing perspectives of stakeholders. Do you agree?

No. See our comments under items 1.1 and 2.5 above.

4. Comments requested by IESBA on other matters

4.1 Special considerations on application in audit of small entities

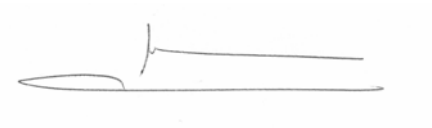
We draw attention to our observations in item 1.1 above.

4.2 Translations

We do not have any specific observations on translation issues but draw attention to the need to ensure sufficient time is allowed for translation, referred to in item 2.8 above.

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

Yours sincerely,



Jacques Potdevin
President