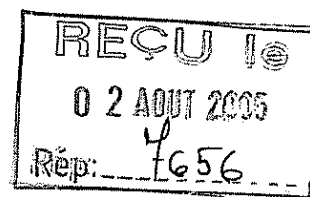




AUDITOR GENERAL
VICTORIA

28 July 2005



Ms Hilde Blomme
Director of Practice Regulation
Fédération des Experts Comptables Européens
Avenue d' Auderghem 22-28
B - 1040 Brussels, Belgium

Dear Ms Bloome,

**Risk Management and Internal Control in the EU Discussion
Paper**

I refer to your request for comments on the EU Discussion paper on Risk Management and Internal Control from Wayne Cameron, a member of the International Public Sector Accounting Standards Board (IPSASB). Wayne is currently overseas and in his absence, the following comments are offered.

Our comments on specific matters are contained in the attachment.

The opportunity to comment is appreciated and I trust you will find the attached comments useful. Should you require any further information, please contact Jim Dixon, Executive Director – Accounting and Auditing Policy on +613 8601 7033.

Yours sincerely,

Edward M Hay
Acting Auditor-General

Specific questions for comment

1. *Do you agree with FEE that there is a need to promote discussion and evidence gathering to encourage coordination and convergence of the development of risk management and internal control at EU level? If not, please explain. (Section 2.4)*

Yes, we agree with the need to promote discussion in order to encourage the coordination of the development of risk management and internal control at an EU level. The establishment of the recent European Corporate Governance Forum should be the catalyst for further integration of ideas and proposals.

2. *Do you consider it appropriate for public policy on risk management and internal control in the EU to focus on listed entities and the needs of their shareholders? Alternatively, do you think that there is a pressing need to deal with issues relevant to a wider range of entities and stakeholders? If so, please explain. (Section 2.4)*

Public policy on risk management and internal control should not just focus on listed entities. We are of the opinion that a wider range of entities should be subject to such policy, in order to enhance comparability, such as: public sector entities; small, medium and large companies that are not listed; and industry-specific sectors, for example, financial institutions.

3. *Do you agree with FEE that the case for introducing any regulation related to risk management and internal control should have regard to: the business case for risk management; the advantages of principles-based requirements; the distinctive features of listed companies; the primacy of those charged with governance; and reasonable liability? If not, please provide details. (Section 3.6)*

Proposal supported.

4. *Are there overriding principles additional to those identified by FEE in Sections 3.1 to 3.5 that are relevant to risk management and internal control? If so, please explain. (Section 3.6)*

Section 3.2 states that an advantage of a principle-based approach is that it allows for the use of judgment. Caution should be exercised as the use of judgment by those charged with governance could potentially lead to differing applications of risk management and internal control, due to the multi-cultural, multi-lingual and multi-jurisdictional environments of the EU.

For example, two very similar controls could be treated entirely differently within two separate countries, if the use of judgment is allowed, which obviously doesn't promote consistency or comparability.

5. *Is the matrix for analysis presented in Figure 1 in Section 4.1 clear and useful? If not, please explain why not. (Section 4.4)*

Proposal supported, however, we believe another box should be included within the 'manage risks' activity types. We suggest that the new box be titled 'monitoring' and be placed directly under 'conclude on effectiveness'. It is essential that identified risks are continually monitored on an ongoing basis, even when those risks have been mitigated for.

6. *Is there any need to develop an EU framework for risk management and internal control? If so, how would you address the concerns about resources and benefits identified by FEE in Section 4.2? (Section 4.4)*

We believe there is a definite need to develop an EU framework on risk management and internal control. This need is similar to the introduction of international accounting standards, which were initiated in order to promote comparability between reporting entities across the globe.

An independent working group could be established with its purpose on developing an EU-wide risk management and internal control framework. All EU member states should be given the opportunity to contribute to the development process. In the long-term, an EU framework should provide benefits that exceed costs, if it is consistently applied. If an EU framework is not developed, then any of the three existing frameworks from Canada, UK and USA could be used by companies and thus the financial report disclosures could potentially not be comparable.

The concern with resources could be mitigated by an increase in FEE's budget allocation or by the possibility of seeking funds from the standard-setters, regulators and/or accounting professions within Europe. Alternatively, place a levy on listed companies as is the case within the USA.

7. *Do you agree with FEE's disclosure principles for risk management and internal control set out in Section 4.3? If not, why not and are there additional factors that should be considered? (Section 4.4)*

Proposal supported, so long as the benefits outweigh any associated costs and that the prescribed disclosures are relevant, understandable and useful to stakeholders.

8. *Do you agree with FEE's proposal that there should be a basic EU requirement for all companies to maintain accounting records that support information for published financial statements? If not, why not? (Section 5.6)*

Proposal supported, otherwise it would be extremely difficult, if not impossible to conduct a financial statement audit and thus provide reasonable assurance to stakeholders, without complete and accurate accounting records. The maintenance of accounting records would ultimately lead to a proper foundation of shareholder confidence in financial reporting.

9. *Do high-level criteria need to be developed to promote meaningful descriptions of internal control and risk management as envisaged by the proposal to amend the Fourth and Seventh Directives? If so, who should develop the criteria and if not, why not? (Section 5.6)*

We agree that high-level criteria should be developed with examples and guidance provided to EU member states. The European Commission should develop the criteria as they are the responsible party for issuing Directives. Consultation could be sought from the standard-setters, regulators and accounting professions.

10. *What role should regulatory requirements play in promoting improvement in risk management and internal control? (Section 5.6)*

In promoting improvements to risk management and internal control, regulatory requirements should be implemented via a phasing period, in order to reduce the burden on entities complying fully with all requirements during its first year of application.

11. Do you agree with FEE's identification of the issues for consideration by listed companies and regulators set out in Section 5.5? Are there any other matters which should be dealt with?

FEE's identification of issues is supported. We believe no other significant matters require consideration.

12. What views do you have on the issues for consideration discussed in Section 5.5? (Section 5.6)

We believe the following issues require major consideration:

- The risk of companies using standardised risk management and internal control disclosures in annual reports that don't truly reflect the financial, compliance and operational/strategic risks of the individual entity.
- The issue of trying to avoid lengthy disclosures, which change little from year to year.
- The process of changing organisations behaviour and culture towards risk management and internal control and the difficulty in 'embedding' these into an entities existing business process.
- In an ever increasing world of litigation, the issues surrounding disclosures relating to commercially sensitive information.

13. Do you consider that the current financial statement audit provides adequate assurance to investors in respect of internal controls over financial reporting? Please explain your responses. (Section 6.7)

We are of the opinion that the current financial statement audit provides adequate assurance to investors in respect of internal controls over financial reporting. This is due to the fact that auditors consider an entity's internal controls in order to formulate an audit strategy and consequently to form an opinion on whether the financial statements are free of material misstatement.

14. Should new disclosures related to risk management and internal control be subject to external assurance? If so, why, and should this be as part of an integrated financial statement audit as in the United States? (Section 6.7)

We believe that disclosures relating to risk management and internal control should be subject to external assurance. Shareholders could potentially rely on a company's evaluation of their risk management and internal controls in order to determine whether an allocation of resources is appropriate, from an investment perspective. This could be a determining factor if, for example, an investor is looking at two similar companies, both with very strong financials. An investment decision in this scenario could be decided by an evaluation of their risk management and internal control disclosures in order to differentiate the two companies. The investment decision could be influenced by whether assurance on the disclosures was produced.

Disclosures could possibly form part of an integrated financial statement audit, however, an option to provide separate assurance on elements of risk management and internal control should also be an allowable approach. The latter option could serve smaller, specialist accounting firms, who possibly focus on risk management and internal control, rather than financial statement audits due to either: their size, resource capacity, areas of expertise or pure preference.

15. *What do you see as the principal priorities in the possible development of new forms of assurance related to risk management and internal controls? (Section 6.7)*

We believe that some of the principal priorities in the development of new forms of assurance related to risk management and internal control include the following:

- Auditors must liaise with those charged with governance
- Auditing professions and standard setters must work with the community at large to determine what their expectations are and whether the benefits would outweigh the costs associated with the development of new assurances
- Seek input from other jurisdictions that already have such frameworks on assurance in place and, if relevant and appropriate, whether some of those principles could be used during the development phase.

Other comments

- Figure 3 on page 20 of the discussion paper contains a typing error. The title word for *Sarbanes* is misspelled.