



## Foreningen af Statsautoriserede Revisorer

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

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Below is The Institute of State Authorised Public Accountants in Denmark's response to Fédération des Experts Comptables Européen's discussion paper on "Risk Management and Internal Control in the EU", issued in March 2005.

Generally, we should like to state that overall the discussion paper is a good basis for the further discussion of Risk Management and Internal Control in the European Union.

Below, we have provided our thoughts and responses to the specifically asked questions.

#### **Question 1**

We agree with FFE's opinion of preparing/developing towards a common Risk Management and internal control standard at EU level. This initiative will strengthen a possible later reporting and comparison of different EU companies for the benefit of the capital markets.

#### **Question 2**

We believe that listed enterprises are the most important enterprises to become subject to possible requirements of Risk Management and Internal Control. In this connection, large enterprises which are not necessarily listed, but which are of significant public interest to other stakeholders, including employees, lenders, etc., should also be considered in order to perhaps also be able to include such enterprises under requirements of Risk Management and Internal Control.

#### **Question 3**

##### **A The Business Case for Risk Management**

We agree that Company Wide Risk Management and Internal Control is the fundamental basis for defining and operating as well as for meeting business objectives. Accordingly, we also agree that the use of personal judgement is a significant element of the Risk Management process. On the other hand, we believe that such judgement is to be exercised within fixed and uniformly set limits, so that the necessary comparability is obtained between the individual companies/sectors.

## **A The Advantage of Principles-based Requirements**

Using principles-based requirements naturally provides great flexibility in connection with the implementation of Risk Management and Internal Control. This flexibility unfortunately also results in problems of how to determine the minimum requirements of implementation, including that the rules are to be effective in a multi-lingual and, not least, multi-legal environment. Based on the Sarbanes Oxley implementation just completed in many American enterprises, experience shows that it is extremely difficult to carry out such implementation, including to give advice on it, if somewhat precise guidelines for the performance of the implementation do not exist. Experience thereby shows that there are extremely great cultural and environmental differences as to how principles are perceived in USA, and how they are perceived in Denmark. Therefore, we believe it to be necessary to provide detailed guidelines of how to carry out the implementation and of the requirements ensuring that the information provided by the individual enterprises on the internal controls, etc., is comparable vertically between countries as well as horizontally between businesses in the individual countries. We must expect that any requirements/recommendations without the necessary authoritative interpretation by a competent body (for example as PCAOB has functioned in USA) will make it difficult to ensure a fairly uniform and reasonable implementation in the individual member countries. The advantage of such interpretative body also is that it will relatively quickly and flexibly adapt requirements and interpretations of overall legislation.

## **C The distinctive features of listed companies**

We agree that such rules on Risk Management and internal controls are of course also to apply to all listed enterprises as well as other enterprises. We also agree that too strict requirements within Risk Management and Internal Control will of course result in SME enterprises refraining from being listed by reason of too strict administrative requirements of Risk Management and Internal Control. However, we do not necessarily agree that a principles-based concept limits such risk any more than a rules-based concept. This exclusively means that rules-based concepts are defined as being relatively easy to meet for small and medium-sized enterprises that wish to become listed.

## **D Primacy of those charged with governance**

We completely agree with the thoughts provided that the auditor's responsibility shall naturally never exceed the management's responsibility in connection with Corporate Governance. Accordingly, it must be management's responsibility to introduce Corporate Governance in the enterprise and never the auditor's. The auditor will only be responsible for reporting on whether or not the rules have been observed, whether rules-based or principles-based.

## **E Reasonable liability**

We agree with this section, as we also note that the most important feature is that the enterprise informs of the risk profile of which the activities of the relevant enterprise are an expression.

## **Question 4**

We have no comments on this point.

## **Question 5**

The matrix as such is not self-explanatory, and it requires that you read large text sections to gain the complete understanding of its purpose. Therefore, it is not particularly applicable in situations in which no comparisons are made of "frameworks", but are on the other hand suitable for purposes of comparing different "frameworks".

### **Question 6**

We agree that it is basically not necessary to set out a specific EU-framework, but that it should instead be intended to gain agreement of a worldwide control concept, for example COSO. In this connection, it will be desirable to gain influence in the COSO-committee with representatives of FEE or other relevant EU bodies.

### **Question 7**

It appears in several places in the material that the cost of, for instance, collecting information shall not exceed the use value of such information. This of course is a valid view.

However, it is difficult to quantify the view, how to calculate the costs and how to calculate the use value (benefit) from the relevant information. Which costs are, for instance, to be included in the information about collecting the necessary information or in obtaining a given level of control. Are only direct costs to be included or does it also apply to indirect costs?

Especially the use value will be difficult to calculate in practice for the relevant information/the relevant controls. Will for instance potential investors' "profit" from having priced a given share be lower if material comments exist on the internal control level, and thereby an increased risk of the enterprise losing money or becoming insolvent?

Whether the European system, including especially the Danish system, provides a better position for the investors in relation to collecting information of risks as well as the internal control environment is difficult to assess. However, in general, we find that any advantage in legislation which the investors may have for claiming such issues addressed in Danish financial statements, etc., this far has not showed in large Risk Management/Internal Control programs in Danish enterprises, measured in relation to foreign enterprises.

### **Question 8**

We agree that common requirements of filing, maintenance and documentation should be determined to form the basis of preparation of the financial statements. We also see this point as important, including that the individual countries cannot expand such rules by special legislation, which obstructs/forbids filing of bookkeeping records or IT systems outside of the borders of the relevant countries. Provided that the rules are not expanded by country-specific rules, common rules on this area will in many cases be a cost-saving feature for enterprises operating in several European countries.

### **Question 9**

We understand the necessity to draw up criteria to obtain a fairly uniform understanding and reporting of Risk Management and Internal Control, as proposed in the 4<sup>th</sup> and 7<sup>th</sup> directives. We also find it important to carry out this work in a common European body, preferably under EU, which can accordingly give such criteria the necessary "legal weight".

### **Question 10**

We understand that an actual optional adjustment of these issues of Risk Management and Internal Control will have an extremely long period of implementation, if this process is not supported by "legislation", preferably set out by EU. We believe that such "legislation" may become effective successively, so that the enterprises voluntarily gain the possibility to adapt to the new rules over a period.

### **Question 11**

Generally, we agree to the issues raised which should be considered by listed enterprises and the legislative powers as shown in section 5.5.

### **Question 12**

We find that whether concerning Managing Risk or disclosure, the most important factor for enterprises to ensure the full benefit of Risk Management initiatives will be reached if requirements era dealing with management performing a control of whether the internal controls function as described. The experience from the Sarbanes Oxley implementation shows that especially in connection with the assessment and the test of whether the internal controls function as described and provided the enterprise will gain the overall benefit from the entire initiated Risk Management/Internal Control process.

### **Question 13**

The present financial statements, including auditor's reports, do not only state/provide very limited mentioning of the subject of internal controls, etc. Such information is never/normally not provided about public/listed enterprises as to how the internal control environment and its efficiency is. For instance in connection with large implementations of ERP systems or other financial systems, efficiency of the internal controls often drops for a period until the new systems are correctly implemented. Such lack of internal controls or lack of efficiency of the controls is actually not mentioned. Such lack of controls may lead to increased risk of errors, intentional as well as unintentional in present as well as next financial period, and thereby contributes to affect the pricing of the shares of the relevant enterprise in the market.

### **Question 14**

In our opinion, such Risk Management/Internal Control review is to be comprised by the statutory audit, especially concerning the internal controls as they are a natural part as regards the financial reporting of the presentation of it and are therefore a natural part of the audit process. Therefore, it is natural for these internal controls to be mentioned in reporting and comprised by the statutory audit, and for this responsibility to also be attached to the same appointed auditor as the one auditing the financial statements in order to achieve the most synergies in connection with the audit of the two areas.

### **Question 15**

As we see it, the necessary legal basis and the necessary frameworks are created at the most important points of the audit of Risk Management and Internal Control, so that it actually becomes possible to make the necessary assessment of Risk Management and Internal Control in the enterprise.

In case you have any questions please do not hesitate to contact us.

Yours sincerely,

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