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9 September 2005

Dear Sirs

COMFORT LETTERS ISSUED IN RELATION TO FINANCIAL INFORMATION IN A PROSPECTUS - DISCUSSION PAPER

We welcome the opportunity to participate in this consultation by FEE. This response is submitted on behalf of the PricewaterhouseCoopers member firms in Europe.

Our specific comments on the questions in the discussion paper are set out in the attached Annex. In this covering letter we set out some broader observations.

Need for a common approach – and limitations

Ultimately, we believe it would be desirable to have a common internationally-recognised framework for providing comfort letters. Currently there are different practices in each country, and it would be useful for auditors and for the market to have, as far as possible, a common approach. We therefore support this initiative by FEE as an important first step in summarising current practice and stimulating debate on the appropriate features of comfort letter reporting.

That said, we note that the term 'comfort letter' is ill-defined and may be used in different countries for a range of reporting situations. Also, market participants have become used to particular practices with which they are familiar. For example, many underwriters familiar with US practices insist on a SAS 72-type letter, even in circumstances where the issue is not destined for the US market. As a result, expectations of convergence in this area must be realistic. We suggest that, as a first stage, the discussion should focus on the most usual situation in which comfort letters are used – in connection with an accountant's report on historical financial information included in a prospectus.

Also, given that different requirements for responsibility, liability and reporting pertain in different countries, it is unlikely that an international standard (even if limited to dealing only with comfort letters in connection with accountant's reports for prospectuses) can address all these aspects. It could however set out basic principles and objectives to be used when issuing such a comfort letter, as outlined below.

As stated in our previous response to FEE on its paper on 'The Auditor's involvement with the new EU Prospectus Directive', we believe there should be a fair and proportionate distribution of responsibility – and ability to limit or cap liability to reasonable levels – among the various parties in the financial reporting process (issuers, auditors and other advisers). This does not mean that a uniform regime throughout the EU is needed (or attainable) – but all member state regimes should be founded on the principles of proportionality and fairness. We would welcome any steps by FEE, the European Commission or others to promote fair liability regimes.

Principles and objectives of reporting

Some countries have well established securities laws and auditing standards that together provide a framework for issuing comfort letters in their domestic markets. In circumstances where market practices are less well developed, and in the case of cross-border securities offerings, there is a greater need to establish common principles around the use of comfort letters.

These principles and objectives might include, for example:

- Reinforcing the fact that the comfort letter is issued in the context of the underwriters' responsibility to undertake enquiries and procedures
- Making clear the respective responsibilities of management and the auditors for any financial statements referred to, and indicating the type of assurance work previously performed by the auditors on those statements
- Indicating the auditors' independence
- Making clear that the underwriters are responsible for setting the scope of the additional procedures the auditors agree to perform
- Ensuring the limitations of the procedures the auditors perform are understood
- Indicating clearly the dates of any 'change period' and 'cut-off' date in relation to procedures applied
- Making clear what law and/or legal jurisdiction will apply to the relationship with the recipients of the comfort letter.

Assurance and agreed-upon procedures

The work performed by auditors that is referred to in comfort letters embraces both assurance (in relation to previous audits or reviews of annual and interim financial information included in a prospectus) and agreed-upon procedures (in relation to the 'change period' – the period between the date to which the last audited or reviewed financial statements are drawn up and the 'cut-off date' for purposes of the comfort letter).

Although, generally, work performed in relation to the change period is considered to be of the agreed-upon procedures type, there are some inconsistencies between current practice and the assurance and related service standards issued by IAASB, as indicated in our response to Issue 1. We believe these areas of difference should be further debated. The example comfort letter proposed in Appendix 1 of the discussion paper illustrates these differences and provides a good basis for further consideration if a standard or common approach is to be developed for use at international level.

We would be happy to discuss these issues further with you. If you have any questions regarding this letter, please contact Stefan Schmidt (tel +49 69 9585 1146) or Graham Gilmour (tel +44 20 7804 2297).

Yours faithfully

PricewaterhouseCoopers LLP

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ANNEX

Comfort Letters Issued in relation to Financial Information in a Prospectus – Comments on detailed questions in the Discussion Paper

Issue 1
Which of the different reporting models do you prefer and why? Are there any other reporting models you think should be considered?

An international approach or 'standard' on comfort letters would most logically be developed by the International Audit and Assurance Standards Board (IAASB). The IAASB already has in place a structure for its pronouncements, covering both assurance engagements and related services. The development of each new standard has to fit into this structure.

Any discussion of this issue should take account of the fact that the provision of comfort letters is already a customary part of the auditor's reporting process to both issuers and the underwriters. Current practices and professional standards, such as the widely-used US SAS 72, should be given consideration in the development of an international approach to ensure that an adequate degree of market acceptance can be attained.

However, it should be noted that there are some potential inconsistencies between current practices and the ISA framework. For example, the procedures performed with respect to the change period are often accompanied by a negative assurance-type opinion or conclusion '…nothing came to our attention as a result of the foregoing procedures that caused us to believe that...' (This is a feature of the change-period negative assurance language used in SAS 72 and in comfort letters typically issued in other jurisdictions such as the UK.) To be consistent with the IAASB's structure, any comfort letter standard would more clearly have to be presented as a limited (negative) assurance engagement or an agreed upon procedures engagement.

We note that the illustrative comfort letter included in Appendix 1 of the FEE paper sets out the procedures performed and factual findings, but is not accompanied by a negative assurance conclusion of the type mentioned above. We believe this illustrative letter should be compatible with the IAASB's structure since each of the elements of work referred to in the letter is related to the respective assurance or related service standard. Further discussion is needed to determine whether this model meets the needs of interested parties.

Issue 2
Underwriters or other parties other than the issuer may be reluctant to enter into a written agreement with the auditor. As, by the nature of the engagement – agreed-upon procedures – the responsibility of the definition of the scope of work is with the underwriter, it is preferable to formalise the agreement of the scope of work in writing, especially on a liability standpoint.

Can the auditor only issue a comfort letter to the parties that have signed the engagement letter?

This depends on the applicable legal requirements. The law and regulations in different countries may differently stipulate the respective roles of the addressees and the need for written terms of engagement between the auditor and the recipients of the comfort letter.

Therefore, a standard should not include specific guidance with respect to the underlying contractual relationship, but should be limited to addressing the objectives of such reporting and the main issues an auditor should consider before issuing a comfort letter.

One of these issues relates to the fact that each recipient of a comfort letter should be fully aware of the type of engagement and that such requesting party/underwriter takes responsibility for the adequacy of the scope of procedures performed by the auditor, to avoid any misunderstanding regarding such matters and the extent of the auditor's responsibility.

Depending on the underlying legal framework, such awareness might be achieved either through an engagement letter signed by all recipients of a comfort letter or through the underlying professional standard or the comfort letter itself.

Issue 3
The fact that a private comfort letter is issued to banks/underwriters could raise the issue of the banks/underwriters having a different level of information compared to investors. However, the issuance of a comfort letter does not create differences in the level of information available to banks and investors, as (a) the letter is sent to the bank in respect of their capacity as underwriter, not in their capacity as investors, (b) the comfort letter is part of the due diligence process that the bank has to perform to accept its responsibility towards the investing public, and (c) it does not include other information than the information in the prospectus.

Does the issuance of a comfort letter create a different level of information?

Given the role of underwriters as those involved in drafting the prospectus, and hence obliged to perform due diligence procedures, they inherently receive more information than an investor in order to disclose all material information in a prospectus. This applies not only to the content of a comfort letter, but also to a number of other internal and external reports provided by the issuer or other persons to the underwriters. It therefore seems neither unacceptable nor avoidable that comfort letters include information, for

example with respect to changes in financial statement items, that is not (in that form) included in the prospectus but provided solely for the information of the underwriters in their specific role.

Issue 4

Certain jurisdictions have professional secrecy provisions; the auditor should assess if he is authorised, according to the applicable laws and regulations, to provide information to a third party. In particular, he should consider if the applicable law permits the issuer to relieve the auditor of its professional secrecy; in certain jurisdictions, nobody, including the issuer, can relieve an auditor of this obligation.

Should the issuer, being the auditor's client, relieve the auditor of his professional secrecy in all cases, if at all possible?

The release from confidentiality obligations is subject in each case to the applicable underlying national law. Accordingly, such a release should be a precondition for the issuance of a comfort letter and is ordinarily granted by the issuer.

Issue 5

It is practice that the auditor only issues comfort letters to underwriters or other parties to the transaction that have a "due diligence defence" and that request such involvement as part of their own reasonable investigation and not as a substitute for their due diligence responsibility. For example, it is common in the US for other parties (such as a selling shareholder or sales agent) that receive the comfort letter to provide a representation letter that states:

'This review process applied to the information relating to the issuer is substantially consistent with the due diligence review process that an underwriter would perform in connection with this placement of securities. We are knowledgeable with respect to the due diligence review process that an underwriter would perform in connection with a placement of securities registered pursuant to the [applicable law]'.

To which parties and under which conditions can the auditor issue a comfort letter?

The question of who is entitled to receive a comfort letter depends on the underlying legal requirements regarding responsibility for the content of a prospectus. We believe a comfort letter should be addressed only to those persons who bear a legal responsibility for the prospectus (including a corresponding due diligence defence) in order to support those persons in fulfilling their due diligence obligations. The respective statutory due diligence defence obligation is therefore the essential pre-condition to receive a comfort letter.

If such responsibility is clearly determined by law, there seems to be no necessity for a specific representation letter issued by the underwriter. If such responsibility is not clearly determined, a representation letter should be required to clarify the respective roles.

However, in any case it may be appropriate to state in a comfort letter that such a representation letter does not diminish the responsibility of its addressees to carry out their own independent due diligence procedures.

Issue 6

Even if an audit base is preferable, the auditor can assess if his understanding of the entity's internal control is sufficient to allow him to issue a comfort letter. The extent of the matters that can be comforted need to be adapted to the circumstances, and it is likely that an auditor that has no audit base will be able to provide a different level of comfort compared with that provided by an auditor that has an audit base.

This situation can exist in several circumstances:

- First year of operations,
- Change in statutory auditor, and
- Information in the prospectus reviewed by a reporting auditor and not by the statutory auditor. This situation is not possible in certain countries (such as France), possible in others (such as United Kingdom) and mandatory in others (such as Greece).

Is an audit base always possible or required?

This depends on the individual content of a comfort letter. However, as a principle, an auditor issuing a comfort letter should have sufficient knowledge of the subject matter – the financial information and records and the control systems around the financial reporting function - under consideration.

Therefore, an auditor has to exercise his or her professional judgement to decide the extent of knowledge or understanding of the issuer needed for the individual engagement. For an assessment of financial information, as a minimum, the auditor will have to possess or obtain an understanding of the issuer's internal control system relevant to its accounting function in order to evaluate its appropriateness and effectiveness relevant to the engagement. This applies irrespective of whether the previous annual financial statements have been audited by the auditor issuing the comfort letter or by another auditor.

Issue 7

The Independence Section of the IFAC Code of Ethics strictly is not required for agreed-upon procedures work where only factual findings are reported. Given that the procedures carried out are of an audit nature and are often combined with assurance work in practice, we recommend that auditors should be required to respect the independence requirements for comfort-letter types of engagement.

Should explicit independence requirements be introduced? Should the comfort letter contain a section on independence?

Since it is customary that the auditor issues the comfort letter in his or her specific role as an independent accountant, and taking into account the different legal environments, a comfort letter should clearly indicate that it is being provided by an independent accountant.

Normally, a comfort letter is requested from the auditor that audited the latest financial statements included in the prospectus. The auditor is required to be independent with respect to the audit engagement, so would be independent with regard to the issuance of the comfort letter. In situations where a comfort letter is requested from a predecessor auditor, independence should not be required to be maintained for the issuance of the comfort letter.

We believe the standard comfort letter should include a reference to independence, and should be modified accordingly in predecessor auditor situations, to indicate independence as of the date of the prior audit report included in the document.

Issue 8

The discussion paper takes the position that any interim financial information that has been reviewed should be put in the prospectus, together with the review report. Keeping the review report private in a comfort letter would result in supplying more information to the underwriter than to the users of the prospectus, which in our view is not acceptable.

However, the Regulation seems to allow the issuer to choose not to publish the interim financial information (if they were not otherwise required to).

How do you think the requirement in the Regulation (Annex I, item 20.6.1) should be understood?

With respect to the inclusion of interim financial information in a prospectus, the Regulation seems to be very specific and clear. However, the same does not apply to the inclusion of review reports in a prospectus.

National authorities responsible for the approval of prospectuses seem to adopt different views regarding the inclusion of review reports in prospectuses.

The Prospectus Directive requires as a principle that all previously *published* information should be presented to investors in a prospectus. In respect of reviews of interim financial information by auditors, this may imply that review reports should be included in prospectuses where such reports have previously been published (with the interim financial information) prior to the preparation of the prospectus. Where reviews were performed solely for the issuer’s internal use, or in the case of a comfort letter the issuer's and underwriters' internal purposes, but not to be provided to the public, such reports would seem to be outside the scope of the Regulation and may simply be referred to in a comfort letter.

With respect to the question of different levels of information being provided to the underwriters and the investors, see our response to Issue 3 above.

Issue 9

Underwriters sometimes require comfort as to subsequent changes up to the cut-off date. Such comfort can be given by means of specific procedures performed or in the form of limited assurance. Where the latter is required, the auditor needs to apply the procedures of a review (ISRE 2400), which requires interim information to be available at a date as close as possible to the cut-off date. No limited assurance can be given for the period after that date.

In which circumstances can the auditor give assurance through the date of a prospectus?

Do you agree that any review or audit carried out for the purposes of providing comfort should lead to the auditor's assurance engagement being included in the prospectus together with the interim financial information that is being reported on?

Having regard to the IAASB assurance standards, we believe that *assurance* can only be provided through performing an audit or review-type engagement. Therefore, assurance through the cut-off date of a comfort letter may only be provided in accordance with the respective requirements of the IAASB standards. See also our response to Issue 1.

It is customary in some markets to provide in comfort letters statements of findings that, as a result of the procedures applied, there are no changes through a cut-off date compared with the position reported in the previous financial statements. However this is on the basis of specified agreed upon procedures and accompanied by an explanation that the procedures applied do not constitute an audit or a review. Such procedures should be tightly defined and related back to financial information.

In respect of the second part of the question see our response to Issue 8 above.

Issue 10

In some circumstances, the auditor needs to derive comfort from internal monthly financial reporting.

Which criteria should be met to make internal management reporting a useful basis for giving (limited) comfort provided it is performed in line with the IAASB Assurance Framework?

An essential element of a comfort letter is to provide comfort with respect to changes in financial statement items during the change period. Where comfort is provided on the

basis of internal monthly financial reports, such reports should consist at least of a condensed balance sheet and a condensed income statement, each prepared on a basis substantially consistent with that of the last annual or interim financial statements.

Issue 11
General practice prohibits comfort from being issued on general assertions such as "material adverse changes", as these assertions are not defined from an accounting standpoint. The role of the auditor should be limited to reporting on accounting figures or figures derived from accounting figures (differences, percentages …)

Do you agree with this statement? If not, why not?

Yes. As outlined above, an essential element of a comfort letter is to provide comfort with respect to changes in financial statement items during the change period. This financial information should be prepared on a basis consistent with the accounting standards applied in the issuer's financial reporting. In order to avoid any misunderstanding, a comfort letter should only refer to such financial statement items, but not to any other terms that are not defined in the relevant accounting standards.

We agree that general assertions such as 'material adverse changes' should not be referred to in a comfort letter. As noted in our response to Issue 9, any procedures performed should be tightly defined and related back to financial information.