SULLIVAN & CROMWELL LLP

A LIMITED LIABILITY PARTNERSHIP

TELEPHONE: +44 (0)20-7959-8900
FACSIMILE: +44 (0)20-7959-8950

WWW.SULLCROM.COM

One New Fetter Lane
London EC4A 1AN, England

FRANKFURT • PARIS
LOS ANGELES • NEW YORK • PALO ALTO • WASHINGTON, D.C.
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VIA E-MAIL: saskia.slomp@fee.be

Fédération des Experts-Comptables Européens,
European Capital Markets Reporting Project Group,
Avenue d'Auderghem, 22-28,
B-1040 Brussels.

Re: Discussion Paper on Comfort Letters Issued in relation to Financial Information in a Prospectus

We are pleased to have the opportunity to respond to the Discussion Paper on Comfort Letters Issued in relation to Financial Information in a Prospectus (the "Discussion Paper") in which the Fédération des Experts Comptables Europeéens ("FEE") has solicited comments on the procedures and related reporting to be performed by auditors for purposes of furnishing "comfort letters" in the context of securities offerings.

Sullivan & Cromwell has a long history of involvement in the international capital markets. We have offices in Germany, France and the United Kingdom, and we advise our clients located or otherwise engaged in Europe with respect to English, French, German, U.S. and certain aspects of EU law. We are actively involved in advising on the emerging body of law and practice surrounding the EU Prospectus, Transparency and Market Abuse Directives[1] and their implementing measures in the jurisdictions in which we practice.

[1] Respectively, Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC; Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC; and Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse).

It is with this background and in this context that we comment upon the FEE's suggested revisions to comfort letter practices in Europe in light of the adoption of the Prospective Directive and its recent implementation through Commission Regulation (EC) No. 809/2004 (the "Regulation"). We agree that the implementation of the Prospectus Directive and the Regulation provides an opportunity to harmonize European comfort letter practices. However, we have serious reservations regarding the Discussion Paper's central proposals.

Liability and Defenses

As a threshold matter, we note that the principal purpose of comfort letters is to assist underwriters and selling agents with their due diligence efforts. Comfort letters are sought and delivered primarily in the context of prospectus liability rules that apply to sellers of securities in the jurisdiction(s) in which the relevant offering takes place. In other words, the main reason comfort letters are requested by their recipients is for the protection, real or presumed, that they provide against claims that may be brought against recipients on the basis that prospectus disclosure is deficient.

The standards applicable to the determination of whether a party is potentially liable for deficient prospectus disclosure vary across the EU, depending on the Member State(s) in which a proposed offering is to be made. As the Discussion Paper notes: "Protection of investors against misleading information, and hence the liability of the issuer and others involved in the prospectus, are currently governed by national law. Liability regimes differ between Member States, and there is no pan-European liability system".[2]

In many EU jurisdictions, offering participants such as underwriters and selling agents (who are the primary recipients of comfort letters) are potentially subject to such prospectus-based liability, but they may avoid such liability if they can demonstrate that they have applied appropriate "due diligence" in their investigation of the prospectus disclosure. In many countries, receipt of a comfort letter is considered to be an important element in the establishment of such a due diligence defense by underwriters. As a result, comfort letters often are tailored to the liability standard of the relevant jurisdiction. We are, therefore, concerned that the Discussion Paper proposes the harmonization of comfort letter practices within the EU without taking into account the principal reason why such practices do in fact differ. Indeed, in the absence of an EU-wide regime for the determination of prospectus-based liability (and defenses to such liability), it seems to us ill-advised, at best, to harmonize comfort letter procedures within the EU without, at a minimum, first having assessed the consequences of that harmonization upon the suitability of the harmonized comfort letters for the purposes for which they are delivered.

Existence of Accepted Current International Practices

We note that the international capital markets already benefit from widely accepted international practices, based to some extent on the provisions of the U.S.

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[2] Discussion Paper, page 4.

Statement on Auditing Standards No. 72 (as codified in AU§634, "SAS 72"), and on other national standards, several of which have been influenced by SAS 72. Our experience is that current comfort letter practice in the EU generally is based on SAS 72 concepts with jurisdiction-based adjustments.

The comfort letter model advocated in the Discussion Paper substantially deviates from this current international market practice, particularly as regards negative assurance. In particular and as set forth in more detail in our specific comments below, the sole "reporting model" considered in the Discussion Paper is a comfort letter standard based solely on an "agreed-upon procedures" engagement. Pursuant to this "reporting model", accountants would not provide "negative assurance" within a comfort letter in respect of either (i) interim financial information for which a (limited) review has been performed or (ii) the absence of any decreases (or, as applicable, increases) in specified financial statement items between the date of the latest financial statements contained in the prospectus and the "cut-off" date (referred to herein as "Subsequent Changes").

Negative assurance in respect of Subsequent Changes aids the due diligence process and is one of the most important statements typically made in a comfort letter. Accordingly, the Discussion Paper's statements that "the auditor simply provides a report of the factual findings of agreed-upon procedures" and that "no assurance is expressed" are not consistent with the purpose of comfort letters or long-standing international market practice. If the "agreed-upon procedures" model were to become the reference point for a European comfort letter framework, one of the most valuable benefits derived from a comfort letter to its recipients would be, as a practical matter, eviscerated. Also, a comfort letter standard that precludes accountants from providing negative assurance within a comfort letter would effectively lower due diligence standards in European capital markets transactions below the norm for international capital markets transactions. Accordingly, for these and other reasons described in more detail below, we respectfully urge the FEE to reconsider the comfort letter paradigm it appears to be advocating and, in this connection, refrain from recommending a standard that would weaken the level of assurance provided by comfort letters delivered pursuant to current international market standards.

To facilitate the FEE's review of our comments upon selected Discussion Points in the Discussion Paper, we have included in this response letter the section numbering contained in the Discussion Paper and have set forth our responses and additional related comments to correspond with this organizational framework.

1. INTRODUCTION

Issue for Discussion 1:

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

The first model addressed in the Discussion Paper, which is described therein as a "mixture" between "agreed-upon procedures" and "assurance" engagements,

represents the generally accepted international market practice in which accountants either issue a SAS 72 comfort letter or otherwise furnish a letter that closely follows, both in form and content, SAS 72. As indicated above, we strongly urge that any European comfort letter framework not reject this paradigm in favour of the alternative model set forth in the Discussion Paper. The adoption of this alternative model, described in the Discussion Paper as "solely an 'agreed-upon procedures' engagement, as a result of which the reader has to draw their own conclusion and no assurance is expressed",[3] would, as a practical matter, significantly diminish the contribution that the auditing profession can bring to a securities offering and the attendant benefits of a comfort letter to its addressees and, ultimately, to the capital markets.

By way of example, we note that, in instances where the Regulation may require the inclusion of published quarterly or half-year financial information and the related review report appears in the registration document, the review report is not required to provide any particular standard of "assurance". It is therefore unclear whether such report would necessarily provide the same level of "negative assurance" obtained pursuant to a review under IRSE 2400 (i.e., a statement that "nothing has come to the auditor's attention based on the review that causes the auditor to believe the financial statements do not give a true and fair view (or are not presented fairly, in all material respects) in accordance with the identified financial reporting framework")).[4] Underwriters may nevertheless justifiably request that accountants perform such procedures as are necessary for them to provide such assurance, and these procedures would not necessarily generate a report of the sort which may be required to be included in the prospectus. Consequently, the coming into force of the Regulation has not necessarily rendered negative assurance in respect of quarterly or half-year financial information contained in a prospectus superfluous. Moreover, even if one were to assume that accounting professionals will uniformly (and without exception) strictly follow IRSE 2400 when they complete a review in respect of interim financial information and that such report will appear in the prospectus,[5] we see no reason why the negative assurance contained in an IRSE review report cannot be set forth explicitly in the comfort letter. We would note that this is the existing practice for comfort letters issued under SAS 72, whether or not a review report in respect of interim financials is included in (or incorporated by reference into) the registration statement.

Second, there will also be instances in which underwriters may reasonably request the issuer's accountants to perform a review of interim financial information that has neither been previously published nor is required to appear in the prospectus. This

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3 Discussion Paper, page 4.

4 International Standard on Review Engagements (ISRE) 2400, par. 27.

5 The text of paragraph 4 of the "Illustrative Example of a Comfort Letter" set forth in Appendix 1 of the Discussion Paper would appear to indicate that the FEE assumes this will indeed be the case. In this connection, we would note that the FEE appears to assume that the Regulation requires, if interim financials have been subject to a review, that the corresponding review report be included in the prospectus and offers this as a justification for eliminating "negative assurances" in respect of interim financial statements from comfort letters. We believe this assumption is unwarranted and that Member State capital market regulators may reasonably interpret Annex I – 20.6.1 and other corresponding provisions of the Regulation so as not to require inclusion in the prospectus of a review report in respect of interim financial statements under all circumstances, for example if those financial statements have not previously been published.

review may be in respect of either quarterly financial information or interim financial information of a shorter duration (e.g., a two or three-month "stub period") that the issuer may not want to include in the offering document to avoid, among other things, setting an undesirable precedent for future financial reporting. Of course, the decision not to include such interim financial information would require a determination on the part of both the issuer and the underwriters that it was not required to be included or otherwise material to investors, but once this determination were made there would be no need to include such financial information (or the related report) in the prospectus. In such circumstances, underwriters may, however, justifiably request the negative assurance contained in the review report (which, like the more recent financial statements themselves will not be included in the prospectus) be included in the comfort letter.

We also do not agree with the FEE's implied premise that in the absence of the inclusion of reviewed financial information in the prospectus, auditors cannot give negative assurance on Subsequent Changes. The negative assurance in respect of Subsequent Changes that is regularly given pursuant to current international market practice is substantially less than that provided under ISRE 2400 but nevertheless provides qualitatively more comfort than the mere "performance of agreed-upon procedures and the communication of the auditor's findings". One of the most important concerns of underwriters in conducting their due diligence efforts is to become reasonably satisfied that there have been no Subsequent Changes that could negatively affect the issuer's financial results or condition as disclosed in the prospectus. As the auditors are the party independent of the issuer most familiar with its accounting system and its internal control structure, they are uniquely well situated to (a) make inquiries of officials of the issuer who have responsibility for financial and accounting matters ("Financial Management") in respect of the change period, (b) obtain from Financial Management appropriate written representations to support the answers to these inquiries, (c) read the minutes of the issuer's shareholders, board of directors and any relevant committees thereof (such as the audit and risk control committees) and (d) read, to the extent applicable, monthly management accounts to be able, at the conclusion of these procedures, to provide "negative assurance" in respect of Subsequent Changes.

Although the negative assurance provided by auditors in respect of Subsequent Changes in no way constitutes affirmative verification of the absence of negative developments (and, as stated above, affords substantially less comfort that that provided under ISRE 2400), underwriters and selling agents can nevertheless take significantly more comfort in their due diligence efforts if they also have the negative assurance provided by the issuer's independent accountants than they would be able to derive on the basis of only their own inquiries.[6] Failure of auditors to provide negative assurance with regard to Subsequent Changes could therefore have an adverse effect on the ability of underwriters and other addressees of comfort letters to establish their due diligence defense. Furthermore, refusal of auditors to provide such negative assurance could ultimately harm the interests of investors in situations where underwriters request

[6] While underwriters will become familiar with an issuer's accounting policies during the course of their due diligence efforts, they simply do not (and cannot) possess the same degree of knowledge of the issuer's accounting system and its internal controls as the issuer's independent auditors.

the removal of potentially helpful disclosure due to lack of sufficient comfort on Subsequent Changes when such comfort could have been readily provided by the auditors.

Finally, adopting a comfort letter model that departs materially from existing SAS 72-based international market practice would regrettably impede efforts toward international harmonization in comfort letter practices and therefore contribute to uncertainty and inefficiency for both underwriters and issuers alike. Adopting a European comfort letter standard that would offer less than the customary level of comfort provided under a SAS 72 (or SAS 72-based) comfort letter would reduce the relative attractiveness of the newly adopted standard compared with other available standards and seem inconsistent with evolving standards of financial due diligence in capital markets transactions.

Issue for Discussion 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?

While we can understand the desire of accountants to enter into an engagement letter with their (issuer) client to formalize each party's understanding of the general scope of work to be performed in the context of delivering a comfort letter, we believe that it is neither appropriate nor necessary to require the underwriters to become a signatory to such agreement (or otherwise to execute a separate acknowledgment thereof). It is not appropriate for underwriters to sign the engagement letter because there is no contractual relationship between the accountants and the underwriters: although both the underwriters and the issuer derive direct or indirect benefits from the delivery of the comfort letter (and the work that goes into producing it), it is the issuer, not the underwriters, that engages the accountants to perform the related services. Furthermore, requiring underwriters to sign an engagement letter is unnecessary when underwriting agreements for securities transactions in Europe commonly include the agreed form of comfort letter as an annex, which generally reflects the expectations of the underwriters in a more precise fashion than set forth in an engagement letter. Indeed, our recent experience with European capital markets transactions has been that engagement letters are largely repetitive of the comfort letter itself, and having two separate documents may create the potential risk of contradictory statements made therein.

As to the items that an engagement letter ostensibly "normally covers" set forth in bullet-point form on the bottom of page 21 of the Discussion Paper, we would strenuously differ with the contention that such coverage include "**[**t**]**he underwriter's

responsibility to do due diligence appropriate to the offering and inform the auditor of any misstatements". As indicated above, underwriters should not be a party to the engagement letter and, in any event, should be under no obligation to inform the auditor of any misstatements. Furthermore, to the extent the underwriters may have an affirmative "responsibility" to conduct due diligence under the laws of certain Member States, such legal obligation is certainly not to the accountants, and the engagement letter should not reflect this incorrect assumption. The only representations that the underwriters should make to the accountants in respect of the conduct of their due diligence should be in the context of a representation letter, if applicable.[7]

Issue for Discussion 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?

No. In practice, the procedures followed in connection with the preparation of a comfort letter and the delivery of a comfort letter serve to further ensure that information is accurate and complete and that there are not differing levels of information. For example, if in the course of their engagement, accountants discover mistakes or omissions in the financial information included in the draft prospectus, such findings are as a rule reported to the issuer and, unless immaterial, are corrected in the offering document, thereby indirectly benefiting investors. In addition, if auditors are unable to provide negative assurance on the absence of Subsequent Changes because revenues significantly decreased in the "change period" (and instead report on such decrease in the comfort letter), this information would be material to an investor and ordinarily would be corrected and included in the prospectus in an appropriate fashion (if indeed the issuer and underwriters decide to proceed with the offering under such circumstances). However, providing negative assurance in a comfort letter in respect of the *absence* of Subsequent Changes assists the offering participants in concluding that the disclosure is accurate and complete and, in this context, the statement is not in itself material information.

[7] Please see our remarks to "*Issue for Discussion 5*" for our views on the circumstances under which a representation letter should be delivered by the underwriters to the accountants.

Issue for Discussion 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?

Yes, to the extent necessary to provide the appropriate negative assurances and to foster an open dialogue regarding the financial reporting and condition of the issuer. We do not comment on the assertion that auditor professional secrecy standards in certain European jurisdictions do not permit auditors from communicating with underwriters even after consent of their issuer client. We do, however, believe that it would be beneficial for all offering participants and, indirectly, for the investing public, for an auditor to request the issuer to relieve it of its applicable professional secrecy obligations to permit the accountants and the underwriters (and their counsel) to have and maintain an open dialogue, not only in respect of the comfort letter but also in connection with other aspects of their due diligence (including, in particular, due diligence on the issuer's financial statements, accounting policies and internal controls of its accounting system). This open communication between accountants and underwriters is critical to preserving the integrity of the due diligence process. We also believe that it ultimately serves to advance the interests of investors by facilitating the free flow of information between the parties involved in the drafting process, thereby contributing to the quality of the disclosure contained in the prospectus.

Issue for Discussion 5:

It is practice that the auditor only issues comfort letters to underwriters or other parties to the transaction that have a "due diligence defense" 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?

This Issue for Discussion refers to U.S. comfort letter practice, which is governed principally by SAS 72 . SAS 72 provides that accountants may provide a comfort letter to "underwriters" as such term is defined in Section 2 of the United States

Securities Act of 1933 (as amended, the "U.S. Securities Act") or to other parties with a due diligence defense under Section 11 thereof "in connection with financial statements and financial statement schedules included (incorporated by reference) in registration statements filed with the SEC under the **[**U.S. Securities**]** Act". Under SAS 72, accountants may also issue a comfort letter to a "broker-dealer or other financial intermediary", acting as principal or agent in an offering or placement of securities, in connection with securities offerings that include (but are not limited to) "foreign offerings, including Regulation S, Eurodollar, and other offshore offerings" as well as "transactions that are exempt from the registration requirements of Section 5 of the **[**U.S. Securities**]** Act, including those pursuant to Regulation A, Regulation D, and Rule 144A", provided that such broker-dealer or other financial intermediary provides a representation letter containing language similar to the language set forth in the boxed "*Issue for Discussion 5*" above.

SAS 72 therefore permits delivery of a comfort letter to parties with a "statutory due diligence defense". The U.S. concept of the "statutory due diligence defense" (as set forth in the U.S. Securities Act and clarified by the U.S. courts) is not readily importable into Europe given that there is no pan-European understanding of the type and scope of due diligence required for underwriters to establish their due diligence defense (whether it be "statutory" or other). That said, we believe that it would be sensible to clarify that any "underwriter" or other financial intermediary that participates in a securities offering on behalf of an issuer (whether as principal or agent in the offering) should be eligible to receive a comfort letter without requiring it to deliver the representation letter described above in so far as the offering is effected by use of a prospectus in compliance with the Regulation. We do not express any comment at this time as to whether other (non-underwriter) parties should benefit from a similar clarification.

Issue for Discussion 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?

For the reasons offered in our response to "*Issue for Discussion 1*", we strenuously challenge the assumption that "limited assurance"[8] may only be given on interim financial statements subjected to the procedures of an IRSE 2400 review (and in that case only in the underlying report and not in the comfort letter itself). Among other things, ISRE 2400 does not provide a standard for providing negative assurance in respect of Subsequent Changes, a critical element in a comfort letter delivered pursuant to current international market practice. In this connection, we would once again argue that by (i) making the relevant inquiries with (and obtaining the appropriate written representations from) Financial Management, (ii) reading the minutes of the issuer's shareholders and other relevant corporate bodies and (iii) reading, to the extent applicable, monthly management accounts that accountants can, generally reflected in current international market practice, provide negative assurance on Subsequent Changes without performing an ISRE 2400 review.

Pro Forma Information

We disagree with the first sentence of the subsection "Pro Forma Information" stating that "**[**a**]**uditors do not usually comment on pro forma information in the comfort letter". Our experience with European comfort letter practice is that comfort letters routinely address pro forma information where such information is included in a prospectus. In this connection, we would also point out that SAS 72 contains clear guidance (and specific examples of wording) on the relevant procedures to be followed for accountants to provide comfort on pro forma information.[9]

Responsibility and Liability

If a European standard were to provide for guidance in respect of governing law and jurisdiction, it should not mandate exclusive jurisdiction as litigation may arise in any number of jurisdictions. In the alternative, should a European comfort letter standard provide for exclusive jurisdiction of the courts of the Member State in which the issuer is organized, the comfort letter should at minimum clarify that if underwriters are sued in another jurisdiction that they will not be prevented from introducing the comfort letter as evidence in any action or proceeding in any court of competent jurisdiction, whether inside or outside such Member State.

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We appreciate the opportunity to comment to the FEE on the Discussion Paper, and we would be pleased to discuss any questions the FEE may have in respect to this letter. Any questions to this letter may be directed to David B. Rockwell

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[8] The term "limited assurance" as it appears it the Discussion Paper should be referred to as "negative assurance" in line with common usage in the comfort letter context.

[9] See AU § 634.42, 43 and Example "D" thereof.

(+44 207 959 8575) in our London office and Krystian Czerniecki (+49 69 42 72 5525) in our Frankfurt office.

Very truly yours,

SULLIVAN & CROMWELL LLP