20 September 2005

Fédération des Experts Comptables Européens
Avenue d'Auderghem 22-28
B-1040 Bruxelles
BELGIUM

Dear Sirs

**Re: FEE Discussion Paper on Comfort Letters issued in relation to Financial Information in a Prospectus**

The Institute of Chartered Accountants in England and Wales ("the Institute") is pleased to respond to your request for comments on the Discussion Paper on Comfort Letters issued in relation to Financial Information in a Prospectus ("the Discussion Paper").

In the Discussion Paper, FEE identifies three approaches to a comfort letter engagement issued in relation to financial information in a Prospectus:

1. continue the current practice of mixing agreed-upon procedures and assurance conclusions. This is at odds with the IFAC Framework for Assurance Engagements ("the Framework") and hence, as an IFAC member, the ICAEW is unable to support it;

2. turn the engagement into an agreed-upon procedures engagement, express no assurance and leave the readers to draw their own conclusion. This is consistent with the Framework; and

3. treat the engagement as a "non-assurance" engagement outside the Framework. For engagements to be outside the scope of the Framework, they need to meet the conditions in paragraph 14 (b) of the Framework, including "opinions, views or wording are merely incidental to the overall engagement" and "under a written understanding with the specified intended users, the engagement is not intended to be an assurance engagement". We are unable to support this position because the conditions are unlikely to be satisfied.

The discussion paper is based on the second approach. In principle, we support the position that FEE has chosen, even though this would mean that current UK practice might need to go through substantial changes.



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We would also like to stress that the scope of comfort letters in this discussion paper is limited to financial information in a prospectus. Our support for agreed-upon procedures may not necessarily be applicable to comfort letters issued in relation to other non-GAAP information such as working capital statements or an accountants' review of accounting systems and procedures where, for instance, a limited assurance engagement may be more suitable than agreed-upon procedures.

We are also conscious that the second approach may not be popular among users, in particular underwriters. We hope that FEE's consultation may establish whether this is the case and whether users make any compelling arguments of principle in supporting their view.

Finally, we would like to draw FEE's attention to paragraph 13 of the Framework as a possibility. This paragraph states that an assurance engagement may be a part of a larger engagement, for example, when a business acquisition consulting engagement includes a requirement to convey assurance regarding historical or prospective financial information. In the event of a deadlock with users, FEE may wish to consider whether this formula might be applied to a comfort letter engagement, applying ISRE 2400 or another relevant assurance standard on a specific segment of the comfort letter engagement that is otherwise an agreed-upon procedures engagement.

We attach our detailed responses to the specific questions raised, which we restrict to the material points that we wish to address. Our comments on issues which fall outside the questions asked are stated at the very end.

Please contact me should you wish to discuss any of the points raised in this response.

Yours sincerely

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**Attachment**

## ICAEW COMMENTS ON FEE DISCUSSION PAPER ON COMFORT LETTERS ISSUED IN RELATION TO FINANCIAL INFORMATION IN A PROSPECTUS

### 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?*

To date each jurisdiction has had its own reporting practice in terms of Comfort Letters. As noted in the cover letter, existing reporting practices may not necessarily conform to a specific reporting model, although this has not prevented them from functioning effectively. In the UK, reporting accountants have often followed existing approaches which are based on or derived from US SAS 72, and in particular the reporting approach to material changes, which includes a conclusion "whether the accountant has on the basis of work performed become aware of any increase or decrease in an agreed financial measure".

In the absence of specific standards on comfort letters internationally or at a European level, we believe the IAASB's structure of pronouncements provides a useful point of reference. In considering a model for comfort letter engagements, in principle, we support the approach adopted by FEE of treating a comfort letter engagement as an agreed-upon procedures engagement, expressing no opinion and leaving readers to draw their own conclusion.

We would also welcome further debate on the form of wording that can be used in an agreed-upon procedures engagement. For instance, we would welcome a debate on whether the form of wording highlighted above constitutes "assurance" over the entire information covered or is a form of summary of findings from agreed-upon procedures.

Finally, in providing assurance on financial information relating to periods after the date of the last audited accounts, we wonder if the use of ISRE 2400 is appropriate for comfort letter engagements. ISRE 2400 is clearly relevant to consideration of obtaining assurance on accounts taken as a whole, but it is less clear that it is intended to apply where the information is limited to the limited period and does not constitute full accounts. Ideally, we would welcome standard setters to develop a specific standard on comfort letter engagements.

## 2. COMFORT LETTERS

***Addressee***

*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?*

We believe it to be best practice for accountants to issue a comfort letter only to those who have signed the engagement letter.

In the UK, Standard for Investment Reporting 1000 (SIR1000) states basic principles where accountants are performing engagements in relation to investment circulars that are applicable to both public and other reporting engagements. Such basic principles include that the reporting accountants should agree the terms of the engagement and the terms of engagement should be recorded in writing. It is hence a necessary step to comply with the UK standard.

*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?*

Yes, potentially. It depends on the actual contents of the comfort letter, and whether it is considered that the findings of procedures performed on information in the prospectus are themselves 'information'. The question of whether a comfort letter can include any information which is not in the prospectus is clearly fundamental, since the parameters for drafting such letters will differ depending on the answer to this question.

The question has, however, been set on the basis that the bank/underwriter undertakes several roles. In the United Kingdom, that role is frequently split between two separate advisers. One function includes confirmation to the appropriate authority (which would include compliance with the Prospectus Directive) that the document complies with the relevant

requirements. In undertaking due diligence, the adviser needs to consider all relevant information, not merely that contained within the document. The second function, which may include marketing the security, needs to be considered separately.

The rules of the particular jurisdiction under which the responsibilities of banks/underwriters arise, and any provisions relating to the investigation which the banks/underwriters are permitted to undertake in order to establish a due diligence defence, will be relevant issues in answering the question. We consider that this may need further analysis/guidance from regulators in each jurisdiction.

*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?*

The question is not applicable in the UK. Unless specifically agreed between the parties, reporting accountants are authorised by the issuer to speak to engagement parties and other professional advisors advising on the proposed issue. In connection with the reporting accountants' work pursuant to the engagement, reporting accountants may also release to the engagement parties and other professional advisors any information relating to the issuer, whether confidential or not and obtained during the course of their work or otherwise.

*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 defence" and that they 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?*

Please see our response to Question 2.

In the UK, generally comfort letters prepared by reporting accountants are accepted in writing by the directors of the issuer and, where relevant, the sponsor.

***Reference to Auditing Standards***

*Issue for Discussion 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?*

In the UK although an audit base is considered preferable, there is no formal requirement to have an audit base in order to perform a comfort letter engagement.

The question of the need for an audit base requires consideration of what the audit base provides in the context of the comfort letter. Where the "comfort" letter is restricted to agreed-upon procedures, it is clearly an open question whether the factual findings of an accountant with an audit base would differ from the findings of an accountant without an audit base. At the same time, it may be questioned whether a responsible and prudent accountant would agree to perform procedures in relation to information if the accountant had actual doubts as to its validity. An accountant may find that an audit base is useful when assessing whether there is reason to doubt the validity of certain information to which the work relates, but the question will be influenced by the degree to which the audit work is relevant to the specific item of information in question. Where the audit base is not relevant, it would be illogical to consider it a requirement. It follows that an audit base per se is not necessarily required, but there is a case for the accountant having performed some additional work which provides a basis for distinguishing between information which derives from a system which prima facie provides control over its validity from information which is not supported by such a system.

A similar analysis applies in cases where assurance is to form part of the comfort letter. The accountant will need to ensure that the work performed as a whole supports the assurance to be given. Work performed in relation to an audit may or may not be relevant depending on the matters to be reported on and the nature and focus of the audit work. We note the assertion in the paper that "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". We assume that this is a reference to the practical issues in terms of time and costs which may be encountered where a firm does not have an existing familiarity with the issuer compared to a firm which does have that familiarity, and is not a statement that the firms cannot in principle get to a position of being able to give the same comfort.

On the basis described above, we disagree with the statement "(a) comfort letter should only be issued when the auditor has an audit base" (page 10). In addition, although it may be appropriate to refer to the standards followed to provide the comfort letter, because the work for the comfort letter is separate from any audit procedures, we do not agree with the illustrative wording set out in the paper (page 11). The wording suggested describes the standards adopted in connection with the audit of historical financial statements rather than the comfort letter. It is therefore inappropriate in the context of recording the basis for the comfort letter. The information which is contained in the illustrative wording will be available to banks/underwriters as a consequence of the published audit reports, and therefore even if it were thought to be information of interest to readers of the comfort letter, it is unnecessary for it to be repeated.

***Independence***

*Issue for Discussion 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?*

If the scope of comfort letters is limited to agreed-upon procedures and if a comfort letter is the only professional service the accountants provide, the independence section of the IFAC Code of Ethics need not be followed by the accountants. It is irrelevant to the question of applying independence standards that agreed-upon procedures are of an 'audit nature.' It is also not entirely clear what it means to describe the agreed-upon procedures as being of an 'audit nature'. Even if the procedures are of an 'audit nature', it does not follow that independence standards for an audit are relevant. However, the accountants are expected to highlight the fact to the client if they are not independent even though this does not need to be dealt with in any comfort letter.

If the comfort letter exercise is combined with assurance work, independence requirements applicable to that element of the work will be relevant. In any event, it is not necessary for the comfort letter to mention the independence of reporting accountants.

***Interim Information***

*Issue for Discussion 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?*

As we have stated in the response to *Issue 3*, we consider that it is largely a regulatory matter whether or not it is acceptable for underwriters to receive more information than investors. We do not however favour the provision of a review report on interim financial information in a comfort letter.

In relation to the interpretation of the Regulation, this is also primarily a matter for regulators. We consider that a reasonable interpretation of the Regulation's requirement is that where interim financial information has been previously published it must be reproduced in the prospectus. Where the published interim financial information was accompanied by a published audit or review report, the audit or review report also needs to be reproduced in the prospectus. We agree, however, that the Regulation seems to allow the issuer to choose not to publish interim financial information (if they are not otherwise required to do so).

***Subsequent Changes***

*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?*

We question the assertion made in the paper that assurance as to subsequent changes in specified financial statement items can only be provided by a review in accordance with ISRE 2400.

As stated above, it would appear to be possible, in principle at least, under the international framework, to provide assurance other than through an audit or review of historical financial information, albeit that fully developed standards may not yet exist in relation to significant changes. It may be possible for such assurance to extend to a cut off date which is after the most recent month end, but which would not extend to the date of the prospectus itself.

Where reporting accountants have performed a review of unpublished financial information for the purposes of providing comfort (although as noted above we do not favour the performance of such work), we do not consider that the report should be included in the prospectus.

*Issue for Discussion 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?*

Assuming that the reference to providing (limited) comfort in accordance with the IAASB Assurance Framework is a reference to providing assurance comfort, we agree that the key issues will be whether the management reporting derives from a system which incorporates appropriate controls, and whether the information is in agreement with the underlying accounting records.

The question of the contents of management reporting (e.g. whether at least an income statement and a balance sheet is required) will need to be assessed having regard to the subject matter of the comfort letter procedures.

*Issue for Discussion 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?*

We agree that as a general matter comfort should not be provided on assertions which do not have clear and unambiguous meanings, although in circumstances where there is agreement between the reporting accountant and the readers of the report as to the meaning of a term, it may be possible to give comfort on terms which, whilst not generally defined from the accounting standpoint, are defined for the purposes of the comfort letter.

ADDITIONAL COMMENTS

We note the illustrative example of a comfort letter contained in Appendix 1 to the paper. We have commented above that we do not consider that reference should be made to the auditing standards applied by a reporting accountant which is the auditor, nor to the independence of the reporting accountant. More generally, in relation to the example, we do not consider that the opening paragraphs (from the opening paragraph to paragraph 4) are relevant or necessary (since they do not record the work actually performed in providing the comfort letter). We believe that as the illustrative example purports to be issued in accordance with ISRS 4400, it should restrict itself to an illustration of the agreed upon procedures and findings as illustrated in ISRS 4400.