Deutsche Bank

Deutsche Bank AG
Taunusanlage 12
60325 Frankfurt am Main

To: Fédération des Experts Comptables Européens AISBL
Av. d'Auderghem 22-28
B-1040 Bruxelles

Recht/Legal
Dr. Andreas Meyer

Frankfurt am Main, August 9, 2005

Comments on the Discussion Paper „Comfort Letters Issued in relation to Financial Information in a Prospectus"

issued by the Fédération des Experts Comptables Européens, April 2005

General

In April 2005, the Fédération des Experts Comptables Européens (FEE) issued a Discussion Paper „Comfort Letters Issued in relation to Financial Information in a Prospectus" (the "FEE Discussion Paper"). In this context, it makes reference to the EU Prospectus Directive (the "Prospectus Directive") which the FEE has taken as an opportunity to propose a European framework for the issuance of comfort letters. Following the implementation of the Prospectus Directive, a single prospectus may now be used for placements in various European jurisdictions, as it is outlined in the introduction to the FEE Discussion Paper. However, offerings in various European jurisdictions are by no means something really new. Of course, the Prospectus Directive provides for new, pan-European requirements for the structure and contents of a prospectus used for the offering of securities and/or their listing on a regulated market in an EU Member State. However, placements to institutional investors across Europe on the basis of one single "international" prospectus have already been common practice before. For retail offerings, a system of mutual recognition was in place that had also been made use of. Thus, the impact that the Prospectus Directive might have on the comfort letter practice as it exists in leading European capital markets appears to be fairly limited, especially since the required scope of financial information to be provided and discussed in a prospectus should not change substantially.

Moreover, the prospectus liability requirements have not been changed at all. It might be regrettable that a harmonisation of the applicable prospectus liability rules was omitted. However, this leads to the fact that the requirements for the underwriters' diligence and their defense position in a prospectus liability lawsuit remain the same, being governed by the prospectus liability rules of the respective jurisdiction.

A closer look at the FEE Discussion Paper reveals, however, that its purpose might be a different one. Current practice has widely been based on the U.S. standard for comfort letters as set forth in the Statement on Auditing Standards (SAS) 72 issued by the American

Institute of Certified Public Accountants (AICPA). National standards, that were developed in the recent years, mostly took SAS 72 as a reference point, such as the German standard PS 910 issued by the Institut der Wirtschaftsprüfer in Deutschland (IDW) or the recommendation of the Institut Österreichischer Wirtschaftsprüfer in Austria. In those national standards, structure and content of SAS 72 as an internationally accepted standard were retained and only adjustments in detail made in order to appropriately consider peculiarities of the respective national legal environment.

In contrast, the FEE Discussion Paper constitutes a substantial setback both for underwriters and investors. The contents of the proposed comfort letter significantly fall short of what is customarily obtained at present in international capital markets transactions. The FEE Discussion Paper also appears to be based on an inaccurate understanding of the current market practice. It cannot be expected as being acceptable by the underwriting community. In a regulatory environment of increasing sensitivity for investor protection, the European auditing profession appears not to be interested in making an own contribution or at least uphold the level of co-operation that has been the practice so far. Rather, the predominant goal of the FEE Discussion Paper appears to be self-protection rather than granting services to clients. Thus, the auditing profession should carefully consider, also in its own interest, whether it is advisable to continue the approach evidenced by the FEE Discussion Paper.

In particular, we should like to comment as follows:

1. INTRODUCTION

In the introduction, the FEE Discussion Paper elaborates the dogmatic concept of a comfort letter. More specifically, the statements customarily made in a comfort letter are compared to the distinction in auditing standards between “assurance” and “agreed-upon-procedures” engagements. In this context, comfort letter engagements as they are customary in current practice are described as a “mixture” between “agreed upon procedures” and “assurance” engagements. The FEE Discussion Paper points out that this could cause difficulties in relation to the IFAC International Framework for Assurance Engagements. Thus, it proposes to consider the mandate to issue a comfort letter solely as an “agreed upon procedures” engagement. As a result, the addressees of a comfort letter, namely issuers and in particular underwriters would have to draw their own conclusions based on the factual findings reported by the auditors as a result of their procedures. This appears to be the essence of the proposed new concept. It would consist in a substantial devaluation of the contribution that the auditing profession can give to a securities offering. A mere reporting of factual findings without giving an assurance takes away most of the substance a comfort letter can offer beyond the auditor’s reports on audited or reviewed financials that, in most cases, will now have to be included in a prospectus anyway.

The reference to a current practice under which a comfort letter was just prepared on the basis of agreed-upon procedures and simply provided a report of factual findings with no expression of an assurance, leaving it up to the underwriters to assess those findings and draw their own conclusions therefrom is simply wrong and does by no means reflect the actual market practice. Rather, comfort letters usually contain a negative assurance covering the period from the date of the latest audited or reviewed financial statements until the so-called cut-off date. Therein, the auditor confirms that in the course of the procedures performed by him, nothing came to his attention that causes him to believe that certain predefined accounting line items have increased, decreased or changed. This is the core message contained in a comfort letter. In contrast, a comfort letter without such a negative assurance is accepted only on an exceptional basis. This is the case, for example, if since the date of the latest audited or reviewed financial statements 135 days or more have elapsed

(so called “135 day rule”). The usual request of underwriters to the issuer of securities to provide interim financial statements before the expiry of the aforementioned 135 day period shows the importance of this “negative assurance” to give underwriters sufficient “comfort” to go ahead with a securities offering.

Thus, the reluctance to provide assurance and the impression given by the FEE Discussion Paper that “comfort letters (…) *may also* involve assurance work” pretends that the aforementioned rule is an exception and not the other way around. This is not acceptable and should not become the basis for the issuance of comfort letters.

The FEE Discussion Paper further points out that it is a general principle for comfort letters that “*areas in the prospectus on which the auditor already reports are not subject to the procedures in the comfort letter*”. This could be understandable on the background of prospectus liability regimes where there is a specific liability of an expert for those sections of a prospectus “expertised” by himself (such as in the U.S. or in Switzerland). This, however is not the case in many European jurisdictions. In Germany for example, it is the common view in legal literature that an auditor is not liable to investors for his audit opinion included in a prospectus. Rather, as a result of the statutory provisions on the limitation of liability for statutory audit work, his liability to underwriters (who have to take responsibility also for those expertised sections towards the investors) is highly unlikely in general. This has been one of the reasons why, as a result of long negotiations with the underwriting community, the auditing profession in Germany developed so-called “post audit review procedures” (*Untersuchungshandlungen nach Erteilung eines Bestätigungsvermerks*) that enable auditors to give a substantive statement on audited financials without jeopardising the statutory liability concept for the statutory audit work. These procedures are the main added value IDW PS 910 offers to underwriters compared to a SAS 72 comfort letter (if issued in relation to a German offering). Thus, those procedures have become a commonly accepted and valuable tool for comfort letters. This concept should by no means be withdrawn as a result of a new European comfort letter standard. Rather, it should be a model setting new standards for other countries where no comfort letter standards exist yet.

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 (“*mixture of ‘agreed upon procedures’ and ‘assurance’ engagements*”) describes the current comfort letter practice as it has been customary and accepted for many years in Europe for international securities offerings. However, it does not appear appropriate to give the impression that this concept is technically “improper” by using the expression “*mixture*”. Rather, the customary comfort letter structure follows from the fact that the level of detail both of the financial information and of the measures that can possibly be undertaken in respect thereof typically declines towards the actual prospectus date. In particular, the period after the date of the latest annual financial statements until the prospectus date is usually covered by information with a lower level of detail than those statements. Also, there is usually less time available than necessary to perform an audit, so that this last period might be covered by interim financial statements that could be reviewed but not audited. To the extent that interim financials are not in place (as it is the case at least for the last couple of months or weeks before the prospectus date) such period can just be assessed by the reading of minutes and management accounts as well as inquiries of the issuer’s management. Those procedures usually form the basis of a “negative assurance” in relation to the development of certain key figures (the so-called “line items”). This stepped approach is a logic consequence of the factual situation just

explained and should be described as a "combination" of the different levels of procedures rather than a "*mixture*". It was established by SAS 72 that has become a comfort letter standard accepted worldwide. A deviation therefrom, as it is shown in the FEE Discussion Paper, would mean that Europe fell significantly short of those international standards. At a time when current market practice in performing due diligence, including financial due diligence, has come under increasing scrutiny by law courts in many jurisdictions (see for example the cases *WorldCom* in the U.S. and *EM.TV* in Germany), a reduction in the customary level of comfort granted in a comfort letter appears counter-productive, especially if it just seems to be based on conceptional, if not dogmatic concerns that had not been an issue for the auditing profession for many years.

Interestingly enough, the dogmatic concept that the FEE tries to introduce remains pretty unclear still. In particular, in connection with the use of the term "assurance" various types of "assurance" are used which have not been commonly known so far. It remains open what "*reasonable assurance*", "*limited assurance*" or "*private assurance*" actually mean and what the differences between those types of assurances are. Conversely, the known distinction between "positive assurance" and "negative assurance" [1] is not used.

2. COMFORT LETTERS

The FEE Discussion Paper sets out that underwriters request auditors to provide them with a "comfort letter" only in relation to unexpertised financial information. As explained, this is not an accurate description of the scope of a comfort letter in current market practice that also contains statements in relation to expertised sections, see above.

At least, the FEE Discussion Paper expressly asks auditors to follow national professional standards relating to comfort letters, where available. This is of paramount importance given the deficiencies of the FEE Discussion Paper. Where comfort letters under the existing standards, in particular SAS 72 and PS 910, have already been current practice (which is true at least for the most important European capital markets like, for example, the UK and Germany), the FEE proposal is by no means acceptable and is not suitable to replace the existing and accepted standards.

The FEE Discussion Paper further points out that it may help auditors in the performing of the procedures and the reporting in a comfort letter where no national standards exist. It should be emphasised that it may not help the addressees of such a letter since they have to face the fact that the comfort they receive is significantly less than what is obtainable under the standards in more developed markets.

2.2 The Comfort Letter

Addressee

The FEE Discussion Paper recommends that the auditor should be provided with a draft of the underwriting agreement "*to understand the context in which a comfort letter will be issued*". This is both uncommon and unnecessary. In order to obtain sufficient (background) information about the transaction, it is sufficient if the auditor will be provided with a (draft) prospectus.

---

[1] See for example AICPA Professional Standards, section AU §634.34.

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?

No. Requiring recipients of a comfort letter to sign an engagement letter is a concept that auditors had tried to introduce in the last couple of years in certain jurisdictions against the fierce resistance of underwriters. They have broadly been unsuccessful in doing so, except for comfort letters following the IPMA standard that, however, has a limited scope of application (stand-alone bonds under English law). To have such an engagement letter is also uncommon, if compared to other expert statements to be given to underwriters such as legal opinions by legal advisers. Further, it is not customary for comfort letters in the U.S. and, still, in many European jurisdictions. Engagement letters, like the example attached to the FEE Discussion Paper, commonly contain repetitive statements explaining the nature of a comfort letter where the comfort letter should rather speak for itself. This also brings about the risk of contradictions. The only reason for having an engagement letter with the underwriters that becomes apparent is the attempt to introduce a hidden limitation of liability. This, however, is not acceptable to underwriters since they are liable with out any limitation of liability themselves. Also, it is uncommon in international offerings, in particular in offerings involving a placement in the U.S.

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. The comfort letter as understood in current market practice is just a confirmation that gives the issuer and underwriters a certain “comfort” that also from the auditor’s perspective the financial information contained in a prospectus is accurate. Thus, it does not disclose additional information. Rather, it is only a tool (among others) to ensure that the information disclosed to the public is correct, complete and not misleading. If, on an exceptional basis, specific findings are reported in the comfort letter, they should be immaterial and thus not relevant from an investor’s perspective.

Further, it is unclear what the reference to a “*private*” comfort letter is supposed to mean. So far, we are not aware of a distinction between a “private” and a “public” comfort letter.

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. The relief of an auditor of his professional secrecy obligations by an issuer is a crucial precondition for a securities offering. The auditors must be in a position to have a full and frank discussion with the underwriters (not only in relation to the comfort letter but also in connection with their support of the due diligence conducted by the underwriters). This is also an important help to the underwriters in their role as "gatekeepers" to the market in order to protect investors.

In turn, if an issuer rejected to relieve an auditor from its professional secrecy, this would have to be considered as a sign of alarm for underwriters. If an auditor contributed to the offering nevertheless, thereby withheld information from the underwriters and in doing so prevent them from being recognised in the preparation of the prospectus, he would run the risk of assisting an issuer in defrauding the market. Thus, the auditor himself should have an interest in being relieved from his professional secrecy obligations.

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 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?

There should not be any specific conditions as to the recipients of a comfort letter. In particular, anyone who might be held responsible for the contents of a prospectus should be a possible addressee of a comfort letter to be able to use it for its legal defense. The question raised under "Issue for Discussion 5" is based on an assumption that is factually wrong. It describes a principle that is only known under the U.S. standard SAS 72 and mixes two different concepts contained therein. According to SAS 72 accountants may firstly provide a comfort letter to underwriters or other parties with a statutory due diligence defense under section 11 of the U.S. Securities Act of 1933 (the "Act"). Secondly, it may also be addressed to parties not having a due diligence defense if they provide a representation letter. The same applies if a comfort letter is issued to a broker-dealer or other financial intermediary in a foreign offer-

ing under Regulation S or a transaction exempt from the registration requirement under the Act.[2] Whether such a representation letter needs to be obtained from underwriters in a 144A offering as well, appears questionable but underwriters are regularly asked for it.

However, given the role of underwriters in a securities offering, it is beyond dispute that they need some assurance, irrespective of what kind of defence under what legal concept is available to them. Underwriters take a placement or underwriting risk in securities offerings, they take a liability risk and a reputational risk as it is them who are responsible for the actual placement of securities with investors. Thus, it is obvious that they have a legitimate interest in obtaining assurance from the auditors, who are the appropriate experts in the area of financial information.

Auditors had tried to introduce the concept of obtaining "representation letters" also in connection with comfort letters under the European standards developed on the basis of SAS 72. They have not been successful in doing so. Such a requirement is not found in IDW PS 910 where it had been discussed but dropped before the publication of the final draft (and accordingly is not contained in the final version). A "SAS 72 look-alike" representation letter is contained in the recommendation of the Austrian profession,[3] but – as a matter of fact – it has simply not been accepted in the market. The reason is twofold. A specific "statutory due diligence defense" comparable to Section 11 of the Act is unknown in Europe, nor is there concretised understanding as to what sufficient due diligence is. Further, there is no direct auditor's liability towards investors in many European jurisdictions. In other words: the legal concepts on which the U.S. restrictions in relation to the addressees of a comfort letter are based, do not exist in European jurisdictions.

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?

An audit base should not be required. There may be circumstances where a comfort letter will have to be issued by an auditor who had not done an audit of the issuer's financial statements before. Apart from the situation in Greece mentioned above, this could for example be the case if the issuer had appointed a different auditor for the

[2] See AICPA Professional Standards, section AU §634.03 and 04.

[3] Empfehlung des Instituts Österreichischer Wirtschaftsprüfer für die Durchführung von Arbeiten im Zusammenhang mir der Ausfertigung eines Comfort Letter, item 4.2

next business year. It appears unlikely that the auditor who had just lost the issuer's mandate will be willing to issue a comfort letter. Requiring that former auditor to issue a comfort letter might in fact prevent a company from accessing the capital markets for more than a full year until the new auditor completed his audit work. This seems inappropriate. It is understandable, though, that an auditor who cannot base his comfort letter work on the experience made in connection with his previous audit and his familiarity with the issuer's accounting systems might have to do some extra work to become sufficiently confident to issue a comfort letter. However, as in the case of a first audit, this should not create irresolvable difficulties in issuing a comfort letter.

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?

The introduction of explicit independence requirements does not appear necessary if the general independence requirements for audit work apply mutatis mutandis.

A section on independence is already common practice under the existing comfort letter standards (usually section 1). This practice should be continued.

Level of Comfort

The elaborations in the "level of comfort" section appear quite irritating. Based on the understanding of the term "comfort" in current market practice, "comfort" and "assurance" are no contradictions. Rather, "comfort" in itself is not understood as a certain level of quality of an auditor's work. Rather it comprises different levels of "comfort" that can be reached by various types of professional work by an auditor. This is also reflected in the customary "circle up" section where symbols or (more common) letters, used to mark certain numbers in a prospectus, are allocated to different "levels" of comfort. Each of these levels is based on a different type of an auditor's work, such as audit, review or certain agreed-upon-procedures such as comparing to accounting records.

Agreed upon procedures

As already pointed out, the description of the nature of a comfort letter is by far not consistent with the understanding of a comfort letter in securities offerings both in Europe and in the US. In particular, the FEE apparently fails to understand that the customary negative assurance in relation to the "change period" between the date of the latest audited or reviewed financial statements and the Cut-off Date is one of the most important statements in a comfort letter. Underwriters hardly ever accept a comfort letter without such a negative assurance. Thus, it is also not consistent with current market practice that "*the auditor simply provides a report of the factual findings of agreed-upon procedures*" and that "*no assurance is expressed*". Also, it is not true that *„users of the report assess for themselves the procedures and findings reported by the auditor and draw their own conclusions from the auditor's*

work." If this were the case, the most valuable contribution of auditors to the preparation of a prospectus and the verification of the statements therein would be questioned. This would mean a severe setback in the attempt of underwriters to achieve a higher quality of capital markets information, also by involving experts like auditors.

Review

It appears odd that the FEE Discussion Paper refers to "*limited*" assurance as the result of a review, in particular under ISRE 2400. The term commonly used for the professional statement that is usually the outcome of a review is "negative assurance". This is the expression that has been customary for a long time in connection with review engagements.[4] It is still being used in the new review standard ISRE 2400.[5] Interestingly enough, nowhere in ISRE 2400 the term "limited assurance" appears.

The statement "*under ISRE 2400 (previously ISA 910), limited assurance can only been provided if the related figures have been subject to a review*" is also misleading. It neglects the fact that ISRE 2400 is a standard for "review engagements", but not a conclusive standard on the conditions to be met in order to put the auditor in a position to issue a negative assurance. As said, comfort letters usually and in accordance with the standards presently existing contain a negative assurance for the period from the date of the latest audited or reviewed financial statements until the Cutoff date, based on agreed-upon-procedures.

Other than indicated in the FEE Consultation Paper, it is not required under the existing comfort letter standards that interim financial information need to be audited or reviewed and a separate(?) report to be issued on these financial statements in order to enable the auditor to issue such a (negative) assurance on subsequent changes occurring up to the date of these financial statements. Rather, it depends on the actual timing of the comfort letter and the application of the so-called 135 day rule in that regard.[6]

Interim Information

Issue for Discussion 8:

The FEE Discussion Paper takes the position that any interim financial information that has be 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?

Annex I item 20.6.1 requires the issuer to include in the registration document quarterly or half yearly financial information since the date of its last audited financial statements if it has published such financial information. If this interim financial infor-

4 For example IFAC Handbook 1999, ISA 910, item 23.

5 For example ISRE 2400, item 3.

6 AICPA Professional Standards, section AU §634.47; IDW PS 910, item. 4.8.3.1., margin no. 73 et seq.

mation has been reviewed or audited, the audit or review report must also be included. It is commonly understood that this latter requirement does not apply if the issuer had prepared interim financial information on a voluntary basis that were not published yet.

The auditing profession should not impose stricter prospectus disclosure rules than required by the competent authorities. Also, as already pointed out, the assumption that a review report might constitute (insider) information that needs to be disclosed to an investor shows a remarkable misunderstanding of the actual nature of such a report and its purpose in connection with a securities offering. The report is just a confirmation of the accuracy of the financial information covered thereby, but does not contain any additional factual information relevant for the assessment of the issuer. Thus, there is no reason to include it under general prospectus disclosure rules.

Subsequent Changes

This section mostly deals with issues relation to the review of financial information. Those should rather be discussed in the previous section "interim information". That said, the following should be noted:

Whether a review opinion has been included in the prospectus or not, does not have any relevance for the comfort letter. Moreover, at least in jurisdictions where the inclusion of professional statements of an auditor does not trigger the auditor's liability, the underwriters should be able to ask for the review opinion to be part of the comfort letter as well in order to ensure that the auditor is responsible to them for the contents of such an opinion. This is in particular appropriate when the underwriters themselves are liable for the correctness of the entire prospectus, including any financial information contained therein.

It is not in line with market practice and would constitute a major and unjustified setback if, for the residual period not reviewed, assurance could no longer be provided (see above). Agreed-upon procedures mentioned, namely reading of minutes of the board and shareholders' meetings, and enquiries to management as well as on the basis of the reading of monthly management reporting should still constitute a sufficient basis therefore.

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?

The FEE Discussion Paper mixes several different levels of the stepped approach on which the various established comfort letter standards such as SAS 72 or IDW PS 910 are based. Under those standards and, as a consequence, in current practice, a negative assurance, based on agreed-upon-procedures specified in the comfort letter, covers the change period after the date of the latest audited or reviewed fi-

nancial statements until the Cutoff date. As said, this principle has proved to be a useful approach and should not be changed.

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?

Since a negative assurance has been possible under the applicable comfort letter standards even if there are no monthly reports at all, it appears counter-productive to impose additional criteria for a (negative) assurance in the future.

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?

Yes.

Tables, Statistics and Other Financial Information

As part of the so-called "circle-up" or "tick-and-tie" procedure it is common practice that an auditor compares certain items in a prospectus with schedules prepared by the management of the issuer. This practice should be upheld.

Narrative Description of GAAP Differences

The proposed wording deviates from market practice and is unclear. In particular an auditor who had audited an issuer's IFRS financial statements should be able to identify all IFRS accounting policies applicable to those financial statements and, as a consequence, should not state the opposite. Further, the GAAP discussion should not only be compared to the notes of the respective financial statements but rather to the respective GAAP requirements themselves.

Financial Forecasts

It is not true that auditors do not comment on forecast information in the comfort letter. Rather, SAS 72 (for example) even expressly provides guidance in that regard.[7]

[7] AICPA Professional Standards, section AU §634.44.

Pro Forma Information

Unfortunately, the statement in the FEE Discussion Paper that "*auditors do not usually comment on pro forma information in the comfort letter*" is also wrong. Both the U.S. standard SAS 72 and the German standard IDW PS 910 provide for the respective wording and procedures.

Also, the requirements of the Prospectus Regulation 809/2004 are not accurately reflected. If pro forma financial information needs to be included in a prospectus according to no. 20.2 of Schedule I of the Prospectus Regulation, it must be accompanied by a report prepared by an independent accountant or auditor.

In order to ensure the auditor's responsibility for his statement on those pro forma financials, there is still a need from an underwriters' perspective to obtain comfort in that regard in a comfort letter (see above).

Other Information

The comfort in relation to the statement of capitalisation and indebtedness would usually be provided in the course of the "circle up" or "tick-and-tie" procedure. If the amounts contained therein have not been derived from audited or reviewed financials they would usually receive the level of comfort

> "*compared the amount with the corresponding amount contained in the Company's accounting records (neither audited nor reviewed by us) and found the amounts to be in agreement, except for rounding*" or
>
> "*recomputed the amount for arithmetical accuracy based upon amounts contained in the Company's accounting records (neither audited nor reviewed by us) and found the amounts to be in agreement, except for rounding*".[8]

This is widely accepted and regarded as necessary but also sufficient. There is no need at all to change this practice.

Restriction on Use

The restriction on use language proposed in the FEE Discussion Paper is broadly in line with the current practice and the existing comfort letter standards. However, the clause "*as being responsible for the content of the prospectus*" is unnecessary and unknown under SAS 72. Admittedly, though, similar wording can be found in IDW PS 910. However, this has been widely criticised and the auditing profession has not been able to explain the legal grounds therefor.

Responsibility and Liability

Interestingly, under SAS 72, choice of law and jurisdiction are not dealt with in a comfort letter. If a choice of law and a jurisdiction clause are inserted nevertheless (as it is the case under IDW PS 910), an exclusive venue is not appropriate. It should be possible for underwriters that are sued by investors on the ground of prospectus liability to call in the auditor in

[8] See the template for a comfort letter in: Appendices to IDW PS 910, Example 2.2.

order to support them in defending the action. Under civil procedure laws, this might be impossible if the forum of that trial is different from the exclusive venue referred to in the comfort letter.

Date and Signature

The "cut-off date concept" is common practice for comfort letters. However, such cut-off date is not referred specified in the underwriting agreement but rather in the comfort letter itself (since it is only relevant for the purposes of the comfort letter). While SAS 72 also uses a cut-off date five days before the date of the comfort letter as an example,[9] IDW PS 910 refers to a cut-off date one to three working days before the date of the letter.[10] The latter seems preferable. Since the addressees of a comfort letter, in particular the underwriters, are responsible for the accuracy and completeness of a prospectus as of its date, the gap between the cut-off date and the prospectus date (usually identical with the comfort letter date) should be as short as possible.

4. ENGAGEMENT LETTER

We agree that engagements of auditors are based on different terms in different legal environments. This also applies for the issuance of comfort letters. It appears to be common practice that an issuer mandates its auditor to issue a comfort letter on the basis of an engagement letter. However, it is uncommon to include the further recipients of a comfort letter into the mandate or even to make them a party to an engagement letter. Any reference to different kinds of engagements are not relevant since they do not consider the peculiarities of a comfort letter that is exactly made for the very purpose of supporting an underwriter's due diligence defense in connection with securities offerings.

Rather, as it is the case with the other confirmations from third parties like legal opinions, the comfort letter should contain all relevant statements itself and should not be qualified or explained by any other side documents.

As regards the description in the FEE Discussion Paper of the issues "normally" covered by an engagement letter, it has to be emphasised that an engagement letter for the issuance of a comfort letter does not contain any responsibilities for the underwriters. They are usually not a party to the engagement letter and there is no reason for them to be made a party thereto. Also, they do not owe any duties to the auditor, in particular not any kind of due diligence or reporting. The underwriters perform the procedures they deem appropriate themselves under the circumstances given. Interestingly, no other advisers that are asked to contribute to the preparation of a prospectus require such a statement of responsibility, in particular not legal counsel who customarily issue opinions to the underwriters and are thus in a similar position to the underwriters as an auditor when issuing a comfort letter.

As regards the determination of the procedures to be employed, in reality the determining factor is the auditors' ability and willingness to make certain statements rather than the guidance given by non-expert recipients. The auditors typically define what they believe they are able to say on the basis of their professional standards. It is also unusual in this context to mention a "regulatory body" as recipient of a comfort letter.

---

9 AICPA Professional Standards, section AU §634.23.

10 IDW PS 910, item 4.13.2, margin no. 108.

The FEE Discussion Paper further recommends that the auditor should get a draft of the underwriting agreement to make sure it can comply with its terms. This is irritating since the auditor is never a party to the underwriting agreement and, thus, no duties arise form that agreement that the auditor will have to comply with. Again, there is no need for the auditors to receive a copy of the underwriting agreement as it does not have any impact on their actual work.

APPENDIX 1 – ILLUSTRATIVE EXAMPLE OF A COMFORT LETTER

The following comments are meant to supplement the remarks already made above.

Preamble

It is not appropriate to make reference to ISRS 4400. The comfort letter does not only consist in agreed-upon-procedures. Also, there are specific comfort letter standards in place like SAS 72 or IDW PS 910 that give detailed guidance and form a more suitable basis for the issuance of a comfort letter.

No. 3

The reference to "post audit review" procedures as they are well established in Germany under IDW PS 910 is missing.

No. 4

The negative assurance based on the review engagement is missing.

No. 6

The second sentence is unusual and not relevant for the auditors' work. Thus, it should be deleted.

No. 7

As usual, reading of the minutes must extend to all existing governing bodies and/or committees of the issuer.

The inquiries under "a. (ii) (2)" seem to be redundant since those changes should be reflected in the management accounts referred to in the same paragraph.

Also, in no. 7a, an own conclusion by the auditor is missing that is usually given in the form of a "negative assurance".[11] A mere repetition of the statements made by the management in relation to the changes in the period covered by the management accounts, as proposed in the FEE Discussion Paper is not adequate. It lacks any own statement by the auditor and thus significantly falls short of the comfort given by the usual "negative assurance".

The same applies to 7b. Also, the concept of just only reporting of changes above a certain threshold is uncommon and gives the banks less certainty as to the relevance of a change.

[11] IDW PS 910, item 4.8.3.2, margin no. 78; AICPA Professional Standards, section AU §634.64, Example A no. 4b and 5b.