

July [] 2005

Ms. Hilde Blomme
Director of Practice Regulation
Fédération des Experts-Comptables Européens
Secretariat
Avenue d'Auderghem 22-28
1040 Brussels
Belgium

Dear Ms. Blomme

We appreciate this opportunity to comment on the discussion paper *Risk management and Internal Control in the EU* as developed by the Fédération des Experts-Comptables Européens (FEE). We believe that this is a timely paper, given the current proposals by the European Commission and early experience of the Sarbanes-Oxley Act.

1. Do you agree with FEE that there is a need to promote discussion and evidence gathering to encourage coordination and convergence of the development of risk management and internal control at EU level? If not, please explain.

We agree that there is a need to promote discussion. The current proliferation of different reporting requirements in Member States may serve as a barrier to integration of European capital markets, burden companies with securities traded on exchanges on several markets as well as confusing investors. We would welcome the development of common overriding principles.

2. Do you consider it appropriate for the public policy on risk management and internal control in the EU to focus on listed entities and the needs of their shareholders? Alternatively, do you think that there is a pressing need to deal with issues relevant to a wider range of entities and stakeholders? If so, please explain.

We believe it is appropriate to focus on listed entities (those with securities admitted to trading on a regulated market). Whilst reporting on internal control by directors and/or auditors may be useful to shareholders, the cost may outweigh the benefits to shareholders of small and medium sized entities.

3. Do you agree with FEE that the case for introducing any regulation related to risk management and internal control should have regard to: the business case for risk management; the advantages of principles-based requirements; the distinctive features of listed companies; the primacy of those charged with governance; and reasonable liability? If not, please provide details.

We strongly support a principles-based approach which allows companies to respond to their own circumstances without mandating detailed requirements. Whilst early US experience of the more detailed rules implementing s404 of the Sarbanes-Oxley Act has shown benefits to businesses by leading to improvements in internal control, there remain concerns about the level of prescription and costs of compliance. In particular, recent releases from both the SEC and PCAOB have acknowledged that there has been a focus on detailed compliance at the expense of focussing on the significant risks relevant to a company.

We agree that the primary responsibility for risk management and internal control rests with those charged with governance. We also agree that the reasonable liability of those charged with governance needs to be assessed having regard to the fact that good governance involves the management, rather than avoidance, of risk.

4. Are there overriding principles additional to those identified by FEE in Sections 3.1 to 3.5 that are relevant to risk management and internal control? If so, please explain.

No.

5. Is the matrix for analysis presented in Figure 1 in Section 4.1 clear and useful? If not, please explain why not.

The matrix for analysis is helpful in analysing the activities undertaken by companies in respect of risk management and internal control.

6. Is there any need to develop an EU framework for risk management and internal control? If so, how would you address the concerns about resources and benefits identified by FEE in Section 4.2?

We do not support the development of a separate EU framework, particularly given the European Commission's support for global standards in other areas. We acknowledge that a global framework may be appropriate, but there is not currently any global standard-setter in this area. We believe that the key principles of any new framework are unlikely to differ significantly from those in COSO, Turnbull and CoCo, which already have much in common. Companies should be allowed to apply any appropriate framework provided that they disclose which one they have applied, together with the degree of compliance with that code and explanation of any non-compliance. This is consistent with the EC's current proposals with regard to wider corporate governance requirements set out in the proposed revisions to the 4th and 7th Company Law Directives.

7. Do you agree with FEE's disclosure principles for risk management and internal control set out in Section 4.3? If not, why not and are there additional factors that should be considered?

We believe that any disclosure requirements for companies should be flexible enough to allow the company to provide information which meets the needs of investors.

Disclosures should also focus on significant issues rather than confirming compliance with detailed policies and procedures. This is again consistent with the SEC and PCAOB's response to the first year of s404 where they have indicated that work should be concentrated more on the overall control environment and less on detailed control and monitoring activities.

8. Do you agree with FEE's proposal that there should be a basic EU requirement for all companies to maintain accounting records that support information for published financial statements? If not, why not?

We agree. As similar laws exist in almost all member states, such a European requirement would be an important principle to reinforce the European Commission's proposals to clarify the directors' responsibility for the financial statements whilst not significantly increasing the burdens on companies.

9. Do high level criteria need to be developed to promote meaningful descriptions of internal control and risk management as envisaged by the proposal to amend the Fourth and Seventh Directives? If so, who should develop the criteria and if not, why not?

We believe that high level criteria should be restricted to key principles and not mandate detailed disclosures.

The implementation of the Modernisation Directive will require companies for the first time to describe in their management report the principal risks and uncertainties that it faces in a balanced and comprehensive way consistent with the size and complexity of the business. The key elements of any description should be limited to:

- acknowledgement by the directors of their responsibility for risk management and internal control and an explanation of the limitations of any system of internal control, in that it is designed to manage but not eliminate risk;
- a high-level explanation of the process used to identify and evaluate the risks which the company is already required to disclose by the Modernisation Directive and the controls in place to respond to such risks; and
- a description of any actions being taken to deal with internal control aspects of any material problems disclosed elsewhere in the financial statements.

We believe that such disclosures will not be a significant additional burden on companies as the majority of them will already wish to disclose what they are doing to manage the risks they are required to describe in the management report. Indeed, companies who do not make such disclosures are already likely to be questioned by investors as to their efforts in this area.

We support the recommendation not to move early to public disclosures of effectiveness over control in financial reporting until there is more evidence as to the costs and benefits of this

approach in the United States and time for other recent initiatives in various Member States including France, Sweden and the Netherlands to be evaluated.

10. What role should regulatory requirements play in promoting improvement in risk management and internal control?

We believe that regulatory requirements should be limited to disclosure obligations for companies. Market response to disclosures has already been shown to lead to improvements in risk management and internal control, as confirmed in responses to the recent UK and Ireland consultation exercise on revisions to the Turnbull guidance. This is also consistent with the European Commission's 'comply or explain' approach to compliance with corporate governance codes included in the proposed revisions to the 4th and 7th Company Law Directives.

11. Do you agree with FEE's identification of the issues for consideration by listed companies and regulators set out in Section 5.5? Are there any other matters which should be dealt with?

We agree with FEE's identification of the issues.

12. What views do you have on the issues for consideration discussed in Section 5.5?

1. Issues related to managing risks

We agree that any new requirements should have sufficient lead time to allow them to be embedded into the business, and that disclosures in earlier years may properly be limited to a description of the steps being taken to do so.

2, 3 and 4. Issues related to disclosures of overall process, management of specific risks and effectiveness conclusions.

See our response to question 7 above.

13. Do you consider that the current financial statement audit provides adequate assurance to investors in respect of internal controls over financial reporting? Please explain your response.

No. An audit under International Standards on Auditing is designed to lead to an opinion on the annual financial statements, rather than on the system of internal financial control.

14. Should new disclosures related to risk management and internal control be subject to external assurance? If so, why, and should this be as part of an integrated financial statement audit as in the United States?

We believe that the development of assurance on disclosures related to risk management and internal control should mirror the implementation of such disclosures, and that there is merit in encouraging companies to voluntarily request limited assurance on entity-wide internal control,

without mandating assurance or forcing it to be as detailed as that envisaged by PCAOB Auditing Standard 2.

15. What do you see as the principal priorities in the possible development of new forms of assurance related to risk management and internal control?

Assuming that companies make descriptive disclosures about risk management processes and internal control, we believe that the priority in this area will be the development by the IAASB of a suitable International Standard on Assurance Engagements (ISAE) to underpin the overall ISAE 3000 to provide limited assurance in this area. This will allow for an approach consistent with the International Standards on Auditing which are to be introduced under the proposed 8th Company Law Directive.

We do not believe that development of international standards for an 'integrated audit' similar to the US Public Company Accounting Oversight Board (PCAOB) Auditing Standard No. 2 should be a priority until there is more evidence of the costs and benefits of the US approach.

In addition, do you have any other comments on this discussion paper not covered by the specific questions reproduced above?

We have no additional comments to raise.

We would be pleased to discuss our letter with you or your staff at your convenience. If you have any questions, please contact [] at [number/email].

Very truly yours,

/s/ Deloitte Touche Tohmatsu