

The Auditing Practices Board

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18 October 2004

Mr Fabrice Demarigny
Secretary General
The Committee of European Securities Regulators
11-13 avenue de Friedland
75008 Paris
FRANCE

[Letter posted directly to the “consultations” section of CESR’s website www.cesr-eu.org]

Dear Mr Demarigny

CESR’s recommendations for the consistent implementation of the European Commission’s Regulation on Prospectuses No. 809/2004. Consultation Paper, June 2004.

The Auditing Practices Board (APB), of the United Kingdom and Ireland, welcomes the opportunity to comment on CESR’s important consultation paper dealing with the implementation of the Prospectus Regulation (809/2004).

The APB is responsible for leading the establishment of standards of auditing, in the United Kingdom and Ireland, so as to enhance public confidence in the auditing process and the quality and relevance of auditing services in the public interest.

In 1997 the APB published two “Statements of Investment Circular Reporting Standards” (SIRs). SIR 100 Investment Circulars and Reporting Accountants establishes general principles for the work of reporting accountants common to all engagements dealing with investment circulars. SIR 200 Accountants’ reports on historical financial information in investment circulars establishes specific principles for engagements dealing with historical financial information.

The APB is in the process of:

- (a) Updating SIRs 100 and 200 to reflect the changes to the UK and Irish Listing Regimes arising from the implementation of the Prospectus Directive, the Prospectus Regulation and the Level 3 CESR recommendations that are the subject of this comment letter; and
- (b) Developing two additional SIRs to address prospective and pro forma financial information, respectively.

In drafting this response we have drawn on our experience of working with the UK and Irish Listing Rules relating to the work of auditors and independent accountants. Our comments arise directly from our Standard setting activity and we have not attempted to respond in a wider capacity.

The Consultation Paper poses a number of questions, many of which are outside the ambit of the APB. For convenience, therefore, we summarise the main concerns of the APB in this letter and cross-refer to the relevant paragraphs in the Consultation Paper.

Need for more accounting guidance (50) (85) (92)

The APB welcomes the inclusion of a limited amount of accounting guidance in the proposed CESR recommendations. However, to achieve the consistent application of the CESR recommendations the APB believes that more detailed guidance is needed in the following areas. To be effective the APB believes that this guidance ought, ideally, to be issued on a pan-European basis by an authoritative body.

Profit Forecasts or Estimates: Paragraph 44 refers to certain principles that need to be taken into consideration by preparers when profit forecasts are being compiled. The APB is of the view that this guidance needs substantially more development. Chapter 3 of “Principles for the Preparation of PFI” published by the Institute of Chartered Accountants in England & Wales (ICAEW) provides guidance to the degree of detail considered appropriate by the APB.

Pro forma financial information: Paragraphs 93 to 95 provide helpful guidance for those who are required to prepare pro forma financial information, but needs further development. As the current requirements in the United Kingdom relating to the preparation of pro forma financial information are similar to the CESR proposals, the ICAEW guidance, published in 1998 in Technical Release 18/98, may usefully be developed on a European basis. In addition, the guidance should clarify the timing of transactions to which the requirements apply – in paragraph 94 the reference is to a “current” transaction, but elsewhere (including in the recitals of the Regulations) reference is made to “a particular transaction”. We recommend that the guidance should indicate that relevant transactions are those that have occurred since the date at which the latest financial information included in the document has been drawn up.

Adjustments to previously audited financial information: Meeting the requirements of the Prospectus Regulation with respect to historical financial information is likely to require adjustments to be made to previously published financial statements. Our experience is that there is a need for guidance both with respect to those adjustments that it is appropriate to make, and those adjustments that it is inappropriate to make. Inappropriate adjustments might be “notional adjustments” to make the “track record” more consistent with the issuer’s expected operations or structure following the transaction. In SIR 200, the APB provides limited guidance on these matters. However, under the Prospectus Directive regime adjustments to the financial statements are the responsibility of the issuer rather than the independent accountant. The APB strongly concurs with the issuer being responsible for adjustments. Issuers will, however, need guidance and APB is of the view that the CESR recommendations will be seriously deficient if guidance on adjustments is not included, or provided elsewhere on a pan-European basis.

Complex financial histories: The CESR recommendations seem to be based on the assumption that the financial information to be disclosed in a prospectus will relate to a company that has previously been audited. Our experience is that many prospectuses need to address more complex situations (eg “carve outs” where the financial information formed only part of the totality of previously published information). As presently drafted the proposed CESR recommendations contain no guidance with respect to the content of historical annual financial information where there is a complex financial history.

The APB is of the view that the CESR recommendations will be deficient if appropriate accounting guidance for these circumstances is not provided.

Selected Financial Information (30)

Companies often wish to include non-statutory financial information in a prospectus. The APB supports the position taken in paragraph 25 but believes that this should be supplemented with a statement that non-statutory financial information should not be given greater prominence than the actual historical financial information. The APB notes that there is an overlap between paragraphs 25 and 102 on “Financial Data not Extracted from the Issuer’s Audited Financial Statements” and suggests that they should be made consistent. Other comments on the guidance on selected financial information are

- There appears to be a contradiction between the guidance in paragraphs 24 and 25. If the key figures “must” be extracted directly from the historical information (as required by paragraph 24) this seems to preclude what is contemplated in paragraph 25 which is to include figures that are derived from, rather than direct extractions of, the historical information. It may be helpful to redraft paragraph 24 along the following lines to resolve this difficulty “Where the key figures are also included within the historical and interim financial information included under paragraph 20.1 they must be extracted without alteration from that historical and interim financial information”.
- Certain aspects of paragraph 25 are difficult to understand:
 - (a) To be consistent with paragraph 44, the APB recommends that the word “reliable” be replaced with “relevant”.
 - (b) The comments regarding comparability would seem to be impossible to comply with. As these non-GAAP numbers are by definition not included in the historical financial information it is difficult to see how they can be compared to such information. The APB recommends that the sentence dealing with “comparable” be deleted.

Internal consistency of reliability concept (30), (37) and (50)

The concept of reliability is referred to in a number of places in the consultation paper eg paragraphs 25 (if the change described above is accepted), 36 and 44. There needs to be guidance somewhere on the need for internal consistency of such reliable information. The preparer should seek to ensure that all information in the prospectus is grounded in the same factual strategies, plans and risk analysis. As different components of prospectuses may be prepared by different personnel, there is a real risk that the information in the prospectus is not grounded in the same strategies, plans and risk analysis.

Profit forecasts and estimates (50)

The APB broadly supports the proposed approach to profit forecasts and estimates. However, it is important that investors understand:

- a) the uncertainty that is inherent in any forecast or estimate; and
- b) the level of assurance that is intended to be communicated when independent accountants/auditors report that a forecast or estimate has been “properly compiled”.

Critical to this understanding is the need for the term “properly compiled” to be unambiguously defined. There is a risk that the term will attract different meanings in different parts of Europe. The range of possible meanings is as follows:

- a) That the forecast information has been extracted from the relevant records and adds up and cross casts. (ie a literal interpretation of compilation)
- b) That in addition to (a) the principles of reliability, understandability and comparability have been applied in the preparation of the forecast.

The APB believes that approach (b) best reflects the public interest and, therefore, recommends that paragraph 40 of the CESR guidance begin as follows “In order to be properly compiled, the following principles should be taken into consideration when profit forecasts are being prepared...”. (See also the point above on the need for the guidance on the Principles to be further elaborated).

Audit of the Annual Financial Information (85)

There is an inconsistency between the wording of paragraph 78 and paragraph 81 with respect to the auditing standards to be applied. The APB recommends that the last sentence of paragraph 81 should read “The restated historical annual financial information must be independently audited or reported on as to whether or not for the purpose of the registration document, it gives a true and fair view, in accordance with auditing standards applicable in a Member State or an equivalent standard”.

Ethical requirements to be applied to the work of the independent accountants or auditors (92)

Although positioned under the heading of ‘Pro Forma Financial Information much of the content of paragraphs 86 through 90 deal with ethical matters applicable to auditors which applies more generally to the CESR recommendations. The APB recommends that these paragraphs be repositioned in the guidance.

Paragraph 91 seems to establish that the existing 8th Directive requirements relating to independence should apply. If this is so, the purpose of the guidance included in paragraphs 89 or 90 is unclear.

While the APB believes that it is likely that high level principles in relation to independence of auditors (such as contained in the existing 8th Directive) can be applied to the work of independent accountants involved in a prospectus the APB is uncertain whether more detailed requirements for auditors (such as those in the EC recommendation on Statutory auditors’ Independence in the EU) will be workable. The APB believes that there is a danger in

automatically applying requirements on statutory auditors to the more complex situations that can relate to prospectuses. For example, in a takeover situation where an accountant has to report on pro forma combined financial information of their client and a take-over target, it may be impracticable for them to be independent of the target company. In these circumstances it would be more practicable to expect the accountant to be independent of the target when, and if, the acquisition goes ahead.

The APB presumes that the recommendation in paragraph 91 is intended to be that pro forma information can be reported on only by persons approved to carry out statutory audits. If our understanding is correct paragraph 91 needs to be expressed in terms of “independent accountants or auditors”.

Electronic Publication (333)

The APB agrees with the recommendations in paragraph 332 in so far as they go. However, the recommendation only scratches at the surface of the complex issues that may arise when publishing prospectuses on a web site. In 2001 the APB published a Bulletin entitled “The electronic publication of auditors’ reports” which explores a number of the risks that confront auditors when their reports are posted to web sites along with the financial statements, or other information that they may be reporting on. Among other things, the Bulletin recommends that the following note be appended to audit reports posted on the world-wide-web:

“The maintenance and integrity of the [name of entity] web site is the responsibility of the directors, the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the web site”.

The APB believes that there would be merit in independent accountants/auditors and other experts, whose reports are included in prospectuses, appending such a note to the reports and consents included with a prospectus.

APB contact

If you would like clarification of any of the matters that we raise in this letter please contact Steven Leonard at s.leonard@frc-apb.org.uk .

Yours sincerely



Richard Fleck
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