



Brussels, July 2008

Code of Conduct on Clearing and Settlement

TERMS OF REFERENCE FOR AUDITING COMPLIANCE WITH SERVICE UNBUNDLING AND ACCOUNTING SEPARATION AND ASSESSING GENERAL COMPLIANCE

1. INTRODUCTION.....	1
2. AUDITING COMPLIANCE WITH SERVICE UNBUNDLING AND ACCOUNTING SEPARATION	2
2.1. AGREEING ON THE TERMS OF THE ENGAGEMENT	2
2.2. CHARACTERISTICS OF THE EXTERNAL AUDITOR	2
2.3. STANDARDS AND QUALITY OF THE ENGAGEMENT	3
2.4. RESPONSIBILITY OF THE ENGAGING PARTY	3
2.5. RESPONSIBILITY OF THE EXTERNAL AUDITOR.....	4
2.6. TIMING.....	5
2.7. DISTRIBUTION	5
2.8. INVOLVEMENT OF NATIONAL REGULATORS	5
2.9. INFORMING THE MOG.....	5
3. ASSESSING GENERAL COMPLIANCE WITH THE CODE OF CONDUCT.....	6
3.1. CONTENTS AND FORMAT	6
3.2. TIMING.....	6
ANNEX 1 – MAIN DEFINITIONS FOR THE PURPOSE OF THESE TERMS	7
ANNEX 2 - ILLUSTRATIVE UNQUALIFIED ASSURANCE REPORT	8
ANNEX 3 - ILLUSTRATIVE QUALIFIED ASSURANCE REPORT.....	9
ANNEX 4: OVERVIEW OF PROCEDURES FOR MONITORING COMPLIANCE WITH THE CODE OF CONDUCT.....	10

1. INTRODUCTION

1. Under Article 44 of the Code of Conduct on clearing and settlement ("the Code"), each organisation having signed the Code ("organisation") will "task their external auditor or another external auditor of the organisation's choice, to verify their compliance with the Code."¹ In case of groups that include two or more organisations having signed the Code, each organisation that is part of the group should pursue the external audit procedure outlined below. In case all organisations part of a group belong to one jurisdiction, report to the same National Regulator and apply the same group-wide accounting separation methodology, the audit may be carried out on a group level but respecting the requirements of Article 42 of the Code.
2. The task of the external auditor is to conduct an objective and independent assessment in order to provide a conclusion in the form of an Assurance Report on whether the organisation engaging the external auditor ("the engaging party") complies with the commitments contained in the Code's part V on service unbundling and accounting separation. This will be done on the basis of a Self-assessment Report produced by the organisation annually and the data disclosed as a result of Article 42 and 43 of the Code of Conduct. The Self-assessment Report and the Assurance Report will be sent to national regulators. In addition, organisations will prepare a public statement on compliance with the stipulations of the Code of Conduct on service unbundling and accounting separation. This public statement will be accompanied by an auditor's report. In order to provide a consistent and sound base for the assessment, it will be carried out under the frame of reference provided by the International Framework for Assurance Engagements and the International Standard for Assurance Engagements (ISAE) 3000.²
3. The modalities of this external audit process are outlined in chapter 2 of these Terms and apply to all organisations falling under the scope of the Code's part V on service unbundling and accounting separation.
4. In addition, as outlined in chapter 3 of these Terms, each organisation having signed the Code should describe how it complies with the Code in general (including price transparency, access and interoperability and service unbundling and accounting separation, as applicable). This General Implementation Report should be produced annually, will not be subject to an external audit and should be sent to the Monitoring Group of the Code of Conduct on clearing and settlement (MOG).³
5. These Terms may be reviewed to take account of first experiences. FESE, EACH and ECSDA will consult the MOG prior to making any non-editorial changes.

¹ The Code can be found on the Commission's website: http://ec.europa.eu/internal_market/financial-markets/docs/code/code_en.pdf

² An assurance engagement means "an engagement in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria". For further details see International Framework for Assurance Engagements and ISAE 3000. (see http://www.ifac.org/Members/Downloads/ISAE_3000.pdf).

³ The MOG consists of the European Commission – DG MARKT (chair), COMP and ECFIN – CESR and the ECB.

2. AUDITING COMPLIANCE WITH SERVICE UNBUNDLING AND ACCOUNTING SEPARATION

2.1. Agreeing on the terms of the engagement

6. The external auditor is selected by the engaging party.
7. The external auditor and the engaging party shall agree on the terms of the engagement. This shall be done by an engagement letter, or extending existing engagement terms to cover this aspect, that defines the nature of the engagement and clarifies the responsibilities of the external auditor and the engaging party.
8. The engagement letter shall explicitly state that the external auditor agrees that the engaging party sends the Self-assessment and Assurance Reports to its national regulator(s). It should also state that the external auditor and the engaging party agree on disclosing the data outlined in Articles 42 and 43 of the Code of Conduct to its national regulator(s). It should furthermore state that the external auditor and the engaging party agree with (i) the national regulator informing the Committee of European Securities Regulators (CESR) on the result of its format and completeness check, and (ii) CESR informing the MOG.
9. The engagement letter should explicitly state that the organisation and the external auditor agree to make public the auditor's report in relation to the organisation's public statement on compliance with the stipulations of the Code of Conduct on service unbundling and accounting separation.
10. The national regulator will receive a copy of the engagement letter from the engaging party, if applicable.
11. The liability provisions for the engagement should observe the national rules for this type of assurance engagements.

2.2. Characteristics of the external auditor

12. The engaging party shall inform its national regulator and the MOG about the identity of its external auditor.
13. The external auditor who is selected to carry out the assurance engagement should be external to the engaging party, be of good repute and have relevant experience of the financial sector. The external auditor should also have appropriate education and professional qualifications, as detailed in Directive 2006/46/EC.⁴
14. The external auditor can be the same as the financial statements auditor of the engaging party.

⁴ OJ L 157, 17.5.2006, p. 87.

2.3. Standards and quality of the engagement

15. The engagement will be performed by the auditor with due professional care, independence, integrity, objectivity and confidentiality in accordance with professional auditing practice and the above-mentioned international standards.
16. To address threats to its independence, the external auditor should comply with the requirements of Parts A and B of the IFAC Code of Ethics for Professional Accountants.⁵ It should accordingly identify such threats and if they are deemed to be significant, should apply safeguards to eliminate the threats or reduce them to an acceptable level.
17. The external auditor shall obtain sufficient appropriate evidence on which to base its conclusion.

2.4. Responsibility of the engaging party

18. The engaging party shall each year prepare a **Self-assessment Report** where it outlines how it complies with the Code's part on service unbundling and accounting separation. The Report should be in writing and in English.
19. The Self-assessment Report should be prepared by management on a "comply or explain" basis. The report should accordingly state in detail which provisions have not been complied with, for what period and the reasons for non-compliance and describe the measures and actions undertaken by the engaging party to implement the relevant Code commitments.
20. The report should contain a description of the cost accounting methodology. Organisations should keep it consistent across different reporting periods, and should ensure that it represents a true and fair view of costs so that no parallel system for the same purpose is required. The report should also outline how the engaging party meets with the common guidance principles⁶ for the establishment of the cost accounting methodology.
21. The Self-assessment Report should also contain a central conclusion, with the engaging party clearly affirming the extent to which it complies with the Code.

⁵ The Code can be found on http://www.ifac.org/Members/Downloads/2005_Code_of_Ethics.pdf

⁶ The common guidance principles are:

- § To use methodologies that are in line with the applicable accounting standards [GAAP, IFRS or other] (all).
- § To allocate expenses that are directly linked to the provision of a service defined in the Code directly to that service whereas all other costs are allocated based on a true and reasonable basis (all).
- § To use the published conversion table as a basis for revenue allocation across the five services defined in the Code (CSD only).
- § To ensure that the results of the Accounting Separation show an allocation of the totality of their costs and revenues (with a category "Other" for those entries that do not belong to the five defined services) thereby allowing that the results can be reconciled back to the audited figures (CSD only).

22. The Self-assessment Report will be based on a standard template (to be developed by organisations in consultation with the MOG and external auditors).
23. The Self-assessment Report and additional data disclosed as a result of Article 42 and 43 of the Code of Conduct will be supported by evidence provided to the external auditor in the frame of the assurance process (documentation and audit trail between the data provided and the accounting records).
24. The organisation will also issue a public statement on compliance with the stipulations of the Code of Conduct on service unbundling and accounting separation for each reporting period.

2.5. Responsibility of the external auditor

25. On the basis of the Self-assessment Report and the data disclosed as a result of Article 42 and 43 of the Code of Conduct, the external auditor will provide a conclusion on the engaging party's compliance. To that effect, the external auditor will prepare an **Assurance Report** assessing the content and format of the Self-assessment Report. The Assurance Report should be in writing and in English. The Assurance Report should state the respective responsibilities of the contracting party and the reporting external auditors. It should further state the basis on which the report has been carried out (ISAE3000). It should outline the procedures undertaken to gather evidence.
26. The external auditor should provide a conclusion on whether the annual non-consolidated accounts or, as applicable, the data on costs and revenues defined in Article 42 and 43 of the Code of Conduct, respectively, have been separated as required by the Code of Conduct.
27. In line with a limited assurance engagement, the external auditor should base its conclusion on sufficient appropriate evidence so that its conclusion in the report can be stated in a negative form (e.g. "Based on our work described in this report, nothing has come to our attention that causes us to believe that...").
28. The Assurance Report should contain a central statement/report, where the auditor clearly states the extent of its assurance. If qualified, the report should outline the basis for qualifications, detailing the areas of non-compliance.
29. To illustrate what an Assurance Report could look like, two example reports are annexed to these Terms. One report is unqualified (Annex 3), i.e. it finds no significant areas of non-compliance; the other is qualified (Annex 4), i.e. it outlines areas of non-compliance.
30. For each reporting period, the auditor will also provide a report on the organisation's public statement on compliance with the stipulations of the Code of Conduct on service unbundling and accounting separation in accordance with ISAE 3000. In doing so, the auditor will provide his conclusion on the assertions made by management in the organisation's public statement. The auditor's report will be published together with the organisation's public statement on compliance.

2.6. Timing

31. Reporting should be done on an annual basis. The reporting period covered by the Self-assessment Report and the Assurance Report could be either identical with the financial statement year-end or any 12 month reporting period chosen by the organisation (e.g. fiscal year), which is then constantly applied. The engaging party should notify the national regulator(s) about the chosen reporting period.
32. The Self-assessment and Assurance Reports should be prepared starting with the year 2008.

2.7. Distribution

33. The engaging party should disclose the Self-assessment Report and Assurance Report together with the data outlined in Article 42 (the annual non-consolidated accounts) or, as applicable, Article 43 (data on costs and revenues) of the Code to its national regulator(s). The Self-assessment Report, the Assurance Report and the data should be disclosed together within 120 days from the end of the reporting period⁷.
34. The engaging party should keep copies of the Self-assessment Report, the Assurance Report and the data disclosed as a result of Articles 42 and 43 of the Code of Conduct. The engagement letter should clearly state with which department the copies are being stored (e.g. compliance department). These copies should be stored for a period of 5 years.
35. The public statements on compliance with the stipulations of the Code of Conduct on service unbundling and accounting separation prepared by organisations and the related auditor's report will be distributed in a way that ensures broad publicity (e.g. web or attached to annual report).

2.8. Involvement of national regulators

36. National regulators will check if they have received the information outlined in the first paragraph of 2.7 (i.e. the Self-assessment Report, the Assurance Report and the data).
37. When conducting the check mentioned above, national regulators will not duplicate or check the work of external auditors. Regarding the information disclosed in accordance with Articles 42 and 43 of the Code, national regulators will not review the format or the completeness of the information received. National regulators will not provide a value judgement on the information received.

2.9. Informing the MOG

38. The national regulator will inform the engaging party and CESR of the result of the check mentioned in 2.8.
39. CESR will inform the MOG about the results of the above-mentioned checks.

⁷ In specific exceptional cases this period might be exceeded due to local legal requirements.

40. Non-CESR members will inform the MOG directly about the results of the above-mentioned checks.

3. ASSESSING GENERAL COMPLIANCE WITH THE CODE OF CONDUCT

41. In order to assess organisations' compliance with the Code in general (price transparency, access and interoperability and service unbundling and accounting separation), organisations shall each year produce a General Implementation Report.

42. This report should be sent to the MOG and upon request to the relevant national regulator(s).

3.1. Contents and format

43. This report should outline the *detailed* steps the organisation has taken to comply with the price transparency and access and interoperability parts of the Code, as well as the *general* steps the organisation has taken to comply with the service unbundling and accounting separation part of the Code.

44. For **Price Transparency**, the updated versions of the current FESE / EACH / ECSDA price transparency implementation reports⁸ will be used as a template. This template outlines organisation compliance with Articles 7 through 18 of the Code. The template used so far should take into account the Commission's price transparency monitoring framework.

45. For **Access and Interoperability**, the standard template developed by FESE/EACH/ECSDA will be used and will outline an organisation's compliance with the conditions set out in the Access and Interoperability Guideline of the Code.

46. For **Unbundling and Accounting Separation**, the report should summarise the general conclusions of the Self-assessment Report referred to above. This should be prepared by those organisations affected by this part of the Code.

3.2. Timing

47. Reporting should be done on an annual basis. The reporting period covered by the General Implementation Report could be either identical with the financial statement year-end or any 12 month reporting period chosen by the organisation, which is then constantly applied.

48. The General Implementation Report should be prepared starting with the year 2007. (The summary of the Self-assessment Report on unbundling and accounting separation will be included in the second General Implementation Report).

⁸ For January 2007 FESE version of report, see http://ec.europa.eu/internal_market/financial-markets/docs/code/mog/20070122_fese_report_en.pdf

49. The General Implementation Report should be sent within 150 days from the end of the reporting period.⁹

ANNEX 1 – MAIN DEFINITIONS FOR THE PURPOSE OF THESE TERMS

Term	Explanation
Assurance engagement	An engagement in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria.
Assurance Report	The report of the external auditor, in which it assesses the content and format of the Self-assessment report.
Auditor's report	In relation with the organisation's public statement an auditor's report will be made public on compliance with the stipulations of the Code of Conduct on service unbundling and accounting separation. The auditor will provide his conclusion on the assertions made by management in the organisation's public statement.
Code	Code of Conduct on clearing and settlement
Comply or explain	The principle underpinning the Self-assessment Report, according to which an organisation should outline how it has or has not complied with the Code, explaining the reasons for non-compliance.
Engaging party	Organisation engaging an external auditor to carry out the task of providing a conclusion on the organisation's compliance with the Code
External auditor	Auditor responsible for providing a conclusion on the Self-assessment report drafted by an organisation
General implementation report	The report an organisation has to draft that outlines the detailed steps the organisation has taken to comply with the prices transparency and access and interoperability parts of the Code, as well as the general steps its has taken to comply with the service unbundling and accounting separation parts of the Code.
MOG	Monitoring Group of the Code of Conduct on clearing and settlement
National regulator	National authority competent for supervising and regulating organisations.
Organisation	Organisation having signed the Code of Conduct
Qualified report	If the external auditor finds that the organisation does not fully comply with the Code which the organisation does not properly explain and disclose, it has to write a qualified report. The report should outline the areas of non-compliance.
Reporting period	The period chosen by the organisation for reporting on how it complies with the Code. The period should be annual, but can either be identical with the financial statement year-end or any 12 month reporting period chosen by the organisation, which is then consistently applied.
Self-assessment report	Report an organisation has to draft where it outlines how it complies with the Code's part on service unbundling and accounting separation.
Unqualified report	If the external auditor finds no significant areas of non-compliance, it will draft an unqualified report.

^{9 9} In specific exceptional cases this period might be exceeded due to local legal requirements

ANNEX 2 - ILLUSTRATIVE UNQUALIFIED ASSURANCE REPORT

UNQUALIFIED INDEPENDENT ASSURANCE REPORT ON THE SELF-ASSESSMENT REPORT OF XYZ ORGANISATION

We have been appointed/engaged to provide assurance on the Self-assessment Report of [XYZ Organisation] (subject matter) for the year ended 31 December 2XXX, attached herewith.

Respective Responsibilities of Directors and Reporting Accountants

The Board of Directors of XYZ Organisation is responsible for preparing the Self-assessment Report in accordance with the European Code of Conduct for Clearing and Settlement (“the Code”) [and related guidance/interpretations for directors of organisations subject to that Code.]

Our responsibility is to assess whether the Self-assessment Report has, in all material respects, been properly presented based on the Code (evaluation criteria) and to report our findings to you.

Basis of Statement/Report

Our assessment of the Self-assessment Report was based on our evidence-gathering procedures in accordance with the International Standards on Assurance Engagement (ISAE) “Assurance Engagements Other than Audits or Reviews of Historical Information” (ISAE 3000).

However, we have not performed an audit according to International Standards on Auditing (ISAs). Accordingly, we do not express an audit opinion.

Our evidence-gathering procedures included, for example:

[include paragraphs summarising procedures performed]

Statement/Report

Based on our work described in this report, nothing has come to our attention that causes us to believe that the Self-assessment Report is not properly presented, in all material respects, based on the European Code of Conduct for Clearing and Settlement [and related guidance/interpretations for directors of organisations subject to that Code]

This report is intended solely for the information and use of the management of [XYZ organisation] and the [national regulator] and is not intended to be relied upon and should not be used by anyone other than the specified parties.

ANNEX 3 - ILLUSTRATIVE QUALIFIED ASSURANCE REPORT

QUALIFIED INDEPENDENT ASSURANCE REPORT ON THE SELF-ASSESSMENT REPORT OF XYZ ORGANISATION

We have been appointed/engaged to provide assurance on the Self-assessment Report of [XYZ Organisation] (subject matter) for the year ended 31 December 2XXX, attached herewith.

Respective Responsibilities of Directors and Reporting Accountants

The Board of Directors of XYZ Organisation is responsible for preparing the Self-assessment Report in accordance with the European Code of Conduct for Clearing and Settlement (“the Code”) [and related guidance/interpretations for directors of organisations subject to that Code.]

Our responsibility is to assess whether the Self-assessment Report has, in all material respects, been properly presented based on the Code (evaluation criteria) and to report our findings to you.

Basis of Statement/Report

Our assessment of the Self-assessment Report was based on our evidence-gathering procedures in accordance with the International Standards on Assurance Engagement (ISAE) “Assurance Engagements Other than Audits or Reviews of Historical Information” (ISAE 3000).

However, we have not performed an audit according to International Standards on Auditing (ISAs). Accordingly, we do not express an audit opinion.

Our evidence-gathering procedures included, for example:

[include paragraphs summarising procedures performed]

Basis for qualification

[Example of a possible disagreement with the organisation: XYZ organisation has not published the respective cost-accounting methodology, as required by the Terms of Reference]

Statement/Report

Based on our work described in this report, except for the lack of publication of prices of offered services described in the previous paragraph, nothing has come to our attention that causes us to believe that the Self-assessment Report is not properly presented, in all material respects, based on the European Code of Conduct for Clearing and Settlement [and related guidance/interpretations for directors of organisations subject to that Code].

This report is intended solely for the information and use of the management of [XYZ organisation] and the [national regulator] and is not intended to be relied upon and should not be used by anyone other than the specified parties.

ANNEX 4: OVERVIEW OF PROCEDURES FOR MONITORING COMPLIANCE WITH THE CODE OF CONDUCT

