



THE COMMITTEE OF EUROPEAN SECURITIES REGULATORS

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STANDARD NO. 1 ON FINANCIAL INFORMATION

**ENFORCEMENT OF STANDARDS ON FINANCIAL
INFORMATION IN EUROPE**

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Foreword

This first standard on Enforcement of Standards on Financial Information in Europe has been developed by CESRfin through its Sub-Committee on Enforcement (SCE). The standard is a principle based standard.

CESRfin's Work Plan, which was approved by CESR in January 2002, includes the development of principles, guidelines and standards in the areas of :

- definition of enforcement;
- selection techniques;
- powers to be attributed to the enforcers;
- cross border listings and offerings.

The first two areas are described in the principles of this standard but may need to be expanded on in a later standard.

As regards the other two areas the SCE will develop a new work plan which will be aimed at providing for a sufficiently complete set of standards by 2005.

The SCE is currently working to develop principles on powers to be attributed to enforcers which will be finalised in the short term. Thereafter the SCE will develop enforcement principles related to cross border listings and offerings.

As regards the coordination between CESR and non-CESR members in the area of enforcement CESRfin will establish an appropriate mechanism whereby CESR members and non-CESR members may discuss enforcement issues in order to achieve a high level of coordination and convergence in the enforcement decisions.



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A CONTEXT AND SCOPE OF THE STANDARD

On the 13th of June 2000 the EU Commission issued a Communication¹ to the Council and the European Parliament on the future EU financial reporting strategy. The new approach, which has been implemented by a EU regulation² adopted by the EU Council on 6 June 2002, is based on the introduction of the International Financial Reporting Standards (IFRSs) or International Accounting Standards (IASs)³ in Europe.

Further steps toward harmonization in the EU have also been taken in the field of disclosure including directives on prospectuses and periodic reporting.

The above mentioned Communication as well as the IAS Regulation and the prospectus proposal imply that an efficient and effective financial information system in a transparent European capital market should be based on the development and the harmonization of:

- clear and enforceable financial reporting standards (i.e. IFRS) and other disclosure requirements (e.g. prospectus and regular reporting requirements) which can be timely and efficiently interpreted;
- transparent corporate governance systems;
- auditing regulation, including technical, ethical and quality control standards, up to develop a first external line of defence against inappropriate application of financial reporting standards;
- independent institutional oversight.

In particular, harmonization of enforcement systems in Europe is seen as an effective tool to create an efficient capital market and an actual level playing field within the Union. It is also expected that harmonisation of enforcement practices throughout Europe will help improve investors' confidence in financial markets and enhance comparability between financial information published by listed issuers in Europe.

In particular, the Regulation from its inception calls for CESR to have a role in developing standards for enforcement. Recital n. 16 of the regulation says:

“A proper and rigorous enforcement regime is key to underpinning investors' confidence in financial markets. Member States, by virtue of Article 10 of the Treaty, are required to take appropriate measures to ensure compliance with international accounting standards. The Commission intends to liaise with Member States, notably through the Committee of European Securities Regulators (CESR), to develop a common approach to enforcement.”

To this end CESR set up CESRfin and its Sub-Committee on Enforcement (SCE), which agreed upon a work plan whereby standards, guidelines and practices will be considered by the enforcers.

This document provides for principles on which, in CESR's view, harmonization on the institutional oversight systems in Europe may be achieved.

¹ Communication from the Commission to the Council and the European Parliament, EU Financial Reporting Strategy: the way forward, COM (2000) 359 final, Brussels, 13.6.2000.

² Regulation (EC) no 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards.

³ IFRSs being the same name of IASs since May 2002.



In particular, a definition of enforcement of standards on financial information, its scope, the selection techniques applicable by the enforcers and the responsibility of the different parties involved are outlined.

However, CESR recognises that enforcement of disclosure standards on prospectuses should take into consideration the special characteristics and definition of scope which will be defined by the evolving EU legislation.

The principles hereby provided will be supplemented by the development of other documents whose purpose will be to improve coordination. In particular, standards and guidelines on issues which are not considered by this document (such as cross border listing implications on enforcement) as well as on issues which are hereby considered in general terms (such as powers to be attributed to enforcers) will be adopted in the future.

B DEFINITION OF ENFORCEMENT

Principle 1 **The purpose of enforcement of standards on financial information provided by the issuers mentioned by principle 9 is to protect investors and promote market confidence by contributing to the transparency of financial information relevant to the investors' decision making process.**

With regard to financial statements, the above implies that enforcement contributes to a consistent application of the IFRSs in the EU financial regulated markets.

Principle 2 **For the purpose of this standard enforcement may be defined as:**

- **monitoring compliance of the financial information with the applicable reporting framework;**
- **taking appropriate measures in case of infringements discovered in the course of enforcement .**

The reporting framework includes the accounting and disclosure standards adopted by the EU.

As referred under section A, harmonization of enforcement mechanisms in Europe is needed in order to contribute to the creation of an efficient single capital market in Europe within the context of the evolving EU legislation.

In particular, initiatives on enforcement were mainly considered instrumental to the effectiveness of the forthcoming requirement for listed issuers to prepare consolidated accounts based on the endorsed IFRS as well as the EU rules on disclosure of financial information.

However, CESR notes that investors' protection requires the extension of the scope of enforcement to the whole reporting framework applicable to listed issuers, including national GAAPs when applied to individual accounts. It would also require third countries' accounting standards where non-EU issuers are concerned.

A full comprehensive scope of enforcement is at least required for investors' protection purposes where issuers which will not prepare consolidated accounts (e.g. start-up issuers) are to be dealt with.

In addition, where only IFRS were included in the scope of enforcement an uneven playing field may be created in Europe, as far as enforcement may apply only to those issuers that chose to be organized as groups of companies.

C ENFORCERS

- Principle 3** Competent independent administrative authorities set up by member States should have the ultimate responsibility for enforcement of compliance of the financial information provided by the issuers identified by Principle 9 with the reporting framework.
- Principle 4** Other bodies might carry out enforcement on behalf of the competent administrative authorities, provided that these bodies are supervised by and responsible to the relevant competent administrative authority.
- Principle 5** Irrespective of who carries out enforcement any standard on enforcement established by CESR should be complied with.
- Principle 6** Competent administrative authorities shall have adequate independence from government, and market participants, possessing the necessary powers and having sufficient resources.
- Principle 7** The necessary powers – which may be delegated to those acting on behalf of the competent independent administrative authority – should at least include power to monitor financial information, require supplementary information from issuers and auditors, and take measures consistent with the purposes of enforcement.
- Principle 8** The competent administrative authorities should be responsible for:
- the setting up of an appropriate due process of enforcement consistent with the application of the principles hereby stated;
 - the implementation of that due process.

Differences in corporate governance legislations as well as other companies regulations in the European Member States ask for the organization of the institutional oversight at national level according to the different legal environments. However the integration of European security markets requires that the national models operate on the basis of harmonized concepts and comparable techniques.

CESR recognizes that in the EU Member States various organizational models of the enforcement systems are in place, including enforcement conducted by securities regulators, stock exchanges and review panels.

Harmonization requires at least consistency of the scope and reliability of those enforcement systems, as well as the identification of the characteristics that the enforcers should have in order to promote market confidence and the powers to be attributed to them.

To this end, in its response to the EU Commission New Accounting Strategy, published in 2001, the Forum of European Securities Commissions (FESCO, now CESR) expressed the view that in order to boost market confidence, enforcement of financial information should be overseen by an independent administrative authority.

In this context, independence implies that the authorities should not be unduly influenced by the issuers, their auditors, intermediaries, the government or other stakeholders.

The above requirement is satisfied also where an SRO (Self Regulating Organizations) is involved in the enforcement procedure, provided that the relevant competent administrative authority should monitor that the enforcement mechanism follows all the principles hereby stated.

The principles hereby provided are not aimed at modifying rules on due process provided for by the national legislation. The right of issuers to appeal against decisions and actions taken by the competent independent administrative authorities or those acting on their behalf, as embodied in such legislation, is an important part of the due process of enforcement.

In CESR's view the standard hereby stated together with those that will be adopted in the future should constitute the basis for harmonization of enforcement of the reporting framework on financial information



in Europe. These standards will be supplemented by guidelines whose aim will be to indicate best practices and clarifications on application of the standards on enforcement.

Enforcement of standards on financial information requires that enforcers should be provided with resources sufficient to establish and carry out an effective monitoring system. This includes having professionally skilled staff that should be experienced with the reporting framework and the legal implications of enforcement.

Enforcers' investigations dealt with in these standards are aimed at achieving the goals described under Principles 1 and 2 above. Therefore, for the purpose of these standards requests for information to the management or auditors are aimed at enforcing the reporting framework for financial information. In particular, the requests of information addressed to the auditors hereby envisaged, which are in line with article 21 of the draft directive on prospectus are not as such intended to enforce auditing regulation.

The completeness, accuracy and truthfulness of the financial information is under the responsibility of the issuers' relevant bodies (mainly the board of directors). Where applicable, auditors are required to act as a first external line of defence against misstatements by expressing their opinion on the financial information based on their audit.

Enforcers should monitor this financial information with the aim of ensuring actions where infringements are detected.

Due to the intrinsic limitation of any external monitoring, enforcement will not provide a zero failure assurance.

Where applicable, the selection techniques described below imply that defective information may be out of the sample. Therefore, the enforcer may not have the chance to examine it.

In addition, there is no assurance that the enforcers will detect each and any misstatement affecting the documents that they examine. Fraud for example is organized to overcome controls. Most of the errors connected to fraud may only be discovered if extraordinary controls are put in place.

D ISSUERS AND DOCUMENTS

Principle 9 The principles for enforcement here identified should apply to financial information provided by issuers:

- a) whose securities are admitted to trading on a regulated market;**
- b) that applied for admission to trading of their securities on a regulated market.**

Principle 10 The principles for enforcement here identified should apply to financial information provided by all harmonized documents, including annual and interim financial statements and reports, prepared on individual and consolidated basis as well as prospectuses and equivalent documents.

For the purpose of this standard a document providing financial information is harmonized if EU legislation requires its publication and regulates its format and/or content. The special characteristics of enforcement of prospectuses are considered by principle 12 below.

Non-harmonized documents include reports such as press releases (e.g. press releases providing price sensitive information) and mergers' reports with pro-forma figures.



CESR encourages the consideration of the principles hereby provided as a best practice benchmark for enforcement on issuers and documents other than those identified under principles 9 and 10.

E METHODS OF ENFORCEMENT

- Principle 11** For financial information other than prospectuses ex-post enforcement is the normal procedure, even if pre-clearance is not precluded.
- Principle 12** For prospectuses ex-ante approval is the normal procedure as specified by the EU directives, which also identify the nature of the approval. Ex-post enforcement of financial information provided by prospectuses is possible as a supplementary measure.
- Principle 13** Enforcement of all financial information is normally based on selection of issuers and documents to be examined.
- The preferred models for selecting financial information for enforcement purposes are mixed models whereby a risk based approach is combined with a rotation and/or a sampling approach.
- However, an approach based solely on risk may be an acceptable selection method.
- A pure rotation approach as well as a pure reactive approach is not acceptable. However, indications of misstatements provided by auditors or other regulatory bodies as well as well grounded complaints should be considered for enforcement investigations.
- Principle 14** In order to allow enforcers to adopt gradually the selection methods provided for by Principle 13, a mixed selection technique based on a combination of a random selection and rotation is considered a workable transitional step. However, such a methodology should be designed to give an adequate level of detection risk.
- Principle 15** Methods of enforcement on selected information cover a wide spectrum of possible checking procedures, ranging from pure formal checks to in-depth substantive in-nature checking. The level of risk should normally determine the intensity of the review to be performed by the enforcers. The type of document to be examined and the level of information available on the issuer is also to be taken into consideration.

The above principles regarding the methods of enforcement do not preclude the development of specific principles or measures for the implementation of the Market Abuse Directive, notably regarding misleading information.

Some enforcers offer issuers the possibility to obtain pre-clearance, whose aim is only to allow knowledge of the competent enforcer's view on a certain specific accounting or disclosure treatments. In particular, by means of pre-clearances the enforcers that are willing to provide for this possibility will express their view on the fact that a particular accounting treatment may be considered (or not) an infringement to the reporting framework which may lead to enforcer's actions. These pre-clearances should clearly identify all the circumstances surrounding the specific case submitted by the issuer.

CESR recognises that it is important that pre-clearance should not result in enforcers becoming standard setters. Pre-clearances, as any other decisions, will be subject to the coordination as described under principle 20 and to reporting as referred to under principle 21.

The document suggests the application of selection techniques as the basis for harmonization of the enforcement systems in Europe, taking cost and benefit balances into consideration. The appropriateness of

applying a selection method, however, depends on several circumstances, including the characteristics of the market and other legal constraints. For that reason, some authorities may consider a systematic review more appropriate.

The selection of items to be considered in the enforcement process and intensity of the review on selected information is determined by several factors identified under principles from 11 to 14. For instance, among these factors the result of enforcement of some documents published by an issuer (e.g. its consolidated accounts) may have an impact in estimating the risk associated with other financial information provided by the same company (e.g. its individual accounts).

Selection of items to be checked is also based on the objective of the enforcement, the quality of information available to the enforcer and the time constraint for the enforcement procedure.

Enforcers will receive complaints from investors or other interested parties. Enforcement investigations should be considered where, after a preliminary scrutiny, the complaint received appears reliable and relevant for a possible enforcement action. Accordingly, investigations after complaints are aimed at pursuing the purpose of enforcement described under Principle 1.

Cost-benefit and risk considerations, along with other factors like the availability of information, indications by the auditors and apparent inconsistencies of the enforced document should be taken into account when determining the intensity of review.

F ACTIONS

Principle 16 Where a material misstatement in the financial information is detected enforcers should take appropriate actions to achieve an appropriate disclosure and where relevant, public correction of misstatement (in line with the requirements of the reporting framework). Non-material departures from the reporting framework will not normally trigger public correction even though they normally deserve an action as well.

Materiality should be assessed according to the relevant reporting framework.

Principle 17 Actions taken by the enforcers should be distinguished from sanctions imposed by the national legislation. Actions are measures generally aimed at improving market integrity and confidence.

Principle 18 Actions should be effective, timely enacted and proportional to the impact of the detected infringement.

Principle 19 A consistent policy of actions should be developed, whereby similar actions are adopted where similar infringements are detected

A range of possible actions are available to enforcers (e.g. requests for reconciliation or corrective note, restatement, suspension from trading or delisting). Several factors should be carefully considered in the selection of the appropriate action. These include the type of document affected by the misstatement, the severity of the misstatement, the timing of the detection and the frequency of the misstatement.

Non-material events may also trigger actions by the enforcers as far as the non.-material misstatements may have a negative impact on investors' confidence on the market or contribute to establish inappropriate precedents. Such actions will often consist in a statement from the enforcer conveyed to the infringer.

Provided that enforcement is aimed at taking actions where departures from the reporting framework are detected, materiality should necessarily be defined consistently both for reporting purposes and for enforcement purposes. For instance, where financial statements are prepared in accordance with IFRS reference should be made to the definition of materiality provided by the IASB Framework on the Preparation and Presentation of Financial Statements (paragraphs 29 and 30). On the other hand, where prospectuses are to be dealt with by the enforcers materiality refer to the requirements of the relevant EU directive (article 5 of the draft directive on prospectuses).

Although actions are decided at national level, the creation of a single EU securities market requires coordination and convergence of the enforcers' policies.

G COORDINATION IN ENFORCEMENT

Principle 20 In order to promote harmonization of enforcement practices and to ensure a consistent approach of the enforcers to the application of the IFRSs, coordination on ex-ante and ex-post decisions taken by the authorities and /or delegated entities will take place

Material controversial accounting issues will be conveyed to the bodies responsible for standard setting or interpretation.

No general application guidance on IFRSs will be issued by the enforcers.

Monitoring financial information entails that reporting policies applied by the issuers are compared with the reporting framework in order to take decision on their acceptability.

Decisions of national enforcers reflect the judgement of the enforcer on the compliance of the financial information with the reporting framework. Exchange of information among enforcers prior to the decision are taken is limited by technical feasibility time and confidentiality constraints.

Similar constraints apply where the enforcers are asked by the issuers or their auditors to express opinions before the financial information is published (so called “pre-clearances”).

According to principle 2, enforcement measures have the function to address infringement of the reporting framework. Therefore, an accounting or disclosure treatment which is not prohibited by the relevant standards or interpretations should not lead to an enforcement action.

However, harmonization of the enforcement practices and approaches of the enforcers to the IFRSs, aimed at creating a single EU securities market, requires coordination on ex-ante and ex-post decisions taken by the authorities and/or delegated entities.

Consistent with recital 16 of the EU regulation on IFRSs, CESR will promote coordination in enforcement approaches.

In particular, according to its mandate, the CESRfin’s Sub-Committee on Enforcement is the forum where regulators compare their experiences in the field of enforcement on a regular basis with the aim of convergence.

However, coordination on enforcement practices and decisions requires also involvement of organizations which do not belong to CESR. Therefore, CESRfin will establish an appropriate mechanism whereby CESR members and non-CESR members may discuss enforcement issues in order to achieve a high level of coordination and convergence in the enforcement decisions

The development of legislation or memoranda of understandings will be explored in order to foster exchange of information with non-CESR members involved in enforcement.

Issuing general interpretations of the existing standards is part of the standard setting process conducted by the relevant bodies, such as IFRIC. Enforcers may contribute to this process by providing their experience to the interpretation debate. However, harmonization requires that they should not attempt to create a parallel body of interpretations.



H REPORTING

Principle 21 Enforcers should periodically report to the public on their activities providing at least information on the enforcement policies adopted and decisions taken in individual cases including accounting and disclosure matters.

The proposed publication of individual cases, which may be anonymous, is to contribute to the convergence of enforcement and not interpretation of IFRS's.