

# ACCOUNTING STANDARDS TO BE ENFORCED

## The Committee of European Securities Regulators (CESR) has published a proposed statement of principles regarding the enforcement of accounting standards throughout Europe.

"A proper and rigorous enforcement regime is key to underpinning investors confidence in financial markets," says a proposal from CESR. "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... to develop a common approach to enforcement."

The statement of principles (SOP) examines ways of harmonising institutional oversight in Europe. In particular it provides a definition of enforcement of financial information, looks at the selection techniques used by enforcers to examine companies and financial information, and provides a description of the responsibilities of the different parties involved.

The SOP should be seen as part of a package of measures contributing to an efficient and effective financial information systems in a transparent European capital market. The other measures include:

- clear and enforceable financial reporting standards (ie IFRS) and other material such as prospectus requirements
- corporate governance systems
- auditing regulation.

The paper sets out 21 principles covering different areas:

### Enforcers

- The Competent Independent Administrative Authorities (CIAA) set up by member states should have the ultimate responsibility for enforcement of compliance.
- Other bodies can carry out enforcement provided that they are supervised by the CIAA.
- Any code of conduct or procedure established by the CESR should be complied with.
- The CIAA should be independent of both government and market participants, and have the necessary powers and resources.
- These should include the power to monitor financial information and require supplementary information from companies and their auditors.
- The CIAA should be responsible for "the setting up of an appropriate due process of enforcement" and the implementation of that process.

### Companies and documents

- The principles of enforcement apply to companies "whose securities are admitted to trading on a regulated market".
- The SOP should cover all "harmonised" documents such as annual reports and prospectuses.

### Definition of enforcement

- The purpose of enforcement is to protect investors and promote market confidence by contributing to transparency. "Non-harmonised" includes press releases.
- Enforcement is defined as monitoring compliance of the

financial information with the reporting framework and taking appropriate measures when cases of infringements are discovered.

### Methods of enforcement

- For information other than prospectuses *ex-post* enforcement is the norm, but pre-clearance isn't precluded.
- For prospectuses *ex-ante* approval is the normal procedure. *Ex-post* enforcement is possible as a supplementary measure.
- Enforcement of all financial information is based on a selection of the companies and documents to be examined. The preferred models for selection are the mixed models whereby a risk-based approach is combined with a rotation and/or sampling method. However, a pure risk-based approach may be acceptable.
- A method which includes rotation would be considered as a workable transitional step. Such methodology should be designed to give an adequate level of detection risk.
- Methods of enforcement range from "formal checks" to in-depth substantive checking. The level of risk will determine the intensity of the review to be performed.

### Action

- Where a material misstatement is detected enforcers should take appropriate action to achieve disclosure and, where relevant, correction of the misstatement. Non-material departures may not necessarily trigger public correction.
- Actions taken by enforcers should be distinguished from sanctions imposed by the national legislation. This is because actions are aimed at improving market confidence and integrity while sanctions are mainly aimed at punishment.
- Actions should be effective, timely and proportional to the impact of the infringement.

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

### Co-ordination in enforcement

- Co-ordination in *ex-ante* and *ex-post* decisions taken by the authorities will take place to promote harmonisation. Material controversial accounting issues will be conveyed to accounting standard setting bodies, but general application guidance on IFRSs will be issued by the enforcers.

### Reporting

- Enforcers should report to the public on their activities providing "information in the enforcement policies adopted and decisions taken in individual cases including accounting matters." The proposed publication of individual cases is to contribute to the convergence of enforcement not to help interpretation of IFRSs.

The UK seems likely to welcome the SOP, especially with its risk-based approach and its recognition that different regimes and approaches exist across Europe.

The deadline for submitting responses to the consultation paper is 15 January 2003. Responses should be sent to Fabrice Demarigny, Secretary General, CESR, at [secretariat@europesefesco.org](mailto:secretariat@europesefesco.org).

Peter Williams.

[www.financialdirector.co.uk/briefing](http://www.financialdirector.co.uk/briefing)

### Useful links

- The CESR's proposal can be downloaded from [www.europesefesco.org](http://www.europesefesco.org)