



European Securities and  
Markets Authority

# Consultation Paper

ESMA Guidelines on enforcement of financial information





Date: 19 July 2013  
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## **Responding to this paper**

The European Securities and Markets Authority (ESMA) is seeking comments on all matters covered in this paper and in particular on the specific questions summarised in Annex 1. Comments are most helpful if they:

- respond to the question stated;
- indicate the specific question to which the comment relates;
- contain a clear rationale; and
- describe any alternatives ESMA should consider.

ESMA will consider all comments received by **15 October 2013**.

All contributions should be submitted online at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading “Your input - Consultations”

## **Publication of responses**

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA’s rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA’s Board of Appeal and the European Ombudsman.

## **Data protection**

Information on data protection can be found at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading “Legal Notice”.

## **Who should read this paper**

All interested parties are invited to respond to this consultation paper. It will primarily be of interest to those charged with the governance of issuers preparing financial information, users of financial information, auditors, and other parties who have a particular interest in financial reporting.



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## Acronyms and definitions used

EEA	European Economic Area
EU	European Union
GAAP	Generally Accepted Accounting Principles
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standards

Accounting Directive	Fourth Council Directive 78/660/EC based on Article 54 (3) (g) of the Treaty on the annual accounts of certain types of companies
Consolidated Accounts Directive	Seven Council Directive 83/349/EEC based on the Article 54 (3) (g) of the Treaty on consolidated accounts
Insurance annual accounts Directive	Council Directive 91/674/EEC on annual accounts and consolidated accounts of insurance undertakings
Banks and other financial institutions accounts Directive	Council Directive 86/635/EEC on annual accounts and consolidated accounts of banks and other financial institutions
ESMA Regulation	Regulation 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC
IFRS Regulation	Regulation (EC) No 1606/2002 of 19 July 2002 of the European Parliament and of the Council on the application of international accounting standards
Markets in Financial Instruments Directive or MiFID	Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments
Prospectus Directive	Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading
Transparency Directive	Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market



## **I. Executive Summary**

### **Reasons for publication**

The Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the introduction of the international accounting standards in the European Union provided for the development of a common approach of enforcement by the Committee of European Securities Regulators (CESR), the predecessor of the European Securities and Markets Authority (ESMA).

CESR developed Standards No. 1 and 2 on the enforcement of financial information (CESR/03-073 and CESR/03-317c) in April 2003 and April 2004 respectively. Those standards provided for a common approach of enforcement by establishing principles defining enforcement and its scope, characteristics of the enforcers, selection techniques and other enforcement methods applicable, enforcement actions and coordination of enforcement. CESR also set up the European Enforcers Coordination Sessions (EECS), a forum in which national competent authorities and other bodies, to which enforcement activities are delegated, exchange views and discuss experiences relating to the enforcement of financial reporting requirements.

ESMA has decided to review the previous CESR Standards on enforcement and to propose guidelines on the enforcement of financial information based on experience gained by their use since 2005. This is based on ESMA's powers under Article 1(2) of the ESMA Regulation – to act within the scope of Directive 2004/109 and Directive 2003/71 – under Article 1(3) – to act in relation to market activities not directly covered by the act, but necessary to ensure its effective and consistent application – and on the fact that ESMA took over CESR's responsibilities.

Therefore, ESMA now plans to transform the CESR standards' principles into ESMA guidelines thus ensuring that enforcers of financial information will comply with them or report in a clear and detailed way the reasons for their non-compliance.

### **Content**

ESMA is issuing this consultation paper to inform market participants about the background to ESMA decision to revise the previous standards on enforcement.

Section II "Introduction" indicates who and what is the scope of the application of the proposed guidelines on enforcement of financial information, which are included in full in Annex III.

Section III "Background to the proposed guidelines on enforcement of financial information" describes the approach followed in developing the guidelines, the main developments compared to the previous CESR standards and the main principles to which enforcers should comply.

ESMA would appreciate any comments and answers from constituents on the questions contained in the consultation paper. For convenience, the questions are summarized in Annex I.

### **Next steps**

ESMA will consider the feedback it receives to this consultation in 2013 and expects to publish the final guidelines early 2014.



## II. Introduction

1. ESMA is of the view that in order to achieve a proper and rigorous enforcement regime to underpin investors' confidence in financial markets and to avoid regulatory arbitrage by issuers in the EU Single Market, there is a need for a common European approach to the requirements in the Transparency Directive on the enforcement of financial information.
2. Recital 16 of the IFRS Regulation on the application of international accounting standards provides that: "A proper and rigorous enforcement regime is key to underpinning investor's 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 of enforcement."
3. To this end, CESR developed Standards No. 1 and 2 on the enforcement of financial information in Europe (CESR/03-073 and CESR/03-317c) in April 2003 and April 2004 respectively. These standards provided for such a common approach by establishing principles defining:
  - a. enforcement and its scope;
  - b. characteristics of the enforcers;
  - c. selection techniques;
  - d. enforcement methods and actions, and
  - e. coordination of enforcement in the EU.

ESMA (at that time CESR) also established the European Enforcers Coordination Sessions (EECS), a forum in which national enforcers exchange views and discuss experiences relating to the enforcement of financial reporting requirements.

4. The use of the CESR standards, the discussions in EECS on enforcement decisions and other experiences with enforcement, led to the creation of a group to conduct a fact finding exercise on enforcement actions taken. This was followed by a decision in June 2010 to use the experiences gained through the use of the standards since 2005 and to revise the CESR Standards on enforcement. The proposed guidelines are the result of that work. They are principles-based with the main principles in black lettering and explanatory paragraphs in grey lettering. In order to comply with these proposed guidelines an enforcer has to comply with the guidelines as a whole, black lettering as well as grey lettering.
5. The proposed guidelines are principles-based and:
  - a. define enforcement and its scope;
  - b. set out expected characteristics of enforcer;
  - c. describe acceptable selection techniques and other aspects of enforcement methodology;
  - d. indicate the types of enforcement actions that may be available to enforcers; and
  - e. explain how enforcement activities are coordinated within ESMA.
6. These proposed guidelines apply in relation to the enforcement activities carried out to ensure that financial information in harmonised documents provided by issuers whose securities are admitted to trading, and by issuers who have applied for admission to trading of their securities, on a regulated market comply with applicable requirements. This includes:
  - a. financial information of issuers already listed on a regulated market who are subject to the Transparency Directive, as required by that Directive;



- b. financial information of issuers from third countries who use reporting frameworks which have been declared equivalent to IFRS, according to Commission Regulation no 1569/2007, and are listed or seeking listing in the EU Single Market;
  - c. financial information included in prospectuses by issuers applying for admission on a regulated market, as required by the Prospectus Directive (as disclosed further in the section “Enforcement activities”, further discussion on this matter is currently held).
- 7. These proposed guidelines apply to all competent authorities and any other bodies from the European Union undertaking enforcement responsibilities under the Transparency Directive, and IFRS Regulation and to countries from the European Economic Area who agreed to comply with the above mentioned regulation. They may, at the option of the competent authorities, also apply to other requirements e.g. management reports, in relation to financial information which issuers must comply with under national law.



### **III. Background to the proposed guidelines on enforcement of financial information**

#### **Objective, concept and scope of enforcement**

8. The elements mentioned below are reflected in the sections “Objectives of enforcement”, “Concept of enforcement” and “Scope of enforcement” in the proposed guidelines.
9. In order to ensure that enforcement in the EU will promote consistent application of the financial reporting standards and help avoid regulatory arbitrage, it is important to ensure that there is a common understanding of the enforcement objective across the EU.
10. The objective of enforcement (previously defined under Principle 1 of CESR Std. no. 1) has been revised in order to reflect the importance of compliance with the relevant financial reporting standards and transparency of financial information. These elements contribute to market confidence and investor protection. The concept of enforcement has been extended in order to include, in addition to the enforcers’ review of the financial information, any other actions which might contribute to enforcement such as for example issuing alerts.
11. Regarding the scope, ESMA noted that investor protection requires the extension of the scope of enforcement to the whole financial reporting framework applicable to listed issuers on the EU Single Market. This includes national GAAPs from the EU jurisdictions and third countries’ accounting standards, which have been declared equivalent to IFRS, according to European Commission Regulation no 1569/2007 and further amendments.

**Q1: Do you think that the proposed guidelines will improve the quality and consistency of financial reporting in Europe?**

**Q2: Do you have any comments on the potential costs to the financial reporting community of any aspects of these proposals?**

**Q3: Do you agree that a common European approach to the enforcement of financial information is required in order to avoid regulatory arbitrage by issuers? In this context, regulatory arbitrage refers to the position where an issuer’s choice of the market on which to list its securities may be influenced by different approaches to enforcement being applied in different European jurisdictions.**

**Q4: Do you agree with the objective, definition and scope of enforcement set out in these paragraphs 11 to 21 of the proposed guidelines?**

**Q5: Do you agree that issuers from third countries using an equivalent GAAP to IFRS should be subject to an equivalent enforcement and coordination system? Do you agree with the measures proposed to make this enforcement more efficient?**

#### **European enforcers**

12. The elements set out below are reflected in the section “European enforcers” in the proposed guidelines.
13. The Transparency Directive provides for the designation of the competent authorities and makes a reference to the central administrative competent authorities defined in the Prospectus Directive, but also gives the possibility of delegation to another body, with final responsibility for supervision being





maintained at the level of the competent administrative authority. For the purpose of the proposed guidelines the word “enforcers” is used to denominate all bodies undertaking enforcement activities.

14. The powers necessary for the performance of the enforcement functions are defined in the art. 24 of the Transparency Directive, but ESMA felt it was important to reiterate in the guidelines those powers which are particularly relevant for the purpose of enforcement of financial information.
15. To ensure effective enforcement, European enforcers should have sufficient resources. When considering the level of manpower required, the number and sophistication of issuers and the complexity of their financial statements within the scope of enforcement plays an important role. The probability of being selected for review and investigation, and the way in which the enforcement is performed, should be such that it is not restricted because of lack of resources, creating conditions for regulatory arbitrage by issuers.
16. Independence of enforcers is important when they perform their functions. In this context, independence implies that the authorities should not be unduly influenced by the government, issuers, auditors, users, other markets participants or market operators.
17. In order to ensure appropriate investor protection and avoid regulatory arbitrage by issuers, it is important that enforcers are not unduly influenced either by members of the political system or by issuers and their auditors. Enforcement responsibilities should not be delegated to market operators, as this would create a conflict of interest because the issuers subject to enforcement are at the same time customers for market operators.
18. Government should not be able to unduly influence the decisions taken by an enforcer as part of the enforcement process, whether ex-ante or ex-post enforcement activities. In addition, government should not be able to change the composition of the board or other decision-making body of the enforcer during the appointment period and hence make the enforcement less effective.
19. In practice, actions should be designed to ensure adequate independence from issuers and auditors and could include, but are not limited to:
  - a. the establishment of codes of ethics for those involved in the enforcement process;
  - b. cooling off periods; and
  - c. assurance that enforcement staff do not breach any independence requirements because of relationships with either the issuer or the audit firm involved.

Representatives of the above mentioned groups mentioned above should not be able to have a combined majority of votes in the decision making board of the enforcers.

**Q6: Do you agree that enforcers should have the powers listed in paragraph 30 of the proposed guidelines? Are there additional powers which you believe that enforcers should have?**

**Q7: Do you agree that enforcers should have adequate independence from each of government, issuers, auditors, other market participants and regulated markets? Are the safeguards discussed in paragraphs 38 to 41 of the proposed guidelines sufficient to ensure that independence? Should other safeguards be included in the guidelines? Do you agree that market operators should not be delegated enforcement responsibilities?**



## **Enforcement activities**

20. The elements mentioned below are reflected in the sections “Enforcement activities”, “Selection methods”, “Examination procedures” and “Enforcement actions” from the proposed guidelines.
21. Enforcement normally takes published financial information as its starting point. Hence, by nature, it is an ex-post activity which is carried out according to the examination procedures described in the proposed guidelines, and applied to the financial information selected based on the criteria indicated in the selection methods.
22. However, some enforcers have a well-developed pre-clearance system where issuers are able to secure an enforcement decision ex-ante, i.e. before they publish the relevant financial information. Therefore, it is proposed to not preclude the use of pre-clearance but ensure that certain conditions are in place when used in order to avoid pre-clearance decisions becoming general interpretations.
23. The subject matter of a prospectus is an offer to the public and/or an application for admission to trading on a regulated market of securities. Its only function is to provide information to the potential buyers about the issuer; based on this information the potential investor will take a decision to buy, or not, those securities. It contains historical and other financial information.
24. A prospectus needs approval from the competent authority. The approval of a prospectus is meant to ensure that the information in the document complies with the requirements of the prospectus regime. Due to the interest of the issuer and the information asymmetry between the issuer and the potential investor, the information in the prospectus might be biased, incomplete or inconsistent.
25. The Prospectus Directive defines the approval of a prospectus as follows: “approval’ means the positive act at the outcome of the scrutiny of the completeness of the prospectus by the home Member State's competent authority including the consistency of the information given and its comprehensibility”.
26. The purpose of enforcement on issues relating to financial information, as defined under the Transparency Directive, is to protect investors and promote market confidence by contributing to the transparency of financial information relevant to the investors’ decision-making process. Principle 12 of CESR Standard No. 1 says that: “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.”
27. The provision of full and consistent information concerning issuers of securities promotes the protection of investors. Moreover, such information provides an effective mean of increasing confidence in securities and contributes to the proper functioning and development of securities markets. The challenge for a competent authority is to make sure that no prospectuses with obvious inconsistencies is approved and to develop appropriate procedures for taking into account the risk related to an issuer.
28. It is the understanding of some enforcers of financial information that the approval of a prospectus implies checking that, at a minimum, the financial information included in the prospectus is consistent with the accounting principles and that this would involve a formal enforcement procedure of such financial information. Nevertheless there were different views on this matter and the extent to which financial information in prospectuses should be scrutinised, as it is considered that the limited timeline for approval of prospectuses creates difficulties in practice.

**Q8: Are you in favour of enforcers offering pre-clearance? Do you have any comments on the way the pre-clearance process is described and the pre-conditions set in paragraphs 42 to 45 of the proposed guidelines?**

**Q9: Do you agree that in order to ensure investor protection, the measures included as part of a prospectus approval should be supplemented by additional measures of ex-ante enforcement in relation to financial information? If yes, could you please specify the exact nature of ex-ante enforcement that you would expect from enforcers?**

29. An important step in the enforcement process is the selection of issuers for review. Selection should be based on a combination of a risk based approach and either random sampling or rotation or both. A pure risk based approach would mean that those issuers not fulfilling the risk criteria determined by the enforcer would never be subject to enforcement. A pure random system could mean that issuers with high risk are not selected on a timely basis. The same would apply to a pure rotation system and, in addition, there would be a possibility that an issuer would be able to estimate when its financial statements were likely to be selected for review.
30. Determination of risk should be based on the combination of the probability of infringements and the impact of a potentially significant infringement on the financial markets. The specific criteria for the selection methods are not made public, but they will be subject to internal coordination process within ESMA.
31. In order to ensure European supervisory convergence, when applying the relevant criteria for the selection method, enforcers should take into account the common enforcement priorities identified by enforcers under ESMA coordination.

**Q10: Do you agree that a risk-based approach for selection methods should not be used as the only approach?**

**Q 11: Do you agree that the risk-based approach should take into account both the risk of an individual misstatement and the impact of the misstatement on financial markets as a whole?**

**Q12: Do you think that a maximum period should be set over which all issuers should have been subject to at least one full review (or to be used to determine the number of companies to be selected in sampling)?**

**Q13: What are your views with respect to the best way to take into account the common enforcement priorities established by European enforcers as part of the enforcement process?**

32. The enforcement procedures might imply different types of review. As part of the enforcement process, European enforcers should identify the most effective way for enforcement of financial information. As part of the ex-post enforcement activities, enforcers can either use full reviews, or a combination of full reviews and partial reviews of financial information of selected issuers. Use of only partial reviews should not be considered as being satisfactory for enforcement purposes. Definitions of those terms are provided in the proposed guidelines.
33. A description of the examination procedures available to enforcers as part of the different types of review is included. The proposed guidelines require enforcers to ensure that examination procedures undertaken are sufficient to achieve an effective enforcement process, and that the examination



techniques used, and the related conclusions of the review of the financial information of the selected issuers are documented appropriately.

34. In order to ensure supervisory convergence and consistency of enforcement actions taken by enforcers in the EU Single Market, the proposed guidelines define the types of enforcement actions and when to use them in practice.
35. An important element in the enforcement process is the level of materiality. 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 under IFRS. ESMA has undertaken further work in this area and published a Feedback Statement on materiality application under IFRS in February 2013<sup>1</sup>.
36. As material misstatements could, by definition, have an impact on investor and other users' decisions, it is important that investors are not only informed that there is a misstatement, but are also provided with the corrected information on a timely basis.
37. Market participants should receive accurate information related to the financial information prepared by an issuer. The relevant information should be made available, either directly by the issuer or, alternatively by the enforcer, that should inform the market about any action which might have been taken by the enforcer.

**Q14: Do you agree that the examination procedures listed in paragraph 54 of the proposed guidelines are appropriate for an enforcer to consider using? Are there other procedures which you believe should be included in the list?**

**Q15: Do you agree that, in determining materiality for enforcement purposes, materiality should be assessed according to the relevant reporting framework, e.g. IFRS?**

**Q 16: What are your comments regarding enforcement actions as presented in paragraphs 57 to 67 of the proposed guidelines? Do you agree with the criteria proposed?**

## **European supervisory convergence**

38. The elements mentioned below are included in the sections "European coordination", "Objectives and functions of EECS", "Discussion of emerging issues and decisions", "EECS database and Reporting" from the proposed guidelines.
39. European enforcers have coordinated their activities on IFRS enforcement since the application of IFRS in Europe. Based on the experience gained over 8 years, ESMA proposed refining the principles previously included under the CESR Standard no. 2 and provides for further guidelines in order to ensure a common supervisory culture in the EU.

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<sup>1</sup> <http://www.esma.europa.eu/system/files/2013-218.pdf>



40. Although actions are taken at national level, the creation of the EU Single Market implies the existence of a similar level of investor protection across jurisdictions. Consistent enforcement requires coordination and a high level of harmonisation of actions among enforcers. In order to ensure proper and rigorous enforcement, and avoid regulatory arbitrage, ESMA has a role in ensuring convergence of enforcement approaches through coordination on ex-ante and ex-post decisions taken by enforcers.
41. The issuance of accounting standards and the interpretation of their application is reserved to standard setters. Therefore, ESMA and enforcers do not issue any general IFRS application guidance to issuers. Nevertheless, as part of their enforcement activities, enforcers have to apply their judgement in order to determine whether accounting practices are considered as being within the accepted range as permitted by the relevant reporting frameworks.
42. Reporting by ESMA of any material controversial accounting issues, as well as ambiguities and any lack of specific guidance, discovered during the enforcement process in cases of IFRS application to the bodies responsible for standard setting and interpretation (IASB and IFRS IC), is a necessary step in ensuring consistent application and enforcement. This is also the case for any other issues identified which create enforceability constraints during the enforcement process.
43. In order to achieve a high level of harmonisation in enforcement, meetings of EECS are organised on a regular basis by ESMA. The main function of EECS is to discuss and share experience on the application and enforcement of the relevant financial reporting framework, mainly IFRS, and to coordinate ex-ante as well as ex-post decisions taken by the European enforcers. Since the creation of ESMA, EECS also provides technical advice for the preparation of ESMA Statements and/or opinions on accounting matters.
44. The principles included in the proposed guidelines define the criteria that enforcers should use when submitting cases (emerging issues and decisions) for discussion at EU level and clarify that the outcome of discussions in ESMA should be taken into account for future decisions at national level. One important feature is to ensure that cases with specific characteristics (i.e. covering issues with European relevance because of their nature) are discussed in advance in order to ensure timely identification of practices which would not be in compliance with the IFRSs.
45. One important tool in the coordination of IFRS enforcement was the creation of the EECS database which already includes a significant number of decisions (more than 600) and emerging issues (around 250). The proposed guidelines clarify the submission criteria for the database and for periodical reporting.
46. Finally, in order to ensure transparency to market participants, the proposed guidelines include elements related to establishing common enforcement priorities at EU level and reporting from enforcers on enforcement decisions.

**Q 17: Do you have any comments on the specific criteria for the submission of decisions or emerging issues to the EECS database?**

**Q 18: What are in your opinion appropriate activities that would help to achieve a high level of harmonisation of the enforcement in Europe?**

**Q 19: Do you have any comments on the transparency, timing and frequency of the reporting done by the enforcers with respect to enforcement actions taken against issuers?**



**Q20: What are your views about making public on anonymous basis enforcement actions taken against issuers?**



## Annex I – Summary of questions

- Q1 Do you think that the proposed guidelines will improve the quality and consistency of financial reporting in Europe?
- Q2 Do you have any comments on the potential costs to the financial reporting community of any aspects of these proposals?
- Q3 Do you agree that a common European approach to the enforcement of financial information is required in order to avoid regulatory arbitrage by issuers? In this context, regulatory arbitrage refers to the position where an issuer's choice of the market on which to list its securities may be influenced by different approaches to enforcement being applied in different European jurisdictions.
- Q4 Do you agree with the objective, definition and scope of enforcement set out in paragraphs 11 to 21 of the proposed guidelines?
- Q5 Do you agree that issuers from third countries using an equivalent GAAP to IFRS should be subject to an equivalent enforcement and coordination system? Do you agree with the measures proposed to make this enforcement more efficient?
- Q6 Do you agree that enforcers should have the powers listed in paragraph 30 of the proposed guidelines? Are there additional powers which you believe that enforcers should have?
- Q7 Do you agree that enforcers should have adequate independence from each of government, issuers, auditors, other market participants and regulated markets? Are the safeguards discussed in paragraphs 38 to 41 of the proposed guidelines sufficient to ensure that independence? Should other safeguards be included in the guidelines? Do you agree that market operators should not be delegated enforcement responsibilities?
- Q8 Are you in favour of enforcers offering pre-clearance? Do you have any comments on the way the pre-clearance process is described and the pre-conditions set in paragraph 42 to 45 are described?
- Q9 Do you agree that in order to ensure investor protection, the measures included as part of a prospectus approval should be supplemented by additional measures of ex-ante enforcement in relation to financial information? If yes, could you please specify the exact nature of ex-ante enforcement that you would expect from enforcers?
- Q10 Do you agree that a risk-based approach to selection should not be used as the only approach as this could mean that the accounts of some issuers would potentially never be selected for review?
- Q11 Do you agree that the risk-based approach should take into account both the risk of an individual misstatement and the impact of the misstatement on financial markets as a whole?
- Q12 Do you think that a maximum period should be set over which all issuers should have been subject to at least one full review (or to be used to determine the number of companies to be selected in sampling)?
- Q13 What are your views with respect to the best way to take into account the common enforcement priorities established by European enforcers as part of the enforcement process?
- Q14 Do you agree that the examination procedures listed in paragraph 54 of the proposed guidelines are appropriate for an enforcer to consider using? Are there other



procedures which you believe should be included in the list?

- Q15 Do you agree that, in determining materiality for enforcement purposes, materiality should be assessed according to the relevant reporting framework, e.g. IFRS?
- Q16 What are your comments regarding enforcement actions as presented in paragraphs 57 to 67 of the proposed guidelines? Do you agree with the criteria proposed?
- Q17 Do you have any comments on the specific criteria for the submission of decisions or emerging issues to the EECS database?
- Q18 What are in your opinion appropriate activities that would help to achieve a high level of harmonisation of the enforcement in Europe?
- Q19 Do you have any comments on the transparency, timing and frequency of the reporting done by the enforcers with respect to enforcement actions taken against issuers?
- Q20 What are your views about making public on an anonymous basis enforcement actions taken against issuers?





## **Annex II - Cost-benefit analysis exemption**

### Cost-benefit analysis exemption

In accordance with Article 16(2) of ESMA Regulation, ESMA shall analyse the related potential costs and benefits of the guidelines only where it is appropriate, taking into account the scope, nature and impact of those. In view of the fact that these proposed guidelines are not addressed to financial market participants but to the competent authorities (and therefore do not impose costs (directly) on market participants) ESMA considers that it would not be appropriate to produce a cost benefit analysis in relation to these guidelines.



## **Annex III – Draft Guidelines on the enforcement of financial information**

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## I. Scope

### Who?

1. These guidelines apply to all competent authorities and any other bodies from the European Union undertaking enforcement responsibilities under the Transparency Directive, Prospectus Directive and IFRS Regulation. They also apply to countries from the European Economic Area who agreed to comply with the above mentioned legislation.

### What?

2. These guidelines apply in relation to the enforcement activities set out under the Transparency Directive and Prospectus Directive to ensure that financial information in harmonised documents provided by issuers whose securities are admitted to trading, and by issuers who have applied for admission to trading of their securities, on a regulated market comply with applicable requirements.
3. This includes:
  - financial information of issuers already listed on a regulated market who are subject to the Transparency Directive, as required by that Directive;
  - financial information included in prospectuses by issuers applying for admission on a regulated market, as required by the Prospectus Directive.
  - financial information of issuers from third countries who use reporting frameworks which have been declared equivalent to IFRS, according to Commission Regulation no 1569/2007.

These guidelines may, at the option of the competent authorities, also apply to other requirements in relation to financial information which issuers must comply with under national law.

### When?

4. These guidelines will become effective from one month from the publication of the adoption of the decision by the Board of Supervisors on the ESMA's website.

## II. Definitions

5. Unless otherwise specified, terms used and defined in the Transparency Directive have the same meaning in these guidelines. In addition, the following definitions, legislative references and abbreviations apply:

#### *Legislative references*

<i>Accounting Directive</i>	Fourth Council Directive 78/660/EC based on Article 54 (3) (g) of the Treaty on the annual accounts of certain types of companies
<i>Consolidated Accounts Directive</i>	Seventh Council Directive 83/349/EEC based on the Article 54 (3) (g) of the Treaty on consolidated accounts



<i>Insurance annual accounts Directive</i>	Council Directive <a href="#">91/674/EEC</a> on annual accounts and consolidated accounts of insurance undertakings
<i>Banks and other financial institutions accounts Directive</i>	Council Directive <a href="#">86/635/EEC</a> on annual accounts and consolidated accounts of banks and other financial institutions
<i>IFRS Regulation</i>	Regulation (EC) No 1606/2002 of 19 July 2002 of the European Parliament and of the Council on the application of international accounting standards
<i>ESMA Regulation</i>	Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing an European Supervisory Authority (European Securities and Markets Authority)
<i>Markets in Financial Instruments Directive or MiFID</i>	Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments
<i>Prospectus Directive</i>	Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading
<i>Transparency Directive</i>	Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market

### **Abbreviations**

<i>EEA</i>	European Economic Area
<i>EECS</i>	European Enforcers Coordination Session
<i>EU</i>	European Union
<i>ESMA</i>	European Securities and Markets Authority
<i>GAAP</i>	Generally Accepted Accounting Principles
<i>IASB</i>	International Accounting Standards Board
<i>IFRS</i>	International Financial Reporting Standards
<i>IFRS IC</i>	International Financial Reporting Standards Interpretation Committee

### **Definitions**

<i>Corrective note</i>	Issuance by an enforcer or an issuer, as required by an enforcer, of a note making public a material misstatement with respect to particular item/(s) included in the already published financial information and, unless impracticable, the corrected information.
<i>Enforcement of financial information</i>	Examining compliance of financial information with the relevant reporting framework, taking appropriate measures where infringements are discovered during the enforcement process and taking other measures relevant for the purpose of enforcement.
<i>European Enforcer</i>	Competent administrative authorities or bodies acting on their behalf in the EEA, also referred to as “enforcers”.



<i>Harmonised documents</i>	Documents are considered harmonised if the Transparency Directive or the Prospectus Directive requires their publication.
<i>Home member state</i>	<p>According to Directive 2004/109/EC Article 2 (i) (i) as amended by Directive 2010/73/EC, ‘Home Member State’ means:</p> <p>(i) in the case of an issuer of debt securities the denomination per unit of which is less than EUR 1 000 or an issuer of shares:</p> <ul style="list-style-type: none"><li>– where the issuer is incorporated in the Community, the Member State in which it has its registered office;</li><li>– where the issuer is incorporated in a third country, the Member State as referred to in point (iii) of Article 2(1) (m) of Directive 2003/ 71/EC.</li></ul> <p>The definition of ‘home’ Member State shall be applicable to debt securities in a currency other than Euro, provided that the value of such denomination per unit is, at the date of the issue, less than EUR 1 000, unless it is nearly equivalent to EUR 1 000;</p> <p>(ii) for any issuer not covered by (i), the Member State chosen by the issuer from among the Member State in which the issuer has its registered office and those Member States which have admitted its securities to trading on a regulated market on their territory. The issuer may choose only one Member State as its home Member State. Its choice shall remain valid for at least three years unless its securities are no longer admitted to trading on any regulated market in the Community.</p>
<i>Regulated market</i>	According to Directive 2004/39/EC Article 4, point 14 (also known as the <i>MIFID Directive</i> ), - regulated market “means a multilateral system operated and/or managed by a market operator, which brings together or facilitates the bringing together of multiple third-party buying and selling interests in financial instruments – in the system and in accordance with its non- discretionary rules – in a way that results in a contract, in respect of the financial instruments admitted to trading under its rules and/or systems, and which is authorised and functions regularly and in accordance with the provisions of Title III.
<i>Regulated information</i>	According to Directive 2004/109/EC, Article 2 (k) (also known as the <i>Transparency Directive</i> )- “means all information which the issuer, or any other person who has applied for the admission of securities to trading on a regulated market without the issuer's consent, is required to disclose under this Directive, under Article 6 of Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse) (1), or under the laws, regulations or administrative provisions of a Member State adopted under Article 3(1) of this Directive”.
<i>Relevant reporting framework</i>	IFRS and reporting frameworks deemed equivalent with IFRS as well as national generally accepted accounting principles (national GAAPs) used in the EEA. Requirements for management reports, as transposed from the EU Accounting Directives, are also included.
<i>Full review of financial statements</i>	A review of the issuer’s financial statements has covered all areas which are significant for that issuer under review.
<i>Partial review of financial statements</i>	<p>All other reviews of financial statements that can take one of the following forms:</p> <ul style="list-style-type: none"><li>- Focused review: the review of the issuer’s financial statements has covered only some specified areas, and not the entire financial statements.</li></ul>



- Thematic review: the review of the financial statements for a topic identified for all issuers selected for partial review.

*Restatement of financial statements* Reissuance of financial statements as a result of the need for correction of recognition, measurement and/or disclosure of elements of financial statements.

### III. Purpose

1. The purpose of these guidelines is to reinforce a common European approach, as required in recital 16 of the IFRS Regulation, to the enforcement of requirements in the Transparency Directive on financial information, and notably IFRS, and supervision requirements in the Prospectus Directive in order to achieve a proper and rigorous enforcement regime to underpin investors' confidence in financial markets and to avoid regulatory arbitrage by issuers. The guidelines are principles-based and define enforcement and its scope, set out characteristics expected of enforcers, describe acceptable selection techniques and other aspects of enforcement methodology, describe the types of enforcement actions that may be available to enforcers and explain how enforcement activities are coordinated within ESMA.

### IV. Compliance and reporting obligations

#### Status of the guidelines

2. This document contains guidelines issued under Article 16 of the ESMA Regulation. In accordance with Article 16(3) of the ESMA Regulation, competent authorities must make every effort to comply with them.
3. Competent authorities to whom the guidelines apply should comply by incorporating them into their supervisory practices. ESMA notes that under article 24(1) of the Transparency Directive, enforcement responsibilities are carried out by the competent administrative authorities designated in each Member State and/or in some cases by other bodies which have been designated or have received a delegation for this purpose. However, final responsibility for supervising compliance with the provisions of the Transparency Directive remains with the designated central competent authorities. Irrespective of which body carries out enforcement, competent authorities remain under the obligation to make every effort to comply with these guidelines

#### Reporting requirements

4. Competent authorities to whom these guidelines apply must notify ESMA whether they comply or intend to comply with the guidelines, with reasons for non-compliance, within two months of the date of publication by ESMA to [email address]. In the absence of a response by this deadline, competent authorities will be considered as non-compliant. A template for notifications is available from the ESMA website. Any change in the status of compliance must also be reported to ESMA.



## V. Guidelines on enforcement

### Background

5. Recital 16 of the IFRS Regulation on the application of international accounting standards provides: “A proper and rigorous enforcement regime is key to underpinning investor’s 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 of enforcement.”
6. To this end, CESR, the predecessor of ESMA, established the European Enforcers Coordination Sessions (EECS), a forum in which national enforcers exchange views and discuss experiences relating to the enforcement of financial reporting requirements. EECS is a permanent working group who reports to the Corporate Reporting Standing Committee (CRSC) of ESMA.
7. As indicated in its terms of reference which were revised in 2013, the main activities of EECS are the following:
  - Discuss emerging issues submitted by European enforcers or by ESMA
  - Discuss decisions and actions taken by European enforcers submitted to the EECS database
  - When relevant issues have been identified as not being covered by financial reporting standards or as being subject to conflicting interpretations, prepare the issues for referral to standard setting or interpretive bodies such as the IASB and the IFRS IC
  - Share and compare practical experiences in the field of enforcement such as selection, risk assessment, review methodology, contacts with issuers and auditors
  - Select and prepare communication of common European enforcement priorities
  - Provide advice on enforcement issues and draft ESMA statements, opinions or guidelines,
  - Assist ESMA in conducting studies or reviews on how IFRS is applied in practice
  - Advise ESMA on the publication of selected decisions
  - Organise educational sessions for enforcers.
8. CESR developed Standards No. 1 and 2 on the enforcement of financial information in Europe in April 2003 and April 2004 respectively (CESR/03-073 and CESR/03-317c). These standards provided for a common approach by establishing principles defining enforcement, its scope, characteristics of the enforcer, the selection techniques and other enforcement methods applicable, actions and coordination of enforcement.
9. The use of the standards and discussions in EECS on enforcement decisions and other experiences with enforcement led to the creation of a group under EECS to conduct a fact finding study on actions taken. This resulted in a decision taken by CRSC in June 2010 to revise the CESR Standards on Enforcement, taking into account the experiences gained through the use of the standards since 2005.
10. These guidelines are the result of this work. They are principles based with the main principles in black lettering and explanatory, elaborating and exemplifying paragraphs in grey lettering. In order to comply with these guidelines an enforcer has to comply with the guidelines as a whole, black lettering as well as grey lettering.

### **Questions**

*Q1: Do you think that these guidelines will improve the quality and consistency of financial reporting in Europe?*

*Q2: Do you have any comments on the potential costs to the financial reporting community of any aspects of these proposals?*

*Q3: Do you agree that a common European approach to the enforcement of financial information is required in order to avoid regulatory arbitrage by issuers? In this context, regulatory arbitrage refers to the position where an issuer's choice of the market on which to list its securities may be influenced by different approaches to enforcement being applied in different European jurisdictions.*

### **Objective of enforcement**

- 11. Guideline 1: The objective of enforcement of financial information included in harmonised documents is to contribute to a consistent application of the relevant reporting framework and, thereby, to the transparency of financial information relevant to investors' and other users' decision making process. Enforcement contributes to the protection of investors and promotion of market confidence as well as to the avoidance of regulatory arbitrage in the EU regulated financial markets.**
12. In order for investors and other users to be able to compare the financial statements of different issuers, it is important that the information they contain is based on a consistent application of the relevant reporting framework, in the sense that if facts and circumstances are similar the recognition, presentation, measurement and/or disclosures are similar to the extent required by that reporting framework.
13. For the purposes of enforcement, investors constitute the main users of the financial information. To ensure that enforcement of the financial reporting standards throughout the EEA is done in a similar way, enforcers should share the same understanding of these guidelines and react in a consistent manner if departures from the standards are detected.
14. This will not only promote consistent application of the reporting standards, contributing to the efficient functioning of the Single European Market, which is also important for financial stability, but will also result in avoidance of regulatory arbitrage.

### **Concept of enforcement**

15. For the purpose of these guidelines, enforcement of financial information is defined as examining compliance of financial information with the relevant reporting framework, taking appropriate measures where infringements are discovered during the enforcement process and taking other measures relevant for the purpose of enforcement.
16. Enforcement includes the examining of financial information to assess whether it is in accordance with the reporting framework. In order for enforcement to be effective, enforcers should take appropriate actions in accordance with these guidelines, where departures from the relevant financial re-





porting framework are detected, to ensure that, whenever necessary, the market is provided with accurate information compliant with the relevant financial reporting framework.

17. Enforcers may also seek to encourage compliance by issuing alerts and other publications to assist issuers in preparing their financial statements in accordance with the relevant financial reporting framework.
18. Enforcement of the requirements in the Transparency Directive is not restricted to financial information prepared in accordance with the relevant reporting framework. This includes requirements related to management reports and other disclosure requirements regulated by national legislation in accordance with the EU Accounting Directives and Prospectus Directive which are also subject to enforcement.

## Scope of enforcement

19. These guidelines apply to financial information in harmonised documents provided by issuers whose securities are admitted to trading, and by issuers who have applied for admission to trading of their securities, on a regulated market.
20. These guidelines apply to financial information included in all harmonised documents, including:
  - financial information of issuers already listed on a regulated market who are subject to the Transparency Directive, as required by that Directive;
  - financial information included in prospectuses by issuers applying for admission on a regulated market, as required by the Prospectus Directive.

These guidelines may apply also to other requirements in relation to financial information which issuers must comply with under national law.

21. As indicated in the introduction to these guidelines, they apply to any reporting framework applied by EEA listed issuers because the need for protection of investors does not depend on which reporting framework the issuer is using. IFRS is mandatory for all European issuers in their consolidated accounts while member states can allow or require that local GAAP is used in individual financial statements.
22. **Guideline 2: When supervising and enforcing financial information from third countries, as defined under article 24 of the Transparency Directive, European enforcers should ensure that they have access to appropriately skilled resources or otherwise should coordinate with ESMA and other European enforcers to ensure having the right resources and expertise. European enforcers within ESMA should coordinate enforcement in order to ensure consistency of treatment of financial information prepared by issuers from third countries.**
23. In accordance with the Transparency Directive, financial information of issuers from third countries are subject to enforcement by the enforcer in the EU home Member State. In such cases, financial information of an issuer may not be prepared using IFRS, but using another reporting framework which has been declared equivalent with IFRS according to European Commission Regulation no



1569/2007 and further amendments. These guidelines apply also to the financial information of issuers from third countries that use reporting frameworks which have been declared equivalent to IFRS, according to the above mentioned Regulation and further amendments.

24. Third country issuers may use third country GAAP when accessing regulated markets if that GAAP has been declared equivalent to IFRS by the EU. In such cases, if the responsible European national enforcer determines that it is not efficient or possible to carry out the enforcement itself, the enforcer may refer the task of examination of compliance with the relevant reporting framework to another enforcer or to a centralised team to be organised by ESMA at the request of enforcers. Nevertheless, the enforcement decision always remains with the responsible European national enforcer.
25. According to the Transparency Directive, Article 25.4, Member States may conclude cooperation agreements providing for the exchange of information with the competent authorities of third countries enabled by their respective legislation to carry out any of the tasks assigned by the Directive.

### **Questions**

*Q4: Do you agree with the objective, definition and scope of enforcement set out in paragraphs 11 to 21?*

*Q5: Do you agree that issuers from third countries using an equivalent GAAP to IFRS should be subject to an equivalent enforcement and coordination system? Do you agree with the measures proposed to make this enforcement more efficient?*

### **European enforcers**

26. Under article 24 (1) of the Transparency Directive, enforcement responsibilities are carried out by the competent administrative authorities designated in each Member State and/or in some cases by other bodies which have been designated or have received a delegation for this purpose. Final responsibility for supervising compliance with the provisions of the Transparency Directive remains, however, with the designated central competent administrative authorities of the relevant Member State.
27. According to article 24 (1) of the Transparency Directive, Member States shall designate a central competent administrative authority (cf. article 21 (1) in the Prospectus Directive) responsible for carrying out the obligations in the directive. However, when it comes to the obligation to examine that financial information is drawn up in accordance with the relevant reporting framework and take appropriate measures in case of discovered infringements, the Member States can choose not to use the securities regulator as the competent administrative authority, but instead give responsibilities to another body or cooperate with such a body.
28. The designated central competent administrative authority is responsible for enforcement, whether it carries out enforcement itself or whether it has delegated the task to another body. Any such delegated body must be supervised by the competent administrative authority and be responsible to it. The responsibility for the establishment and maintenance of an appropriate due process of enforcement remains with the competent administrative authority where delegation has taken place.
29. As the central competent administrative authority can be an authority other than the securities regulator represented in ESMA, these guidelines make clear that other authorities, including delegated bodies, shall also carry out enforcement in accordance with any guidelines issued by ESMA. This re-

quirement ensures that enforcement is carried out according to the same principles irrespective of the administrative position.

30. According to Article 24 (4) of the Transparency Directive, enforcers in all Member States shall have all necessary powers, which shall at least include:
  - a) the power to examine compliance of financial information in the harmonised documents with the relevant financial reporting framework,
  - b) the right to require any information and documentation relevant for enforcement at least from issuers and their auditors,
  - c) the ability to carry out on-site inspections and
  - d) the power to ensure that investors are informed of material infringements discovered and provided with timely corrected information.
31. In order to ensure that all relevant information can be obtained as part of the enforcement process, and in accordance with art.24.4 (a) of the Transparency Directive, when performing their functions enforcers shall also have the necessary powers to require information from the holders of shares or other persons exercising voting rights over an issuer and the persons that control them or are controlled by them.
32. To achieve a common approach on enforcement and ensure a level playing field, it is necessary that all enforcers have similar powers. They should have the power to monitor financial information in all harmonised documents from issuers, cf. Guideline 4 and art. 24, 4(h) of the Transparency Directive. They should also be able to perform the examination of financial statements to the same degree in all member states, in particular, by being able to require all information relevant for their enforcement from issuers and auditors.
33. In performing their function, enforcers should have the right to require necessary information irrespective whether a suspicion exists or not in relation to the issuer's financial information accuracy.
34. Enforcers should be able to ensure that, either by requiring issuers and/or by their own initiative, relevant markets are informed of material infringements and are provided with corrected information for the purpose of investor protection and the avoidance of regulatory arbitrage.
- 35. Guideline 3: Enforcers should ensure the effectiveness of enforcement activities. In order to do so, they should have sufficient human and financial resources to carry out their activities in an effective manner. The manpower should be professionally skilled, experienced with the relevant reporting frameworks and sufficient in number, taking into account the number of issuers subject to enforcement, their characteristics, the complexity of their financial statements and their ability to apply the relevant financial reporting framework.**
36. To ensure effective enforcement European enforcers should have sufficient resources. When considering the level of manpower required the number of issuers within the scope of enforcement, the complexity of the financial information and the ability of the preparers and auditors to apply the financial reporting play an important role. The probability of being selected for review and investigation and the degree by which the enforcement is performed should be such that it is not restricted because of lack of resources, creating conditions for regulatory arbitrage by issuers.

37. There should be sufficient financial resources to ensure that the necessary amount of manpower and services can be used in enforcement. The financial resources should also be sufficient to ensure that the manpower is professionally skilled and experienced.
- 38. Guideline 4: Enforcers should have adequate independence from government, issuers and auditors, other markets participants and regulated markets operators. Independence from government should imply that government cannot unduly influence the decisions taken by enforcers. Independence from issuers and auditors should be achieved through codes of ethics and through the composition of the board of the enforcer.**
39. In order to ensure appropriate investor protection and avoid regulatory arbitrage by issuers, it is important that the enforcer is not unduly influenced either by members of the political system or by issuers and their auditors. Enforcement responsibilities should not be delegated to market operators as this would create a conflict of interest matter because the issuers subject to enforcement are at the same time customers of the market operators.
40. Government should not be able to unduly influence the decisions taken by an enforcer as part of the enforcement process, whether ex-ante or ex-post enforcement activities. In addition, government should not be able to change the composition of the board or other decision-making body of the enforcer during the appointment period and hence make the enforcement less effective.
41. In practice, actions should be designed to ensure adequate independence from issuers and auditors and could include, but are not limited to: the establishment of codes of ethics for those involved in the enforcement process, cooling off periods and assurance that enforcement staff do not breach any independence requirements because of relationships with either the issuer or the audit firm involved. Representatives of these two groups should not be able to have a combined majority of votes in the decision making board of the enforcers.

### **Questions**

*Q6: Do you agree that enforcers should have the powers listed in paragraph 30? Are there additional powers which you believe that enforcers should have?*

*Q7: Do you agree that enforcers should have adequate independence from each of government, issuers, auditors, other market participants and regulated markets? Are the safeguards discussed in paragraphs 38 to 41 sufficient to ensure that independence? Should other safeguards be included in the guidelines? Do you agree that market operators should not be delegated enforcement responsibilities?*

### **Enforcement activities**

- 42. Guideline 5: For financial information other than that contained in prospectuses, ex-post enforcement is the usual procedure. Pre-clearance, if part of a formal process, is also permitted provided that the issuer has finalised its position on the accounting treatment concerned.**
43. Enforcement normally takes published financial information as its starting point. Hence, by nature, it is an ex-post activity which is carried out according to the examination procedures indicated in

these guidelines and applied to the financial information selected based on the criteria indicated in the selection methods. In addition, pre-clearance is sometimes used. Also informal communications of enforcers in relation to matters for attention are a common practice.

44. However, some enforcers have a well-developed pre-clearance system where issuers are able to secure an enforcement decision ex-ante, i.e. before they publish the relevant financial information. These guidelines do not preclude the use of pre-clearance but provide that certain conditions should be in place for its use. In particular, the issuer and its auditor should have determined the accounting treatment to be applied based on specific facts and circumstances as this will enable pre-clearance decision to be based on the same level of information as an ex-post decision. This will avoid pre-clearance decisions becoming general interpretations.
45. Pre-clearance must be part of a formal process, meaning that a proper decision is taken by the enforcer in the same way as if it was an ex-post decision. This includes the requirement that the enforcer cannot reverse its position after the financial information has been published if facts and circumstances have not changed or there are not any other substantial grounds and the enforcer has been completely and correctly informed about those facts and circumstances. This does not preclude discussions between enforcers and issuers and their auditors on accounting matters as long as the outcome does not constitute a decision.

### **Questions**

*Q8: Are you in favour of enforcers offering pre-clearance? Do you have any comments on the way the pre-clearance process is described and the pre-conditions set in paragraphs 42 to 45?*

- 46. Guideline 6: For Prospectuses ex-ante approval is the normal procedure as specified by the Prospectus Directive, which also identify the nature of the approval. Ex-post enforcement of financial information provided in prospectuses is possible as a supplementary measure after publication.**

### **Questions**

*Q9: Do you agree that in order to ensure investor protection, the measures included as part of a prospectus approval should be supplemented by additional measures of ex-ante enforcement in relation to financial information? If yes, could you please specify the exact nature of ex-ante enforcement that you would expect from enforcers?*

## **Selection methods**

- 47. Guideline 7: Enforcement is normally based on selection. The selection model should be based on a mixed model whereby a risk based approach is combined with a sampling and/or a rotation approach. A risk based approach should consider the risk of a misstatement as well as the impact of a misstatement on the market.**

48. Selection should be based on a combination of a risk based approach and either random sampling or rotation or both. A pure risk based approach would mean that those issuers not fulfilling the risk criteria determined by the enforcer would never be subject to enforcement. There should always be a possibility of an issuer being selected for review. A pure random system could mean that issuers with high risk are not selected on a timely basis. The same would apply to a pure rotation system and, in addition, there would be a possibility that an issuer would be able to estimate when its financial statements were likely to be selected.
49. Determination of risk should be based on the combination of the probability of infringements and the impact of a potentially significant infringement on the financial markets. The complexity of the financial statements should be taken into account. Characteristics such as the risk profile of the issuer and its management, ethical standards and experience of the management and their ability or willingness to apply the relevant financial reporting framework correctly, as well as the level of experience of the issuers' auditors with the relevant financial reporting framework should, as far as possible, be taken into consideration. While larger issuers are typically faced with more complex accounting issues, fewer resources and less experience in applying the accounting standards could be more prevalent among smaller and /or new issuers. Hence, not only the number but also the characteristics of issuers are relevant factors.
50. Indications from the auditor of misstatements, whether in their reports or otherwise, will normally trigger a selection of the financial information in question for investigation. Indications of misstatements provided by auditors or regulatory bodies as well as grounded complaints should be considered for enforcement investigations. On the other hand, an unqualified opinion from an auditor should not be considered as proving the absence of risk of a misstatement. Enforcement investigations should be considered where, after preliminary scrutiny, a complaint received appears reliable and relevant for a possible enforcement action.
51. In order to ensure European supervisory convergence, when applying the relevant criteria for the selection method, enforcers should take into account the common enforcement priorities identified by enforcers together with ESMA.
52. Selection models should comply with ESMA supervisory briefing on selection. Such criteria are not public because of their nature. Enforcers should communicate factors used as part of their national selection method and potential subsequent amendments to ESMA for information. ESMA will ensure confidentiality of such documents in line with ESMA Regulation. Such information will serve as a basis for envisaging any further potential developments in the criteria used for the selection methods.

### **Questions**

*Q10: Do you agree that a risk-based approach for selection methods should not be used as the only approach?*

*Q 11: Do you agree that the risk-based approach should take into account both the risk of an individual misstatement and the impact of the misstatement on financial markets as a whole?*

*Q12: Do you think that a maximum period should be set over which all issuers should have been subject to at least one full review (or to be used to determine the number of companies to be selected in sampling)?*

*Q13: What are your views with respect to the best way to take into account the common enforcement priorities established by European enforcers as part of the enforcement process?*

## Examination procedures

**53. Guideline 8: As part of the enforcement process, European enforcers should identify the most effective way for enforcement of financial information. As part of the ex-post enforcement activities, enforcers can either use full reviews or a combination of full reviews and partial reviews of financial information of issuers selected for enforcement. Use of only partial reviews should not be considered as being satisfactory for enforcement purposes.**

54. Examination procedures of an issuer's financial statements could include the following:
- a) Scrutinising the annual and interim (consolidated) financial reports, including any financial report published subsequently
  - b) Asking questions to the issuer, usually in writing, in order to better understand: the significant risky areas of the issuer, the significant accounting issues which arose in the year under review, how the issuer treated the significant accounting issues, and how the issuer's chosen accounting treatment complies with the relevant reporting framework.
  - c) Posing questions to or having meetings with the auditors of the issuer to discuss complex issues or issues of interest, depending on the needs of the examination process
  - d) Identifying accounting issues inherent in the issuer's industry, available, for example, from the EECS database
  - e) Engaging external experts, where considered necessary, to assist in providing industry or other specialist knowledge
  - f) Exchanging information concerning the issuer with other departments within the enforcer, for example, where the issues may concern market abuse, takeovers or major voting rights
  - g) Engaging in on-site inspections

Also the following procedures could be relevant as part of the examination process:

- a) Reviewing other relevant financial information made by the issuer
  - b) Reviewing recent press articles and accounting commentaries concerning the issuer and its industry
  - c) Comparing the issuer's financial reports to those of its competitors
  - d) Comparing key financial relationships and trends within the issuer's financial reports, both in the year under review and for prior periods
55. Enforcers should ensure that examination procedures undertaken are sufficient in order to achieve an effective enforcement process and that the examination techniques used and the related conclusions of the review of the financial information of issuers selected as part of the enforcement process are documented appropriately.
56. The conclusions of an enforcer following the examination procedures can take one of the following forms:
- a) A decision that no further investigation is needed

- b) A decision where an enforcer accepts that a specific accounting treatment is in accordance with the relevant financial reporting framework and no enforcement action is required
- c) A decision where an enforcer finds that a specific accounting treatment is not in accordance with the relevant financial reporting framework and whether it constitutes a material misstatement or an immaterial departure and whether an enforcement action is required.

### **Questions**

*Q14: Do you agree that the examination procedures listed in paragraph 54 are appropriate for an enforcer to consider using? Are there other procedures which you believe should be included in the list?*

### **Enforcement actions**

- 57. Guideline 9: An enforcer should be able to use the actions indicated below, which should be enforceable at the enforcer's initiative. Whenever a material misstatement is detected, the enforcer should in a timely manner take one of the following actions**
- a) **require a restatement,**
  - b) **require a corrective note, or**
  - c) **require correction in future financial statements with adjustments of comparatives, where relevant.**
- 58. Where an immaterial departure is left intentionally uncorrected by an issuer to achieve a particular presentation of an entity's financial position, financial performance or cash flows, the enforcer should require for its correction.**
- 59. Where an immaterial departure from the reporting framework is detected but there is a significant risk that it might become material in the future, the enforcer should inform the issuer about the departure and where appropriate, based on the nature of the item, require a change in the accounting treatment in future financial statements without adjustment of comparatives.**
- 60. Similar actions should be used where similar infringements are detected, after consideration has been taken of materiality.**
61. When deciding the type of action to be applied, enforcers shall take into account the following considerations:
- a) When deciding between requiring a restatement or a corrective note the final objective is that investors should be provided with the best possible information and an assessment should be made whether having the original financial statements and a corrective note provide users with sufficient clarity necessary for taking decisions or a restatement is the best solution;
  - b) When deciding to require either a correction in future financial statements or the publication of a corrective note or restatement at an earlier moment, different factors could be considered, namely:
    - the timing of the decision: for instance where the decision is very close to the date of the publication of the financial statements, a correction in the future financial statements might be appropriate;



- the nature of the decision and the surrounding circumstances:
  - where the market is sufficiently informed at the moment the decision is taken the enforcer could opt for a correction in the future financial statements;
  - where the decision relates merely to the way information was presented in the financial statements rather than to the substance (e.g. information is clearly presented in the notes whereas the relevant accounting framework requires the presentation on the face of the primary financial statements), the enforcer could also opt for a correction in the future financial statements.

The reason for the publication in the future financial statements should be stated clearly in the decision.

**62. Guideline 10: When determining materiality for enforcement, this should be assessed according to the relevant reporting framework used for the preparation of the financial information as of its reporting date.**

63. Materiality should be assessed in the same way for enforcement purposes and for reporting purposes. Where financial information is prepared in accordance with IFRS, the concept of materiality should be the same as that used in the IFRS Conceptual Framework and IAS 8 - *Accounting policies, Changes in Estimates and Errors*.
64. Under IFRS, omissions or misstatements of items are material if they could, individually or aggregated, influence the economic decisions that users make on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor.

**65. Guideline 11: Enforcers should ensure that actions taken are appropriately acted on by the issuers against which they were taken.**

66. As material misstatements could, by definition, have an impact on investor and other users' decisions, it is important that investors are not only informed that there is a misstatement but are also provided with the corrected information on a timely basis.
67. Market participants should receive accurate information related to the financial information prepared by an issuer. Therefore, when one of the actions a) or b) as mentioned above is taken, the relevant information should be made available, either directly by the issuer or, alternatively by the enforcer that should inform the market about the action taken.

**Questions**

*Q15: Do you agree that, in determining materiality for enforcement purposes, materiality should be assessed according to the relevant reporting framework, e.g. IFRS?*

*Q 16: What are your comments regarding enforcement actions as presented in paragraphs 57 to 67? Do you agree with the criteria proposed?*



## European coordination

- 68. Guideline 12: In order to achieve a high level of harmonisation in enforcement, European enforcers should discuss and share experience on the application and enforcement of the relevant financial reporting framework, and mainly IFRS, during organised meetings of the European Enforcers Coordination Sessions.**
69. In order to achieve a high level of harmonisation in enforcement, ESMA has set-up regular meetings of European Enforcers Coordination Sessions (EECS) in which all European enforcers shall be represented and participate.
- 70. Guideline 13: Although the responsibility for enforcement rests with national enforcers, in order to promote harmonisation of enforcement practices and to ensure a consistent approach among enforcers to the application of the relevant financial reporting framework, coordination on ex-ante and ex-post decisions taken should take place in EECS. European enforcers under ESMA coordination should also identify accounting matters and provide technical advice for the preparation of ESMA Statements and/or opinions.**
71. Although actions are taken at national level, the creation of a single EU securities market implies the existence of similar investor protection in all member states. Consistent enforcement in Europe requires coordination and a high level of harmonisation of actions among enforcers. In order to ensure proper and rigorous enforcement and avoid regulatory arbitrage, ESMA will promote harmonisation of enforcement approaches through coordination on ex-ante and ex-post decisions taken by enforcers.
72. The issuance of accounting standards and interpretations of their application is reserved to standard setters. Therefore ESMA and enforcers do not issue any general IFRS application guidance to issuers. Nevertheless, as part of the enforcement activities, enforcers have to apply their judgement in order to determine whether accounting practices are considered as being within the accepted range as permitted by the relevant reporting frameworks.
73. When IFRS are applied, material controversial accounting issues, as well as ambiguities and any lack of specific guidance, discovered during the enforcement process will be conveyed by ESMA to the bodies responsible for standard setting and interpretation (namely, the IASB and IFRS IC). This is also the case for any other issues identified which create enforceability constraints during the enforcement process.

## Discussion of emerging issues and decisions

- 74. Guideline 14: Discussion of cases can take place on either an ex-ante (emerging issues) or an ex-post (decisions) basis. Except in rare circumstances where the deadline imposed to an enforcer makes it impossible to prepare, present and discuss with EECS before a decision is taken, an accounting issue should be submitted as an emerging issue in any of the following situations:**

- **Where no prior decision has yet been taken on a particular accounting issue. This does not apply to matters where the standard is clear and where the infringement is equally obvious;**
- **Where the financial reporting issues are identified by European enforcers or ESMA as of significant importance for the European regulated markets;**
- **Where the enforcer disagrees with an earlier decision on the same accounting issue; or**
- **Where there is a risk of significant different treatments between issuers across Europe.**

**Enforcement decisions taken on the basis of an emerging issue should take into account the outcome of the discussion in EECS.**

75. An accounting issue can be presented as an emerging issue where the enforcer is looking for further guidance from other enforcers because of the complex nature of the accounting issue or where the enforcer is looking for further guidance because the issue might raise an enforceability issue.
76. To ensure effective and efficient discussions, emerging issues and decisions should be clear and concise yet include all relevant facts, issuer's arguments, the basis for the enforcer's rationale and the conclusion.
77. Accounting issues encountered by an enforcer, other than those when a standard is clear and infringement is obvious and on which no decision has yet been taken, should be brought to the attention of ESMA and discussed in EECS to ensure that a consistent enforcement approach is taken. In order to do so, enforcers should present such issues for discussion before they take a decision and take into account the outcome of the discussion in EECS. The outcome should also be taken into account by other enforcers. ESMA may also bring emerging issues to the EECS in case financial reporting issues are of significant importance to the European regulated markets.
78. A decision should be submitted to the EECS database if the decision fulfils one or more of the following criteria:
- The decision refers to accounting matters with technical merit;
  - The decision has been discussed as an emerging issue, unless it was decided otherwise during the discussion in the EECS meeting;
  - The decision will be of interest for other reasons to other European enforcers (this judgement is likely to be informed by EECS discussions);
  - There is a risk of significantly different treatments between issuers ;
  - A decision is likely to have a significant impact on other issuers;
  - A decision is taken on the basis of the provisions in IAS 1.19 or IAS 8.10 because an issue is not covered by a specific standard;
  - A decision has been overruled by an appeals committee or Court; and
  - A decision is apparently in contradiction with an earlier decision on the same or a similar accounting issue.
79. Emerging issues and decisions discussed in EECS normally refer to IFRS financial statements but could also cover financial reporting prepared under IFRS equivalent GAAP.
80. **Guideline 16: Enforcement decisions taken by enforcers should take into account earlier decisions on the same accounting issue, considering that similar facts and circum-**

**stances apply. Enforcement decisions include both ex-ante and ex-post decisions, as well as the outcome of discussions at EECS on decision on whether or not an accounting treatment is in accordance with the relevant reporting framework and the action related to it. Irrespective of the outcome of the discussion, the decision stands.**

81. In order to ensure a consistent enforcement regime throughout the EEA, enforcers should, before taking an enforcement decision, look for decisions taken by other European enforcers on the EECS database and take them into account, as well as taking into account the enforcer's own earlier decisions on the same accounting issue. This is the case irrespective of whether the decision is taken as a pre-clearance or as a decision based on published financial statements.
82. If an enforcer intends to take a decision which apparently is not in accordance with an earlier decision or with the outcome of a discussion of an emerging issue on the same or a similar accounting issue, the enforcer should discuss its tentative decision with the enforcer who took the earlier decision or present it as an emerging issue. This is in order to establish whether differences in facts and circumstances justify a decision which is different from the precedent.

### **Questions**

*Q 17: Do you have any comments on the specific criteria for the submission of decisions or emerging issues to the EECS database?*

*Q 18: What are in your opinion appropriate activities that would help to achieve a high level of harmonisation of the enforcement in Europe?*

## **EECS database and reporting**

**83. Guideline 17: Coordination in EECS shall be facilitated by the existence of a database. The objective of the database is to constitute a platform for sharing information on a continuous basis.**

84. An emerging issue that meets any of the submission criteria should normally be submitted no later than two weeks before the EECS meeting in which it is going to be discussed and using the template in Annex I.
85. All enforcement decisions that meet any of the submission criteria, as mentioned in paragraph 78, should be submitted to ESMA normally within three months of the decision being taken. The enforcer should submit the details of the enforcement decision, based the template for emerging issues. The time frame is set rather tight to avoid too many situations where already taken decisions that should have been taken into account in relation to later decisions are not known to other enforcers.
86. ESMA reviews all submissions for internal consistency, sufficiency of information and use of correct terminology and can require resubmission or the provision of additional information. Following a completed review, ESMA logs the enforcement decision into the database.
87. The EECS database shall contain the outcome of the discussion that took place during the meeting. The data management should also ensure that decisions related to accounting standards which become outdated are moved into a separate section and that decisions which are considered as being



without technical merit are also classified in a separate section. ESMA is responsible for maintaining the database.

**88. Guideline 18: In order to promote consistency of IFRS application, European enforcers within ESMA should decide on which decisions included in the database can be subject to publication on an anonymous basis. In addition to that, European enforcers under ESMA coordination should identify common enforcement priorities on a yearly basis.**

89. A selection of the decisions to be published should be made by enforcers under ESMA coordination. The main criteria to be fulfilled by decisions selected for publication are the following:

- The decision refers to a complex accounting issue or an issue that could lead to different applications of IFRS; or
- The decision is a relatively widespread issue among issuers or in a certain type of business and, thereby, may be of interest to other enforcers or third parties ; or
- The decision is on an issue on which there is no experience or on which enforcers have inconsistent experiences; or
- The decision has been taken on the basis of IAS 1.19 or IAS 8.10 because the issue is not covered by a specific standard.

90. In order to promote supervisory convergence, enforcers under ESMA coordination should identify common accounting matters for enforcement in the EU and communicate them to market participants sufficiently in advance before the end of the reporting period. While most of the areas should be common, some of them might not be relevant for all countries or are specific to some industries.

91. Definition of areas should be done sufficiently in advance in order to allow enforcers to include these in their enforcement programme as areas for review. Subsequently, the enforcers should report back in EECS meetings on findings and actions taken in those areas. ESMA would report in the following year to the market on these matters.

**92. Guideline 19: European enforcers should report periodically on the enforcement activities and their coordination in Europe.**

93. 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, depending on the confidentiality regime used.

### **Questions**

*Q 19: Do you have any comments on the transparency, timing and frequency of the reporting done by the enforcers with respect to enforcement actions taken against issuers?*

*Q20: What are your views about making public on anonymous basis enforcement actions taken against issuers?*



**Appendix I to Guidelines:  
Template for Emerging issues**

1. Date of submission
2. Issue reference number
3. Date discussed in EECS
4. Financial year end or period of the financial statements
5. Document (annual/interim/prospectus)
6. Pre-clearance
7. Jurisdiction and name of enforcer organisation
8. IFRS reference
9. Description of the case
10. Accounting treatment according to the issuer
11. Proposed response from the enforcer
12. Rationale of the enforcer
13. Questions to EECS members



## **Appendix II to Guidelines**

### **Template for submissions to database of decisions dealing with accounting issues (infringements or complex issues)**

Input to the database is decentralised and decisions are sent in electronic form to a holding area of the database by Enforcers using a standardised input form. The following details are recorded on the database:

1. Accounting issue (brief summary of the decision and the decisive factors)
2. Type of decision:
  - decision dealing with accounting issue
  - decision dealing with enforcement action
3. Date of submission to EECS
4. Date decision taken by enforcer
5. Date decision was discussed in EECS (if relevant)
6. Financial year end or period end to which decision relates
7. Type of document (e.g. annual report, interim report, prospectus)
8. Jurisdiction and name of enforcer organisation
9. Name of issuer and any group of which it is part (optional)
10. Market(s) where the securities are listed
11. Indicative market capitalisation of issuer and sector details
12. Key concepts from the decision (e.g. forbearance)
13. Standard or accounting requirement(s) involved
14. Issuer's financial accounting treatment:
  - Detailed description of accounting treatment including relevant facts and circumstances for decisions dealing with accounting issues
  - Brief description of issuer financial reporting treatment and/or disclosure adopted/proposed and the circumstances for decisions dealing with enforcement action
15. Rationale for enforcer decision including the rationale for the materiality assessment
16. Details of the corrective action taken e.g. restatement, corrective note and enforcer rationale and how it was communicated to the market (if the case)
17. Effect of the action taken
18. Outcome of any EECS discussion
19. Whether the decision is final or subject to any appeal process
20. Details of any court decision or appeals commission decision
21. Earlier decision number cross-reference (to precedent followed or contradictory precedent)
22. Auditor opinion (e.g. clean or qualified)
23. The name of the audit firm (optional)
24. Publication by ESMA - text of any selected information relating to the decision that ESMA has published
25. Decision discussed with the IFRS IC
26. Miscellaneous