



ENFORCEMENT OF FINANCIAL REPORTING

Recent events have highlighted the clear need for reliable enforcement of high quality financial reporting in Europe. Consistent with the EU's agreed financial reporting strategy on the adoption of IFRS (accounting standards) for European companies by 2005⁽¹⁾, FEE is today launching a timely discussion paper; outlining a strategy for achieving effective enforcement of accounting standards in Europe.

FEE supports the recent decision of the European Union requiring certain companies to use IFRS by 2005. However the enforcement issue still needs to be resolved if this positive step is to become a reality. FEE's new discussion paper examines how IFRS should be enforced in order to ensure the consistent and rigorous application of financial reporting standards throughout Europe by 2005⁽²⁾.

This FEE discussion paper addresses the enforcement of IFRS at European level. It is a clear example of the European accounting profession's desire to utilise its expertise proactively, providing solutions to difficult issues which are of value to the public interest, to the wider business community the profession serves, and to the profession itself. The paper should be seen in a capital markets context; it supports the creation of a fully integrated European capital market and contributes to the work of CESR⁽³⁾.

Enforcement is very much in the public interest; FEE has made it a priority to encourage a full and thorough debate on creating effective institutional oversight systems for accounting standards in each Member State, to accompany self-enforcement within the reporting enterprise and high quality external audits by the statutory auditor. It is imperative that all relevant players are involved in this discussion. Representatives of preparers, users and other market participants, existing enforcement bodies and Member States should provide input.

The discussion paper calls for:

- EU Member States to urgently review their arrangements for enforcement of accounting standards. Enforcement should be built on effective national enforcement bodies. Those countries without an effective enforcement body are recommended to establish one, based on the review panel model⁽⁴⁾.
- The creation of a European Enforcement Coordination⁽⁵⁾ (EEC). European coordination of the activities of the national enforcement-bodies is necessary to ensure consistency in application decisions within Europe and to avoid 'enforcement shopping'. Action needs to be taken by the EU Commission, CESR and all other relevant parties to establish the EEC.
- A flexible enforcement model, to extend enforcement to all IFRS companies, including public interest companies, banks and insurance undertakings and also other companies which use IFRS in their financial information.

- Enforcement should not result in standard setting. Enforcement bodies should be cautious in issuing interpretations and limit themselves to application guidance in individual cases. This guidance would be referred to IASB or to IFRIC as well as to EFRAG. EFRAG should consider whether to provide additional commentary to IASB giving EFRAG's assessment on general applicability and the need for IFRIC interpretations or amendments to IFRS.

It will be significant challenge for preparers, auditors, regulators and others to be ready to implement IFRS by 2005. It is essential, therefore, that the enforcement mechanisms chosen have strong stakeholder support. The paper outlines the criteria for effective enforcement systems and identifies the implications for companies, accountants and other stakeholders.

Concurrent with the suggestions outlined in the paper, FEE believes that there is a need to strengthen corporate governance arrangements so that they are equally effective across Europe.

Commenting on the paper, FEE Deputy President, Mr. David Devlin stated:

"Recognising that CESR has a major role to play, this paper calls for a review of existing enforcement arrangements, involving all market participants, in order to achieve widespread support for the enforcement mechanisms. This support is essential to the successful implementation of IFRS in Europe by 2005."

"FEE's discussion paper aims to stimulate an informed debate amongst the accountancy profession, stakeholders from the business community and Member States. Broad acceptance by all market participants is the best guarantee for the successful enforcement of high quality financial reporting in Europe."

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Notes for Editors:

1. The EU Commission's Financial Services Action Plan was adopted in March 2000 and the Lamfalussy Report on the Regulation of European Securities Markets in March 2001. This drive to create an integrated financial services market in the EU is endorsed at the highest level by Governments and by the European Parliament. One element of the plan is for all listed companies in the EU to prepare consolidated accounts using International Financial Reporting Standards by 2005.

In recent years FEE has been at the forefront in supporting the proposed EU Regulation on IFRS by establishing EFRAG (together with nine other European organisations). A main role of EFRAG is to provide European input to IASB and to recommend improvements to IFRS. To be ready by the 2005 deadline is a large challenge for preparers, auditors, regulators and others. For more on EFRAG visit: <http://www.fee.be/secretariat/EFRAG.htm>

For more information on the European Commission's Financial Services Action Plan and the Lamfalussy Report, visit the website of the Commission's Internal Market DG: http://europa.eu.int/comm/internal_market/en/index.htm

2. However, pending new EU Commission proposals on prospectuses, enforcement in relation to prospectuses is not specifically addressed in this paper.
3. The Commission's NOTE FOR THE INFORMAL ECOFIN COUNCIL OVIEDO 12 AND 13 APRIL includes the following policy action, which outlines CESR's role in the enforcement process:

Further development of EU and national enforcement mechanisms so as to ensure proper and harmonised application of IAS within the EU in co-ordination with the Committee of European Securities Regulators (CESR).

The note is available to download from:

http://europa.eu.int/comm/internal_market/en/company/company/news/ecofin_2004_04_enron_en.pdf

For more on the Committee of European Securities Regulators visit: <http://www.europafesco.org/v1/default.asp>

4. There are two distinct models of enforcement. The enforcement body with delegated power can be a securities regulator, (such as COB in France or CONSOB in Italy), or a body constituted by stakeholders for the specific purpose and referred to as review panel, (such as the UK Financial Reporting Review Panel).

Taking into account the public interest in financial reporting, it is necessary for there to be an official government body ultimately responsible for the establishment and maintenance of an enforcement body which is able to enforce IFRS in a proper and rigorous way and which could delegate power to the enforcement body. Equally it is clear that there are compelling advantages in involving a wide range of representation and expertise resulting in broader acceptance and better mutual communication of the parties concerned and coverage of all companies using IFRS.

There is no reason why both models could not co-exist in Europe. Indeed it may not be practical to expect to have precisely the same arrangements for enforcement in each country. Thus a mixed model comprising a public body in some countries and a review panel in others, both with delegated powers, would accommodate such necessary variations, while encouraging convergence in practice.

5. The coordination mechanism should be established as a partnership between the national enforcement bodies, whether they follow a securities regulator or a review panel model. The partnership mechanism will need to:
 - be confidential, such that an issue about a specific company does not become public knowledge in advance of a formal ruling;
 - respond quickly and work well in practice, so that the process engenders a high level of confidence;
 - be treated as if it is binding on enforcement bodies of all EU Member States, so that confidence in the process does not break down; and
 - be acknowledged as part of the solution, if and when individual decisions of general significance are made public.
6. The Discussion Paper is available free of charge and can be downloaded from the FEE website www.fee.be or ordered from Sylvie Romancide (Fax: + 32 (2) 231 11 12, Email: Sylvie_Romancide@fee.be).
7. The **Fédération des Experts Comptables Européens** (FEE) is the representative organisation for the accountancy profession in Europe. It groups together 38 professional bodies from 26 countries, including all 15 Member States of the European Union and 3 member countries of EFTA. Between them, these bodies have a combined membership of 450.000 individuals, of whom approximately 95% are from EU countries