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FESCO's response to the EU's new accounting strategy  
**The final report from the Expert Group on Accounting**



## **1. Introduction**

### **1.1 Executive summary**

The Expert Group concluded that as regards the endorsement mechanism of the EU's new accounting strategy FESCO has a central role to play in conveying the needs of the investors and the capital markets and its own views as to the enforceability of the International Accounting Standards. The securities markets supervisors know what information the markets need to function and have an insight into whether or not the suggested accounting standards are enforceable.

Therefore, FESCO should play an active role at the expert level, since this level is supposed to play the reactive as well as the pro-active role in the further development of the international standard setting process. The group concluded that an observer status for FESCO could be appropriate, assuming that FESCO, as an observer, would have the possibility of expressing its views in the discussions before a decision would be made at the regulatory level. According to the group an active role also implies that, in the hopefully few cases where FESCO disagrees with the decisions that are made at the expert level, FESCO would have the right to be consulted on these issues by the regulatory level.

On the basis of the Expert Group's recommendation, the Chairmen of FESCO agreed to advocate in a letter to Commissioner Bolkestein an active role for FESCO at the expert level as an observer.

Commissioner Bolkestein replied to FESCO's letter by saying that the Commission supports FESCO's request for an observer status in the Accounting Technical Committee. Furthermore, Commissioner Bolkestein stated that the Commission, who is to chair the regulatory level of the endorsement mechanism, will make sure that before any decisions are made at the regulatory level the members of the Accounting Regulatory Committee will be fully informed of any views that FESCO might have that are different from those expressed by the Accounting Technical Committee.

The Expert Group concluded that if enforcement is to be successful it would be necessary to have competent administrative authorities to supervise companies issuing listed securities, especially their compliance with the accounting regulation, and impose the sanctions. Furthermore, the group agreed that European legislation might be helpful in establishing the relevant characteristics that the administrative authorities should comply with. The Group agreed that sanctions available to these authorities in the member states should have an adequate minimum level and that the ultimate sanction should be the same in all the member countries.

Concerning the cross-border issue the group agreed that the approach by the prospectus group should be expanded to cover other aspects of information requirements, especially financial statements.

The Expert Group was encouraged by the FESCO Chairmen's meeting in Vienna to do further work on issues to do with the establishment and operation of a standing FESCO group



The Expert Group recommends to the Chairmen of FESCO that a standing Committee on Financial Reporting is set up.

The Expert Group recommends to the Chairmen of FESCO that a letter is sent to Commissioner Bolkestein notifying him of the FESCO's work in the enforcement area.

## **1.2 Background**

In June of last year the European Commission issued a Communication on its new accounting strategy "The EU Financial Reporting Strategy: The Way Forward"<sup>1</sup>. The Communication stated that all EU companies listed on a regulated market should be required to prepare their consolidated accounts in accordance with a single set of accounting standards, namely International Accounting Standards (IAS), from 2005, at the latest<sup>2</sup>. In the Communication, the Commission stated that it would present a formal proposal on the two-tier structure of the endorsement mechanism before the end of 2000. The proposal was presented on the 13<sup>th</sup> of February 2001.<sup>3</sup> The content of the proposal was not very different from the way the endorsement mechanism was presented in the Commission's Communication.<sup>4</sup>

The EU strategy as presented in the Communication consisted of two main parts - an endorsement mechanism and enforcement of the standards. The endorsement mechanism consists of overseeing the integration of IAS in the EU legislation and confirming that IAS will represent an appropriate basis for financial reporting by EU listed companies. In the Commission's Communication it is suggested that the endorsement mechanism should have a two-tier structure.

The Commission asked Fédération des experts comptables européens (FEE), which is an organisation representing the accountants in Europe, to contribute ideas about the structure of the expert level of the endorsement mechanism. This enquiry resulted in a draft report from the FEE<sup>5</sup> which gave a more explicit idea of how the two-tier structure, that was suggested by the Commission, could be constructed. The FEE had ongoing discussions with the Commission while they were drawing up their report, and therefore their report was looked upon as an indication of how the Commission's proposal on the structure of the institutional aspects of the two-tier endorsement mechanism would be.

The purpose of enforcement is to ensure that IAS will be properly enforced throughout the EU. The enforcement will contribute to comparable financial statements for the listed companies and a level playing field in Europe that would prevent regulatory arbitrage.

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<sup>1</sup> EU Financial Reporting Strategy: The Way Forward, Communication from the Commission to the Council and the European Parliament, Brussels, 13 June 2000, COM (2000) 359 Final.

<sup>2</sup> The Member States would be allowed to extend the application of IAS to unlisted companies as well as to individual accounts.

<sup>3</sup> Proposal for a Regulation of the European Parliament and of the Council on the Application of International Accounting Standards, Brussels, COM(2001) 80 final.

<sup>4</sup> However, the terms used for the two-tier structure were not the same. The political level in the Communication is called the regulatory level in the proposal, and the technical level in the Communication is called the expert level in the proposal. To avoid any unnecessary confusion the terms from the proposal will be the ones used in this report.

<sup>5</sup> Technical Level of the Endorsement Mechanism - The establishment of "The European Financial Reporting Advisory Group" (EFRAG), FEE, 2000.



The Commission's Communication was not very explicit concerning the enforcement issue although the Commission did designate FESCO to have a central role concerning enforcement of IAS. The Commission stated in its Communication that it looked to the European securities markets supervisors through FESCO to develop and implement a common approach to enforcement.

Therefore, the creation of the new EU accounting strategy raised a number of questions for FESCO. One of these questions was at what level FESCO should be involved in the endorsement mechanism and whether or not this work had any organisational implications within FESCO. Furthermore, FESCO needed to establish how it was going to help develop and implement a common approach to enforcement in the EEA.

### 1.3 The Establishment of the Expert Group

At the Chairmen's meeting in Paris on the 14<sup>th</sup> of September 2000, it was decided to set up an Expert Group on Accounting, that was to be chaired by Mr. Henrik Bjerre-Nielsen, Director General of the Danish Financial Supervisory Authority (DFSA). The group's task was to formulate a proposal for the future work of FESCO on accounting in response to the new EU accounting strategy. The work was to proceed on the basis of the FESCO issues paper on Accounting (FESCO/00-97) which raised a number of questions concerning FESCO's role in the endorsement mechanism and in the area of enforcement.

The group has consisted of the following members:

#### Chairman:

Mr. Henrik Bjerre-Nielsen	Finanstilsynet	Denmark
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#### Members:

Mrs. Edith Pfeiffer	Austrian Securities Authority	Austrian
Mr. Michel Colinet	Banking and Finance Commission	Belgium
Ms. Marketta Andersen	Rahoitustarkastus	Finland
Mr. Philippe Danjou	COB	France
Mr. Philipp Sudeck	Bundesaufsichtsamt für den Wertpapierhandel	Germany
Mr. Xenophon Avlonitis	Capital Market Commission	Greece
Ms. Mary Burke	Central Bank of Ireland	Ireland
Mr. Angelo Apponi	CONSOB	Italy
Mr. Carlo Biancheri	CONSOB	Italy
Mr. Pierre van de Berg	Commission de Surveillance	Luxembourg
Mr. Johan B.M. Penterman	Securities Board of the Netherlands	Netherlands
Mr. Eirik Bunæs	Kreditilsynet	Norway
Mr. Jarle Johansen	Kreditilsynet	Norway
Mrs. Teresa Almeida	CMVM	Portugal
Mr. Rafael Sánchez de la Pena	CNMV	Spain
Mr. Anders Torgander	Finansinspektionen	Sweden
Mr. Richard Thorpe	Financial Services Authority	United Kingdom
Mr. Stig Nielsen	Finanstilsynet	Denmark
Mr. Lars Østergaard	Finanstilsynet	Denmark

#### Observer :

Mr. Karel Van Hulle	European Commission
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#### Secretariat:

Mr. Frank Dankers	FESCO	
Ms. Anne Charlotte Helskov	Finanstilsynet	Denmark



The Expert Group on Accounting has held three meetings in Copenhagen. An interim report was given to the Chairmen's meeting in Vienna in December 2000 and the final report is to be presented at the Chairmen's meeting in Paris in March 2001.

## **2. The Endorsement Mechanism**

### **2.1 Introduction and background**

An important part of the Commission's Communication on The EU Financial Strategy - The Way Forward is the endorsement mechanism, which will oversee the integration of IAS in the EU legislation and confirm that IAS will represent an appropriate basis for financial reporting by EU listed companies. Therefore the role of the endorsement mechanism is not to reformulate or replace IAS, but to oversee the adoption of new standards and interpretations, intervening only when these contain material deficiencies or have failed to cater for features specific to the EU environment.

In the Commission's Communication it is suggested that the endorsement mechanism should have two levels - a regulatory level and an expert level. The creation of this two-tier structure raises the question of what role FESCO should play. In FESCO issues paper (00-097) a great deal of questions are raised about FESCO's role in relation to the Commission's financial strategy and especially in relation to the endorsement mechanism.

In the Commission's Communication it is suggested that the expert level should consist of highly qualified specialists. Fédération des Experts Comptable Européens (FEE), has been asked by the Commission to contribute ideas about the structure of expert level of the endorsement mechanism. Therefore, the FEE has drafted a report which gives a more explicit idea of how the two-tier structure, that was suggested by the Commission, can be constructed. One of the aspects of the FEE suggestion is that the expert level has been divided into two parts, a Technical Expert Group and a Supervisory Board. The Supervisory Board in the FEE draft carries out a Trustees function and gives the expert level the governance structure which it needs according to the FEE.

### **2.2 The two-tier system**

#### **2.2.1 The Expert Level**

According to the Commission's Communication the role of the expert level is to recommend the standards and interpretations that are to be used. Furthermore, it is the expert level's responsibility to examine whether the standards conform to the requirements in the Accounting Directives. In the event of non-conformity between an IAS and the EU Directives, it is also the expert level's responsibility to recommend appropriate changes to the Directives. Lastly, the level will also propose the dates by which the new IAS will apply within the EU.

The Commission's Communication is not very explicit in regards to the specific functions of the technical group. The FEE proposal on the other hand is much more specific in this area. The FEE paper stresses that the pro-active contribution to the work of IASC in the endorsement mechanism lies solely at the expert level with the Technical Expert Group<sup>6</sup>. The pro-active role is among other things to comment on discussion papers and drafts issued by the IASC or the Standing Interpretations Committee (SIC), and furthermore to

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<sup>6</sup> According to the FEE report the Technical Expert Group should have a limited size (8 to 10 members).

contribute to the development of technical and conceptual papers on emerging topics that could be brought to the attention of the IASC. The conclusion that the pro-active role lies solely at the expert level is also supported in the Commission's issues paper concerning the implementation of the EU Financial Reporting Strategy<sup>7</sup>.

In light of these two papers it is clear to the Expert Group that if FESCO wants to take part in the pro-active role then FESCO needs to be a part of the expert level, more specifically FESCO needs to participate in the group in charge of the technical work<sup>8</sup>.

The group also agreed that given FESCO's objectives in this area it was most appropriate to become an observer of the Technical Expert Group, if the FEE suggestion was implemented. This status would give FESCO the possibility of trying to influence the committees discussions and decisions without being committed by those decisions of the committee which are not in accordance with the views of FESCO, instead, FESCO would have the option of trying to get its views across at other levels of the system. Another advantage of this status would be that FESCO would know what was being discussed, but FESCO would not need to use the same amount of resources in connection with its participation in the work of the committee. Instead, FESCO could focus on the issues that were important to the securities markets and play an active role in those discussions. In the case of membership FESCO would be obliged to take part in all the discussions.

### **2.2.2 The Supervisory Board**

As mentioned earlier the FEE's proposal includes a Supervisory Board of a committee to be name EFRAG<sup>9</sup>. The Supervisory Board's role is to monitor the Technical Expert Group. The FEE draft suggests that such a board will ensure that all the views within Europe are taken into account and that the FEE sees the Supervisory Board as consisting of European organisations who represent the constituencies of the national standard setters. The FEE suggests that the Supervisory Board should consist of 12-14 members, and that the EU Commission and FESCO should be observers.

The responsibilities of the Board according to the FEE will be to select the members of the Technical Expert Group, appoint the Chairman of the Technical Expert Group, advise on the work program of the Technical Expert Group, monitor the Technical Expert Group, approve the budget for the expert level and organise the funding of the expert level. On the other hand, the board does not take part in the ongoing work in the Technical Expert Group.

The members of the Expert Group agreed that if the FEE proposal was accepted then given the way the tasks had been divided by the FEE between the Supervisory Board and the Technical Expert Group, it was much more important to be represented in the Technical Expert Group. This was due to the fact that the Technical Expert Group had been given the reactive as well as the pro-active role in the endorsement mechanism. Therefore it seemed to be a prerequisite for the advancement of FESCO's points of view in the standard setting process, that it was represented in the Technical Expert Group because this position would create the greatest possibilities for influencing the contents of the standards.

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<sup>7</sup> EU Financial Reporting Strategy - Implementation, Issues Paper to the Members of the Technical Subcommittee (TS), Brussels, 25 September 2000.

<sup>8</sup> The proposal from the Commission has confirmed that the pro-active role lies at the expert level.

<sup>9</sup> The Commission's proposal only mentions the Accounting Technical Committee.



### **2.2.3 The Regulatory Level**

The other level of the two-tier system suggested by the Commission's Proposal is the regulatory level. The regulatory level will be based on a committee composed of representatives from all the Member States and chaired by the Commission. In the Commission's paper on implementation it is suggested that the Commission will present the committee with a report that will contain a proposal on whether to accept/reject a standard based on the recommendations from the Accounting Technical Committee and views expressed by other parties (for instance FESCO).

The group concluded that FESCO should seek to obtain the possibility of expressing its views in the discussions before a decision would be made at the regulatory level. This would imply that, in the hopefully few cases where FESCO disagreed with the decisions that were made at the expert level, FESCO would have the right to be consulted on these issues by the regulatory level.

### **2.3 Interim report to the Chairmen FESCO**

The Chairman of the group presented the Expert Group's conclusions on FESCO's role in the endorsement mechanism at the FESCO Chairmen's meeting in Vienna in December. Based on these recommendations the Chairmen agreed to send a letter to Commissioner Bolkestein to advocate the importance of having FESCO as an observer of the expert level and FESCO's desire to be consulted at the regulatory level in the cases where it disagreed with the decisions that had been made by the expert level<sup>10</sup>.

A letter was sent to Commissioner Bolkestein on January 15<sup>th</sup>. Commissioner Bolkestein replied on February 12<sup>th</sup> by saying that the Commission supports FESCO's request for an observer status in the Accounting Technical Committee. Furthermore, Commissioner Bolkestein stated that the Commission, who is to chair the regulatory level of the endorsement mechanism, will make sure that, before any decisions are made at this level, the members of the Accounting Regulatory Committee will be fully informed of any views that FESCO might have that are different from those expressed by the Accounting Technical Committee.

## **3. Enforcement**

### **3.1 Introduction and background**

According to the Commission's Communication on the EU Financial Strategy - The Way Forward, the Commission looks to the European markets supervisors through FESCO to develop and implement a common approach to enforcement of IAS in Europe. Enforcement may generally be defined as the combination of supervision and sanctioning in cases of non-compliance with the rules.

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<sup>10</sup> At the time when the Chairman of the Expert Group on Accounting gave his interim report to the FESCO chairmen the formal proposal had not yet been presented. That is the reason why the terms used in the letter to Bolkestein, cf. Annex 1, are the terms used in the Commission's Communication.



International Accounting Standards must be properly applied and enforced to prevent the development of national IAS and to ensure efficient markets just like other information requirements. This applies to the primary securities markets as well as to the secondary markets. Furthermore, it is important that accounting standards are enforced at an adequate level throughout the EEA. A common approach to enforcement in the EEA is needed. Otherwise the goal of comparable financial statements for companies issuing listed securities will be undermined and a level playing field will not be possible.

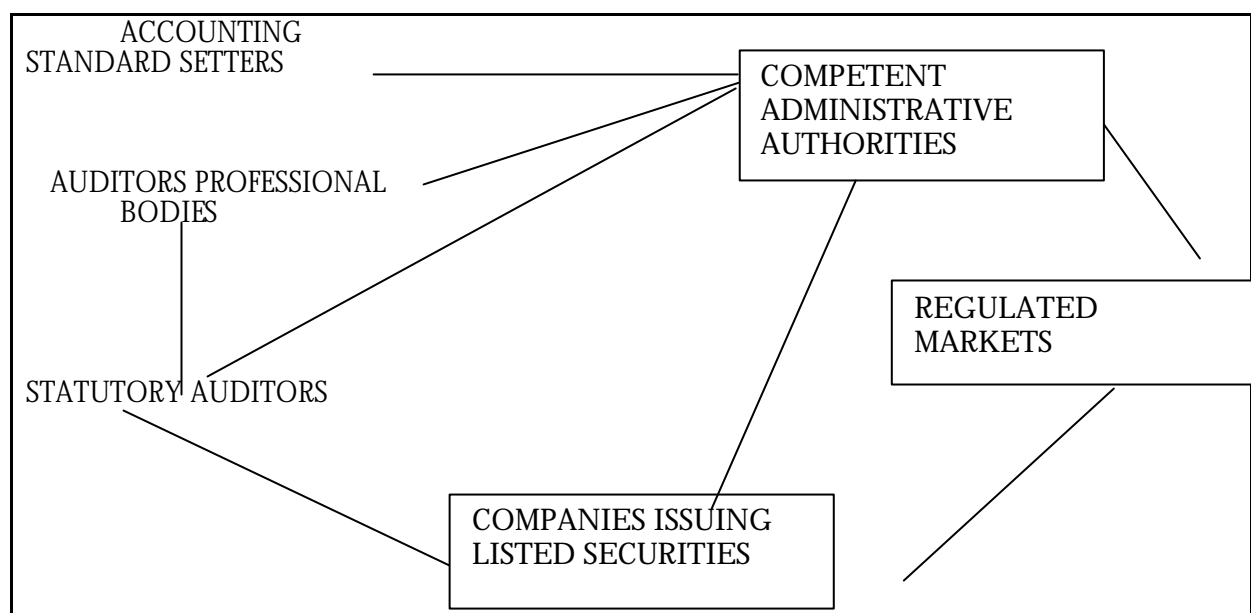
It is clear from the answers to the questionnaire on accounting competencies and policies sent out by FESCO (00-098b) that today there is a substantial diversity in this area between the FESCO member countries. FESCO's task in this area is to ensure that there is an adequate level of supervision of compliance with the future EU accounting legislation in all the member states, whereas it is less important who carries out the supervision as long as the competent authority fulfils certain characteristics.

If FESCO is going to play an active part in the development and implementation of a common approach to enforcement of IAS in Europe, there are a number of issues that FESCO needs to resolve, some of these are mentioned in FESCO issues paper (00-097). These issues include which characteristics authorities should have to in order to be considered competent in this respect, what needs to be supervised and how to improve the cross-border co-operation.

### 3.1.1 Descriptive overview of the present regulatory framework

Before looking closer at a common approach to enforcement it could be useful to present a general overview of the participants in the regulatory framework for financial information. The regulatory framework differs from country to country but figure 1 indicates the possible participants. The relationship between the participants may also vary from co-operation to monitoring. Therefore the lines in the figure are only an indication of the possible flows of information.

Figure 1: An overview of the present regulatory framework for supervision of financial information requirements for companies issuing listed securities.



## INVESTORS AND OTHER STAKEHOLDERS

The starting point is that the management of each company issuing listed securities is liable for providing the market with the necessary information according to the legal requirements and its contractual obligations. This liability is complemented by the responsibility of the statutory auditors of the companies, as some financial information provided to the market must be audited.

The competent administrative authorities and the accounting standard setters in most countries co-operate<sup>11</sup> and consult each other or have the opportunity to provide input when accounting standards are being developed, and when new standards are or need to be introduced in the regulatory framework.

In some countries there is also co-operation between the competent administrative authorities and the auditors' professional bodies. For instance, in some countries, the competent administrative authorities may ask for reports, explanations or information from the auditor regarding the companies issuing listed securities. In other countries the competent administrative authorities may exercise oversight on the development of auditing standards and ethical standards. Together they may establish and operate quality control systems and monitoring systems. The competent administrative authorities in these countries may exercise oversight over the results from the quality control systems (cf. the recent European Commission recommendation on this subject<sup>12</sup>), and furthermore oversight on ethical standards committees. In other countries such quality control, monitoring and standard setting systems are operated by the profession itself or by a chamber of auditors organised and supervised under public law. The administrative authorities in these countries largely rely on the control exercised by such systems.

The auditors' professional body may have the power to license the statutory auditors and to discipline them. In some cases, certain or all the listed companies must obtain the approval of the competent administrative authorities before the appointment of the statutory auditor. Furthermore, the professional body may have the power to set professional standards. Consultations between the auditors and their professional body may take place on technical and ethical matters.

Consultations between the competent administrative authorities and statutory auditors may also take place if needed. In some countries the competent administrative authorities and the statutory auditors may also propose reports on qualifications and suspected fraud (depending on national requirements). Disciplinary actions and sanctions are other issues that the two parties may discuss in these countries.

The competent administrative authorities approve prospectuses and give an agreement for the reference documents from the companies. Furthermore, the competent administrative

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<sup>11</sup> In some countries the securities regulators themselves are standard setters or involved in some aspects of standard setting (at least for financial and other specified types of companies).

<sup>12</sup> EU Commission's recommendation "Quality Assurance for the Statutory Audit in the EU: Minimum Requirements"

authorities may in most countries exercise oversight over financial information that is published by the companies issuing listed securities on a regular basis.

It is clear from this framework that the competent administrative authorities may build their work on the activities of statutory auditors, their professional bodies and the regulated markets – however this requires that these parties not only are financially liable for their actions but also are subject to adequate supervision from competent authorities.

### **3.2 The Competent Authorities**

If enforcement of IAS is to be successful it is necessary to have competent administrative authorities<sup>13</sup> to supervise the companies issuing listed securities and impose administrative sanctions. Credible supervisory authorities are competent administrative authorities that are characterised by having adequate independence from government, and market participants<sup>14</sup>, possessing the necessary powers and having sufficient resources. The necessary powers should among other things include the powers to scrutinise financial statements, require supplementary information from the companies issuing listed securities and take appropriate measures.

As mentioned above at present there are a number of countries where the regulated markets are responsible for enforcement on a private basis but such a structure may not be sustainable. This is due to the fact that these regulated markets may find themselves in a conflict of interest between their role as a profit making enterprise and the role as a supervisor of their own customers. The FESCO Standards for Regulated Markets (99-Fesco-c) have also stressed the possibility of a conflict of interest in this area. However, this potential conflict could be reduced by having the regulated markets supervised by competent administrative authorities and by giving the regulated markets a legal obligation to examine the companies issuing listed securities on their exchanges and report any irregularities including non-compliance with accounting regulation to the competent administrative authorities.

It is important that the bodies responsible for the supervision, sanctioning and other tasks in the enforcement process are formally acknowledged. The reason is that the enforcement systems in the EU at present are rather different in scope and legal powers, and that the Commission has emphasised the need to avoid supervisory arbitrage. The final report from the Committee of Wise Men<sup>15</sup> has also stressed this. Furthermore, as FESCO has concluded, the enforcement should be carried out primarily on a national basis. However, the only way to achieve an adequate level of enforcement in all Member States is to include a requirement to establish such enforcement by EU legislation.

EU legislation on this issue should include the overall guidelines concerning which powers the bodies responsible for supervising and sanctioning the companies issuing listed

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<sup>13</sup> "Competent administrative authority" is the same term that is used in article 18 of the draft for the new directive on prospectuses.

<sup>14</sup> This excludes the possibility of the enforcement system being operated by self regulating organizations (SROs) such as private auditors' organizations or company organizations or private organizations that are financed by either of these types of organizations.

<sup>15</sup> "Final report from the Committee of Wise Men on the Regulation of European Securities Markets", Brussels, 15 February 2001

securities should possess<sup>16</sup>. In this respect, EU legislation might help clear up possible conflicts between different administrative authorities in the Members States concerning who is responsible for the supervision and sanctioning of the companies. EU legislation should, however, not state specifically which authority can or can not fulfil this responsibility. By notifying the Commission of which authorities have been chosen in the different member states, the Commission can make up a list of competent authorities throughout the EU.

### **3.3 Supervision and sanctioning**

Supervision is an essential part of ensuring that the markets receive sufficient, timely and correct information about the companies issuing listed securities. This in turn helps protect the investors and helps maintain the integrity of the securities markets.

The supervision performed by administrative authorities which have the competencies describes above will have to contribute to ensuring that companies issuing listed securities comply with financial information requirements including International Accounting Standards. This is especially important because financial statements are a crucial source of information for the markets and enable the investors to make informed decisions. Therefore, FESCO members should agree on the adequate level of supervision in this regard.

For reasons of efficiency, supervision must be based on selection. The intensity of supervision of each company must be related to the competent administrative authorities' assessment of the risk of non-compliance with financial information requirements and their potential consequences.

The other issue is what form a supervision of the listed companies should take. It all depends on the situation which type of supervision is best. Ex-ante approval is best suited for the primary market – i.e. prospectuses. In the secondary market – i.e. for already listed securities ex-post supervision of the financial statements of the company is the preferred method. This differentiation is due to the nature of the situations. In the case of the prospectus the company may be unknown to the supervisor but in the case of the secondary markets the companies may have a reputation for properly fulfilling its financial information requirements and therefore in general there is not the same need for supervision. Furthermore, ex-ante approval would result in the markets receiving the financial statements at a much later date.

Finally, it must be observed that supervision of financial statements is a two-step procedure. The first is concerned with whether the stated accounting policies are in line with required accounting standards. The second is concerned with whether the accounting rules actually in use are in line with the stated accounting policies. In practice it may be impossible for the supervisor to perform the second step without taking into consideration the work of the auditors – either employed or appointed by the supervisor.

In the countries where the regulated markets are supervised by competent administrative authorities and the regulated markets have a duty to examine the companies issuing listed

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<sup>16</sup> FESCO places great emphasis on the fact that the EU legislation of the primary and secondary markets respectively is consistent.

securities on their exchanges on a private basis and report any irregularities to the competent administrative authorities, the competent administrative authorities have two supervisory functions. One is to carefully examine the cases that the regulated markets have reported concerning possible irregularities. The other function the regulator has is to take samples of companies issuing listed securities in order to assess whether or not the regulated markets live up to their obligations in the area of quality control.

At present, there is a large degree of diversity between the FESCO Members concerning what sanctions are available and which sanctions are imposed when accounting standards and other information requirements are not met. The objective of sanctions is to contribute to providing the right information to the markets.

Sanctions can have various forms: public criticism, fines, suspension of listing, and combinations of these sanctions. A large diversity in the use of sanctions may create incentives for regulatory and supervisory arbitrage because the companies may seek the jurisdiction where the sanctioning is less strict compared to other jurisdictions. To minimise the potential arbitrage the members of FESCO should consider harmonising their sanctions, at least by having the same ultimate sanction, namely delisting. This sanction should only be used in very extreme cases and as a last resort. This is due to the fact that the company issuing listed securities is hurt by the decision to delist. On the other hand the threat of delisting has to be credible in order to serve as a deterrent.

### **3.4 A European Passport for Issuers**

Once the EU's new accounting strategy has been put into effect in 2005, all EEA companies issuing listed securities as well as the companies preparing admission to trading will be required to prepare their consolidated accounts in accordance with one single set of accounting standards. Furthermore, Member States will be allowed to extend the application of IAS to unlisted companies as well as individual accounts. This initiative is expected to induce the European securities markets to grow and eventually help develop a deep liquid single capital market.

The possibilities that have been created for such companies as a consequence of these developments raise the question of how FESCO should organise cross-border co-operation among the members. The Expert Group concentrated its considerations primarily on the case of dual listing, where the issuing company is listed in its country of registration as well as in another EEA country.

The report from the expert group, which was chaired by Mr. Salvatore Bragantini of CONSOB, was adopted at the FESCO-meeting in Vienna in December of last year and deals with the issue of mutual recognition of prospectuses in Europe. The report "A "European Passport" for Issuers" (Fesco/00-138b) stated that FESCO wished to create the opportunity for an issuer to make European public offers to all European investors or to apply for listing in a manner that simplifies regulatory compliance of issuers while at the same time ensuring proper investor protection.

The idea is to create a "European Passport" that allows issuers to extend their offers (or to apply for listing) to other EEA states without having to produce duplicative sets of

documentation or respond to numerous additional national requirements and, also, to facilitate the access to approved documents for all European investors.

The report suggests that once the prospectus has been approved by the home country authority the issuer may make an offer or list its securities in the other EEA states simply by notifying its intention to the competent authorities of the countries where it is making the offer. This is based on the mutual recognition of competent authorities within the EEA.

This approach solves the enforcement problem of the primary markets – but not of the secondary markets. The largest enforcement problem lies in supervising the listed companies once the prospectus have been approved. Therefore, there is a need to extend this principle of home country supervision to the recurrent information requirements concerning financial statements. There is also a strong need to harmonise the object of that supervision, i.e. the recurrent information requirements for the companies issuing listed securities (as for prospectuses). It is interesting here to note the huge difference in substance between the EU directives (and other FESCO or European initiatives) harmonising the regulations applicable to prospectus matters and the only one directive co-ordinating requirements regarding information to be published on a regular basis by companies issuing listed securities (Council directive 82/121/EEC of 15 February 1982). A first work plan could be to develop harmonised requirements in the field of ongoing information.

This principle implies that if the company is listed in its home country it is allowed to issue and list securities in all the Member States. This corresponds to the procedures for banks, insurance companies, securities brokers and other financial companies, who are under supervision in one Member State can do business in all member states because there is mutual recognition.

This procedure would have several advantages. First of all, it would be clearer to both the companies and the public that there are special requirements for companies issuing listed securities. Secondly, it would make it easier to make the management of the companies aware of the requirements. Thirdly, it would be easier for the authorities to supervise that the requirements are fulfilled, since this would be a prerequisite for being present on both the primary and the secondary markets. Fourthly, it would be fairer to the companies to gather the requirements in one set of rules and thereby contribute to transparency in regulation.

The passport should be European in its scope (i.e. valid in the EEA) and therefore common rules have to be laid down in an EU-directive. The passport should ultimately be granted by the home country authorities and be subject to mutual recognition. The company will thereby get a European passport to be an issuer of listed securities. This would enhance the European integration.

If the home country authority withdraws the passport to be an issuer of listed securities because the company no longer fulfils the requirements the listing of the company's securities would no longer be permissible on any of the EEA regulated markets. The passport should only be withdrawn in case of severe and/or repeated non-compliance with the established requirements. Normally, it should not be necessary to withdraw the passport, the mere possibility should normally be sufficient for the competent authorities to ensure compliance with the rules.



The regulated market on which the company's securities are listed should have the authority to delist the securities or to impose sanctions if the rules of that market are not obeyed. The home country should then have the obligation to decide whether the license to be an issuer of listed securities should be withdrawn as well. This would e.g. not necessarily be the case if the delisting were made because of insufficient liquidity and/or an insufficient traded volume.

The already existing issuers of listed securities should automatically receive a passport, which of course can be withdrawn if the issuer does meet the requirements.

Dual listing is however not the only case, where an issuing company is listed outside its home country. At present an issuing company may only be listed in a host country. This practice may be more frequent in the future as a result of the consolidation of regulated markets. As a consequence of this, the need for guidelines to determine which country is responsible for supervising which listed companies will grow. The Wise Men have also stressed in their Final Report one of the priorities that should be adopted and brought into affect at the latest by the end of 2003 as "A single passport for recognised stock markets (on the basis of the home country control principle)".

This issue needs to be considered in depth but it would be too comprehensive to deal with in this report. The Expert Group recommends that such guidelines be based on objective criteria and that FESCO needs to maintain a consistent approach for dealing with information requirements and supervision across borders.

As is clear from the preceding pages there is a growing need for co-operation between the competent administrative authorities in Europe due to the present developments. It must also be stressed that there is a need for bilateral consultations and exchange of information if the implementation of the new financial reporting strategy is to be a success.

#### **4. Future Work**

If FESCO is to meet the challenges that lie ahead as a result of the Commissions new accounting strategy FESCO needs to establish a standing Committee on Financial Reporting to co-ordinate FESCO's view on endorsement as well as enforcement of IAS.

The Expert Group finds that it is most expedient to set up a standing Committee that co-ordinates FESCO's work in the area of endorsement and enforcement. A co-ordination of the work in these two areas is needed because these two areas are so closely linked. The Expert Group believes that the accounting experts could benefit from hearing about the experiences in the enforcement area, so that they can be made aware of any possible difficulties in the enforcement area due to the approved standards. In return, the accounting experts might help the enforcement experts with understanding and interpreting the standards through the thorough knowledge that they have achieved by examining and discussing existing standards as well as new standards. In this way a co-ordination of the endorsement and enforcement aspects is possible.

One possible way of structuring the work would be to have a Committee with an obligation to co-ordinate the work that is being done in the two areas and then set up two permanent subcommittees, one dealing with enforcement issues and the other dealing with endorsement issues. The advantage of this approach is that FESCO's work in the two areas



will be co-ordinated and at the same time the subcommittees will have a size that is not an impediment to their efficiency.

It is clear from the Expert Group's discussions that there is quite a lot of work for FESCO in both areas and therefore one possible way of ensuring that progress will be made in both areas is to set up two permanent subcommittees which report to the standing Committee on Financial Reporting. The endorsement mechanism creates a need for a permanent subcommittee to ensure that the necessary support is present for the observer of the Accounting Technical Committee, if FESCO becomes an observer as has been requested. A permanent subcommittee is also necessary to ensure FESCO co-ordinates its views on the accounting issues and it is a prerequisite for the pro-active role that FESCO wishes to have at the expert level of the endorsement mechanism. This is due to the fact that a permanent subcommittee will help enhance the knowledge of the accounting standard setting discussion among the FESCO members. It is crucial that FESCO is capable of playing a part in the discussions since the financial statements provide a very important part of the information given to the capital markets from companies issuing listed securities. Furthermore, FESCO has a major role to play in ensuring that new standards on the one hand are beneficial to financial markets, and on the other hand are enforceable.

For FESCO to be able to live up to its designated role by the Commission it would seem appropriate also to have a permanent subcommittee dealing with enforcement issues. This subcommittee should be a forum where the FESCO members could exchange views and experiences on methods for supervising the companies issuing listed securities. This subcommittee should also be instrumental in establishing standards of best practices or a peer review. One of the subcommittee's tasks would be to give recommendations on how to converge supervisory practices, including sanctions.

Another task for the Committee and its subcommittee's is to help produce implementation guidance that facilitates common application of IAS in the FESCO member countries.

It should also be possible for the subcommittees to set up other smaller subgroups if the need arises. Smaller subgroups are more expedient for exploring issues in greater depth and are better suited for including experts in the discussions. Another advantage of subgroups is that the workload could be more equally divided among the FESCO members. The work of the subgroups should then be discussed in the subcommittees and eventually, in the Committee.

The Expert Group will suggest to the FESCO Chairmen that they should set out the overall guidelines for the standing Committee's work, (cf. Annexe 1). Whenever necessary, the guidelines can be amended by the Chairmen. This structure will supply efficiency, which may be useful in relation to FESCO's participation in the Accounting Technical Committee. The standing Committee will give a yearly report to the FESCO Chairmen.

All FESCO members who want to be part of a subcommittee or a subgroup should be invited to appoint a member. It should also be possible for the member to be accompanied by an accounting expert (standard setter) and for an enforcement expert if a member finds it appropriate.

One of the first tasks is to assess IAS. It is important for FESCO's credibility as an organisation that FESCO proceeds to a formal review of IAS. To this aim, for the sake of



efficiency and to avoid duplication, it should build on the work already carried out by IOSCO and on existing papers from the European Commission.



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(Annex 1 of the document ref.  
FESCO/01-039b: FESCO's response to the  
EU's new accounting strategy – The final  
report from the Expert Group on  
Accounting)

**TERMS OF REFERENCE ON THE  
ORGANIZATION AND FUNCTIONING OF COMMITTEE ON FINANCIAL REPORTING  
(FESCOFIN)**

1. The purpose of the standing Committee on Financial Reporting is to enable FESCO to play an active role in the implementation and enforcement of IAS in Europe Union in the context of the EU's new accounting strategy. The Committee is to provide the necessary support to FESCO's observer at the expert level of the endorsement mechanism put in place to legally endorse IAS for their application in the Union. Furthermore, the Committee will help ensure that FESCO lives up to the pro-active role that FESCO intends to have at the expert level of the endorsement mechanism but also in ensuring the effective and proper application of IAS by EU listed companies.
2. These objectives can best be achieved by having a standing Committee on Financial Reporting to co-ordinate the work of the FESCO members in the area of endorsement and enforcement. This Committee is to establish two permanent subcommittees, one dealing with enforcement issues and the other dealing with endorsement issues of the EU's new accounting strategy.

The permanent subcommittee on enforcement is to be a forum where the FESCO members could exchange views and experiences on methods for supervising the companies issuing listed securities. This subcommittee should also be instrumental in establishing standards of best practices or a peer review.

One of the first tasks for the Committee and its subcommittee's is to assess the existing IAS. It is important for FESCO's credibility as an organisation that FESCO proceeds to a formal review of the IAS. To this aim, for the sake of efficiency and to avoid duplication, it should build on the work already carried out by IOSCO and on existing papers from the European Commission.

It is also possible for the subcommittees to set up other smaller subgroups if the need arises. Smaller subgroups are more expedient for exploring issues in greater depth and are better suited for including experts in the discussions. The work of the subgroups should then be discussed in the subcommittees and eventually, in the Committee.

3. FESCO Chairmen will appoint the Chairman of the Committee on Financial Reporting for two years.



4. The Committee should consist of senior Officials of the FESCO members who are responsible for surveillance and enforcement of compliance with information requirements. The permanent subcommittees should consist of experts responsible for endorsement i.e. accounting experts (standard setters) and experts responsible for enforcement of compliance with information requirements.
5. The Secretariat will provide the technical support to the work of the group. The Chairman of the Committee on Financial Reporting will report to the FESCO Chairmen once a year on the activities of the group.