Comments on the CESR Consultation Paper regarding the Proposed Statement of Principles of Enforcement of Accounting Standards in Europe

13 January 2003

Deutsches Aktieninstitut e.V. is the association of German listed stock corporations and other companies and institutions which are interested in the capital markets with a particular focus on equity. Its most important task is to promote the acceptance for equity among investors and companies. It also represents the interests of the financial centre as a whole.

I. Introduction

Deutsches Aktieninstitut e.V. welcomes the Statement of Principles (SOP) as a further step on the road to an integrated European financial centre. The SOP offers another general foundation that is intended to help create a "level playing field" on the capital market in Europe.

Regarding their legal character, it should be noted that these principles do not automatically become valid as national law. Nor can their implementation be made compulsory by the Commission through litigation, as in the case of Directives. With the Principles, in other words, it is more a matter of a political mission than of a legally binding requirement. The question is whether this format will work in the current situation, after the dubious accounting practices of companies like Enron and Worldcom. In view of these events, a binding legal formulation would be more appropriate. Nonetheless, in view of the current loss of confidence in the markets and on the exchanges, it can be assumed the nations of the EU are assigning sufficient importance to the subject of enforcement, because they are well aware of the seriousness of the situation – they have taken on this political mission.

The SOP provides for a flexible system which, while still unclear on some of the fine points, is basically well-designed. However, there is a certain amount of tension between the desire to keep general formulations and rules in the interest of swift and flexible implementation in the Member States, on the one hand, and the desire for more concretisation, on the other, given the abiding interest in more uniform implementation in the Member States. In the view of Deutsches Aktieninstitut, however, the focus should be on implementing enforcement rules as quickly as possible; therefore, it also favours the more flexible design and does not deem any further concretisation necessary beyond the individual points mentioned in the following.

Deutsches Aktieninstitut e.V.
Börsenplatz 5 60313 Frankfurt am Main
Telefon 0 69 / 9 29 15-0 Telefax 0 69 / 9 29 15-11
E-Mail dai@dai.de Internet http://www.dai.de

II. Principles 1-6 (Enforcers)

Principles 1 to 6 specify which bodies or entities are to be responsible for enforcement in the Member States. As a matter of principle, an administrative (i.e. public-sector) authority should have the ultimate responsibility for enforcing compliance with the accounting principles of the SOP (Principle 1). According to Principle 2, other bodies, which also means private-sector entities, can carry out enforcement on behalf of administrative authorities if those bodies are supervised by and responsible to the competent administrative authority. This possibility of linking public and private-sector organisations is to be favoured. It also enables the mixed private/public-sector solution (public/private partnership) favoured in Germany in the meantime. The ultimate responsibility, however, rightly remains with the competent administrative authority, this is laid down in detail in Principle 6.

This also ensures that a decision taken by an enforcer (competent administrative authority and/or delegated entity) is subject to the required judicial review.

III. Principles 9 and 10 (Definition of Enforcement)

Principle 9 and 10 contain definitions of enforcement, in other words on its purpose and content. The only suggestion to be made here is that these provisions be moved to the beginning in line with the usual legislation methodology of the EU.

IV. Principles 11 to 15 (Methods of Enforcement)

Principles 11 to 15 contain the various approaches as of when an enforcer (competent administrative authority) should take action. In the SOP, a proactive approach is regarded as being absolutely necessary. The enforcer, in other words, shall not just take action reactively to irregularities or complaints. A mixed model consisting of proactive components like the sampling or rotation approach, on the one hand, and the so-called risk based approach, on the other, is considered preferable in these Principles. Deutsches Aktieninstitut does not consider a proactive approach useful since it is not very practicable. An enforcer would have to have sizeable capacities if, in addition to becoming active in response to complaints/notices from third parties or based on irregularities at a given company, it also had to carry out its monitoring duties according to a rotation approach, for example. In practice, it is probably very costly and time-consuming to carry out such an investigation in the form of random checks or rotation, in which the widest variety of companies come under scrutiny. Moreover, it has to be borne in mind that, under certain circumstances, conducting such an examination may arouse suspicion about irregularities among the capital market participants if it becomes known to the public, and even if it is only being conducted as a proactive random check. This is not in any way commensurate with the preventive effect that

such proactive approaches are intended to have. Not least of all, the definition of the term risk based approach is also important. It has to be made clear what is meant by that. This should already be made clear in the SOP itself. It if is intended to mean that the competent administrative authority becomes active whenever any signs/indications of an accounting irregularity are given, then that seems sufficient and practicable for the time being.

It goes without saying that it must be possible for an investigation to be conducted in response to a request/complaints from capital market participants. But this, in our estimation, already follows from Principle 13, where the reactive approach is mentioned. However, there is a need for some kind of preliminary investigation in such cases to determine whether there is any foundation for the suspicion, in order to avoid quibbling and backbiting.

V. Principles 16 to 19 (Actions)

Principles 16 to 19 present measures to be taken by the competent enforcement authority in the event of misstatements. In this case, a more uniform rule is required for the Member States as a matter of principle, so that the legal consequences in cases of violations are the same in all of the Member States.

In the Deutsches Aktieninstitut's estimation, the following terms need to be fleshed out:

- “material misstatement” in Principle 16

- “effective” in Principle 18

- “consistent policy of actions” in Principle 19

The distinction between sanctions and actions (measures) in Principle 17 is somewhat open to misunderstanding. Here the actions of the enforcement authority that serve to improve confidence are to be distinguished from *sanctions*, which are based on national legislation and are intended as punishment for violating the law. But, as Deutsches Aktieninstitut e.V. understands it, this cannot mean that an enforcement authority would not also be authorised to impose sanctions.

VI. Principle 20 (Co-ordination in Enforcement) and Principle 21 (Reporting)

In Principle 20, it is made clear that the enforcers will not issue any general application guidelines for the interpretation of IFRS. This authority remains with the offices in charge (such as IFRIC, for example). Otherwise, in the case of ex ante and ex post decisions, there is a need for co-ordination between the administrative authorities responsible for enforcement and/or the organisations acting on their behalf, in order to ensure that enforcement of compliance is as harmonious and uniform as possible.

Moreover, according to Principle 21, enforcers are to publish regular reports on their activities, the enforcement policies adopted and individual decisions taken. This rule is intended to guarantee that the publication of the various national interpretations of the SOP is also as uniform as possible. The question is whether the decisions of the respective enforcers that are made public should be anonymised and whether the publication requirement should only apply to certain decisions.

It remains to be seen whether the last two principles are sufficient to guarantee an interpretation that is as uniform as possible.