

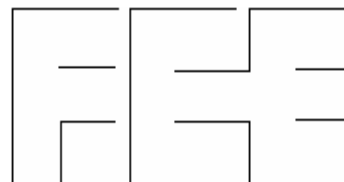
Date
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Dear Mr Demarigny,

Re: CESR consultation on Principles of Enforcement of Accounting Standards in Europe

FEE (Fédération des Experts Comptables Européens, European Federation of Accountants) welcomes the draft Statement of Principles of Enforcement of Accounting Standards in Europe since it is crucial that effective enforcement for IFRS is in place at latest by 2005. FEE issued a Discussion Paper on Enforcement of IFRS within Europe in April 2002 in order to stimulate the debate both on enforcement of high quality financial reporting and on the need for the improvement or establishment of effective institutional oversight systems by Member States involving all stakeholders and key players in financial reporting. In 2001 FEE published a factual study about "Enforcement Mechanisms in Europe", which concluded that in particular in relation to enforcement of financial reporting standards, for nearly half of the countries surveyed there was in 2001 no institutional oversight system in place. We see the Statement of Principles as a first step to build, where not yet existing, effective national enforcement bodies.

General

1. In section A, Context and Scope of the SOP, the CESR Work Plan of January 2002 is referred to. As set out in our letter of 19 November, it would be of great help to the planning of activities and resources of other organisations, like ours, if this work plan were to be made public. We believe that this would also well fit within the transparency strategy of CESR.
2. We are pleased that CESR recognises different forms of national enforcement bodies, whether they follow a securities regulator or review panel model. Although realising that only listed companies are within the competency of CESR, a merit of the review panel model is that it would be sufficiently flexible to extend enforcement to all IFRS companies, including non-listed public interest companies, banks and insurance undertakings and also other companies which use IFRS in their financial information (depending on the use the Member State makes of the options provided for in the IAS Regulation). For example, though there are few listed companies in the Central and Eastern European countries, many if not all companies apply IFRS and need to be subject to enforcement to some appropriate degree. An adequate coverage of public interest companies is needed in all countries. Ultimately all IFRS financial statements should be subject to enforcement.

Although we appreciate that CESR is focused on listed companies, CESR should recognise the need and welcome parallel initiatives to cover other than listed companies applying IFRS. CESR should also support the coordination between different enforcement bodies in the various countries, irrespective of whether they are regulators or review panels. The quality of capital market is also improved by getting more companies to the market. It should be avoided to create additional procedures for companies considering listing, as might be the case if enforcement arises only when they move to listing.

In addition we are of the opinion that also a wider forum than apparently envisaged by the SOP, involving all relevant stakeholders should be considered to exchange relevant information on enforcement issues. This forum should be wider than regulators and review panels. EFRAG could play a prominent role in such a forum, or at least the same stakeholders should be involved. This would guarantee a wide consultation process and attract support for its conclusions. EFRAG could check if an issue could happen in other countries and develop it into a European case to be put to IASB/IFRIC for interpretation.

In some countries an enforcement mechanism for only listed companies may create a legal problem since companies need ultimately to be subject to the same penalty system in the event of financial reporting defaults constituting a breach of law.

3. In some countries the banking and insurance supervisors operate separately from securities regulators. In other countries there is one overall regulator. The principles of enforcement should also extend to separate banking and insurance supervisors (to the extent they are responsible for enforcement of financial statements), or at least CESR should support national coordination so that there will be effective enforcement of IFRS for all public interest companies (see also our comments under 2).
4. We fully agree with CESR that enforcement should be built on effective national enforcement bodies. As supported by principle 20 there is a clear need for a European coordination on enforcement in order to ensure consistency in application decisions within Europe. We strongly believe, as set out in our discussion paper, that such a European coordination needs to involve all enforcement bodies, whether they follow a securities regulator or review panel model. In this respect we doubt if the solution proposed by CESR is sufficient: "CESRfin's Subcommittee on Enforcement is the forum where **regulators** compare their experiences[...]. The development of legislation or memoranda of understanding will be explored in order to foster exchange of information with non-CESR members" (i.e. review panels). It is necessary for all enforcement bodies to participate actively. There needs to be a proper forum for a full exchange of information on questions arising. If a review panel is accepted as a legitimate element of the framework of enforcement, it should also be allowed to participate fully. We refer in this respect to our Discussion Paper on Enforcement of IFRS within Europe: sections 7.4 and 7.5 discuss a possible form of coordination: European Enforcement Coordination (EEC). At present we have an internal discussion at FEE to develop the coordination further and as to how it can be made operational.
5. We believe it is crucial that enforcement should not result in standard setting. Enforcement bodies should be cautious in issuing interpretations and limit themselves to application guidance in individual cases. However, further debate is needed as to how to fill the gap between standard setting and enforcement in the light of consistent interpretations. Inconsistencies in interpretations should be avoided. IASB needs to make sure that a proper global interpretation mechanism is in place. In Europe, for example EFRAG could play a pro-active role in pulling information together on a pan-European basis based on the decisions taken or issues identified by enforcement bodies in one or more countries. This would enable EFRAG to offer IASB or IFRIC a well researched proposal and set of background facts. It would also help to ensure that issues were considered on a pan European rather than a national basis.

When accounting standards are more principles-based there will be only a need for high-level interpretations. The lower-level decisions need to be taken by the company subject to the work of the auditor. It is important that the management of the company forms its own views on issues and that the process leading to these decisions is adequately documented.

CESR should support a principles-based approach in financial reporting standard setting.

6. Recital 16 of the IAS Regulation gives CESR a role in development of a common approach to enforcement – to ensure compliance with international accounting standards. It is important that the regulatory role in relation to financial information is not mixed with the role of oversight of the profession. These are two separate tasks, although in some countries carried out by the same

regulator (although in such cases usually involving separate procedures). The European Commission has taken separate initiatives in relation to (European) oversight of the profession including the Recommendation on Quality Control and more recently evolving a system of oversight.

If regulators find deficiencies in the financial information, this may raise questions about the related audit work and these cases should be referred to the relevant supervisory authority for auditors (which will differ from country to country). The SOP is about the security regulatory role of CESR and not directly about the oversight of auditors. This distinction is extremely relevant in relation to the exchange of information, see our comment below.

7. We note that the proposed Statement of Principles does not yet cover principles on powers to be attributed to enforcement, nor on the responsibilities in cross-border listings and offerings (page 4 SOP). These further statements to be issued in due course may address some of our comments raised in this letter.

Comments on Principles 1 to 21

8. CESR might consider a step by step approach to introduction of some of its principles. This could relate both to the scope of documents and the enforcement methods. In this respect we refer to the three step approach we have set out in our Discussion Paper on Enforcement of IFRS within Europe.
9. Principle 5 refers to the power of the competent independent administrative authority (or of those acting on behalf of the authority) to require supplementary information from companies and auditors.

The primary responsibility for proper financial information lies with the management of the company involved. Companies should have their own files and document their own conclusions, for example for accounting policies chosen. They should supply the responses, explanations and additional information that the competent authority might need in terms of the information. Under statute law and contract auditors have the obligation to maintain confidentiality. This encourages companies to be frank and open with their auditors.

In practice, empowering authorities to require information from auditors is likely to translate into them requesting access to audit working papers. The auditors are responsible solely for their report. Their information (and working papers for example) will therefore be relevant to only supporting that opinion and will have not been prepared for any other purpose nor for any form of publication or disclosure, even to a competent authority. It is impractical for all aspects of internal working paper files, despite auditors preparing their working papers with integrity and good faith, to be prepared in a way which could address the unforeseen subsequent information requests of competent authorities or which would make them satisfactory as stand alone documents. In any case the working papers would be unlikely to meet the authority's needs for information on the accounts.

Competent authorities should go directly to the management or directors of the company for any information they need on the company. Competent authorities might request companies to obtain a special report on the issue from their auditors. Auditors can prepare a considered paper on a special issue relating to a company on the basis of their working papers prepared at the time of the audit and any hindsight they have at that stage of writing the special report. The fact that the auditors give their view on certain issues does not impact their opinion on the financial statements as a whole. The auditors should in our view always act at the request of the company in the case of provision of information to the competent authorities.

It is important that the management of the company forms its own views on issues, and that the process leading to the formation of these views is adequately documented by internal officers of the company. The auditors should not and cannot take the role of management, as set out in the Commission Recommendation on Independence of the Statutory Auditor. An appropriate corporate governance structure needs to be in place. Following the IAS Regulation, management and directors need to make themselves adequately informed and resourced about IAS. We believe that

the emphasis of principle 5 should be that companies are expected to maintain information justifying their selected approaches. Any request of a competent authority to a company and through the company to its auditor should be based on appropriate grounds for investigation. Fairness needs to be built into procedures and investigations in general in form of a proper due process without specifying the grounds, purposes and documents sought should not be allowed.

If principle 5 were to remain unchanged it should at least be elaborated, in the principle, or in the further details on exchange of information, with an indication that auditors should be indemnified for breaking client confidentiality. In this respect Directive 95/26/EC, the so called BCCI Directive, could be referred to. Moreover, if information is gained for regulatory purposes, it should be made clear that the information can only be used for that purpose.

In summary it needs to be made clear that:

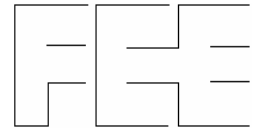
- companies are expected to maintain information justifying their selected approaches to financial reporting as the first source of information for regulators enforcing accounting standards;
 - if the regulator wishes to obtain further information or assurance from the auditor, the regulator should then ask the company to instruct the auditor to make a special report for the regulator on the matter in question;
 - an exchange of information between the auditor and the regulator could then be sought as the next step, if considered necessary by the regulator; and it should be made clear that seeking access to the internal working papers of the auditors would be a last step in this process if indeed it is decided that it is justifiable at all. (As is clear from our remarks elsewhere, we consider that access to the internal audit working papers of the auditors is not the appropriate route to obtaining information for the purposes of enforcement of accounting standards by companies);
 - where information is obtained from the auditors, it should be used only for regulatory purposes of enforcement and not made available by any other means to the public or other parties, most obviously for reasons of confidentiality of the company's affairs but also for reasons of potential litigation which could increase the present unsatisfactory exposure of auditors to professional liability claims;
 - in order to facilitate the exchange of information sought by regulators for this purpose, indemnity clauses are needed to protect auditors providing information to regulators for this purpose in good faith.
10. Principle 5 should also include an indication where to appeal in case of a disputed decision, although we appreciate that this may form part of the principles on powers to be attributed to enforcement, which are under development. There should at least be a principle that an appeal mechanism should be available. The appeal period should be related to the period during which the information is price sensitive. The right to appeal should remain a principle of natural justice.
 11. Principle 8: we are of the opinion that non-harmonised documents when they contain financial information should also be subject to enforcement principle as far as the financial information part is concerned and this financial information is based on IFRS. The enforcement system should extend to all documents that provide price-sensitive financial information using IFRS. Principle 8 should in our opinion refer to information related to harmonised requirements rather than to harmonised documents.
 12. Principle 8: The principle specifically refers to individual financial statements – annual financial statements prepared on individual basis – and states that the principles for enforcement identified in the SOP should apply also to them. The IAS Regulation however requires only the use of IFRS for the consolidated financial statements of listed companies. There will be countries where IFRS will not be required or not even be allowed for the individual financial statements of listed companies. In this case individual financial statements will be prepared under national GAAP. We doubt if all the

principles for enforcement of the SOP are also relevant in case of enforcement of national GAAP financial statements. In our view for example principles 20 and 21 on coordination and reporting might not be relevant, since there may be no European dimension when national GAAP is enforced.

13. Principle 9: Recital 16 of the IAS Regulation as quoted on page 3 of the SOP clearly indicates that the purpose of enforcement is underpinning investor's confidence in financial markets. Principle 9 is too narrowly defined in referring to the protection of investors. The purpose of enforcement is rather underpinning investor's confidence in financial markets and the confidence in the reliability of financial information.
14. Principle 10: enforcement in principle 10 is strictly defined from the point of view of the regulator. It would be helpful if attention could be drawn in the SOP to the value of a broader definition of enforcement in order to promote the best quality of reporting. We refer in this respect to Chapter 4 "A Framework for High Quality Financial Reporting" of our April 2002 Discussion Paper on Enforcement of IFRS within Europe. Each of the parties in a framework for high quality financial reporting should be subject to appropriate accountability in relation to their responsibilities to support high quality financial reporting.
15. Principle 11 to 15: methods of enforcement should make clear that enforcement bodies have at least to consider complaints in addition to the mixed model. Consideration of complaints should at least be guaranteed. A similar remark can be made for qualified audit reports and instances of true and fair override. It would be helpful for CESR to indicate priorities. The principle for the enforcement mechanism should be to examine cases in the order of risk that they present. In our view this might well mean that the order of priorities would be:
 - where there have been qualified audit reports (it is important that the first line of external defence should be backed up)
 - reacting to complaints received from users and others
 - other risk-based selections
 - random or rotational selections.
16. Principle 11: pre-clearance: the principle states that "pre-clearance is not precluded". FEE's view on pre-clearance is that it should be offered only where cost effective and with the full involvement of the Board of Directors and the auditors of the relevant company. Pre-clearance should be limited to issues where IFRS or IFRIC interpretations are not available. Where a pre-clearance mechanism is offered by a national enforcement body, it should publish a detailed set of procedures to be followed which should implement a framework of common European principles. Not all enforcement bodies may consider it necessary or even desirable to have a pre-clearance mechanism. In this respect we refer also to section 8.5 of our Discussion Paper on Enforcement of IFRS within Europe. Where pre-clearance exists some form of European coordination may be considered.

In 2004/2005 no doubt there will be an increase in questions on application and implementation issues. Instead of increasing the pre-clearance issues, the company together with the auditor should deal with these issues in a constructive way, with emphasis on the company being able to demonstrate (in the event of query) that difficult issues have been carefully considered. Such a process should offer some protection, in terms of penalty at least. If the decision taken is subsequently considered wrong by an enforcement body, especially during the period of IAS implementation. Once IASB/IFRIC issues interpretations or standards on the issues concerned it should override previous pre-clearance and enforcement decisions of the enforcer.

17. Principle 16: we are unclear as to why there should be normally an action in case of non-material departures (i.e. not able to affect investors' decision and no negative impact on market confidence). We assume that this implies a "management letter type of comment" by the enforcement body to the company and its auditor, but no public reference.



18. Principle 16: it is to be regretted that the SOP uses a different definition than the one used in the IASC Framework: "Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of financial statements" (para 30 IASC Framework). The same definition is used in the IFAC handbook.

The CESR definition introduces two forms of impact. Principle 18 refers to impact but, given the CESR definition of materiality, it is unclear if reference is made to the impact on the financial statements or impact on market confidence. In case the latter is meant, it would be helpful if CESR could provide guidance as to how to assess the impact on market confidence.

19. Principle 16: we suggest to include as a principle the timely correction of information. Furthermore it is unclear what kind of appropriate actions are referred to. We appreciate that this is a principles paper, but the harmonisation aspect needs to be considered in the next stage. Certain points need to be further debated. In this respect, we would like to refer to the legal implications (dividend etc.) as a consequence of correcting financial statements. It may be needed to provide for refiling of accounts or at least to open the possibility.
20. Principle 18: the principle of appeal as well as the principle of due process need to be mentioned here (to whom to appeal, how is process and what are procedures, what due process needs to be in place). Companies need to be able to appeal. See also our comments on principle 5. Please see also our comment 7.
21. Principle 19: we are of the opinion that the type of company should be taken into account so that it will not always be the case that there should be similar actions for similar infringements.
22. Principle 21: only where public action is taken decisions should be made public. Otherwise the reporting should be without mentioning of names in the form of statistics.

We would be pleased to discuss any aspect of this letter you may wish to raise with us.

Yours sincerely,

David Devlin
President