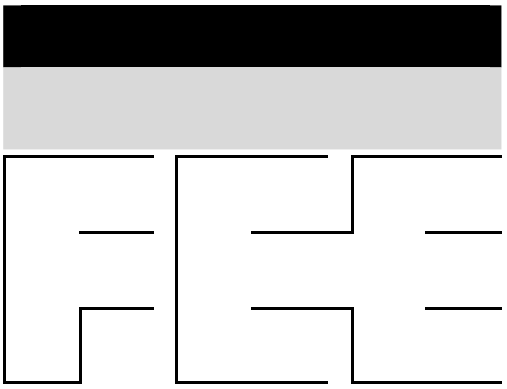

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DISCUSSION PAPER

EUROPEAN ENFORCEMENT COORDINATION

Discussion Paper on Coordination at European level of national enforcement mechanisms and how an interpretation mechanism should work post-2005

November 2003

CONTENTS

1. EXECUTIVE SUMMARY

1.1 Key Messages and Recommendations

Coordination of Enforcement

- There is a need for enforcement coordination at European level, based on national arrangements, involving all enforcement bodies, including review panels.

- European Enforcement Coordination (EEC) would have as functions:

  - Coordination of major enforcement issues, in order to create a level playing field
  - Monitoring and reporting to CESR how the CESR enforcement principles have been upheld by CESR members as well as overseeing and monitoring the implementation of CESR enforcement principles by non-CESR enforcement bodies
  - Facilitating relationships – in cooperation with CESR – with other enforcement bodies in the world, notably with IOSCO
  - Operating a Consultative Mechanism
  - Coordination of internal and external versions of the databases of enforcement decisions
  - Monitoring enforcement sanctions.

- There should be a commitment for all enforcement bodies to use reasonable efforts to consult and coordinate with EEC on main decisions with an obligation to consult on enforcement decisions with countries involved in dual and cross-border listings.

- There is a need to establish criteria or guidelines as to which decisions should preferably be referred to the EEC before a final (national) decision is taken, including:

  - Where there are dual listings or cross-border listings involved
  - Where a decision potentially contradicts a previous decision (of the same or another European enforcement body)
  - Where a decision may be expected to have a major impact on the financial market
  - Where a decision has relevance for other enforcement bodies (criteria would need to be decided on what is "relevance")
  - Where there is a risk of significantly different treatments across companies and countries in Europe.

- The EEC should have the right to enquire about the justification of any particular enforcement decision, but not to override national decisions.

- Ultimately the EEC should be open to cover the enforcement of all IFRS financial statements, regardless of whether the entity is listed or not.

- An additional wider Consultation Mechanism is desirable involving all stakeholders in order to give them the opportunity to review general experience and to act at the same time as a sounding board for the EEC. The structure of such a mechanism does not need to be formal. It could take place in the form of public hearings, round tables or a consultation panel organised by the EEC.

- The Consultative Mechanism would have the following functions:

  - Commenting on the effectiveness and efficiency of operations of the European Enforcement Coordination
  - Providing input on any apparent enforcement inconsistencies into the Coordination in order to draw attention to any problems experienced
  - Discussion of experiences of enforcement including operations and processes in individual countries
  - Communication of general and frequently encountered issues.

- EFRAG should not be directly involved in enforcement decisions, including consequent interpretations, but have a task in filtering cases to be brought to the attention of IASB/IFRIC based on wider European experience after national enforcement decisions have been taken.

How an interpretation mechanism should work post-2005

- Strong commitment is needed to high quality, global, principles-based neutral financial reporting standards. Global financial markets require financial information prepared in accordance with global standards for reasons of competitiveness, comparison and capital raising. Global standards require global interpretations.

- Enforcement bodies should not be involved in standard setting, including issuing interpretations. Enforcement bodies should not reduce the different options or flexibility offered by IFRS. Enforcement decisions should not interfere with areas where IFRIC has already provided an interpretation. IFRIC is the only body able to issue authoritative interpretations of IFRS.

- EEC should have the power to raise questions and to draw the attention of IASB and IFRIC to problems of a general nature, for example where the EEC concludes that an IFRS needs amendment, addition or interpretation. IASB/IFRIC subsequent interpretation may differ from enforcement decisions taken earlier.

- Is there a need for European interpretations? In summary the advantages and disadvantages of European interpretations are as follows:

  <u>Advantages</u>

  - Addressing specific European and national circumstances
  - Uniform application of the specific issue in Europe
  - Temporary addressing of topical issues until IFRIC has finished its due process
  - Avoiding the risk of companies and auditors taking different decisions in similar situations
  - Could assist IFRIC in forming their interpretations

  <u>Disadvantages</u>

  - Risk of creating European IFRS
  - Risk of stimulating other parts of the world to issue their own interpretations and their own version of IFRS

- Taking away from companies and auditors the responsibility for making their own judgements
- Impossibility of having interpretations for all specific situations, rather principles should be applied involving careful judgement of the particular circumstances
- Risk of worldwide inconsistency

- FEE promotes having one set of global standards and interpretations: IFRS and IFRIC interpretations. FEE does not support the creation of European standards or interpretations that are different to IFRS/IFRIC interpretations and would only apply in Europe. FEE concludes that a European interpretation structure is neither appropriate nor needed. However a consultation mechanism with potentially a specific role for EFRAG would help to identify the real issues of general importance which should be addressed by IASB/IFRIC. The Consultative Mechanism suggested by FEE could play an important role in facilitating this debate.

2. INTRODUCTION

In building a single capital market, there is a balance to be struck between common European benchmarks and diversity of national law, practice and custom. Uniform solutions should be mandated only in areas where this is essential to ensure outcome of equivalent quality. In other areas it will be best to set European principles allowing sufficient implementation flexibility at Member State level, but yet to achieve equivalent quality and practice.

It is important that developments in the Member States are well coordinated so that implementation and enforcement of agreed policies and measures is demonstrated. This approach allows for convergence of European practice through experience and market forces and provides an alternative to regulating in detail every aspect of the single capital market.

Coordination at European level is important in many areas of activity of the European Commission whereby a balance needs to be struck between harmonisation and subsidiarity. For example in its consultation on modernisation of EU competition law the Commission proposes that a network of national competition authorities should be established to ensure consistency in decision-making across the EU.

There seems to be agreement in Europe that in all areas of standard setting, the principles-based approach is preferable to a rules-based approach. IFRS are such global, principles-based standards for financial reporting, as embraced in the IAS Regulation. The objective of any coordination mechanism and the issue of addressing interpretations should be to operate within and to maintain such a principles-based system.

The FEE Discussion Paper on Enforcement of IFRS[1] within Europe had amongst its key messages:

- Enforcement should be built on effective national enforcement bodies
- There is a clear need for a European coordination on enforcement to ensure consistency in application decisions within Europe: European Enforcement Coordination (EEC)
- Such a European coordination needs to involve all enforcement bodies, whether they follow a securities regulation or review panel model[2].

The priority should be the establishment of common rules and practices aiming at a level playing field in Europe with consistency of outcomes despite the differences in enforcement systems. It is essential to avoid a conflict of decisions between enforcement bodies in different countries.

In section 7.4 of the FEE Discussion Paper it was indicated that the European Enforcement Coordination – partnership mechanism for coordination – 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

[1] published by FEE in April 2002

[2] Chapter 7 Enforcement Models at a European Level: The Choice of Model of the FEE Discussion Paper on Enforcement of IFRS in Europe, provides a description of the review panel model

- Be acknowledged as part of the solution, if and when individual decisions of general significance are made public.

The CESR Standard No 1 on Financial Information – Enforcement of Standards on Financial Information in Europe as published on 12 March 2003 states:

> **"COORDINATION IN ENFORCEMENT**
>
> Principle 20 In order to promote harmonization of enforcement practices and to ensure a consistent approach of the enforcers to the application of the IFRSs, coordination on ex-ante and ex-post decisions taken by the authorities and /or delegated entities will take place.
>
> **Material controversial accounting issues will be conveyed to the bodies responsible for standard setting or interpretation.**
>
> **No general application guidance on IFRSs will be issued by the enforcers.**
>
> Monitoring financial information entails that reporting policies applied by the issuers are compared with the reporting framework in order to take decision on their acceptability.
>
> Decisions of national enforcers reflect the judgement of the enforcer on the compliance of the financial information with the reporting framework. Exchange of information among enforcers prior to the decision are taken is limited by technical feasibility time and confidentiality constraints.
>
> Similar constraints apply where the enforcers are asked by the issuers or their auditors to express opinions before the financial information is published (so called "pre-clearances").
>
> According to principle 2, enforcement measures have the function to address infringement of the reporting framework. Therefore, an accounting or disclosure treatment which is not prohibited by the relevant standards or interpretations should not lead to an enforcement action.
>
> However, harmonization of the enforcement practices and approaches of the enforcers to the IFRSs, aimed at creating a single EU securities market, requires coordination on ex-ante and ex-post decisions taken by the authorities and/or delegated entities.
>
> Consistent with recital 16 of the EU regulation on IFRSs, CESR will promote coordination in enforcement approaches.
>
> In particular, according to its mandate, the CESRfin's Sub-Committee on Enforcement is the forum where regulators compare their experiences in the field of enforcement on a regular basis with the aim of convergence.
>
> However, coordination on enforcement practices and decisions requires also involvement of organizations which do not belong to CESR. Therefore, CESRfin will establish an appropriate mechanism whereby CESR members and non-CESR members may discuss enforcement issues in order to achieve a high level of coordination and convergence in the enforcement decisions.
>
> The development of legislation or memoranda of understandings will be explored in order to foster exchange of information with non-CESR members involved in enforcement.
>
> Issuing general interpretations of the existing standards is part of the standard setting process conducted by the relevant bodies, such as IFRIC. Enforcers may contribute to this process by providing their experience to the interpretation debate. However, harmonization requires that they should not attempt to create a parallel body of interpretations."

In addition the feedback statement on the CESR consultation on the statement of principles on the enforcement of standards of financial information states that:

> "CESR recognises that various enforcement mechanisms already exist in the EU Member States where the securities regulators' model is applied only in some Member States."

The CESRfin Subcommittee on Enforcement has issued on 8 October a consultation paper "Draft Standard No 2 on Financial Information – Coordination of Enforcement Activities" exposing CESR's proposals for achieving the necessary condition and convergence of enforcement activities carried out by EU National Enforcers. It is intended to be a principles-based standard establishing a framework that will be completed by the implementation measures. The consultation period is open until 7 January 2004.

The proposed standard contains four main principles:

> "B. Coordination of enforcement activities
>
> Principle 1 Ex ante and ex post enforcement decisions taken by competent independent administrative authorities or by bodies delegated by these authorities ("EU National Enforcers") should take into account existing precedents consistent with the timing and feasibility constraints which characterize the decision. Where practicable, discussions with other EU National Enforcers should take place before significant decisions are taken.
>
> Principle 2 Within a reasonable time after decisions are taken by an EU National Enforcer, details of these decisions should be made available to the other EU National Enforcers in accordance with the policies developed by CESR.
>
> Principle 3 The EU National Enforcers should follow a confidentiality regime consistent with that applicable to CESR members.
>
> Principle 4 In order to achieve a high level of harmonization, the chairman of the SCE shall call European Enforcers Coordination Sessions (EECS) of the SCE to which all EU National Enforcers of standards on financial information should participate. Such sessions will be aimed at discussing decisions taken at national level, as well as experiences in the application of standards on enforcement."

The consultation paper explicitly states that the draft standard does not deal with general interpretation nor with application guidance of financial reporting standards. Coordination under the proposed standard No 2 is meant to address cases where specific financial information treatments come to enforcers' attention and decisions on their compliance with the reporting framework have to be taken. Enforcers should try to take their decisions in the most consistent way, the aim being that similar decisions are taken where similar circumstances take place all over Europe.

FEE intends to contribute to this consultation by setting out its thoughts on how a European coordination could work. The underlying principles and ideas of European Enforcers Coordination Sessions (EECS) may be broadly similar to the European Enforcement Coordination (EEC) referred to in the FEE Discussion Paper of 2002.

There is common agreement that enforcement coordination at European level is needed, that it should be based on national arrangements and involve all enforcement bodies including review panels (and other forms of enforcement). With this discussion paper, FEE hopes to contribute to the debate on coordination of enforcement at European level to stimulate this debate and to

enter into discussion with the relevant parties concerned. FEE also hopes to provide a contribution to the CESR consultation process on draft Standard No 2 on coordination of enforcement activities.

Enforcement of financial information in prospectuses is well established in each of the EEA countries and is carried out by securities regulators. A question that may need to be considered if different enforcement bodies in a country are responsible for enforcement of prospectuses and for enforcement of accounting standards in other documents is whether the securities regulator should consult with the other enforcement body on enforcement of financial information, especially historical financial information, in prospectuses. FEE is at present involved in a separate project on guidance on financial information in prospectuses.

This paper discusses in particular the coordination at European level of enforcement of IFRS, following our discussion paper of April 2002 on enforcement of IFRS. The FEE proposals are operational within principle 20 of the CESR Standard No 1, and within the draft Standard No 2.

3. GENERAL CONTEXT FOR EUROPEAN COORDINATION ACTIVITIES

Coordination at European level is important in the accounting area notably in the area of enforcement of accounting standards, as discussed in this paper and in the area of oversight of the audit profession. However, coordination at European level has some general characteristics regardless of the activity being coordinated. Therefore there is a need to develop underlying overall general principles which each form of coordination should meet.

Such general principles would include:

- A form of official recognition

  It is important that the coordination mechanism is recognised and has appropriate authority within the EU. Only in this way it will be credible to other equivalent bodies in the world, notably as part of the transatlantic dialogue. A coordination mechanism needs to be accepted by the national mechanisms that are coordinated and by the relevant stakeholders. The coordination mechanism should have the right to be heard and should have a right to take initiative in consultation.

  There are several ways in which this can be achieved:

  - Official delegation of power by legislation
  - Recognition of the mechanism in preambles to legislation
  - Recognition through soft law[3].

  Use of a separate legal entity structure may assist to achieve the above. A fully private, voluntary coordination without any form of recognition may not have sufficient credibility. The use of memoranda of understanding could be of help in arranging the actual working of the Coordination, but might as such not provide a sufficiently robust solution.

- Involvement of all relevant bodies carrying out the coordinated activity at national level

  All bodies carrying out the activity at national level should be involved regardless from their legal structure and scope at national level. Several degrees of integration could be considered.

- A form of due process to coordinate decisions with cross-border implications

  A due process needs to be established clarifying how coordination would work and what issues need to be coordinated. The due process would also include timing and confidentiality aspects.

- Consultation process and connection with stakeholders

  A coordination mechanism should have a proper due process including a consultation process on this and related matters. A coordination mechanism needs to consider to what extent and how to involve the relevant stakeholders. Involvement of stakeholders may depend on the type of activity to be coordinated and the extent to which the activity is carried out in the public interest. Appropriate involvement of stakeholders can add to the credibility of the coordination mechanism.

[3] Soft law may include codes and guidelines that are not formally belonging to the law.

- Transparency: a form of reporting on decisions

  A coordination mechanism needs to be transparent. It should publish an annual report of its activities. Where the coordination mechanism advises on decisions, or where there are national decisions with a cross-border impact, a form of public reporting is needed – for national decisions at national level.

  In addition a European wide database of national decisions should be created for internal use to make sure that earlier decisions on the same or similar issues are considered in order to create equivalent decisions all over Europe (precedent setting). Confidentiality and legal issues need to be considered.

- Creation of level playing fields

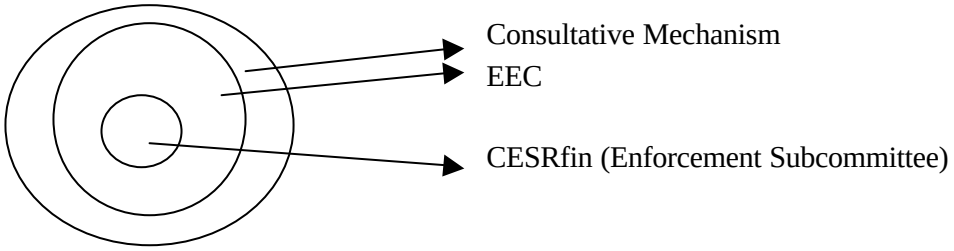
  A level playing field needs to be created in Europe so that equivalent decisions are taken for similar cases, including sanctions. Therefore a monitoring of the national decision processes is needed to give quality assurance. Any complaints about the national decision making process should be considered. National decision processes should meet the European principles laid down. The coordination mechanism should assess whether this is the case, and should make recommendations for any necessary improvements in connection with wider consultation. The coordination mechanism should encourage convergence of best practice at national level. Differences in national decisions should be avoided. However, according to the principle of subsidiarity, final decisions need to be taken solely at national level. In practice, there must be confidence that decisions are applicable across borders.

- Coordination and exchange at global level

  The coordination mechanism needs to take account of developments at global level and be open to exchange of views and consultation with counterparts at the global level. On some subjects, coordination should ideally take place at global level. European coordination can in this respect be seen as a step towards global coordination.

4. FUNCTIONS OF ENFORCEMENT COORDINATION

At the European level various levels of activities with the aim of enforcement coordination can be distinguished, each with their specific functions:



4.1 CESR and CESRfin

Under the structure proposed in this paper, CESR should be responsible for the development of the CESR principles on enforcement. Within CESR, the CESRfin Enforcement Subcommittee is in charge of enforcement issues and has developed Standard No 1 and proposed Standard No 2. It has to monitor and to oversee the implementation of the principles of CESR Standard No 1 and proposed Standard No 2 by the national securities regulators. Quality assurance needs to be put in place.

4.2 European Enforcement Coordination

4.2.1 General

CESR recognises in Standard No 1 and proposed Standard No 2 the need to establish a coordination mechanism with CESR and non-CESR members with authority on the enforcement of accounting standards for financial statements, the so-called European Enforcers Coordination Sessions (EECS) as laid down in principle 4 of the proposed Standard No 2. FEE supports the view that the CESR enforcement principles should to the extent possible also be applied to other enforcement bodies which are not members of CESR. CESR has among the relevant parties a prominent role to play in the coordination at European level. Recital 16 of the IAS Regulation requests CESR to promote coordination in enforcement approaches. The European Enforcement Coordination suggested in this paper could fulfil the function of the EECS envisaged by CESR.

The following functions could be identified for the European Enforcement Coordination:

- **Coordination of major enforcement issues, in order to create a level playing field**

  According to the principle of subsidiarity and due to the existing differences in the legal and economic environment of the EU Member States, final enforcement decisions should be taken at national level. However a level playing field needs to be created to provide consistent and coordinated decisions which are widely accepted and to avoid arbitrage and "enforcement" shopping. There are clear benefits in providing a EU consultation facility for national enforcement bodies in order to take also into account existing precedents. The consultation process needs to be quick since enforcement bodies need to take quick decisions based on a particular set of facts. It is understandable that national enforcement

bodies will have to take decisions within a tight timeframe. Coordination could take place without physical meetings (e-mail, conversation, electronic search of precedents, etc.).

The authority of the European Enforcement Coordination and related consultation should be clear. For dual listings and cross-border listings related enforcement or pre-clearance decisions, there should be an obligation to consult with the countries involved despite the tight timeframe under which enforcement bodies have to operate. The ultimate authority in case of dual listings and cross-border listings should be determined as that from the home country.

The European Enforcement Coordination should be confidential, such that an issue about a specific company does not become public knowledge in advance of a formal national ruling. Enforcement decisions should continue to be taken at national level but the European Enforcement Coordination should be consulted before a final decision (see details below). European Enforcement Coordination cannot be left at the discretion of the national enforcement body but some form of required coordination for major issues needs to be introduced. Clear criteria would need to be developed as to when consultation is required.

For any coordination system to be successful, it would require that enforcement actions to be coordinated and actively consulted on would at least cover significant breaches of the true and fair view presentation – either perceived or real but it should not be necessary to cover immaterial items. Any coordination and enforcement system should allow for an appropriate degree of judgement on the part of the company and their auditors. Enforcement bodies need increasingly to focus on how that judgement has been reached in a particular case (looking at the arguments why a particular conclusion was reached in that set of specific facts and circumstances). The private database (see chapter 6) could involve all relevant enforcement decisions including those of no-action.

- **Monitoring and reporting to CESR how the CESR enforcement principles[4] have been upheld by CESR members as well as overseeing and monitoring the implementation of CESR enforcement principles by non-CESR enforcement bodies**

  This may include establishing a form of quality assurance for non-CESR members to ensure that the same level and due process in decision-making are upheld. This quality assurance system needs to be coordinated with the quality assurance system CESR intends to establish for its members (be it peer review or otherwise).

- **Facilitating relationships – in cooperation with CESR – with other enforcement bodies in the world, notably with IOSCO and in particular with IOSCO members approving the use of IFRS such as the SEC**

  The IASB and FASB have agreed on a convergence programme and have certain joint projects with other standard setters. Over time this may result in identical standards except in certain areas. However there is a risk that the SEC might interpret these standards differently (SEC may be expected to interpret US GAAP, IFRS and reconciliations from IFRS and other GAAP to US GAAP). Therefore cooperation with the SEC is needed. With Australia also requiring the use of IFRS by 2005, it becomes important to give enforcement coordination a global dimension.

[4] CESR Standard No 1 on Financial Information: Enforcement of Standards on Financial Information in Europe

The European Enforcement Coordination must not only be a coordination but provide a counterbalance to the SEC, it must produce European and nationally valid answers. A European focal point is needed in close cooperation with IASB/IFRIC. The European Enforcement Coordination should help to establish mutual recognition of enforcement activities with the US.

- **Operating a Consultative Mechanism**

  The European Enforcement Coordination should operate a Consultative Mechanism with a wider range of stakeholders involved to exchange views and experiences with enforcement and to establish communication (see details below), but not to discuss specific impending enforcement decisions. The mechanism could act as a sounding board.

- **Coordination of internal and external versions of the databases of enforcement decisions (details chapter 6)**

- **Monitoring enforcement sanctions**

  A credible enforcement system should preferably involve some harmonisation of sanctions and at least a minimum level of sanctioning at the national level in order to create a level playing field. However, the Court has at national level the final say about the application of accounting standards, rather than the regulator, and concerning sanctions applied. This may limit the scope for harmonising sanctions.

  In addition to the existing established complaint system at national level including court systems, any complaints about national enforcement procedures could also be passed to the European Enforcement Coordination which may be able to provide advice to the national enforcement body. The Consultative Mechanism could also play a role in identifying such complaints or issues of general concern. Any formal complaints about individual national decisions should be dealt with by the appeal system at national level whereby the relevant court has the "final say".

4.2.2 Coordination of National Decisions

Final enforcement decisions will continue to be taken at national level, but it is important that where appropriate, coordination takes place at European level before these decisions have been taken at national level. There should be a commitment (in the form of an agreement or otherwise) for all enforcement bodies to use reasonable efforts to consult and coordinate with the EEC on these main decisions with an obligation to consult on enforcement decisions with the countries involved in dual and cross-border listings. This leads to the question of which proposed national decisions should be referred to the European Enforcement Coordination, since it is not likely to be feasible to feed all national proposed decisions through the European Enforcement Coordination for pre-consultation and coordination of decisions. There is a need to establish criteria or guidelines as to which decisions should preferably be referred to the European Enforcement Coordination before a final (national) decision is taken. Several criteria could be considered:

- Where there are dual listings or cross-border listings involved
- Where a decision potentially contradicts a previous decision (of the same or another European enforcement body)

- Where a decision may be expected to have a major impact on the financial market
- Where a decision has relevance for other enforcement bodies (criteria would need to be decided on what is "relevance")
- Where there is a risk of significantly different treatments across companies and countries in Europe.

Enforcement decisions would include pre-clearance decisions in those jurisdictions where it is common practice for enforcement bodies to issue pre-clearance decisions.

For coordination to be effective, it must be precedent setting amongst those involved in the European Enforcement Coordination. A due process may need to be created in this respect.

The European Enforcement Coordination may wish to prepare internally on general issues, such as discussion of new standards – how these may be understood and how these will be understood by enforcers in terms of implementation, even in advance of enforcement cases. National enforcement bodies are to share views in the European Enforcement Coordination on potential enforcement issues in advance of a specific case arising. The European Enforcement Coordination should not be permitted to comment publicly on general issues and new standards in advance of specific cases.

The European Enforcement Coordination should have the right to enquire about the justification for any particular enforcement decision, but not to challenge the right of a national enforcement body to take enforcement decisions. National decisions should not be overridden by the European Enforcement Coordination. However in terms of decisions already taken, as well as procedures, principles and benchmarks, the European Enforcement Coordination should be able to enquire and evaluate whether CESR's principles and standards have been respected and, if not, refer the matter to CESR for follow-up. If the enforcement body concerned is a non-CESR member, it is expected that the CESR member concerned or any other body responsible for the supervision of the enforcement body would instigate appropriate action at national level.

Enforcement bodies need the power to request and force amendment of the financial statements if they are wrong. In some Member States this may require a change of law. Enforcement bodies are ultimately subject to decisions of the national court. This inevitably involves a risk of creating inconsistency in financial statements in Europe since the court can overrule enforcement decisions, and there is also the possibility of further appeal to the European Court of Justice.

The European Enforcement Coordination needs to have appropriate technical resources with sufficient IFRS knowledge. The European Enforcement Coordination may need expert advice (from the national standard setter or EFRAG) until they have developed sufficient resources. Also at national level, the enforcement body must have sufficient technical IFRS resources.

Ultimately FEE believes that the European Enforcement Coordination should be open to cover the enforcement of all IFRS financial statements, regardless of whether the entity is listed or not.

4.3 Consultative Mechanism

A wider consultation mechanism than the European Enforcement Coordination is desirable involving all stakeholders in order to give them the opportunity to review general experience and to act at the same time as a sounding board for the EEC.

The structure of such a consultation mechanism does not need to be formal. It could take place in the form of public hearings, round tables or a consultation panel organised by the European Enforcement Coordination.

The Consultative Mechanism would not be involved in specific impending enforcement decisions. The Consultative Mechanism, operating with input from all relevant European stakeholders, would have the following functions:

- Commenting on the effectiveness and efficiency of operations of the European Enforcement Coordination
- Providing input on any apparent enforcement inconsistencies into the European Enforcement Coordination in order to draw attention to any problems experienced
- Discussion of experiences of enforcement including operations and processes in individual countries
- Communication of general and frequently encountered issues.

The Consultative Mechanism, through its wider participation and possibility to discuss also the more political issues, would help to restore public confidence in the financial markets and the oversight of the financial markets. It needs to be transparent and to provide an opportunity for debate and public hearing on issues that are sensitive or otherwise politically or socially relevant. It gives parties interested in financial reporting access to the European Enforcement Coordination.

The Consultative Mechanism should have a minimum frequency of meetings. It should be open to anybody with an interest in financial reporting. Results (minutes) of the meeting would be published.

The European Enforcement Coordination would use the Consultative Mechanism to raise awareness of major enforcement decisions which set an important precedent and to provide an understanding of the process reaching such decisions (feedback).

5. STRUCTURE OF ENFORCEMENT COORDINATION

5.1 European Enforcement Coordination

The European Enforcement Coordination would directly include the national review panels that cannot be directly members of CESR.

It is crucial that members of the European Enforcement Coordination have the ability to share information across borders. The confidentiality of information could be arranged by law or possibly by multilateral mutual agreement or memorandum of understanding. The discussions in the European Enforcement Coordination need to be confidential, such that an issue about a specific company does not become public knowledge in advance of a formal ruling. It may be possible to discuss individual cases on a no-name basis.

In addition non-CESR members should be obliged – on the same basis as CESR members – to implement the CESR enforcement principles.

It could be envisaged that part of the coordination function could be carried out by a small group with high level technical expertise from the European Enforcement Coordination in order to keep the structure practical and operational. Several questions may need to be addressed in a further debate in relation to the appointment of such a small group, including:

- What due process to be put in place to recognise relative importance of CESR members and others ?
- How can the group be representative of CESR and non-CESR members ?
- What type of expertise is needed ?
- What is the formal authority or mandate of the small group ?
- In what case is approval by the entire EEC needed, etc. ?

The EEC should be a separately established body with a form of official recognition. As the establishment of such a body would take some time an interim solution might be advisable. As an temporary solution the coordination mechanism could be organised as part of CESR provided that non-CESR members are involved on an equal basis. FEE considers that this should, however, be a temporary mechanism in order to prepare a more integrated solution as suggested above. The coordination mechanism needs to be recognised and needs to show authority in the EU. It should have the right to be heard and the right to take initiative. The EEC structure opens the possibility of an extension to public interest entities and other non-listed companies using IFRS. In accordance with the role given to CESR in the IFRS-Regulation CESR should have a prominent role in the European Enforcement Coordination.

Funding

The European Enforcement Coordination, if to be organised as a separate private body, would need some limited financing. There are several forms that can be considered:

- By national enforcement bodies
- Levy on listed companies
- Levy on all companies using IFRS
- Governments
- European Commission

- A combination of the above.

In selecting a form of financing, it should be considered to what extent the European Enforcement Coordination needs to be independent and be perceived as independent. In selecting the form of financing, the issue of widening the scope of enforcement to other companies than listed companies using IFRS should be considered, following the implementation of the options of the IAS Regulation in the individual Member States.

5.2 Consultative Mechanism

The Consultative Mechanism should involve all relevant stakeholders to exchange relevant information and experience on enforcement issues. The mechanism is intended to act as a sounding board but should not be directly involved in specific impending enforcement decisions. It could address political and socially relevant issues. This would guarantee a wide consultation process, collection of a wide range of experience, discussion of a potentially wider range of circumstances of cases in a generalised way and attract support for the conclusions of the European Enforcement Coordination. The Consultative Mechanism would allow for European stakeholder input at European level.

The Consultative Mechanism does not need to have legal authority but should be formally recognised by CESR.

The Consultative Mechanism would be a relatively large group in order to obtain input from all relevant stakeholders. In addition to the EEC, it would involve:

- Representatives of business/preparers, European credit organisations, insurance, accountancy profession, stock exchanges, financial analysts, SMEs and other users (either represented by EFRAG founding father organisations or otherwise)
- European Commission
- EFRAG
- EU national accounting standard setters.

5.3 National Banking and Insurance Supervisors

In many countries the banking and insurance supervisors operate separately from securities regulators. In some countries there is one overall regulator. The CESR principles of enforcement – which also cover listed banks and insurance undertakings – should also extend to separate banking and insurance supervisors (to the extent that they are responsible for the enforcement of financial statements), or there should be national coordination so that there will be effective enforcement of IFRS for all such public interest companies. Through review panels the public interest companies could also be covered, as well as banks and insurance companies, since banking and insurance regulators could support the national review panels.

The national bank and insurance supervisors could feed in particularities for regulated financial services industries directly into the European Enforcement Coordination, or indirectly through the national enforcement body.

Over time a European supervisory coordination for banking activities and a European supervisory coordination for insurance activities could be envisaged. This could in time provide a means of linking enforcement activities.

5.4 EFRAG

EFRAG should not be directly involved in enforcement decisions, including consequent interpretations, but have a task in filtering cases to be brought to the attention of IASB/IFRIC based on wider European experience after national enforcement decisions have been taken. EFRAG would therefore need to maintain direct relationships with both CESR and the European Enforcement Coordination as well as being directly involved in the Consultative Forum.

5.5 Overall Relationships

The structure, which is an elaboration of the mixed model for the European Enforcement Coordination as presented in the FEE Discussion Paper on Enforcement of IFRS within Europe, could be envisaged to explain the coordination mechanism, is included in Appendix I.

6. INTERPRETATIONS AND IMPLEMENTATION GUIDANCE

Issues at stake

Strong commitment is needed to high quality, global, principles-based neutral financial reporting standards. Global financial markets require financial information prepared in accordance with global standards for reasons of competitiveness, comparison and capital raising. A principle-based approach to financial reporting means that clear principles designed to serve the public interest underpin rules that show how those principles should be applied in common situations. This approach promotes consistency and transparency and helps companies and their advisers to respond appropriately to complex situations and new developments in business practice. It also prevents regulatory overload from detailed rules that may be developed in an attempt to cope with all the eventualities that may arise in practice. Global standards require global interpretations. IASB/IFRIC has the difficult task of striking a proper balance between principles-based standards and interpretations.

Principles-based standards leave a role for preparers and auditors in implementing these standards and to assume their responsibility different from a rule-based system.

At present, with the IAS Regulation and implementation of IFRS by listed companies for their consolidated accounts in 2005, many questions arise around the issue of interpretations and implementation guidance. It is difficult to distinguish between enforcement, interpretation and implementation guidance. The less clear enforcement issues involve automatically interpretation. Despite the general agreement that global standards require global interpretations, i.e. by IFRIC, there are concerns whether IFRIC will be able to cope promptly with interpretation requests approaching 2005 and as to how the interpretation mechanism should work post 2005. While some even call for European interpretations, others strongly argue for only a global interpretations and against a European interpretation structure. IFRIC/IASB should develop criteria for national guidance, which would support IASB standards and IFRIC interpretations. IASB and IFRIC should also develop criteria to distinguish interpretations from national guidance in order to establish a useful division of labour.

At present IFRIC has to deal with few cases on which interpretations are needed. It is unsure if there will be a substantial increase in demand in the approach to 2005 and, if so, whether companies and their auditors would not be able to solve such matters without recourse to a supplementary interpretative or pre-clearance body. If IFRIC decides not to address an issue referred to it, it should explain clearly why it considered that an interpretation is not needed. IFRIC needs to be properly resourced in order to address issues in a timely manner.

Guidance and education should be distinguished from interpretations. In the following the term interpretation is used when referring to pronouncements having the same authority as IASB standards. Companies need to comply with those interpretations in addition to IASB standards if they want to state in their financial statements that they have applied IFRS. In contrast, guidance should not have the same authority. It should aim at improving the comparability and quality of financial statements by giving an indication how certain national issues might best be treated. There may be need for guidance in particular circumstances at national level and education that could be provided by different organisations. However, interpretations should come from a single source: from the standard setter, i.e. IASB/IFRIC.

Background

A clear distinction is needed between enforcement and standard setting. Enforcement bodies should not be involved in standard setting nor in issuing interpretations. CESR Standard No 1 on Financial Information states in principle 20:

> "No general application guidance on IFRSs will be issued by the enforcers."

This is confirmed by the proposed Standard No 2 where it is also said that Standard No 2 does not deal with general interpretation not with application guidance of financial reporting standards.

Coordination of enforcement decisions is a major issue, since there is a real danger of developing national or European interpretations that might prove to be inconsistent with or narrower than the official global interpretations of IFRIC or IASB. Enforcement by nature could involve an element of interpretation. Separation of interpretations from other forms of guidance is necessary. A discussion is needed as to how a pragmatic solution can be found, involving the major players.

Neither the enforcement body nor the EEC should have the right to assess an accounting treatment as not appropriate unless the treatment is not in line with IAS 1.22 which provides guidance on how to account for transactions which are not dealt with explicitly in a standard or where there is a gap in SIC/IFRIC interpretations.

The EEC or national enforcement bodies should not reduce the existing flexibility contained in IFRS. In making enforcement decisions, enforcement bodies should not reduce the different options or flexibility offered by IFRS. This is also recognised by CESR in Standard No 1 under Principle 20:

> "According to principle 2, enforcement measures have the function to address infringement of the reporting framework. Therefore, an accounting or disclosure treatment which is not prohibited by the relevant standards or interpretations should not lead to an enforcement action".

In very rare circumstances, a principles based environment may lead to situations where enforcement bodies have to investigate accounting decisions taken that are not explicitly prohibited by the standards but appear to create a significant breach of the true and fair view.

In addition enforcement decisions should not interfere with areas where IFRIC has already provided an interpretation. IFRIC is the only body able to issue authoritative interpretations of IFRS.

In some countries companies are used to consult with the enforcement body (pre-clearance) and expect to be able to do so. How can it be avoided that these activities result effectively in national or European interpretations or a narrowing of accounting treatments available under IFRS?

In its feedback statement CESR also discusses pre-clearance provided by the enforcer:

> "Some enforcers presently offer issuers the possibility of obtaining pre-clearance. This practice has been seen by some respondents as conflicting with harmonization of accounting practices. The financial market participants may indeed tend to apply interpretations of standards provided by their national regulator. Regulatory arbitrage may also take place.

The SCE recognised that where enforcers issue general interpretation of the reporting standards they act as standard setters rather than real enforcers, which is inappropriate. For instance this may happen where the enforcer identifies the preferable accounting treatment where options are provided by the reporting framework to the issuers.

However, CESR recognised that the enforcers' role entail to take decision based on their judgement of the reporting policies followed. In practice, enforcers should only consider whether a specific reporting treatment is allowed or prohibited by the reporting framework.

Those decisions are normally taken when financial information has already been published. In some circumstances regulators allow the issuers to ask for their opinion on the legality of a projected reporting behaviour (i.e. before the information is published). This possibility, which is an option to companies, is considered in certain jurisdictions to be useful to the market and does not conflict with CESR standards on enforcement, as far as it is clearly characterized as limited to the specific case examined; this should be described in the pre-clearance.

On this basis, the SCE proposes to clarify within the standard all those characteristics that pre-clearance should have in order to be in line with the standard, which include amongst others the need for coordination described under principle 20 and the reporting requirement provided by principle 21."

There are different understandings of pre-clearance. The regulators involved in pre-clearance explain that pre-clearance resulting in a formal pre-clearance decision is relatively rare. Their regulator activity should be rather described as consultation or counselling. The counselling provides protection for investors and markets by getting things right in the first place. Also the informal pre-clearance (consultation or counselling) involves due process, it constitutes an open discussion between the regulator, company and the auditor providing a form of comfort. In countries without pre-clearance, similar forms of consultation mechanisms may be present, but organised in a different way.

It is however of serious concern that a level playing field should be created and how pre-clearance information can be shared in the European Enforcement Coordination. Pre-clearance risks weakening the position of the auditor and increases the risk of a system of interpretations. The assumption should be that companies in general try to report correctly and that they do not intend to circumvent standards and rules, but that there are issues to which companies do not know the answers. Therefore it could be argued that all companies should have the right to a form of consultation if their accounting and reporting is open to subsequent judgement by enforcers.

Here it is also emphasised that it is not appropriate for an enforcer to act as a standard setter and that pre-clearance decisions should also be subject to the same coordination and reporting requirements as other enforcement decisions.

FEE is also of the opinion that no separate, additional mechanism is needed to handle coordination of pre-clearance decisions. This should also be the task of the EEC, including some form of ex-ante consultation for enforcers (for example of an EEC internal database of earlier decisions).

Highlighting problems for IASB/IFRIC

The EEC should regularly communicate with IASB, IFRIC and EFRAG. The EEC should have the power to raise questions and to draw the attention of IASB and IFRIC to problems of a general nature, for example where the EEC concludes that an IFRS needs amendment, addition or interpretation. This would take place only after individual enforcement decisions have been taken at national or EEC level. EEC could invite EFRAG's views on whether, and if so how, a particular standard or interpretation should be changed or a new interpretation prepared. EFRAG could also play a role in identifying whether a case is relevant to other EU countries, undertake further research and develop it into a European case to be put to IFRIC/IASB for interpretation, as part of its pro-active role towards IASB. EFRAG should not be directly involved in enforcement decisions. Nor should it be directly involved in interpretations other than passing on cases relevant for Europe to IFRIC since it is not and should not be a standard setter itself.

It should be noted that IASB/IFRIC subsequent interpretation may differ from enforcement decisions taken earlier. Global standards require global interpretations and IFRIC is the only body to provide such interpretations.

How should the interpretation mechanism work post 2005

If any guidance, other than observable best practice, is to be considered, some issues could arise:

- If there is doubt on the meaning of a standard – to what extent is authoritative interpretation required?

- Is there any other interpretations or confirmation mechanism necessary if there is no IFRIC interpretation?

- How to avoid other than IFRIC interpretations?

As of today IFRIC has received requests by preparers, auditors and analysts for interpretations on only few issues. It remains still to be seen if there will be substantial demand in 2005 that will overload IFRIC. It should also be noted that IASB is working on adding significant additional guidance to many existing IAS, which may cover a significant number of interpretative issues.

Some argue that IFRIC might not be able to address promptly all issues that may arise in Europe approaching 2005 and in the aftermath of 2005 - due to lack of resources or due to the specific European circumstances, and that there is some need for additional national or European interpretations. However it may be questioned if this would be the most effective route and one could consider additional resources at IASB dedicated to interpretation questions from European sources.

One issue to be considered is where issues are not dealt with by IFRIC or the IASB is there a need for (temporary) European or national interpretations or guidance? Implementation issues may possibly also arise in connection with national legal or economic environments. These would not be taken up by IASB/IFRIC being a national matter and of limited relevance to the international scene. Any national and/or European guidance which might possibly arise should be withdrawn immediately when IASB or IFRIC have addressed the issue.

Present national systems and networks such as emerging issues task forces should be kept to discuss implementation issues. If the issue cannot be solved at national level, it should be discussed with other countries and EFRAG through linkage of the Existing European network. If it turns out to be a general problem, it could be brought to IFRIC with a proposed solution. EFRAG would also have a role in encouraging national standard setters to address issues in a similar way. However, only IFRIC should issue formal interpretations of IFRS.

For accountants and their clients there are significant potential disadvantages of having multiple levels of interpretation. If there would be substantial additional demand should it not be rather met by increasing IFRIC resources instead of creating a new interpretative body?

IFRS are principles based and cannot and should not provide detailed rules. Neither can they address each specific situation but, since they are principles based, they are comprehensive in that also for each specific situation based on general principles a proper accounting treatment can be found. The management of the company and their auditors need to use judgement in applying IFRS.

An interpretative body should not address obvious or trivial issues. Companies and auditors should be able to solve such matters without recourse to an interpretative body. Business asked the IASB for a quiet period between 2004 and 2005. Would the market want a significant number of interpretative solutions over this period? Issues to be considered by an interpretative body need to be substantive and arise because there is no current guidance, or the current guidance appears to contain conflicts. A body, different from IFRIC, would be at disadvantage of not to have the opportunity to have assistance of those that were involved in the development of the standard and its interpretations would not be subject to prior approval by the IASB.

European interpretations, more disadvantages than advantages?

In summary the advantages and disadvantages of European interpretations are as follows:

Advantages

- Addressing specific European and national circumstances
- Uniform application of the specific issue in Europe
- Temporary addressing of topical issues until IFRIC has finished its due process
- Avoiding the risk of companies and auditors taking different decisions in similar situations
- Could assist IFRIC in forming their interpretations

Disadvantages

- Risk of creating European IFRS
- Risk of stimulating other parts of the world to issue their own interpretations and their own version of IFRS
- Taking away from companies and auditors the responsibility for making their own judgements
- Impossibility of having interpretations for all specific situations, rather principles should be applied involving careful judgement of the particular circumstances
- Risk of worldwide inconsistency

FEE continues to promote having one set of global standards and interpretations: IFRS and IFRIC interpretations. FEE does not support the creation of European standards or interpretations that are different to IFRS/IFRIC interpretations and would only apply in Europe. FEE concludes that a European interpretation structure is neither appropriate nor needed. However a consultation mechanism with potentially a specific role for EFRAG would help to identify the real issues of general importance which should be addressed by IASB/IFRIC. The Consultative Mechanism suggested by FEE could play an important role in facilitating this debate.

7. TRANSPARENCY AND PUBLICATION

It is important that both the European Enforcement Coordination and Consultative Mechanism adhere to transparency, within – at least for the European Enforcement Coordination – the limitations set by confidentiality.

7.1 European Enforcement Coordination (EEC)

The European Enforcement Coordination should publish an annual report on its procedures and the coordination on enforcement decisions. The European Enforcement Coordination in addition should maintain two databases:

- Internal database

  A database internal to the European Enforcement Coordination needs to be kept of all decisions taken at national level in specific cases, for consultation in new enforcement decisions in order to establish equivalence in enforcement decisions all over Europe. The databases should also include certain particularly relevant no-action decisions. This gives each national enforcement body the possibility to be aware what decisions have already been taken in the area in other countries. A major problem in establishing such a database is translation and the control over translation. The Prospectuses Directive regime of providing information in English with summaries in other languages could be considered.

  Criteria need to be developed as to what enforcement decisions should be published. These could include considerations of the true and fair view and materiality. The criteria could be the same as the criteria for consultation by the European Enforcement Coordination.

- Public database

  In addition a public database could be provided by the European Enforcement Coordination with all enforcement decisions that have been made public in each of the countries, including pre-clearance decisions in order to have a central information point. As far as possible under the respective national law this might will be on a no-name basis. Also here translation may provide a problem.

7.2 Consultative Mechanism

The minutes of the Consultative Mechanism should be published. The meetings of the Consultative Mechanism are in principle public and should involve all relevant stakeholders.

APPENDIX I: COORDINATION MECHANISM