INSTITUT
DER
WIRTSCHAFTSPRÜFER
IDW

Mr Fabrice Demarigny
Secretary General
The Committee of European Securities
Regulators
11-13 avenue de Friedland

75008 Paris
France

Düsseldorf, January 3, 2003
486/500

Dear Mr Demarigny

CESR consultation on Principles of Enforcement of Accounting Standards in Europe

The German Institut der Wirtschaftsprüfer (IDW) appreciates the opportunity to comment on the CESR Statement of Principles on Enforcement of Accounting Standards.

We agree that – in addition to high quality accounting standards, transparent and effective corporate governance systems and a high quality statutory audit – the existence of effective enforcement bodies being independent from the reporting enterprise, its auditor and other stakeholders (institutional oversight) is a prerequisite to restore and improve investors' and other stakeholders' confidence in financial information. Therefore, IDW welcomes the principles of the CESR initiative to improve and strengthen the enforcement system by establishing a common approach to enforcement of IFRS within Europe. We also welcome the level of detail of these principles which allows for taking into account the differences in the legal, economic and political environment of the EU member states. However, we would like to express our concerns on some positions taken by CESR in developing such a common approach:

Principles 1 and 2:

We strongly agree with CESR that effective and efficient enforcement bodies need to be established at national level rather than at European level. Differences in corpo-

Institut der Wirtschaftsprüfer
in Deutschland e.V.
Tersteegenstr. 14
40474 Düsseldorf
Postfach 320580
40420 Düsseldorf

Telefonzentrale 0211/4561-0
Fax Geschäftsleitung 0211/4541097
Fax Fachabteilung 0211/4561233
Fax Bibliothek 0211/4561204
Internet http://www.idw.de
E-Mail info@idw.de

Geschäftsführender Vorstand:
Prof. Dr. Klaus-Peter Naumann,
WP StB, Sprecher des Vorstands
Dr. Gerhard Gross
Dipl.-Kfm. Peter Marks, WP StB

Bankverbindung:
Deutsche Bank AG
Düsseldorf
BLZ 300 700 10
Kto. Nr. 7 480 213

rate governance legislation require the organization of institutional oversight at national rather than at European level.

We also share CESR's opinion, that, if enforcement is carried out by a self-regulating organization (e.g. stock exchanges, review panels), the stakeholders' as well as the public interest require that the self-regulating organization is supervised in an appropriate manner. However, IDW would disagree with the necessity to assign the responsibility for supervision of the self-regulating organization to no other authority than the competent administrative authority as mentioned in Principle 1.

To restore and improve public confidence in financial reporting it is important that IAS/IFRS are applied and enforced in a consistent manner – irrespectively of whether IAS/IFRS are applied by listed or non-listed companies. The EU-Regulation provides member states with the option to allow or require the application of IAS/IFRS not only in the consolidated financial statements of listed but also of non-listed companies and in the individual financial statements. It could be assumed that at least the option to allow or require the application of IAS/IFRS in consolidated financial statements of non-listed companies will be widely used by the member states. Therefore, at least in the long run, enforcement of IAS/IFRS needs to cover all companies. A scope-restriction excluding other than listed companies could only be a first step in order to allow building up sufficient personnel resources gradually.

An enforcement structure needs to be established which allows member states to extend the scope of enforcement to non-listed companies without a fundamental change in the existing organizational arrangements. This is not the case if enforcement lies within the ultimate responsibility of the securities regulator. Instead, member states should also be allowed to give the responsibility for recognition and supervision of the self-regulating organization, which is in charge of enforcement, to another authority or a governmental body, e.g. to the ministry of justice or the ministry of finance depending on the responsibility within the government for accounting issues. To enhance the independence of the self-regulating organisation, the recognition and supervision by the governmental body should be supplemented by an appropriate public oversight over the self-regulating organisation. Such public oversight might be established by a structure comparable to the structure of EFRAG having a technical expert group and a supervisory board with participation of all stakeholder groups being interested in financial reporting.

Such a structure would ensure that the securities regulators would play an important role as they – depending on national legislation – could stay responsible for imposing sanctions in case of detected violations of the applicable accounting principles in financial statements of listed companies.

Principle 3:

For the reasons explained in our comments to Principles 1 and 2 IDW does not fully agree with Principle 3. Indisputably, as pointed out in the Statement of Principles, there is a clear need for harmonisation of the national enforcement systems in order to create a level playing field and to avoid enforcement arbitrage. Therefore, we support the general idea of developing benchmarks for carrying out enforcement of IAS/IFRS at national level. However, in our opinion, such benchmarks should be developed not only by CESR as an organisation representing the securities regulators, but with active involvement and participation of all stakeholder groups interested in financial reporting. In this context we refer to the European Enforcement Coordination (EEC) as proposed by FEE in its discussion paper “Enforcement of IFRS within Europe” of April 2002 (see also our comments on principle 20).

Principle 5:

According to Principle 5 the enforcement body should have the right to require supplementary information not only from the company, but also from the company’s auditor. Irrespectively of whether enforcement is carried out by a competent administrative authority or a self-regulating organization, IDW does not agree with the proposed powers the enforcement body should be endowed with:

It is the management, which should provide the competent authority with explanations, and additional information the authority might need to fulfil its tasks. In case the management needs assistance to provide the required information it might decide to consult its auditor. However, the auditor should always act in co-operation with the company and at the company’s request. Direct contacts between the authority and the auditor would undermine the responsibilities of the management for financial reporting. As set out in the Commission’s recommendation on independence of the statutory auditor the auditor should not and cannot take the role of management.

Moreover, in most member states, the confidentiality requirement for auditors is enshrined in law and therefore auditors are precluded from providing third parties with information about their clients unless the client specifically allows such access. Consequently, auditors would be legally precluded from allowing the enforcement body access to information about their clients.

Furthermore, with regard to the information obtained from the companies it should be clarified in the Statement of Principles that prior to his conclusion on the compliance of the financial information under review the enforcer should discuss the relevant issues with the reporting company and should take into account their arguments.

Principle 7:

Taking into account our comments on Principles 1 and 2, the scope of enforcement as defined in Principle 7 covering companies whose securities are admitted to trading on a regulated market or that applied for admission to trading their securities on a regulated market could only be seen as a kind of “minimum-scope”. Insofar IDW supports CESR in encouraging member states to consider the Principles provided by CESR as a benchmark for companies others than those identified under Principle 7. However, principles being developed at EU-level should be applicable to enforcement in relation to both listed and non-listed companies and, therefore, should be defined in a way, that adaptations as referred to in the explanations to Principles 7 and 8 are not needed.

Principle 8:

With regard to the documents the enforcement should apply to we have reservations whether it is appropriate to refer to harmonised documents, i.e. documents providing financial information for which EU legislation requires its publication and provides guidance on its format and/or content.

According to this definition the principles – contrary to the title of the CESR consultation paper – would not only apply to the enforcement of accounting standards but also to enforcement of other requirements, e.g. on the format and content of prospectuses. As stated in the explanations to Principles 7 and 8 and in Principle 12 enforcement of prospectuses has special characteristics, including ex-ante approval as being the normal enforcement procedure for prospectuses but not for annual and quarterly financial statements (see also Principle 11). For this reason we would propose to exclude enforcement of prospectuses from the general principles on enforcement and to restrict the scope of the principles only to enforcement of accounting standards, namely IFRS including IAS 34 for interim financial statements and the requirements of the 4th and 7th Directive for the content of the financial statements and of the management report.

Principles for the enforcement of prospectuses should be provided separately in order to take into account appropriately all the special characteristics of prospectuses not only in the enforcement process itself but also in the organizational structure of the enforcement body.

Principle 9:

According to Principle 9 the purpose of enforcement of financial information is to protect investors and promote market confidence by contributing to the transparency of financial information relevant to the investors' decision-making process.

From a capital markets point of view we agree with this objective. However, it should be taken into account that financial reporting is not only addressed to investors in financial regulated markets, but also to all other stakeholders of the reporting enterprise including employers, suppliers, etc. Therefore, the purpose of enforcement is not only to protect investors but to protect all stakeholders and, in a wider sense, to restore public confidence in financial reporting. This should be clarified in Principle 9.

For the consequences of the wider purpose of enforcement for the scope and organization of enforcement we refer to our comments on Principles 1, 2 and 7.

Principle 11:

According to Principle 11 for financial information other than prospectuses ex-post enforcement is the normal procedure, even if pre-clearance is not precluded. We recognize that some European securities regulators offer the facility of pre-clearance. However, in providing the facility of pre-clearance the enforcement body should be cautious not to serve a standard setter function. As being clearly stated in the explanatory text to Principle 20 enforcement bodies should not attempt to create a parallel body of interpretations in addition to IFRIC.

Principle 13 and 14:

As indicated in Principle 13, a pure reactive approach of enforcement on a complaint basis is not acceptable for CESR.

IDW understands that a proactive approach including a risk based approach combined with a rotation and/or sampling approach to select companies and documents to be examined without specific indications for material errors or omissions might have a preventive influence on the quality of financial reporting. But it should be taken into account that an approach with both proactive and reactive elements would increase the need for high qualified personnel resources substantially, even if the selection methods are adopted gradually as proposed in Principle 14. Therefore, the principles on enforcement should allow for a "step-by-step approach" permitting

member states to change over from a pure reactive approach on a complaint basis to an approach with both reactive and proactive elements in a defined period of time.

Principle 20:

We agree with CESR that there is a clear need for a European coordination of the decisions on the compliance of the financial statements with the applicable accounting standards taken by the national enforcement bodies in order to ensure consistency in application decisions within Europe. However, we strongly believe that European coordination arrangements need to extent beyond CESR and need to involve all European enforcement bodies, whether they follow a securities regulator or review panel model. Therefore, instead of CESRfin's Subcommittee on Enforcement in our opinion a separate coordination mechanism needs to be developed with active involvement and participation not only of securities regulators but also of other types of enforcement bodies. In this context we also refer to the proposals of FEE in its Discussion Paper on Enforcement of IFRS within Europe.

Such a coordination mechanism as proposed by FEE should be the forum for the discussion of accounting issues under examination by the enforcement bodies before taking a decision on the compliance of the financial statements with the applicable accounting standards. However, the aim of the coordination mechanism would only be to avoid conflicting decisions taken by different enforcement bodies on the same or similar issues, but not to issue general application guidance on IFRS. The same applies for the national enforcement bodies. The decisions of the enforcement bodies – whether it is a securities regulator or a review panel – could only be binding in the individual case under examination. Therefore, we strongly support the last sentence of Principle 20.

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

Yours sincerely

Klaus-Peter Naumann
Chief Executive Officer