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Ms Roxana Damianov
Senior Officer, Corporate Reporting
European Securities and Markets Authority
103 Rue de Grenelle
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10 October 2013
602/631

Dear Ms Damianov

Re.: ESMA Consultation Paper "ESMA Guidelines on enforcement of financial information"

The Institut der Wirtschaftsprüfer in Deutschland e.V. [Institute of Public Auditors in Germany, Incorporated Association (IDW)], would like to thank ESMA for the opportunity to comment on the Consultation Paper "ESMA Guidelines on enforcement of financial information". The IDW represents over 12,000 Wirtschaftsprüfer (German Public Auditors), or about 86 % of all Wirtschaftsprüfer in Germany. Wirtschaftsprüfer are, among other things, entrusted with the performance of statutory audits of financial statements of business enterprises, including publicly listed companies.

In addition to high quality accounting standards, transparent and effective corporate governance systems and a high quality statutory audit, the role assumed by efficient and effective competent enforcement authorities that are independent of the reporting company, its auditor and other stakeholders (institutional oversight) is a prerequisite for enhancing investors' and other stakeholders' confidence in financial information and the EU regulated financial markets.

We would like to comment on certain matters, as set out below.

Question 3:

Do you agree that a common European approach to the enforcement of financial information is required in order to avoid regulatory arbitrage by issuers? In this context, regulatory arbitrage refers to the position where an issuer's choice of the market on which to list its securities may be influenced by different approaches to enforcement being applied in different European jurisdictions.

We agree that an appropriate and rigorous European enforcement regime can underpin investors' confidence in financial markets and that a common approach to enforcement can help to avoid regulatory arbitrage by issuers.

However, effective and efficient enforcement bodies still need to be established at national level. Different economic environments as well as the many differences in corporate governance legislation, civil law, tax and other regulations prevalent in the various European Member States mean that national competent enforcement authorities are still required. The integration of European security markets requires harmonised concepts and comparable techniques as a basis for their respective day-to-day operations. The cooperation of the national European enforcement authorities should be supported by ESMA, e.g. by organising meetings and providing a platform for discussions.

Question 4:

Do you agree with the objective, definition and scope of enforcement set out in these paragraphs 11 to 21 of the proposed guidelines?

Objective of enforcement

We welcome the fact that ESMA has now adjusted the objective of enforcement compared to that included in CESR Standards No. 1 on financial information by recognising that financial reporting is not only addressed to investors in financial regulated markets, but also to all other stakeholders of the reporting company, including employees, suppliers, etc. The purpose of enforcement is not only to protect investors but to protect *all* stakeholders and, in the broader sense, to improve public confidence in financial reporting.

Scope of enforcement

Regarding the inclusion of prospectuses in the scope of enforcement we refer to our answer to question 9.

Question 6:

Do you agree that enforcers should have the powers listed in paragraph 30 of the proposed guidelines? Are there additional powers which you believe that enforcers should have?

National enforcement structures

As already mentioned above, the IDW has always recognised the need for an efficient and well-developed national enforcement system and supports a reasonable and appropriate cooperation of national competent enforcement authorities at the European level. For this reason, we proactively participated in the discussions leading to the establishment of both, our national enforcement system and the European Transparency Directive. The German enforcement system was established by law in 2004. It is in line with the Transparency Directive, which is explicitly confirmed by national law (Transparenzrichtlinien-umsetzungsgesetz from 2006). Moreover, our national enforcement system is generally accepted and it is proven to be effective and efficient.

We seriously doubt the appropriateness of the approach in the proposed ESMA Guidelines to make own demands on the structure of national enforcement systems for the following reasons:

1. The requirements concerning the structure of national enforcement systems in the Member States established in the Transparency Directive are exhaustive. We doubt whether ESMA is empowered to issue additional provisions.
2. The statements in the ESMA Guidelines regarding the structure of European enforcement systems do not appear to be completely consistent with the Transparency Directive. This could result in legal uncertainty which has to be avoided.

Powers that enforcers in all Member States should have

According to paragraph 30b enforcers shall have the right to require any information relevant for enforcement at least from issuers and their auditors.

As both, audit and enforcement, contribute to the protection of the financial statement users and the promotion of market confidence, involvement of the companies' auditors in the enforcement process is important. However, it is the financial information provided by the company that is subject to enforcement. Therefore, it is primarily up to the company's management to provide the competent enforcement authority with the explanations and any additional information it might need to fulfil its tasks. Direct contact between the competent enforcement authority and the company's auditor would undermine management's responsibilities for financial reporting. As set out in the European Directive on statutory audits of annual accounts and consolidated accounts, the auditor must be independent of the audited company and may not be involved in the audited company's decision-making, i.e. an auditor may not assume the role of management.

In our opinion, companies should be obliged to inform their auditors of any enforcement activities. Should management need assistance in providing the required information, it might decide to consult the auditor. The auditor should only act in cooperation with the company's management and at their request. Legal confidentiality requirements generally preclude auditors from providing information about their clients to enforcement authorities unless there is an exception in law, or the client specifically consents to such access. We would like to emphasise that in these cases, the information and documentation required from the auditor is limited to matters pertaining to the financial information that have become known during the audit. Audit working papers that the auditor prepared for his or her own use, such as planning memoranda, work plans etc. do not have to be submitted to the enforcement authority unless they relate directly to the financial information of the entity subject to enforcement.

Question 8:

Are you in favour of enforcers offering pre-clearance? Do you have any comments on the way the pre-clearance process is described and the pre-conditions set in paragraphs 42 to 45 of the proposed guidelines?

We understand the objective of those proposals. However, the establishment of a pre-clearance system must fulfil the following conditions:

1. A clear distinction between the setting of financial reporting standards and their enforcement must be ensured. Enforcement bodies must not assume the role of a standardsetter.

2. If it is a controversial accounting issue that has a material impact on the company's financial statements and that issue cannot be clarified due to ambiguities or a lack of specific guidance in the relevant financial reporting framework, the competent enforcement authority should be required to submit the issue to the bodies responsible for standard setting and interpretation (IASB and IFRS IC) for their consideration.
3. In order to safeguard the independence of the enforcement body from a particular issuer as required in Guideline 4, care must be taken that the enforcement body does not become too actively involved in the arrangement of facts and in the preparation of financial statements.
4. Providing the possibility to submit accounting issues for pre-clearance must not undermine the role of the auditor.

Consequently, pre-clearance should only be sought in exceptional, well-defined circumstances. In our view, a formal process needs to be established that fulfils inter alia the following conditions:

- Any request by a company must be limited to a specified accounting issue, which that company must describe precisely,
- the company has already developed a proposed accounting treatment in consideration of the specific facts and circumstances (where applicable, in consultation with its auditor),
- the enforcer seeks the views of the company's auditor, and such views are to be considered and discussed within the pre-clearance process.

Question 9:

Do you agree that in order to ensure investor protection, the measures included as part of a prospectus approval should be supplemented by additional measures of ex-ante enforcement in relation to financial information? If yes, could you please specify the exact nature of ex-ante enforcement that you would expect from enforcers?

Currently, the formal approval process for prospectuses, which comprises a scrutiny of the completeness of the prospectus, including the consistency of the information given and its comprehensibility, does not include any assessment of the content of the financial information of a prospectus (e.g. consolidated historical financial statements, pro-forma financial statements, profit estimates, MD&A). In direct contrast, the content of (published) historical financial statements of companies listed on the regulated market is subject to statutory

audit and an additional separate enforcement process, which represents the usual procedure of ex-post enforcement.

Before deciding whether measures included as part of a prospectus approval should be supplemented by additional measures of ex-ante enforcement in relation to financial information ESMA should determine which consequences introducing ex-ante enforcement of prospectuses in the ESMA Guidelines will have and whether enforcers are even able to afford this. For example:

1. If additional ex-ante enforcement measures (legally required governmental enforcement processes) with respect to financial information in a prospectus are established, a sufficient time frame for such additional processes will need to be prescribed by law (e.g. six weeks). It should be clear to all market participants that this will lead to longer time schedules when entering capital markets.
2. As most of the historical financial information included in the prospectuses has already been subject to statutory audit and ex-post enforcement (financial statements), ex-ante enforcement would concentrate only on other financial information, e.g. pro-forma financial statements, profit estimates, MD&A. Although, most such other financial information is also subject by law to appropriate engagements performed by auditors (Prospectus Directive), the enforcement of projected financial information might be difficult.
3. The national competent enforcement authorities will necessitate an increased number of high qualified staff to fulfil such a new and complex task.

Question 13:

What are your views with respect to the best way to take into account the common enforcement priorities established by European enforcers as part of the enforcement process?

We agree that one means to improve the coordination of European enforcement activities is to set out common enforcement priorities. These enforcement priorities should be commonly identified by the national competent enforcement authorities and ESMA. However, sufficient flexibility should be still provided to the national competent enforcement authorities, i.e. they should not be legally forced to take into account *all* of the commonly identified European enforcement priorities and they must be able to add additional national enforcement priorities in consideration of specific national facts and circumstances.

Question 14:

Do you agree that the examination procedures listed in paragraph 54 of the proposed guidelines are appropriate for an enforcer to consider using? Are there other procedures which you believe should be included in the list?

Guideline 8 states that as part of the ex-post enforcement activities, enforcers can either use full reviews or a combination of full reviews and partial reviews of financial information of issuers selected for enforcement. Further, the ESMA Guidelines express that the use of only partial reviews cannot be satisfactory for enforcement purposes. The IDW does not share this view.

The requirement of a "full review" might create expectations that an enforcement authority could not meet. In our opinion, a "full review" contradicts an efficient and effective examination process and consequently, it causes increased costs for both the enforcement authority and the issuer. From the IDW's point of view, a partial review is the only reasonable examination procedure. Additionally, it is important to clarify that a review exercised by an enforcement authority does not represent a second audit.

Regarding the examination procedure in paragraph 54.c) "posing questions to or having meetings with the auditors of the issuer to discuss complex issues or issues of interest" we refer to our answer to question 6.

Question 15:

Do you agree that, in determining materiality for enforcement purposes, materiality should be assessed according to the relevant reporting framework, e.g. IFRS?

The concept of materiality is crucial to financial reporting. We support ESMA's view that improvement is needed in this area and therefore, we welcome the IASB initiative to start a project on materiality.

With reference to our comment letter on the ESMA Consultation Paper: Considerations of Materiality in Financial Reporting (from 9 March 2012), we would like to point out again that – as currently recognised by IFRS and other financial reporting standards as well as other accounting literature – materiality is a financial reporting concept that is user-driven – i.e., it is user needs that determine what materiality is. Consequently, by definition, materiality for the preparation of financial statements by companies, and for auditors, financial reporting enforcement authorities and regulators, cannot be different than materiality for users.

On these grounds, it is important that users, preparers, auditors, financial reporting enforcement authorities, and regulators, have a common understanding of materiality because differences in understanding among these groups would lead to miscommunication in financial reporting and thereby diminish the value of financial reporting to users and cause friction among the parties.

Question 16:

What are your comments regarding enforcement actions as presented in paragraphs 57 to 67 of the proposed guidelines? Do you agree with the criteria proposed?

In our opinion, the three enforcement actions listed in paragraph 57 and the criteria for deciding which action is required to be taken might be generally suitable. Additionally, we suggest the section on European coordination in the ESMA Guidelines (paragraphs 68 to 73) also stipulate that the decisions on which action is required to be taken should be a matter for coordination among European enforcers. This would help to avoid regulatory arbitrage and could increase the transparency and comparability regarding enforcement decisions taken by the enforcement authorities of the Member States.

However, we are concerned about the practical feasibility of these proposals. At present, enforcement actions are defined at national level. For instance, in Germany a requirement to restate financial information does not exist. Moreover, identifying and introducing common European enforcement actions and criteria for deciding which action is required to be taken in specific circumstances would be a significant interference in the national enforcement systems and in the responsibilities of the national competent enforcement authorities.

Considering the objective of enforcement stated in Guideline 1, we would welcome clarification that no further enforcement action needs to be taken if the issuer has corrected a misstatement by means of a restatement, a corrective note or a correction in its future financial statements, thereby ensuring that investors and other users were well-informed on a timely basis.

Question 17:

Do you have any comments on the specific criteria for the submission of decisions or emerging issues to the EECS database?

Guideline 14 states that (except in rare circumstances) an accounting issue should be submitted as an emerging issue to the EECS and that the enforcement decisions taken on the basis of an emerging issue should take into account the outcome of the discussion in the EECS.

We welcome providing national competent enforcement authorities with the opportunity to submit and discuss emerging issues in the EECS. However, we do not agree with the proposal to require national competent enforcement authorities to submit and discuss each emerging issue in the EECS before taking their enforcement decision. On the one hand this would mean a significant interference in the responsibilities of the national competent authorities without legal cause. On the other hand enforcement processes would become more unwieldy, which would result in additional costs for issuers under investigation.

Question 19:

Do you have any comments on the transparency, timing and frequency of the reporting done by the enforcers with respect to enforcement actions taken against issuers?

Question 20:

What are your views about making public on anonymous basis enforcement actions taken against issuers?

We agree with ESMA that the publication of enforcement actions taken against issuers on an anonymous basis in the EECS Database of Enforcement could provide helpful advice to all issuers. However, we think that enforcement authorities should be cautious so as not to assume a standard setting role by issuing reports that contain statements on specific accounting treatments (we also refer to our comment on question 8).

Further, we would like to propose that the content of the periodic reports on enforcements activities from the national enforcement authorities should also be subject to European coordination in order to avoid perceived differences in the strength of enforcement between the European Member States. This is especially the case if data reported includes sheer numbers, or percentages, relating to the misstatement of specific matters or enforcement actions taken. Including

numbers or percentages implies a degree of exactness, which is only valid when such numbers or percentages are derived on a uniform basis.

We would be pleased to answer any questions that you may have or discuss any aspect of this letter.

Yours sincerely

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Chief Executive Officer

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