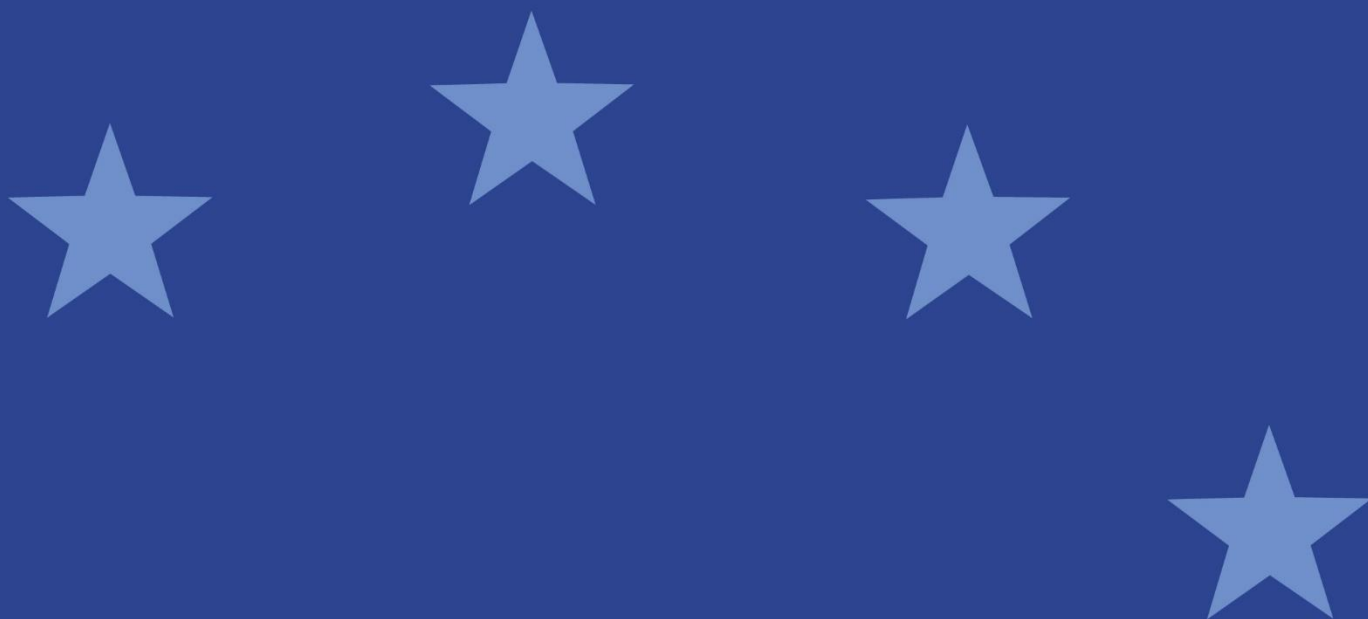


# Report

## Amendments to ESMA Guidelines on enforcement of financial information





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## Executive summary

### Reasons for publication

In 2014, ESMA published its Guidelines on enforcement of financial information (Guidelines) with the objective of establishing consistent, efficient and effective supervisory practices in relation to, and ensuring common, uniform and consistent application of Article 24 of the Transparency Directive in relation to the examination of financial information by competent authorities. The Guidelines became effective in December 2014 and 26 of the 31 EEA countries have declared that they comply with the Guidelines.

In 2017, following a peer review on the way national enforcers have implemented certain of the Guidelines, ESMA published a Report<sup>1</sup> containing recommendations addressed to enforcers regarding Guideline 2 *Human and financial resources*, Guideline 5 *Selection methods* and Guideline 6 *Examination procedures*. These recommendations aimed to strengthen supervisory convergence in the area of enforcement of financial information and prevent regulatory arbitrage and thus overall contribute to investor protection.

Certain recommendations arising from the peer review required amendments to the Guidelines. Today, ESMA publishes an amended version of the Guidelines to reflect those recommendations (please refer to the document ESMA32-50-218). Considering that the amendments to the Guidelines address supervisory practices of European enforcers, ESMA has not consulted on these amendments as it considers that this would be disproportionate taking into account the scope and impact of the amendments on financial market participants. ESMA furthermore observes that financial market participants were informed of the potential modifications to the Guidelines through the publication of the Peer Review Report in 2017.

In the absence of consultation, and in order to ensure full transparency, the present Report provides an overview of the amendments made to the Guidelines as well as the underlying reasons for these amendments.

### Content

This Report provides an explanation for the amendments made to the Guidelines and includes a track-changes version of the main amendments made to the Guidelines in Annex I.

### Next steps

Following the translation of the amendments to the Guidelines into all the official languages of the EU, a version of the amended Guidelines will be published on ESMA's website in each language.

The amendments to the Guidelines will become effective on 1 January 2022.

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<sup>1</sup> [ESMA42-111-4138](#), Peer Review Report *Peer review on Guidelines on enforcement of financial information*, 18 July 2017

## 1 Introduction

### 1.1 Background

1. Based on the empowerment contained in Article 16 of Regulation (EU) No 1095/2010 (the ESMA Regulation),<sup>2</sup> on 14 October 2014 ESMA published its Guidelines on enforcement of financial information (Guidelines). The Guidelines became effective on 30 December 2014. 26 European Economic Area (EEA) countries have declared that they comply with the Guidelines.<sup>3</sup>
2. In 2017, ESMA carried out a peer review on European enforcers' implementation of certain of the Guidelines, specifically Guidelines 2 *Human and financial resources*, 5 *Selection methods* and 6 *Examination procedures*. The peer review identified areas where further convergence was necessary in order to strengthen harmonisation of the procedures undertaken by enforcers when supervising financial information published in accordance with Directive 2004/109/EC (the Transparency Directive).<sup>4</sup> In the context of the Capital Markets Union, it is key that issuers are subject to a similar level of scrutiny by national competent authorities as this leads to market confidence, reduces regulatory arbitrage and enhances investor protection.
3. The Peer Review Report,<sup>5</sup> published in July 2017, included several recommendations, some of which required amendments to the Guidelines, and ESMA has amended the Guidelines on that basis. The present Report provides an overview of the amendments which have been made to the Guidelines and the rationale behind those amendments. Other recommendations included in the Peer Review Report will be addressed via internal guidance or further action at national level.
4. Considering that the amendments to the Guidelines address supervisory practices of enforcers, ESMA has not consulted on these amendments as it considers that this would be disproportionate taking into account the scope and impact of the amendments on financial market participants. ESMA furthermore observes that financial market participants were informed of the potential modifications to the Guidelines through the publication of the Peer Review Report in 2017.

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<sup>2</sup> Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC

<sup>3</sup> [ESMA32-67-142](#) Guidelines compliance table – Guidelines on the enforcement of financial information (ESMA/2014/1293), 21 March 2019

<sup>4</sup> Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC

<sup>5</sup> [ESMA42-111-4138](#) Peer Review Report – *Peer review on Guidelines on enforcement of financial information*, 18 July 2017

## 1.2 Recommended modifications to the Guidelines

5. According to the Peer Review Report, ESMA should, inter alia, undertake the following actions:

### Guideline 5 *Selection methods*

6. Modify Guideline 5 to require that:
  - (a) enforcers select issuers for examination not only based on risk but also based on random sampling and rotation (currently, Guideline 5 requires selection based on risk, sampling and / or rotation);
  - (b) all issuers under an enforcer's supervision are examined during a specific period of time;

### Guideline 6 *Examination procedures*

7. Modify Guideline 6 in order to:
  - (a) strengthen enforcers' focus on the recognition and measurement principles when they examine financial information;
  - (b) limit the use of focused examinations (i.e. examinations whereby the enforcer pre-defines the topics to be examined before reading the financial information) and the use of desktop examinations (i.e. examinations whereby the enforcer examines the financial information without interacting with the issuer); and
  - (c) require that enforcers apply a 4-eyes principle / quality review when examining financial information;
8. In order to address these recommendations, ESMA has made the following changes to the Guidelines:
  - (a) the existing definitions of unlimited scope and focused examination have been amended and two new definitions of desktop unlimited and desktop focused examination have been added, as explained in section 2.1 below;
  - (b) the wording of Guidelines 5 and 6 has been amended, as explained in sections 2.2 and 2.3 below.
9. Considering the amendments made to the definition of materiality in IAS 1 *Presentation of Financial Statements*, ESMA has taken the opportunity to make an amendment to Guideline 8, as explained in section 2.4. Section 2.4 also explains a small number of other changes made to various paragraphs of the Guidelines.
10. Finally, ESMA considers that Guideline 2 *Human and financial resources* is still fit for purpose and as such decided not to amend it.

## 2 Amendments to the Guidelines

### 2.1 Definitions

11. Based on the recommendations in the Peer Review Report but also on discussions held in the European Enforcers Coordination Sessions (EECS), ESMA has amended the pre-existing definitions and introduced two new definitions. These changes clarify that enforcers may make use of four categories of examinations depending on whether an examination:
  - (a) covers the entire content or pre-defined issues of the financial information included in an issuer's harmonised document (unlimited vs. focused examination); and
  - (b) does or does not entail an interaction between the enforcer and the issuer (desktop vs. interactive examination).
12. This leads to the categories of interactive unlimited, interactive focused, desktop unlimited and desktop focused examinations.
13. The purpose of the amended definitions is to establish a harmonised understanding among enforcers of the types of examinations and consequently of what type of procedures should be undertaken when performing each of these examinations. The amendments to the definitions will also facilitate a more harmonised application of Guideline 6. Furthermore, the amendments to the definitions clarify that all examinations should lead to a conclusion on whether infringements have been discovered in relation to the relevant applicable financial framework and introduce the concept of interaction with the issuer which is further explained in Guideline 6.

### 2.2 Amendments to Guideline 5

14. The main changes to Guideline 5 have the purpose of harmonising the way enforcers select issuers for examination.

*Selection should be based on risk + random + rotation approach*
15. The peer review showed that half of the European enforcers already have both a rotation and a random sampling system in place for selecting issuers for examination. Indeed, the peer review found that 15 enforcers already use both random sampling and rotation in their selection model, 11 enforcers use a rotation approach without also using random sampling and 3 enforcers use only random sampling (see paragraphs 206 - 208 of the Peer Review Report).<sup>6</sup>
16. The Peer Review Report noted that the purpose of the random sampling approach is to ensure that all issuers have a chance of being examined every year and to prevent them from being able to estimate when they will be examined. To reach this purpose, only a small portion of issuers needs to be selected via the random sampling approach and it

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<sup>6</sup> LI and HR did not participate in the peer review due to a lack of final enforcement responsibility and authority (HR) and because there were no issuers admitted to trading on regulated market (LI). In 2019, HR is implementing their enforcement system.

is therefore expected that requiring both rotation and random sampling in addition to the risk-based approach should not in and by itself have a significant impact on most enforcers' supervisory practices. It would, however, improve convergence as all enforcers would include all selection approaches.

17. Therefore, ESMA has amended Guideline 5 to require that all selection approaches (risk, random sampling and rotation) form part of enforcers' selection methods.

*All issuers under an enforcer's supervision should be examined at least once in a given time period*

18. The Peer Review Report concluded that greater harmonisation of enforcement in Europe would be ensured by introducing a maximum time period within which all issuers in a given jurisdiction should be examined. At the time of the peer review, 21 enforcers already had selection procedures ensuring the coverage of all issuers over a defined period of time while 8 enforcers did not.<sup>7</sup>
19. Taking into account the differences that exist in the number of issuers under supervision in the different EEA countries and the differences in the resources allocated to enforcement of financial information, ESMA has not prescribed a specific time period for which all issuers under supervision should be examined in Guideline 5. Instead, a principle has been added to the Guideline which requires all issuers to be subjected to examination at least once in a defined period of time. Based on this principle, enforcers should, based on their resources, the number of issuers under their supervision and the characteristics of their markets, decide on the specific time period for their jurisdiction.

### **2.3 Amendments to Guideline 6**

20. The peer review showed significant divergence in enforcers' practices when examining financial information. For example, while some enforcers focus their analysis on presentation and disclosure issues, other enforcers focus their attention on recognition and measurement issues. In addition, there are differences in the extent to which enforcers contact the issuer during the examination. Even when such contact is established, differences remain as, for instance, some enforcers only ask questions when something in the financial information points to an accounting misstatement or something is unclear, whilst other enforcers ask questions regardless of the quality of the financial information.
21. In light of the recommendations arising from the peer review, ESMA has amended Guideline 6 (focused on the different types of examinations) and introduced two new Guidelines; 6a (focused on what should be achieved during an examination) and 6b (focused on quality review). This section explains those changes and the rationale behind them. As a general comment, ESMA observes that the existing references to unlimited scope and focused examinations in Guideline 6 were replaced with references to the four new categories of examinations (please refer to section 2.1).

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<sup>7</sup> LI and HR did not participate in the peer review due to a lack of final enforcement responsibility and authority (HR) and because there were no issuers admitted to trading on regulated market (LI). In 2019, HR is implementing their enforcement system.

- Guideline 6

*Thresholds related to interactive unlimited examinations*

22. Guideline 6 has been amended to include a minimum proportion of examinations which should generally be interactive unlimited. This change has the purpose of creating convergence regarding the proportion of examinations in which enforcers ask issuers questions and in which they evaluate the entire financial information. It furthermore aims to ensure that enforcers challenge measurement and recognition issues, as these areas usually require interaction with issuers.
23. The Guideline gives enforcers the flexibility to choose between two thresholds: either 33% of the examinations undertaken within a given year should be interactive unlimited or 10% of the total amount of issuers under the enforcer's supervision should be subject to interactive unlimited examinations. The inclusion of two alternative thresholds reflects the fact that securities markets and issuers under supervision of the different enforcers differ widely amongst EEA countries.
24. In addition, inclusion of the 10% threshold allows enforcers not to limit the number of interactive focused or desktop examinations undertaken during one year.
25. As regards both thresholds, it is important to note that the enforcer would only be in breach of Guideline 6, if the enforcer would in general not meet either of the thresholds. In other words, to comply with the Guideline, the enforcer should live up to just one of the thresholds on average over a few years. If an enforcer within a specific year finds itself unable to meet either of the two thresholds, the enforcer may explain why this was the case. The fact that neither threshold was met in an individual year does not immediately constitute non-compliance with Guideline 6.
26. ESMA observes that the basis for the inclusion of the thresholds was implicit in the previous version of Guideline 6 which stated that the enforcement model should not be based only on focused examination. However, the previous version did not specify which proportion was considered to be adequate and thus diversity emerged.

*Other changes*

27. Taking into consideration the fact that the new definitions introduce the concept of interaction between the enforcer and the issuer, a new paragraph has been added to Guideline 6 to explain what this interaction entails. In light of this new paragraph, ESMA has removed the list of examples of examination procedures in paragraph 54 of the old version of the Guidelines which was considered to not contribute to supervisory convergence as it did not indicate when and how enforcers should make use of each procedure.
28. The explanatory text in Guideline 6 emphasises the importance of interactive examinations over desktop examinations. While Guideline 6 does not establish a specific maximum threshold for desktop examinations, it clarifies that the use of these types of examinations should be limited.



- New Guideline 6a

29. The peer review highlighted that the examination procedures carried out by enforcers should be sufficient to cover presentation and disclosure principles but also recognition and measurement principles included in the relevant financial reporting framework. Therefore, ESMA has strengthened this aspect of the Guidelines by introducing Guideline 6a.
30. Considering that the Guidelines did not explicitly address the examination of the management report, ESMA furthermore included a paragraph in Guideline 6a in this regard, providing guidance on what is expected from enforcers when they examine management reports.
31. Finally, Guideline 6a contains a paragraph which clarifies the differences between the work of the enforcer and the work performed by the auditor. In this respect, ESMA notes that the enforcer is not required to provide a positive assurance regarding the issuer's compliance with the relevant financial reporting framework, as its focus is on whether infringements are encountered (as clarified in the definitions).

- New Guideline 6b

32. Guideline 6b was introduced to foster the implementation of the 4-eyes principle in the examination of financial information. This change was based on the Peer Review Report which recommended that in order to ensure that the examination procedures carried out and the related conclusions are robust and adequately supported, enforcers should have adequate quality reviews in place.
33. ESMA observes that Guideline 6b is worded in such a way as to provide enforcers with flexibility on how to apply this principle on the basis of their resources and how enforcement of financial information is organised at national level.

## **2.4 Other modifications**

34. In light of the modifications summarised above, the Guidelines include wording in section III *Purpose* and section V *Guidelines on enforcement – Background* to explain the changes made.
35. Furthermore, paragraph 65 of the Guidelines as published in 2014 was deleted. This was done following the changes to the definition of materiality in IAS 1 *Presentation of Financial Statements*, as ESMA considered that the wording of the bold text in Guideline 8 sufficiently covers the topic of materiality.
36. Finally, the Guidelines were modified to clarify their scope of application. Notably, it has been clarified that the Guidelines do not apply to the enforcement of the non-financial statement under Article 19a and Article 29a of Directive 2013/34/EU (the Accounting Directive).<sup>8</sup> Notwithstanding this clarification, ESMA will continue to actively monitor the

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<sup>8</sup> Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC



disclosure of non-financial information in Europe and remains committed to improve the quality of such disclosures.

## Annex I: Main amendments to the GLEFI (extract)

Please note that amendments to the GLEFI are presented in track changes.

### **Types of examinations**

#### Desktop focused examination of financial information

The assessment of whether pre-defined issues / areas in the financial information included in one or more harmonised documents of an issuer are in accordance with the relevant financial reporting framework. The desktop focused examination does not entail any interaction between the enforcer and the issuer. Based on the examination procedures undertaken, the enforcer concludes whether there are indications that infringements exist in relation to the pre-defined issues / areas analysed.

#### Desktop unlimited examination of financial information

The evaluation of the entire content of the financial information included in one or more harmonised documents of an issuer in order to identify issues / areas that, in the enforcer's opinion, need further analysis, and the subsequent assessment of whether the financial information regarding those issues / areas is in accordance with the relevant financial reporting framework. The desktop unlimited examination does not entail any interaction between the enforcer and the issuer. Based on the examination procedures undertaken, the enforcer concludes whether there are indications that infringements exist in the financial information analysed.

#### Interactive focused examination of financial information

The assessment of whether pre-defined issues / areas in the financial information included in one or more harmonised documents of an issuer are in accordance with the relevant financial reporting framework. The interactive focused examination entails an interaction between the enforcer and the issuer. Based on the examination procedures undertaken and the information received from the issuer, the enforcer concludes whether it has discovered infringements in relation to the pre-defined issues / areas analysed.

#### Interactive unlimited examination of financial information

The evaluation of the entire content of the financial information included in one or more harmonised documents of an issuer in order to identify issues / areas that, in the enforcer's opinion, need further analysis, and the subsequent assessment of whether the financial information regarding those issues / areas is in accordance with the relevant financial reporting framework. The interactive unlimited examination entails an interaction between the enforcer and the issuer. Based on the examination procedures undertaken and the information received from the issuer, the enforcer

concludes whether it has discovered infringements in relation to the issues / areas analysed.

### Selection methods

~~47-53.~~ **Guideline 5: Enforcement normally uses selection. The selection model should be based on a mixed model whereby a risk-based approach is combined with a sampling and/or a rotation approach. A risk-based approach should consider the risk of a misstatement as well as the impact of a misstatement on the financial markets. The selection model should ensure that each issuer is examined at least once during a period selected by the enforcer.**

~~48-54.~~ Selection should be based on a combination of a risk based approach and either random sampling ~~or and~~ rotation ~~or both~~. A pure risk based approach would mean that those issuers not fulfilling the risk criteria determined by the enforcer would never be subject to enforcement. There should always be a possibility of an issuer being selected for review. A pure random system could mean that issuers with high risk are not selected on a timely basis. The same would apply to a pure rotation system and, in addition, there would be a possibility that an issuer would be able to estimate when its financial statements were likely to be selected.

### Examination procedures

~~53-59.~~ **Guideline 6: As part of the enforcement process, ~~European~~ enforcers should identify the most effective way ~~for enforcement of to enforce~~ financial information. As part of the ex-post ~~enforcement~~ activities regarding enforcement of financial information of issuers selected for enforcement, enforcers can either use: unlimited scope examination or a combination of unlimited scope and focused examinations of financial information of issuers selected for enforcement. ~~The sole use of focused examination should not be considered as satisfactory for enforcement purposes.~~**

- a) interactive unlimited examinations,
- b) interactive focused examinations,
- c) desktop unlimited examinations, and
- d) desktop focused examinations.

**Interactive unlimited examinations should generally constitute at least 33% of all examinations undertaken within any given year or cover at least 10% of the total amount of issuers under the enforcer's supervision at the beginning of the year.**

~~54.~~ ~~Examples of examination procedures of an issuer's financial information include the following:~~

- ~~a) Scrutinising the annual and interim (consolidated) financial reports, including any financial report published subsequently;~~
- ~~b) Asking questions of the issuer, usually in writing, in order to better understand: the areas of the issuer involving significant risks, the significant accounting issues which arose in the year under review, how the issuer treated the significant accounting issues, and how the issuer's chosen accounting treatment complies with the relevant reporting framework;~~
- ~~c) Posing questions to or having meetings with the auditors of the issuer to discuss complex issues or issues of interest, depending on the needs of the examination process;~~
- ~~d) Referring matters to the bodies responsible for the audit and/or approval of financial information, such as a supervisory board or audit committee;~~
- ~~e) Identifying accounting issues inherent in the issuer's industry, available, for example, from the EECS database;~~
- ~~f) Engaging external experts, where considered necessary, to assist in providing industry or other specialist knowledge;~~
- ~~g) Exchanging information concerning the issuer with other departments within the enforcer, for example, where the issues may concern market abuse, takeovers or major voting rights;~~
- ~~h) Engaging in on-site inspections.~~

~~Further examples of procedures considered relevant as part of the examination process include:~~

- ~~a) Reviewing other relevant financial information made available by the issuer;~~
- ~~b) Reviewing recent press articles and accounting commentaries concerning the issuer and its industry;~~
- ~~c) Comparing the issuer's financial reports to those of its competitors;~~
- ~~d) Comparing key financial relationships and trends within the issuer's financial reports, both in the year under review and for prior periods.~~

60. Interactive examinations entail an exchange of information between the issuer and the enforcer regarding the financial information under examination. The interaction between the issuer and the enforcer may occur, for example, when the enforcer poses questions to the issuer, requires supporting documents or carries out on-site inspections.

61. Interactive examinations should be the primary procedure used for enforcement of financial information, therefore the use of desktop examinations should be limited. Furthermore, ~~the sole use of interactive focused examinations should not be considered as satisfactory for enforcement purposes.~~

62. Where an enforcer meets neither of the thresholds set out in paragraph 59 within a given year, it should be able to explain why it was unable to meet these thresholds.

**63. Guideline 6a: An enforcer's enforcement model should aim at assessing whether financial information of issuers is in accordance with the recognition, measurement, presentation and disclosure principles of the relevant financial reporting framework. In addition, enforcers should examine if the financial information contained in the management report is consistent with the information included in the financial statements and is in accordance with the relevant financial reporting framework.**

64. Assessing whether financial information is in accordance with the relevant financial reporting framework does not require enforcers to give a positive assurance that the financial information complies with the relevant financial reporting framework. However, if, in the course of its examination, the enforcer concludes that it has encountered a material misstatement or an immaterial departure as set out in paragraph 70 of Guideline 7, the enforcer should apply the enforcement actions set out in paragraph 69 of Guideline 7.

~~55. Enforcers should ensure that examination procedures undertaken are sufficient in order to achieve an effective enforcement process and that the examination techniques used and the related conclusions of the review of the financial information of issuers selected as part of the enforcement process are documented appropriately.~~

~~56-65.~~ The conclusions of an enforcer following ~~the an~~ examination ~~procedures~~ can take one of the following forms:

- a) A decision that no further examination is needed.
- b) A decision whereby an enforcer accepts that a specific accounting treatment is in accordance with the relevant financial reporting framework and no enforcement action is required.
- c) A decision whereby an enforcer finds that a specific accounting treatment is not in accordance with the relevant financial reporting framework, whether it constitutes a material misstatement or an immaterial departure and whether an enforcement action is required.

~~66. Enforcers should ensure that the examination procedures undertaken are sufficient in order to achieve an effective enforcement process and that the examination techniques used and related **and its** conclusions of the review of the financial information of issuers selected as part of the enforcement process are documented appropriately.~~

**67. Guideline 6b: In order to ensure that the examination procedures used and the related conclusions are robust, enforcers should put in place quality reviews of the examinations performed.**

68. Quality reviews should be performed by staff that has relevant experience and expertise in the relevant financial reporting framework or in the accounting issues which are being examined.