By E-mail: www.esma.europa.eu
ESMA
103 rue de Grenelle
75007 Paris
France

21 October 2013

Dear Sirs

Consultation paper - ESMA Guidelines on enforcement of financial information

We[1] appreciate the opportunity to respond to this consultation issued by the European Securities and Market Authority (ESMA). We have considered all of the questions in the consultation paper. Our comments on those specific questions where we have a particular view are included in the accompanying Annex. In this covering letter we provide some overall observations on what we consider to be important issues raised by the paper.

Transparent, accountable principles-based enforcement

It is important that stakeholders have confidence in all aspects of the infrastructure underpinning the capital markets. High quality, principles-based enforcement of financial information by credible national enforcement authorities is therefore an important part of ensuring market confidence.

The ESMA guidelines codify and extend further the approach developed by CESR in its *Principles of Enforcement Standards No. 1 and 2*. The approach is evolutionary, and hence broadly representative of current practice rather than new departures. We broadly support the guidelines, with some refinements as noted in our detailed responses.

It will be important for individual national enforcers to benchmark their current practices against the proposals, to ensure that flexibility is maintained and that national models that differ but are nevertheless effective are accommodated.

Importance of contextual information to support decision-making

As a general principle, we believe that determination of enforcement matters should be made on the basis of all relevant facts and circumstances. In particular, enforcement decision-making benefits from the opportunity of issuers and auditors to provide relevant information.

[1] This response is being filed on behalf of the network of member firms of PricewaterhouseCoopers International Limited and references to "PwC", "we" and "our" refer to the PwC network of member firms.

PricewaterhouseCoopers International Limited
1 Embankment Place
London WC2N 6RH
T: +44 (0) 20 7583 5000, F: +44 (0) 20 7822 4652

As noted in our detailed response to Question 18, our view is that consideration of individual cases by the European Enforcers' Coordination Sessions (EECS) can be helpful, but the national enforcer is likely to have a better understanding of the local reporting environment and of the facts and circumstances. There is also a risk that judgments are made without context if too much anonymity is applied in presenting the matter - this could result in a different view being taken to that which would be reached with the benefit of more contextual information. We would be concerned if enforcement decisions are "pre-determined" through discussion in EECS in the absence of the additional information that can be provided by issuers and auditors in a local setting.

Global sharing of experience

While we consider the EECS is a useful forum for collective discussion of enforcers' experience and of issues being raised in different countries, including those matters of IFRS interpretation that should be referred to the IASB and the IFRS Interpretations Committee (IFRS IC), we believe this model of coordination should be expanded.

We would support a broader-based forum where ESMA enforcers, representatives of the IASB and auditors can debate emerging issues, including those that might be referred for interpretation. Ideally, a broader-based forum would be established on a global basis that includes enforcers from other major non-EU jurisdictions (perhaps through IOSCO), but we would support such a forum on a European basis as an interim step.

We would be delighted to discuss our views further with you. If you have any questions in the meantime regarding this letter, please contact Richard Sexton (+44 207 804 5058), John Hitchins (+44 207 804 2497), Mary Dolson (+44 207 804 2930) or Graham Gilmour (+44 207 804 2297).

Yours sincerely

PricewaterhouseCoopers International Limited

ANNEX

'ESMA Guidelines on enforcement of financial information' - Responses to detailed questions

1. Do you think that the proposed guidelines will improve the quality and consistency of financial reporting in Europe?

- The ESMA guidelines codify and extend further the approach developed by CESR in its *Principles of Enforcement Standards No. 1 and 2* of 2003-04. Now, almost a decade later, is an opportune time to review the regime, in light of the experience gained by Europe's enforcers and market participants over the period since the introduction of IFRS in 2005.
- In general, notwithstanding the financial crisis, successive annual reports on enforcement activities by CESR and ESMA have shown that, as experience with working with IFRS has increased, the quality of financial information has improved. ESMA's most recent annual report on enforcement activities for 2012 stated *"Overall the quality of the IFRS financial statements continued to improve"*. Hence, to the extent that the proposed guidelines are a refinement of the current approach, we would expect to see the trends of improved quality and consistency continue.

2. Do you have any comments on the potential costs to the financial reporting community of any aspects of these proposals?

- As the proposed guidelines are an evolution of the current approach, we would not expect the incremental costs to be significant.
- However, we question ESMA's contention in Annex II that no cost-benefit exercise is needed, since these guidelines are directed at enforcers and not at market participants directly. The market or taxpayers will ultimately have to meet the cost of any increased enforcement activity so, to the extent the guidelines do result in additional or different activity, we believe this should still be subject to some form of cost-benefit analysis.

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?

- An issuer's choice of market on which to list will be influenced by a whole range of different factors. The regulatory regime, including the approach to enforcement, will just be one of those factors.
- Consistent with the European Single Market approach, investors and other market participants should be able to understand the standards of regulation that will generally apply across the EU, and expect that those will be applied in consistent fashion. This will aid understandability and transparency for users, as well as helping to avoid regulatory arbitrage.

- National regulators should not take a different view from their peers in other EU countries with regard to key enforcement issues, but if they were to do so that fact should be made public. We therefore strongly endorse aspects of the guidelines that promote public accountability by enforcers.

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

- We broadly agree with the objective, definition and scope, with the following observations.
- We note that paragraph 17 states that *"enforcers may also seek to encourage compliance by issuing alerts and other publications to assist issuers in preparing their financial statements…."* Our view is that guidance and alerts issued by enforcers can be helpful, for instance by indicating areas of focus for impending reporting period-ends (a particular example being the guidance on impairment disclosures).
- However, at the same time, we suggest ESMA continues to exercise care to ensure enforcement bodies do not go so far as to provide an alternative 'rulebook' or interpretation of IFRS. Matters requiring interpretation should be referred to the IASB and the IFRS Interpretations Committee (IFRS IC), otherwise there is a risk of creating GAAP without adequate due process.

5. Do you agree that issuers from third countries using an equivalent GAAP to IFRS should be subject to an equivalent enforcement and coordination system? Do you agree with the measures proposed to make this enforcement more efficient?

- We agree that in principle broadly similar standards of enforcement should be expected to be applied in the case of third country issuers, and that referring the task of enforcement to the relevant national enforcer in the country concerned is likely to be the most efficient approach. We question whether "*a centralised team to be organised by ESMA at the request of enforcers*" (paragraph 24) is likely be a cost-effective approach, since any such team would have to have knowledge of the financial reporting and enforcement environment in potentially multiple jurisdictions.

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?

- Paragraph 32 states that enforcers should be *"able to require all information relevant for their enforcement from issuers and auditors"*. Auditors seek to co-operate in enforcement actions, but would expect to act usually at the request of the company in providing information to the competent authorities – consistent with and reinforcing the principle of management responsibility for financial reporting. Rules regarding client confidentiality differ between EU member states and may in some circumstances prevent the auditor from responding to all information requests by third parties including national regulatory authorities.
- The proposed power in paragraph 31 appears far-reaching in proposing that enforcers "*have the necessary powers to require information from the holders of shares or other persons exercising voting rights over an issuer and the persons that control them or are controlled by them*". We suggest that ESMA checks whether this is consistent with the data privacy laws in some countries.

- Also, in some countries, our understanding is that the ultimate power in relation to enforcement matters lies with the courts of law, rather than with the enforcer or 'competent authority'. (The UK is an example of this.) This might need explanation in the guidelines.

7. Do you agree that enforcers should have adequate independence from each of government, issuers, auditors, other market participants and regulated markets? Are the safeguards discussed in paragraphs 38 to 41 of the proposed guidelines sufficient to ensure that independence? Should other safeguards be included in the guidelines? Do you agree that market operators should not be delegated enforcement responsibilities?

- Paragraph 40 states that "*government should not be able to change the composition of the board or other decision making body of the enforcer during the appointment period…"* We question whether this is a realistic requirement. For example in the UK, the government may well change the composition of the Board of the Financial Reporting Council (FRC), which ultimately oversees the organisation's Conduct activities including the Review Panel that deals with financial reporting enforcement. The Panel operates independently of the FRC Board and is not influenced in its individual enforcement decisions by the Board. The overall principle should be that anyone connected with a party involved in an enforcement matter should not be able to influence the process of investigation and decision making on the matter.

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 paragraph 42 to 45 are described?

- We recognise that pre-clearance occurs in certain circumstances and that pre-clearance decisions may be perceived by the market to constitute some form of official "interpretation". Hence we agree with the provision in paragraph 44 that certain conditions and safeguards must be in place for its use. We strongly agree that pre-clearance decisions should not be construed as general interpretations.
- Further consideration may be needed as to the appropriate degree of transparency around pre-clearance. Although greater transparency in relation to enforcement decisions would be welcome, it should be made clear in any public notifications that pre-clearance relates to particular company circumstances and is not necessarily indicative of the approach that should be taken in other cases.

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?

- It is not clear from the analysis in the proposed Guidelines what "additional measures" ESMA may have in mind, hence it is difficult to comment. However, to the extent that the ex-ante measures may take some time, regard should be had to the impact of such measures on the timeliness of prospectus approvals and the efficient functioning of the markets.

[We have considered Questions 10-13 together]

10. Do you agree that a risk-based approach to selection should not be used as the only approach as this could mean that the accounts of some issuers would potentially never be selected for review?

11. Do you agree that the risk-based approach should take into account both the risk of an individual misstatement and the impact of the misstatement on financial markets as a whole?

12. Do you think that a maximum period should be set over which all issuers should have been subject to at least one full review (or to be used to determine the number of companies to be selected in sampling)?

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 have no particular comments on the guidelines on selection models, beyond the general observation that a mixed model (involving some combination of risk basis and a random or rotation selection system) seems appropriate. In addition to the pre-determined risk-based selection, we agree that it is important that enforcers should also act on the basis of other events such as referrals by other regulatory bodies, complaints by members of the public, or issues that are raised in the press.
- It is helpful for enforcers to inform the market of those industry sectors or types of activity that they will accord a high priority in their enforcement activity each year (for example, the UK FRC announces priority sectors each year).

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?

- While the procedures generally seem appropriate, please refer also to our response to Question 6 where we comment on potential legal and other constraints on the ability of different parties to respond to enforcement procedures.

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

- We agree that materiality should be assessed in the same way for enforcement purposes and for financial reporting purposes (that is, in accordance with the relevant financial reporting framework). Our further views on this subject were set out in our comment letter dated 30 March 2012 in response to ESMA's recent consultation paper on Materiality.

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?

- We note that paragraph 57 outlines three types of actions that enforcers might take. We understand that some national enforcers may apply other actions, for example some form of public censure or criticism.
- It is important for key enforcement decisions to be made public as soon as is practicable. Timely announcement of enforcement decisions may help other companies to avoid circumstances that may result in misstatement of financial information. Announcements should not be made until a decision is taken, as speculation about a matter that is still being reviewed may affect the market and could unfairly disadvantage investors.

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

- We strongly agree with the provision in paragraph 76 that all the relevant facts pertaining to each decision are included in the database together with the enforcer's basis for conclusions. National enforcers, particularly in smaller EU countries, may rely heavily on the database as a reference tool and there is a risk that, unless all relevant facts are included, inappropriate parallels may be drawn.
- Care should also be taken to ensure that, where differing accounting treatments are permitted by IFRS, enforcement decisions are not seen to close options or promote a particular treatment.
- We believe that greater priority should be given to capturing in the database those matters where the financial reporting issues have significance for the European markets as a whole and hence in which other EU enforcers will have an interest, rather than 'all' decisions.

18. What are in your opinion appropriate activities that would help to achieve a high level of harmonisation of the enforcement in Europe?

- We believe the EECS is a useful forum for discussion of experience - helpful for example in providing enforcers with: an overview of the types of issues that are being raised in other countries as well as their own; a "sense check" of how the overall enforcement regime across Europe is working in practice; and an opportunity to discuss collectively issues of IFRS interpretation that should be referred to IASB and IFRS IC.
- Paragraph 77 proposes that accounting issues (other than those that are straightforward) should be brought to the attention of ESMA and discussed in EECS prior to a decision being taken locally. In general, we believe it will be more helpful to focus EECS discussions on those matters where the financial reporting issues have significance for the European regulated markets as a whole, as noted in the second bullet of paragraph 74, rather than all types of issues listed in that paragraph. While consultation with EECS by national authorities with respect to particular cases will be helpful, we do not consider that the EECS should act in any way as a "second chamber" to or drive the decision of the national enforcement body. The local enforcer is likely to have a better understanding of the local reporting environment and of the facts and circumstances.
- We also consider there is a risk that judgments are made without context if there is too much anonymity applied in presenting the matter – in some situations this could result in a different determination to that which would be made with the benefit of more contextual information.
- Further, we consider that enforcement decisions are better informed if the enforcer is able to hear directly from the issuer and auditor involved. We are therefore wary of

enforcement decisions being "pre-determined" through discussion in EECS where the issuers and auditors have no right to be present to provide information.

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?

- Guideline 19 (paragraph 92) states *"enforcers should report periodically on the enforcement activities and their coordination in Europe."* Some might interpret from the text that enforcers might only issue reports on an annual or other regular periodic basis. However we believe it will be important for key enforcement decisions to be made public as soon as is practicable and this might be included in the guidance.

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

- As noted above, we support making decisions available on a timely basis as this may help other issuers to avoid circumstances that may result in misstatement of financial information. However, we query the implication in the question that anonymity will be preserved even after the enforcement processes are completed. Once a final decision is made and all avenues of appeal have been exhausted, transparency of the decision may be of benefit to the capital markets and may help to increase public confidence in the robustness of the enforcement regime.