

ΕΒΡΟΠΕΪΣΚΑ ΣΜΕΤΗΑ ΠΑΛΑΤΑ  
TRIBUNAL DE CUENTAS EUROPEO  
EVROPSKÝ ÚČETNÍ DVŮR  
DEN EUROPÆISKE REVISIONSRET  
EUROPÄISCHER RECHNUNGSHOF  
EUROOPA KONTROLLIKODA  
ΕΥΡΩΠΑΪΚΟ ΕΛΕΓΚΤΙΚΟ ΣΥΝΕΔΡΙΟ  
EUROPEAN COURT OF AUDITORS  
COUR DES COMPTES EUROPÉENNE  
CÚIRT INIÚCHÓIRÍ NA HEORPA



CORTE DEI CONTI EUROPEA  
EIROPAS REVĪZIJAS PALĀTA  
EUROPOS AUDITO RŪMAI

EURÓPAI SZÁMVEVŐSZÉK  
IL-QORTI EWROPEA TAL-AWDITURI  
EUROPESE REKENKAMER  
EUROPEJSKI TRYBUNAŁ OBRACHUNKOWY  
TRIBUNAL DE CONTAS EUROPEU  
CURTEA DE CONTURI EUROPEANĂ  
EURÓPSKY DVOR AUDÍTOROV  
EVROPSKO RAČUNSKO SODIŠČE  
EUROOPAN TILINTARKASTUSTUOMIOISTUIN  
EUROPEISKA REVISIONSRÄTTEN

Report on the annual accounts  
of the European Securities and Markets Authority  
for the financial year 2011

together with the Authority's replies

## **INTRODUCTION**

1. The European Securities and Markets Authority (hereinafter "the Authority" or "ESMA"), which is located in Paris, was established by Regulation (EU) No 1095/2010 of the European Parliament and of the Council<sup>1</sup>. The Authority's task is to improve the functioning of the EU internal financial market by ensuring a high, effective and consistent level of regulation and supervision, promoting integrity and stability of the financial systems and strengthening international supervisory coordination in order to ensure stability and effectiveness of the financial system<sup>2</sup>. ESMA was set up on 1 January 2011.

## **INFORMATION IN SUPPORT OF THE STATEMENT OF ASSURANCE**

2. The audit approach taken by the Court comprises analytical audit procedures, direct testing of transactions and an assessment of key controls of the Authority's supervisory and control systems. This is supplemented by evidence provided by the work of other auditors (where relevant) and an analysis of management representations.

## **STATEMENT OF ASSURANCE**

3. Pursuant to the provisions of Article 287 of the Treaty on the Functioning of the European Union, the Court has audited the annual accounts<sup>3</sup> of the Authority, which comprise the "financial statements"<sup>4</sup> and the "reports on the

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<sup>1</sup> OJ L 331, 15.12.2010, p. 84.

<sup>2</sup> The ***Annex*** summarises the Authority's competences and activities. It is presented for information purposes.

<sup>3</sup> These accounts are accompanied by a report on the budgetary and financial management during the year which gives further information on budget implementation and management.

<sup>4</sup> The financial statements include the balance sheet and the economic outturn account, the cash-flow table, the statement of changes in net assets and a summary of the significant accounting policies and other explanatory notes.

implementation of the budget”<sup>5</sup> for the financial year ended 31 December 2011, and the legality and regularity of the transactions underlying those accounts.

#### The Management’s responsibility

4. As authorising officer, the Director implements the revenue and expenditure of the budget in accordance with the financial rules of the Authority, under his own responsibility and within the limits of the authorised appropriations<sup>6</sup>. The Director is responsible for putting in place<sup>7</sup> the organisational structure and the internal management and control systems and procedures relevant for drawing up final accounts<sup>8</sup> that are free from material misstatement, whether due to fraud or error, and for ensuring that the transactions underlying those accounts are legal and regular.

#### The Auditor’s responsibility

5. The Court’s responsibility is to provide, on the basis of its audit, the European Parliament and the Council<sup>9</sup> with a statement of assurance as to the reliability of the annual accounts of the Authority and the legality and regularity of the transactions underlying them.

6. The Court conducted its audit in accordance with the IFAC International Standards on Auditing and Codes of Ethics and the INTOSAI International

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<sup>5</sup> The budget implementation reports comprise the budget outturn account and its annex.

<sup>6</sup> Article 33 of Commission Regulation (EC, Euratom) No 2343/2002 (OJ L 357, 31.12.2002, p. 72).

<sup>7</sup> Article 38 of Regulation (EC, Euratom) No 2343/2002.

<sup>8</sup> The rules concerning the presentation of the accounts and accounting by the Agencies are laid down in Chapters 1 and 2 of Title VII of Regulation (EC, Euratom) No 2343/2002 as last amended by Regulation (EC, Euratom) No 652/2008 (OJ L 181, 10.7.2008, p. 23) and are integrated as such in the Financial Regulation of the Authority.

<sup>9</sup> Article 185(2) of Council Regulation (EC, Euratom) No 1605/2002.

Standards of Supreme Audit Institutions. These standards require that the Court plans and performs the audit to obtain reasonable assurance as to whether the annual accounts of the Authority are free of material misstatement and the transactions underlying them are legal and regular.

7. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the accounts and the legality and regularity of the transactions underlying them. The procedures are selected based on the auditor's judgment, including an assessment of the risks of material misstatement of the accounts and of material non-compliance of the underlying transactions with the requirement of the legal framework of the European Union, whether due to fraud or error. In assessing those risks, the auditor considers internal controls relevant to the preparation and fair presentation of the accounts and supervisory and control systems implemented to ensure legality and regularity of underlying transactions, in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of accounting policies used and reasonableness of accounting estimates made, as well as evaluating the overall presentation of the accounts.

8. The Court considers that the audit evidence obtained is sufficient and appropriate to provide a basis for the opinions set out below.

***Opinion on the reliability of the accounts***

9. In the Court's opinion, the Authority's Annual Accounts<sup>10</sup> present fairly, in all material respects, its financial position as of 31 December 2011 and the results of its operations and its cash flows for the year then ended, in accordance with

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<sup>10</sup> The Final Annual Accounts were drawn up on 20 June 2012 and received by the Court on 2 July 2012. The Final Annual Accounts, consolidated with those of the Commission, are published in the Official Journal of the European Union by 15 November of the following year. These can be found on the following website <http://eca.europa.eu> or <http://www.esma.europa.eu>.

the provisions of its Financial Regulation and the accounting rules adopted by the Commission's accounting officer<sup>11</sup>.

***Opinion on the legality and the regularity of the transactions underlying the accounts***

10. In the Court's opinion, the transactions underlying the annual accounts of the Authority for the financial year ended 31 December 2011 are legal and regular in all material respects.

11. The comments which follow do not call the Court's opinions into question. They should be considered in the context of the Authority's transition from its predecessor Committee of European Securities Regulators to a European Authority.

**COMMENTS ON BUDGETARY AND FINANCIAL MANAGEMENT**

12. The Authority's commitments amounted to 12 841 997 euro or 76 % of the 2011 budget. The commitment rates were low especially for Title III "Operational expenditure" (47 %). This impacted on the Authority's IT objectives which were not entirely achieved. The low budget execution rates indicate difficulties in budget planning and implementation.

13. The Authority's budget for the financial year 2011 amounted to 16,9 million euro. In accordance with Article 62(1) of its Founding Regulation, 60 % of the 2011 budget was financed from Member States' and EFTA countries' contributions and 40 % from the Union budget. At the end of 2011, ESMA recorded a positive budget outturn of 4,3 million euro. In compliance with its

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<sup>11</sup> The accounting rules adopted by the Commission's accounting officer are derived from International Public Sector Accounting Standards (IPSAS) issued by the International Federation of Accountants or, in their absence, International Accounting Standards (IAS)/International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board.

Financial Regulation<sup>12</sup> the full amount was then recorded in the accounts as a liability towards the European Commission.

14. Weaknesses were noted as regards six legal commitments made in advance of budget commitments (483 845 euro).

15. The Court identified a number of cases with a total value of 207 442 euro in which payment appropriations carried over to 2012 did not correspond to legal commitments made. These carryovers were therefore irregular and should be cancelled.

### **COMMENTS ON KEY CONTROLS OF THE AUTHORITY'S SUPERVISORY AND CONTROL SYSTEMS**

16. The Authority had not yet adopted internal control standards.

17. There is a need to improve the Authority's management of fixed assets. For intangible assets developed by the Authority, accounting procedures and information on costs were not reliable.

### **OTHER COMMENTS**

18. The implementing rules to the Staff Regulation had not been adopted.

19. ESMA had not yet reached an interinstitutional agreement with the European Anti-Fraud Office (OLAF) on fraud investigations. The Authority should ensure that its Financial Regulation is fully implemented in this respect.

20. The Authority needs to improve the transparency of recruitment procedures. The number of years of experience required for a given position was not respected, applications received after the deadline were accepted, questions for oral and written tests were not set before the applications were examined by the

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<sup>12</sup> Articles 15(4) and 16(1).

selection board and there was no decision of the Appointing Authority to appoint the selection board.

This Report was adopted by Chamber IV, headed by Dr Louis GALEA, Member of the Court of Auditors, in Luxembourg at its meeting of 18 September 2012.

*For the Court of Auditors*

Vítor Manuel da SILVA CALDEIRA  
*President*

**European Securities and Markets Authority (Paris)****Competences and activities**

<p><b>Areas of Union competence deriving from the Treaty</b> <i>(Article 114 of the Treaty on the Functioning of the European Union)</i></p>	<p>The European Parliament and the Council shall, acting in accordance with the ordinary legislative procedure and after consulting the Economic and Social Committee, adopt the measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market.</p>
<p><b>Competences of the Authority</b> <i>(Regulation (EU) No 1095/2010 of the Parliament and of the Council and Regulation (EC) No 1060/2009 of the Parliament and of the Council)</i></p>	<p><b>Tasks</b></p> <ul style="list-style-type: none"> <li>– Develop draft regulatory technical standards.</li> <li>– Develop draft implementing technical standards.</li> <li>– Issue guidelines and recommendations.</li> <li>– Issue recommendations where a national competent authority has not applied sectoral acts or has applied them in a way which appears to be a breach of Union law.</li> <li>– Take individual decisions addressed to competent authorities in certain emergency situations and in settlement of disagreements between competent authorities in cross-border situations.</li> <li>– In cases concerning directly applicable Union law, take individual decisions addressed to financial market participants, where: (i) a national competent authority has not applied sectoral acts or has applied them in a way which appears to be a breach of Union law and where the competent authority has not complied with a formal opinion of the Commission; (ii) in certain emergency situations where a competent authority does not comply with the decision of the Authority adopted; or (iii) in settlement of disagreements between competent authorities in cross-border situations where a competent authority has not complied with the decision of the Authority.</li> <li>– Issue opinions to the European Parliament, the Council or the Commission on all issues related to its areas of competence.</li> <li>– Collect the necessary information concerning financial market participants to carry out the duties assigned to it.</li> <li>– Develop common methodologies for assessing the effect of product characteristics and distribution processes on the financial position of financial market participants and on consumer protection.</li> <li>– Provide a centrally accessible database of registered financial market participants in the area of its competence where specified in sectoral legislation.</li> <li>– Issue warnings in the event that a financial activity poses a serious threat to its objectives.</li> <li>– Temporarily prohibit or restrict certain financial activities that threaten the orderly functioning and integrity of financial markets or the stability of the whole or part of the financial system in the Union in the cases specified and under the conditions laid down in sectoral legislation or if so required in the case of an emergency situation.</li> <li>– Participate in the activities of colleges of supervisors, including on-site examination, carried out jointly by two or more competent authorities.</li> <li>– Address any risk of disruption in financial services that is caused by an impairment of all or parts of the financial system and has the potential to have serious negative consequences for internal market and the real economy.</li> <li>– Draw up additional guidelines and recommendations for key financial market participants, to take account of the systemic risk posed by them.</li> <li>– Conduct an inquiry into a particular type of financial activity or type of product or type of conduct in order to assess potential threats to the integrity of financial markets or the stability of the financial system and make appropriate recommendations for action to the competent authorities concerned.</li> <li>– Carry out tasks and responsibilities delegated by competent authorities.</li> <li>– Provide opinions to competent authorities.</li> <li>– Conduct peer reviews of the activities of competent authorities.</li> <li>– Coordinate between competent authorities, in particular where adverse development could potentially jeopardise the orderly functioning and integrity of financial markets or the stability of the financial system in the Union.</li> <li>– Initiate and coordinate Union-wide assessments of the resilience of financial market participants to adverse market development.</li> <li>– Take decisions on applications for certification and registration of credit rating agencies and on</li> </ul>



	<p>withdrawal of such certification and registration.</p> <ul style="list-style-type: none"> <li>– Establish cooperation agreements with the relevant credit rating agency supervisory authorities of third countries.</li> <li>– Conduct investigations of and on-site inspections at the premises of credit rating agencies, rated entities and related third parties.</li> <li>– Where a credit rating agency has committed an infringement, take decisions to withdraw its registration, temporarily prohibit it from issuing credit ratings, suspend the use for regulatory purposes of the credit ratings it issued, require the infringement to be brought to an end, and/or issue public notices.</li> <li>– Where a credit rating agency has committed an infringement intentionally or negligently, take decisions to impose a fine.</li> </ul>
<b>Governance</b>	<p><b>Board of Supervisors</b></p> <p><i>Composition:</i> Chairperson (non-voting); the head of the national public authority competent for the supervision of financial market participants in each Member State; one representative of the Commission (non-voting); one representative of the European Systemic Risk Board (non-voting); one representative of each of the other two European Supervisory Authorities (non-voting).</p> <p><i>Tasks:</i> Gives guidance to the work of the Authority and is in charge of taking decisions referred to in Chapter II of the founding Regulation.</p> <p><b>Management Board</b></p> <p><i>Composition:</i> Chairperson and six other members of the Board of Supervisors, elected by and from the voting members of the Board of Supervisors. The Executive Director and a representative of the Commission participate in meetings without the right to vote (though the representative of the Commission can vote on budgetary matters).</p> <p><i>Tasks:</i> Ensures that the Authority carries out its mission and performs the tasks assigned to it in accordance with the founding Regulation.</p> <p><b>Chairperson</b></p> <p>Representative of the Authority responsible for preparing the work of the Board of Supervisors and chairing the meetings of the Board of Supervisors and the Management Board. Appointed by the Board of Supervisors after having been heard by the European Parliament.</p> <p><b>Executive Director</b></p> <p>Appointed by the Board of Supervisors after confirmation by the European Parliament. In charge of the management of the Authority and prepares the work of the Management Board.</p> <p><b>Internal audit</b></p> <p>The Authority has had first meetings with the Internal Audit Services, which will organise their first visit in June 2012.</p> <p><b>External audit</b></p> <p>Court of Auditors.</p> <p><b>Discharge authority</b></p> <p>European Parliament, acting on a recommendation from the Council.</p>
<b>Resources made available to the Authority in 2011</b>	<p><b>Final Budget</b></p> <p>Total budget: 16,9 million euro, including:  Union subsidy: 6,8 million euro  Contributions from National Competent Authorities: 10,1 million euro</p> <p><b>Staff as at 31 December 2011</b></p> <ul style="list-style-type: none"> <li>– Statutory staff: 58 temporary agent posts authorised in the establishment plan, of which occupied: 50</li> <li>– Contract agents: 5 contract agent posts planned in the budget, of which occupied: 5</li> <li>– Seconded National Experts: 12 Seconded National Expert posts planned in the budget, of which occupied: 2</li> </ul>
<b>Products and services in 2011</b>	<ul style="list-style-type: none"> <li>– 15 CRAs registered.</li> <li>– First on-site inspections of CRAs including Fitch, Moody's and Standard &amp; Poor's.</li> <li>– Assessed the compliance of three new proposals for MiFID pre-trade transparency waivers.</li> <li>– Published final view on automated high-frequency trading (HFT).</li> <li>– Continued work on commodities and on MiFID review.</li> <li>– Preparatory work for proposed technical standards for the regulation on OTC derivatives, Central Clearing Counterparties (CCPs) and Trade Repositories (European Market Infrastructure Regulation - EMIR).</li> <li>– Produced detailed rules for alternative investment fund managers.</li> <li>– Contributed to development of International Financial Reporting Standards (IFRS).</li> <li>– Provided assistance on application of IFRS when dealing with sovereign debt.</li> </ul>

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|  | <ul style="list-style-type: none"><li>- Work on sharing experiences and discussing implications between national supervisors on market surveillance issues and matters relating to the Prospectus (PD) and Transparency Directives (TD), Takeover Bids, etc.</li><li>- Joint work with the other ESAs.</li><li>- Contributed actively to ESRB on financial stability, including through regular risk reports.</li><li>- Enhanced financial consumer protection through additional rules and requirements for intermediaries and fund managers.</li><li>- First pan-European product warning on foreign exchange to investors.</li><li>- Ran cross-EU database for transaction reports.</li><li>- Developed successful IT solution for the publication of CRA historical ratings.</li><li>- Coordinated national supervisors' responses to the financial crisis.</li><li>- Conducted two peer reviews on market abuse and prospectus.</li></ul> |
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*Source:* Information supplied by the Authority.

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## THE AUTHORITY'S REPLY

12. 2011 was ESMA's first year of operations, although its Founding Regulation had only been published on 15 December 2010. This late publication of the Regulation prevented ESMA from launching its recruitments on time, impacting directly its spending rate. Furthermore, most of ESMA's IT objectives/projects were delayed due to delays in the legislation requiring the implementation of such systems.

13. ESMA's Financial Regulation (which derives from the Framework Financial Regulation) does not adequately reflect ESMA's financing structure. ESMA asked DG Budg in October 2011 to indicate the procedure regarding reimbursement of positive budget outturn. DG Budg confirmed in March 2012 that the surplus should be booked as a liability to the Commission. In May 2012, DG Budg proposed a practical procedure to ensure that this surplus is returned to ESMA, who shall reimburse Member States and Commission on a proportional basis according to their original contributions.

14. ESMA is the legal successor of CESR, therefore some legal commitments were signed by CESR before the creation of ESMA, when the procedures in use differed from EU procedures. Due to technical difficulties and the late implementation of ABAC, the corresponding budget commitments were only registered in the accounts in late 2011.

15. ESMA acknowledges this finding which was due to the unexpectedly heavy work load at the 2011 year end and the carry forward exercise in the EU budgetary system in its first year of operations.

16. During its set-up, ESMA agreed with its parent DG on a plan to set up EU internal control standards. Documentation was submitted to and checked by DG Markt in October 2011. In 2012 ESMA intends to further formalise such controls and have them approved by the Management Board.

17. Regarding fixed assets, ESMA implemented ABAC Assets in September 2011. On intangible assets, ESMA implemented timesheets for internal staff working on IT projects as of 1 January 2012 and is in the process of improving the relevant procedures.

18. In January 2011, the Management Board of ESMA provisionally approved its HR implementing rules before submitting them to the Commission on 17 January 2011. In late spring 2011, DG HR required that there should be common rules from the three ESAs. A new version was submitted to DG HR on 21 December 2011.

19. ESMA sent a letter on 14 December 2011 to OLAF containing its Management Board's approved anti-fraud rules in order to begin setting up this agreement. OLAF has not responded to date.

20. Following the first visit of the Court of Auditors in October 2011, ESMA revised its recruitment procedures to address the mentioned issues in February 2012.