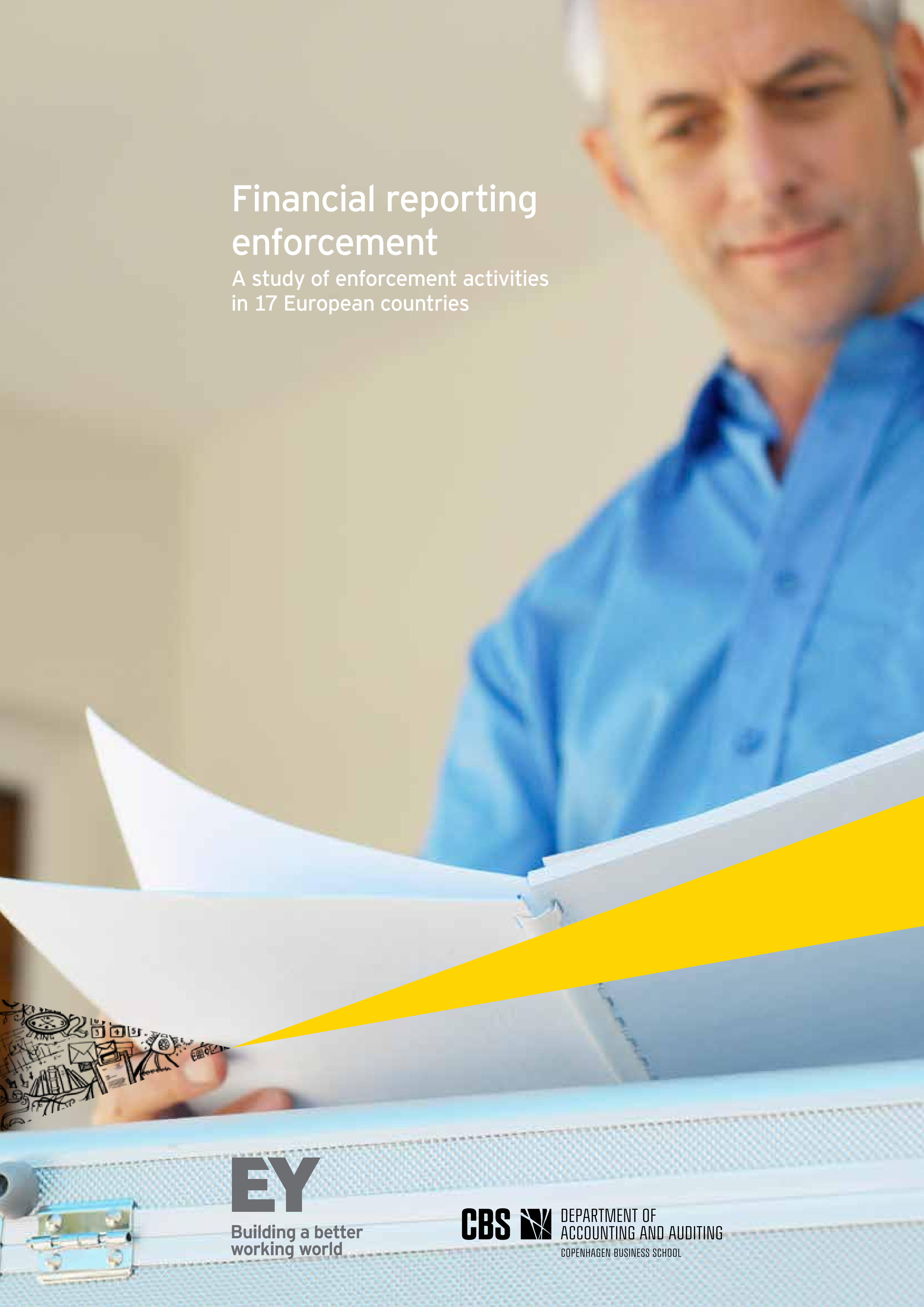

Financial reporting enforcement

A study of enforcement activities in 17 European countries

EY

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CBS DEPARTMENT OF ACCOUNTING AND AUDITING
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Content

Preface

In recent years, enforcement of financial reporting has become significant to the financial reporting environment. The way in which financial information is enforced has an increasing impact on preparers, auditors and ultimately users of financial reports.

Previous anecdotes have indicated that there are diverse approaches to enforcement of financial reporting in Europe. This may be because enforcers choose different levels of strictness or because countries are at different stages of implementation — some may have several years of experience with enforcement, and others may be about to establish enforcement organizations and activities. Differences may also indicate, deliberate or not, different priorities.

What are the specific differences? Which priorities are made? How is enforcement of financial information conducted? These are some of the motivating questions for this study that aims to outline European approaches to enforcement in as much detail as possible. The study is based on a survey of enforcement activities in 17 European countries and focuses on both the formal organization and the processes and methods adopted by enforcement authorities.

The survey reveals significant differences across European countries in respect of the structure, operation and decision-making of national enforcement authorities. Although agreements with respondents prevent us from identifying countries, we consider it useful to provide a detailed picture of the differences in how countries seek to ensure the quality of financial information. This report does not advocate for certain approaches to enforcement. There is so far limited basis for claiming that some approaches to enforcement are better than others, and there is limited evidence on how the nature and scope of enforcement activities impact financial reporting. We do, however, recommend being aware of differences in approaches to financial reporting enforcement and hope to stimulate a debate on these differences. We also hope that future studies may identify which elements of enforcement that appear to be effective, or otherwise, in achieving desirable ends such as financial reporting quality.

This research project has been led by Thomas Plenborg and Thomas Riise Johansen from Copenhagen Business School (CBS) in collaboration with EY Denmark, Hans Peter Lindegaard Buhrkal and Søren Kok Olsen. Sofie Lundrup and Liv Høvsgaard have been research assistants. The study has benefited immensely from the support from a big four audit firm's regulatory specialists across European countries. Furthermore, the study would not have been possible without the participation of enforcement authorities in the 17 countries. We are grateful for the openness and support from these enforcement authorities.

Executive summary

- An enforcement index showing the variation in enforcement across the 17 countries is introduced. The variation of enforcement index scores across the 17 countries indicates a low level of homogeneity of enforcement and may also reflect a variation in the quality of enforcement. These results support ESMA's current review of the standards previously issued by CESR.
- Differences have been found in areas such as
  - Organizational structure
  - Enforcement guidelines
  - Interaction between enforcers and preparers and pre-decisions
  - Methodology for enforcement
  - Decisions and actions
  - Materiality
- The lack of homogeneity of enforcement across the EU goes against the EU's (and ESMA's) ambition to harmonize financial reporting enforcement. Further, it may have consequences for preparers and users of financial statements:
  - Some issuers may find the enforcement too strict resulting in too extensive costs related to the preparation of financial statements. Other issuers may find the enforcement too weak resulting in a perceived low quality of the financial statements in these jurisdictions. This may ultimately lead to higher cost of capital for those issuers.
  - The different approaches to enforcement of financial statements may lead to different perceptions of the quality of financial statements by users and make comparison of financial statements across countries more challenging. The potential differences in the perceived quality of financial statements across countries may also affect risk appetites among investors and creditors as well as the pricing of capital.
- There is a formal pre-clearance procedure in one third of the countries, and in about half of the countries, it is possible to obtain pre-clearance, whether formal or informal. The actual number of pre-clearances per year appears to be low.
- In some countries, the main enforcement authority also has other responsibilities than financial reporting enforcement. These may include oversight of auditors.
- Most enforcement authorities state that they draw on company-specific information in addition to financial statements when performing reviews.
- Nearly half of the authorities select financial statements to be reviewed on the basis of rotation and risk assessments. Some authorities also select financial statements on a random basis.
- Material omissions and misstatements (i.e. decisions) are made public in various formats, and about three thirds of the surveyed authorities also communicate non-material omissions and misstatements to companies.
- Corrections in financial statements and public corrective notes are the most common actions.
- The degree to which authorities agree on materiality varies.
- There is great variation as to which accounting standards have the focus of enforcers.

Research design

- The analysis of enforcement practices in 30 EAA countries is based on an e-survey conducted in March-June 2013. A few enforcement authorities were interviewed.
- A letter which informed the respondents about the survey was mailed to them before the survey was sent out.
- 17 out of 30 national enforcement authorities filled in the questionnaire.
- The respondents generally have a high level of experience with enforcement.
- The feedback from respondents was cross-checked against publicly available information. Together with the high level of experience of the respondents, this ensures a high degree of validity in the answers provided.
- Enforcement is conducted by more than one body in certain countries. For those countries, we generally selected only one respondent to represent enforcement.
- A regulatory specialist from a big four audit firm from each of the 17 countries was asked to complete a separate survey in order to confirm and supplement findings and to obtain their view on enforcement activities. Only a few results from that survey is reported in this publication.
- The e-survey consists of questions of both qualitative and quantitative nature.
- We consulted regulatory specialists from a big four audit firm as well as two enforcement authorities to ensure that the appropriate areas of enforcement were included in the survey. Further, they were also used for pilot testing of the survey.
- Enforcement authorities received questions about the enforcement process including
  - Organization of enforcement
  - Process and methods applied by enforcement authorities in reviewing financial information
  - General approaches to communication and interaction between enforcers and preparers
  - Companies' response to decisions made and actions taken by enforcement authorities
  - Assessment of materiality
- Based on feedback from the e-survey, an enforcement index showing the variation in enforcement across the 17 countries was created. The enforcement index indicates the level of homogeneity and, to some extent, also the strictness of the enforcement across the 17 countries.

Organization of enforcement

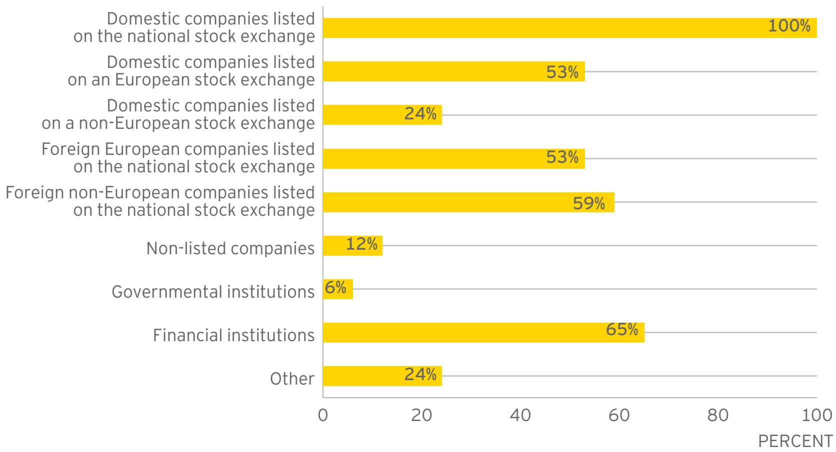
The findings in this section relate to the formal organization of European enforcement authorities.

What are the areas of responsibility for European enforcement authorities?

Areas of responsibility	Review	Decision-making	Actions	Pre-clearance	Guidance
No. of countries	17	17	17	6	11
Percentage	100%	100%	100%	35%	65%

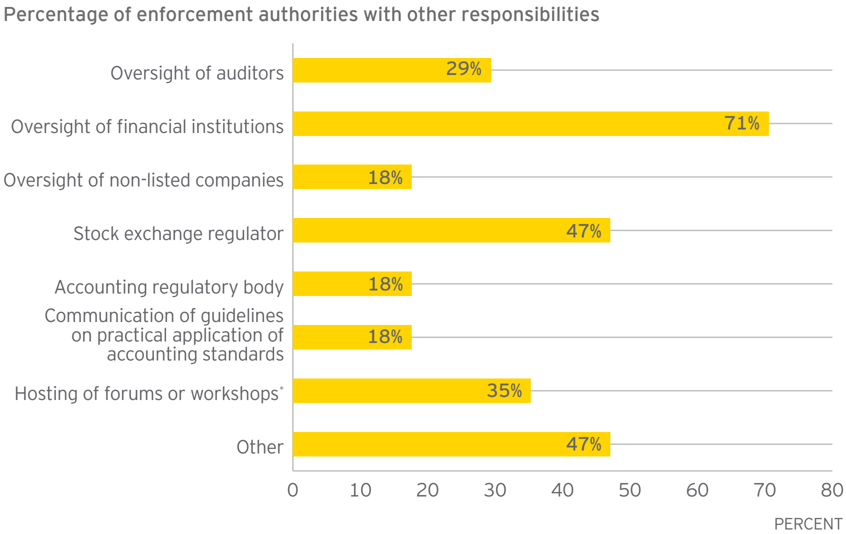
- The 17 enforcement authorities included in the study all assume responsibility for
  - Reviewing financial statements
  - Providing decisions related to errors and omissions in financial statements
  - Defining actions – i.e. specifying the consequences of errors and omissions
- Close to one third has a specified responsibility for the provision of pre-clearance – i.e. responding formally to requests on specific financial reporting interpretations.
- Two thirds of European enforcement authorities are responsible for issuing guidance to the market on financial reporting issues.

Which companies are overseen by enforcement authorities?



- All the enforcement authorities review financial statements from listed domestic companies.
- About half of the enforcers seek to review financial statements from all listed companies, including foreign companies.
- There is little oversight of non-listed companies and government institutions from the enforcers investigated in this study.
  - Other national bodies may, however, assume such roles.

To what extent are enforcers responsible for other areas?

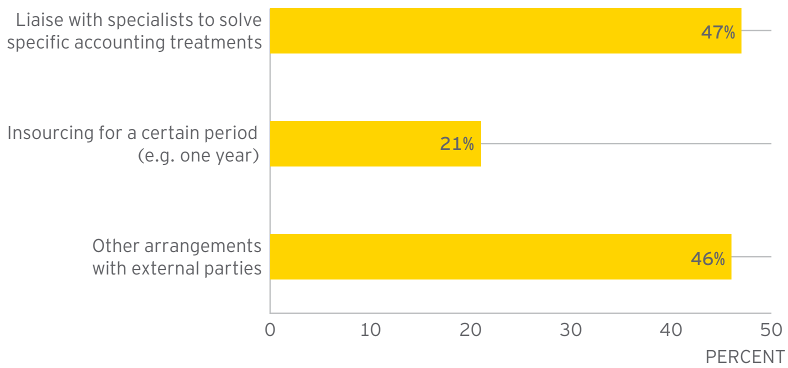


*Hosting of forums or workshops in which financial reporting topics can be discussed in order to initiate debate and discussion on a regular basis

- The extent to which the financial reporting enforcer focuses on financial reporting enforcement only or whether it is assigned with other responsibilities varies across European countries.
- The majority of enforcers also have responsibility for the oversight of financial institutions, and several are highly involved as a stock exchange regulator.
- In some countries, the enforcer is part of a body established to focus on the financial statement environment, including accounting regulation/interpretation and oversight of auditors.
- The comments received under "Other" underline the diversity of bodies that enforce financial reporting in Europe. This includes, for example, training and education, disclosure related to the Transparency Directive and being an advisory body to the government.

To what extent do the enforcers make sourcing arrangements with external parties?

The percentage of enforcers that use sourcing arrangements.



- Sourcing arrangements may be made in order to assign additional resources to reviews of financial statements.
- It is not the norm, but it is common among European enforcers to consult external specialists and other parties in review activities.
- Temporary insourcing of specialists and other staff is used in some countries (21%).
- 'Other arrangements with external parties' cover different sourcing strategies which include the establishment of an expert panel or other ways of consulting with external parties.

Processes and methods applied

The following findings identify the processes and methods applied by enforcement authorities in reviewing financial information.

Materials used by enforcers in reviewing financial statements

	Not possible	Possible but rarely used	Common	Always included in review	Don't know
Published information beyond the financial report	0%	6%	24%	71%	0%
Non-publicly available documentation from issuers as received directly by reviewers/enforcers	0%	18%	59%	18%	6%
Non-publicly available information received from other enforcers, such as tax authorities or those involved in market oversight	0%	53%	18%	0%	29%
Non-publicly available information requested from auditors	6%	35%	41%	6%	12%
Information received from other enforcers	0%	53%	12%	0%	35%
Other materials	0%	12%	6%	6%	76%

- Published information beyond the financial report are used in most cases.
- It is also common to make use of non-publicly available information received from issuers and auditors when reviewing the financial statements.
- Information from other enforcement authorities are rarely used.
- 'Other' covers the European Enforcers Coordination Sessions (EECS) database and industry-specific analyses.

How are financial statements selected for review?

Basis of selection	Enforcers	Percentage
Risk	3	18%
Random	0	0%
Rotation	0	0%
Risk + random	3	18%
Risk + rotation	8	47%
Random + rotation	0	0%
Risk + random + rotation	3	18%
Total	17	

- Enforcement authorities adopt different approaches to selection of financial statements for review.
- A risk assessment is always part of the basis of selection.
- Nearly half of the enforcement authorities adopt an approach that is a combination of risk assessment and rotation.
- The remaining enforcement authorities use either a pure risk assessment approach, a risk assessment approach combined with a random approach or a risk assessment approach combined with a random approach and a rotation approach.

When risk assessment is part of the basis of selection

	Enforcers	Percent
Market value of issuers	4	24%
Revenue or total assets	1	6%
Industry sector	4	24%
Corporate governance	2	12%
Issuers listed for the first time	4	24%
Other	10	59%
Don't know	3	18%

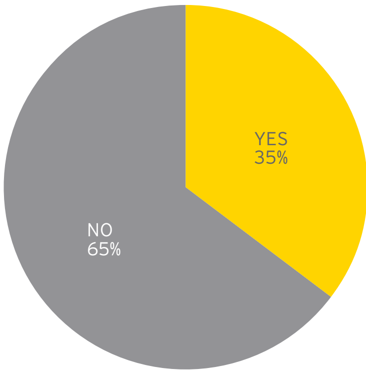
- Enforcement authorities apply a large number of factors when performing a risk assessment.
- Size (market value), industry sector and issuers listed for the first time are often included in risk assessments.
- 'Other' includes factors such as free float, identity of the auditor, reputation of the issuer and issuers with concentrated ownership.

Communication and enforcer-preparer interaction

The following findings identify the general approaches to communication and interaction between enforcers and preparers.

Notification that review is conducted

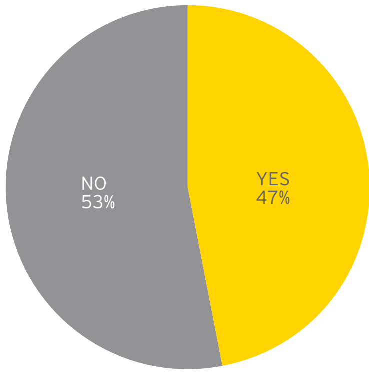
Does an issuer (or other companies subjected to review) receive notification that its financial information is subjected to review (even if no enforcement decision is communicated to the issuer)?



- As other findings show, financial statements are often selected for review on a random basis or based on rotation.
- In about two thirds of the countries in this study, preparers are not informed if their financial statements are selected for review.

Is it possible to obtain pre-clearance?

The percentage of countries in which enforcers offer pre-clearance



- Enforcers may offer pre-clearance where the enforcer communicates an ex ante view on a specific accounting issue.
- It is possible for preparers to seek pre-clearance in about half of the countries.
- Detailed investigation (not shown) suggests that diverse practices for pre-clearance exist.
- Where pre-clearance is possible, some enforcers reported the number of pre-clearances to be as low as between 1 and 4 pre-clearances per year.

Communication between enforcers and companies/auditors

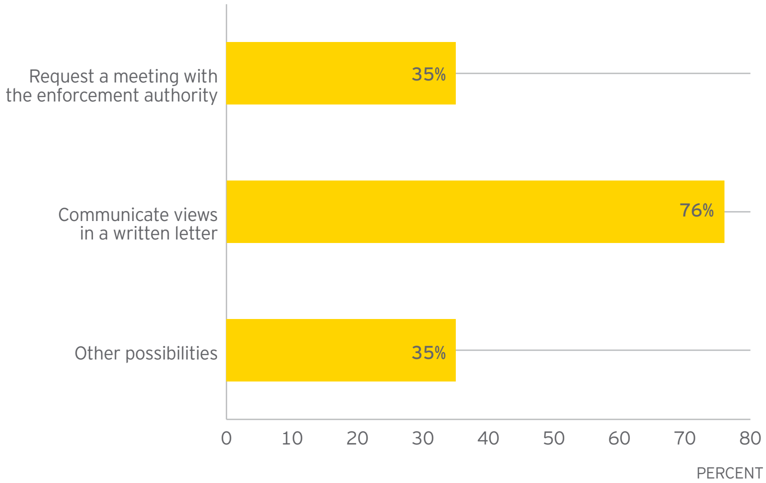
	Number of interactions				
Types of interaction	None	Few	Many	Not possible	Don't know
Informal contact by phone	12%	41%	24%	0%	24%
Personal meeting	6%	59%	24%	0%	12%
Correspondence in writing	6%	24%	65%	0%	6%

- Enforcers, companies and auditors tend to communicate in writing.
- However, contact by phone and personal meetings are options that are available and are used depending on the matters involved.

Decisions and actions

The following section provides findings on how decisions are communicated and actions applied by enforcement authorities. Further, companies' response to decisions and actions are also presented.

How do companies respond to draft decisions from the enforcer?



- The majority of enforcement authorities allow companies to communicate their views in a written letter.
- Approximately one third of the enforcement authorities also offer the possibility to meet with the enforcement authorities.
- 'Other possibilities' covers e-mail and phone.

How are enforcement decisions communicated?

	Percent
All enforcement decisions are made public as a full version	13%
All enforcement decisions are made public in a condensed version	27%
Some enforcement decisions are made public as a full version	13%
Some enforcement decisions are made public in a condensed version	47%
Published, but anonymously	7%
Other	33%
Total	100%

- More than half of the enforcement authorities make some decisions publicly available as a full or as a condensed version.
- 40% of the enforcement authorities make all decisions publicly available as a full or as a condensed version.
- Some enforcement authorities also communicate the decision directly to the issuer and the auditor (Other).

Are omissions or misstatements communicated to issuers if they are not considered material?

	Enforcers	Percentage
Yes, the issuer receives a non-public notification	5	29%
Yes, the issuer receives a notification that is also publicly available	1	6%
Some omissions or misstatements are communicated to some issuers	6	35%
No	4	24%
Don't know	1	6%
Total	17	100%

- Six enforcement authorities inform the issuers about immaterial omissions and misstatements.
- Six enforcement authorities inform the issuers about omissions and misstatements *in some cases*.
- Four enforcement authorities do not inform the issuers about immaterial omissions and misstatements.

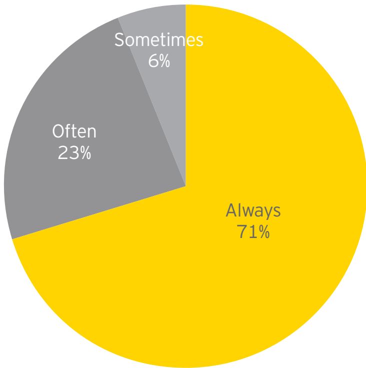
Actions applied for the past three years

	Points (mean)
Warning	4.7
Correction in the next financial statements	37.5
Public corrective note	29.3
Issuance of new financial statements	10.5
Fine	6.2
Suspension from trading	5.8
Delisting	1.7
Other	4.3
	100.0

Respondents are asked to allocate 100 points. The most commonly used actions are assigned the highest number of points.

- Correction in the financial statements and public corrective note are the most common actions taken by enforcement authorities.
- Warning, fine, suspension from trading and delisting are actions rarely taken by enforcement authorities.

To what extent do companies generally accept and respond to decisions and actions?



- Enforcement authorities generally find that companies accept and respond to decisions and actions.
- 94% of the enforcement authorities find that companies *always* or *often* accept and respond to decisions and actions.

What happens if companies do not respond to actions from the enforcement authority?

	Points (mean)
The company can be delisted	0.0
The company can get a fine	42.6
The management and board can get a fine	25.5
The management of the company can get a prison sentence	2.8
Negative exposure in the public	5.9
Nothing happens	0.0
Other	23.1
	100.0

Respondents are asked to allocate 100 points. The most commonly used actions are assigned the highest number of points.

- The previous page illustrated that companies generally respond to actions from the enforcement authority. However, in case a company does not respond to actions, the company or the management and the board will most likely be fined.
- It is unlikely that the company will be delisted, and only in rare cases will the management incur criminal liability or the company receive negative public exposure.
- "Other" includes court cases and suspension of trading.

Materiality

Enforcers were asked to assess materiality in a selection of cases in which an error or omission was identified. Specialists from accounting firms in each of the countries were also asked to assess how they would expect the enforcer in their home country to assess materiality.

Responses to the question "How material are the misstatements and omissions below?". Response scale 1-5, where 1 indicates "Not material " and 5 indicates "Very material".

		Enforcer						Big four regulatory specialists
		1	2	3	4	5	Mean	Mean
Case 1:	An issuer places the disclosures of earnings per share in the notes and not in the statement of comprehensive income as required in IAS 33.66.	-	11%	67%	11%	11%	3.28	3.08
Case 2:	The retirement benefit obligations of an issuer represent 2% gross of the balance. The amount is shown in the balance sheet but the related IFRS 19 disclosures in the notes are omitted.	-	33%	22%	45%	-	3.17	3.00
Case 3:	Disclosure of related party transactions is included in the corporate governance section in the management commentary and not in the notes. There is a cross-reference from the notes to the management commentary.	11%	11%	56%	22%	-	2.83	3.19
Case 4:	An issuer has included an item in the statement of comprehensive income entitled "extraordinary income". The item represents 1% of profit before tax.	11%	22%	34%	11%	22%	3.17	3.50
Case 5:	An issuer has some production facilities for sale. These are presented as inventory and not as non-current assets held for sale as required by IFRS 5. The buildings represent 10% of total inventories and 5% of the balance.	-	-	33%	45%	22%	3.94	3.53
Case 6:	The day before the financial statements are signed off, a claim raised against the issuer is settled. The outcome is negative for the issuer and will reduce the net profit of the year by 3%. The financial statements are already in press so the management decides not to change anything.	-	25%	12%	38%	25%	3.69	3.23
Case 7:	A CEO from an issuer with a balance sheet above 1 billion and a net profit of 50 million EUR receives a fixed salary of 1 million EUR. This salary is properly reported according to IAS 24. A bonus of 0.3 million EUR is not reported.	-	33%	11%	45%	11%	3.28	3.88
Case 8:	A subsidiary is by a mistake recognized as a joint venture with proportionate consolidation. A consolidation as subsidiary would increase sum of the balance and profit with 5%. The profit and shareholders' equity of the parent company are not affected since the increase concerns minority interests, which have not been recognized before.	-	11%	33%	45%	11%	3.56	3.43
Case 9:	An issuer has obtained long term debt with certain covenants. These covenants have to be fulfilled as of January 5th (and not on the balance sheet date, December 31th). On January 5th, the issuer realizes that it will not meet the covenants and by a mistake it reclassifies the debt as short-term. The debt contains 25% of the balance.	-	13%	13%	24%	50%	4.19	3.86

		Enforcer					Big four regulatory specialists
		1	2	3	4	5	Mean	Mean
Case 10:	An issuer has not disclosed the ultimate parent company of the group and therefore it has deviated from IAS 1.138(c).	14%	43%	-	29%	14%	3.07	2.73
Case 11:	The enforcer identifies certain deviations from IAS/IFRS in year 1. These deviations are considered non-material by the enforcer. The enforcer draws the matter to the attention of the issuer, but states that the matter is not material. The issuer decides not to correct the matter in year 2. How material is the issue in year 2?	33%	33%	11%	23%	-	2.22	2.77

Cases in materiality

- At an overall level, specialist assessments generally correspond to enforcer assessments. While this does not mean that they have similar views on materiality, it indicates that most specialists are able to deduce enforcer behavior.
- The detailed findings (not shown) do, however, indicate that enforcer and specialist assessments are very different in some countries, which suggests that enforcer behavior in those countries is unpredictable or not communicated.
- The degree to which enforcers agree on materiality varies. In cases 2 and 5, there are a relatively high level of agreement. On the other hand, in cases 4 and 10 there are a high level of disagreement.
- Whether failure to respond properly to non-material errors (case 11) may become a material issue in year 2 is also subject to disagreement among enforcers. In some countries, the judgment is that it will still be non-material, while in other countries, it is considered to be highly material.

Enforcement of IAS/IFRS

Standards which have the enforcers attention and which do most often lead to a decision are presented in the following section.

	Focus of enforcers*		Decisions (percentage of countries with decisions)	
	Recognition and measurement	Presentation and disclosure	Recognition and measurement	Presentation and disclosure
Management commentary according to national law and other regulation	N/A	Considerable focus	N/A	44%
IFRS 1: First-time adoption of IFRS	Little focus	Considerable focus	11%	11%
IFRS 2: Share-based payment	Little focus	Little focus	0%	11%
IFRS 3: Business combinations	Considerable focus	Considerable focus	56%	44%
IFRS 4: Insurance contracts	Little focus	Little focus	0%	11%
IFRS 5: Non-current assets held for sale a nd discontinued operations	Some focus	Some focus	22%	11%
IFRS 7: Financial instruments: disclosure	N/A	Little focus	N/A	67%
IFRS 8: Operating segments	Considerable focus	Considerable focus	56%	56%
IAS 1: Presentation of financial statements: extraor-dinary items	Some focus	Considerable focus	22%	44%
IAS 1: Presentation of financial statements: applica-tion of non-GAAP measures	Some focus	Considerable focus	22%	22%
IAS 2: Inventories	Little focus	Little focus	33%	33%
IAS 7: Statement of cash flows	Some focus	Some focus	22%	33%
IAS 8: Accounting policies, changes in accounting estimates and errors	Some focus	Considerable focus	33%	33%
IAS 10: Events after the reporting period	Some focus	Considerable focus	11%	22%
IAS 11: Construction contracts	Little focus	Little focus	22%	22%
IAS 12: Income taxes	Some focus	Some focus	33%	44%
IAS 16: Property, plant and equipment	Some focus	Some focus	11%	22%
IAS 17: Leases	Some focus	Some focus	33%	44%
IAS 18: Revenue	Some focus	Some focus	22%	33%
IAS 19: Employee benefits	Some focus	Considerable focus	11%	22%
IAS 20: Accounting for government grants and disclosure of government assistance	Little focus	Little focus	11%	0%
IAS 21: The effects of changes in foreign exchange rates	Little focus	Little focus	22%	11%
IAS 23: Borrowing costs	Little focus	Little focus	11%	22%
IAS 24: Related party disclosure	Considerable focus	Considerable focus	22%	44%
IAS 27: Separate financial statements	Some focus	Considerable focus	11%	0%
IAS 28: Investments in associates and joint ventures	Some focus	Some focus	22%	11%
IAS 29: Financial reporting in hyperinflationary economies	Little focus	Little focus	0%	0%
IAS 31: Interests in joint ventures	Some focus	Some focus	0%	22%
IAS 32: Financial instruments: debt versus equity	Considerable focus	Considerable focus	33%	22%
IAS 32: Financial instruments: offsetting	Some focus	Some focus	11%	11%

	Focus of enforcers*		Decisions (percentage of countries with decisions)	
	Recognition and measurement	Presentation and disclosure	Recognition and measurement	Presentation and disclosure
IAS 33: Earnings per share	Some focus	Some focus	33%	22%
IAS 34: Interim financial reporting	Some focus	Considerable focus	22%	33%
IAS 36: Impairment of assets	Considerable focus	Considerable focus	67%	56%
IAS 37: Provisions, contingent liabilities and contingent assets	Some focus	Some focus	44%	33%
IAS 38: Intangible assets	Considerable focus	Considerable focus	22%	33%
IAS 39: Financial instruments: recognition and measurement	Considerable focus	Considerable focus	44%	33%
IAS 39: Financial instruments: hedge accounting	Considerable focus	Considerable focus	22%	11%
IAS 40: Investment property	Some focus	Considerable focus	33%	44%
IAS 41: Agriculture	Little focus	Little focus	0%	0%

* For recognition/measurement and presentation/disclosure in relation to each standard, it is assessed whether there has been little focus, some focus or considerable focus in connection with the review of financial statements. This is based on an assessment of the answers to the following question: "Please estimate on a scale from 1 (little focus) to 5 (considerable focus) the extent to which the reviews conducted in the past three years have addressed the following standards and other regulation."

Enforcement of IAS/IFRS

- There is a great variation as to which accounting standards have the focus of enforcers. Some standards, such as IFRS 1 (first-time adoption of IFRSs) and IFRS 2 (share-based payments), receive only little focus, while IFRS 3 (business combinations) and IFRS 7 (financial instruments: disclosure) receive considerable focus.
- It appears that enforcers tend to focus slightly more on presentation and disclosure than on recognition and measurement.
- Some of the more complicated standards, such as IFRS 3, IAS 36 (impairment tests) and IAS 39 (financial instruments: recognition and measurement), are also subject to considerable focus.
- With a few exceptions which include IAS 29 (financial reporting in hyperinflationary economies) and IAS 41 (agriculture), the enforcement of standards lead to decisions.
- Enforcement of IFRS 3, IFRS 7, IFRS 8 (operating segments) and IAS 36 are most likely to lead to a decision. It indicates that these standards are among the most challenging for issuers.

Overall enforcement index

The final section summarizes the results of the survey by means of an overall enforcement index.

Degree of implementation of CESR standard no. 1

	CESR 2006	CESR 2009	CBS/EY 2013
Full implementation	35%	64%	88%
Partial but significant implementation	17%	12%	6%
Partial implementation	24%	24%	6%
No implementation	24%	0%	0%

Please note that only statistics for the 17 countries included in this study are reported in the table above. This makes a comparison across time more meaningful. Over time there is an increased number of countries that fully apply standard no. 1. In 2013, 88% of the countries had fully applied standard no. 1.

Enforcement index

- An overall enforcement index showing the variation in enforcement across the 17 countries is introduced in this final section. The enforcement index shows the level of homogeneity of enforcement and to some extent also the strictness of the enforcement across 17 countries in EU.
- The enforcement index is made up by a simple summation of the score from each of the following six sub-indices of enforcement
  - Organizational structure
  - Enforcement guidelines
  - Interaction and pre-decisions
  - Methodology for enforcement
  - Decisions and actions
  - Materiality
- Each sub-index is based on feedback from respondents on a number of different enforcement issues. For example, interaction and pre-decision consist of answers to four different questions describing the possibility of interaction and pre-decision in each of the 17 countries. A score is assigned to each question and may have a value between 0 (low level of enforcement) and 1 (high level of enforcement). This implies that the sub-index for interaction and pre-decision can take a value between 0 and 4 as it consists of feedback from respondents on four questions. It is important to stress that the score is to some extent subjective. For example, we consider the possibility of interaction between the issuer and the enforcement authority as a significant element of an effective and efficient enforcement environment and therefore assign it a high score (1). It is also important to stress that the score is based on both information disclosed in this publication as well as non-disclosed information.
- Since each sub-index consists of responses to a different number of questions and thereby may be assigned a different score, we scale each of the six sub-index. The scaling is based on a division of the 17 countries into three groups based on the score from each sub-index. Countries receive a score equal to 1 if they have a score between the lowest score and the lowest score plus one third of the difference between the highest and lowest scores. Countries receive a

score of 3 if they have a score between the highest score and the highest score minus one third of the difference between the highest and lowest scores. The remaining companies receive a score of 2. So if the lowest score of a sub-index is 1 and the highest score is 4, we assign a) a score of 1 to all countries which have a score between 1 and 2 (1+(4-1)/3), b) a score of 2 to all countries which have a score between 2 and 3 and c) a score of 3 to all countries which have a score between 3 and 4 (4-(4-1)/3). The scaling implies that each sub-index carries the same weight and thereby impacts the overall enforcement index equally.

- A high score on the enforcement index may reflect a high level of strictness in the enforcement of financial statements.

Country	Organizational structure	Guidelines for enforcement	Interaction and pre-decisions	Methodology for enforcement	Decisions/ actions	Materiality	Total
C	3	3	3	2	3	3	17
B	3	2	3	1	3	3	15
D	3	2*	2	2	2*	3	14
E	2	2	3	3*	3	1	14
G	3	2	2	2	2	3	14
L	2*	3	2*	1*	2	3	13
Q	3	2	1	2	3	2	13
H	2	2	1	3	3	2	13
P	2	3	1	3	3	1	13
J	1*	2*	1	3*	2	3*	12
A	1	2	2	2*	3	2	12
O	2	1	2	2	3	1	11
M	2*	1*	3	1*	2	2	11
I	1	1	1	3	2	2	10
K	2	1*	1*	2	2	1	9
F	1*	2*	3	1*	1*	1*	9
N	1	1	1	3	1	1*	8

* = data is partly based on estimates

- The lowest score on the enforcement index is 8, and the highest score is 17.
- The scores decrease monotonically from 17 to 8.
- The variation of the index score across the 17 countries indicates a low level of homogeneity of enforcement and also reflects that the strictness of enforcement varies considerably.
- It is interesting to note that there is a great variation in the score for each of the six sub-indices. This indicates that countries prioritize enforcement of financial statements differently. Some countries like M and F prioritize interaction and pre-decisions, while other countries like I and N prioritize the methodology adopted for enforcement.
- The lack of homogeneity in enforcement across the EU goes against the EU's (and ESMA's) ambition to harmonize financial reporting enforcement.

- Issuers may find the lack of homogeneity in enforcement across the EU problematic for different reasons. Some issuers may find the enforcement too strict resulting in excessive costs related to the preparation of financial statements. Other issuers may find the enforcement too weak resulting in a perceived low quality of the financial statements in these jurisdictions. This may ultimately lead to higher cost of capital for those issuers.
- Users of financial statements may also be influenced by the lack of homogeneity in enforcement across the EU. The different approaches to enforcement of financial statements may lead to differences in perceived quality of financial statements by users and make comparison of financial statements across countries more challenging. The potential differences in the perceived quality of financial statements across countries may also affect investors' and creditors' risk appetite and the pricing of capital.
- Auditors are also affected by the lack of homogeneity in enforcement across the EU. For example, auditors in some countries have the possibility to interact with and to obtain pre-clearance from enforcement authorities, while auditors in other countries do not have similar possibilities.
- The results of this survey show a lack of enforcement homogeneity across the EU and thus supports ESMA's current review of the standards previously issued by CESR.

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B14053