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Enforcement of IFRS in Europe

- A study identifying practical differences between countries

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Abstract

Thesis:

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Problem:

Transforming accounting standards into effective and sensible reporting practices has shown to increase the pressure on enforcement, as it has the power to promote consistent application across countries. Prior literature has acknowledged the increased importance of enforcement, as a result, the field of study has received greater attention in recent years. Findings of recent research point towards considerable differences in how IFRS is implemented, ascribing a lot of explanatory value to differences in enforcement. Even though these studies provide evidence that enforcement systems are different, the majority of research is limited in the sense that it does not focus on actual practices. Thus, it is interesting to investigate how well coordinated the member states are and how national enforcers differ in actual practices.

Purpose:

The purpose of this paper is to identify differences in how enforcement of IFRS is carried out on national level within Europe.

Research Question:

How does enforcement of IFRS differ on national level within Europe?

Research Design:

The study is based upon a qualitative descriptive study, with a primary research approach based on semi-structured interviews, with representatives from nine enforcement bodies. Empirical findings were then analysed through a comparison with prior literature.

Findings:

Throughout the research process we have identified that national enforcement bodies differ in several areas, why we use the term significant differences for areas we want to highlight in the analysis. These have been categorized into seven areas: *structures, resources legal authority, examination approach, results of examination, sanctions* and the *European corporation* of enforcement overseen by ESMA, where amongst structures and legal authority has shown to be the root to the majority of other differences.

Future Research:

A primary suggestion would be to expand the sample and include more influential countries. To conduct a quantitative study examining the availability of information among enforcers would also contribute to the research area. Lastly, a study with similar purpose conducted after the implementation of the consultation paper from ESMA would be of interest.

Keywords:

IFRS, Enforcement, Accounting, regulation, ESMA, International accounting

List of Abbreviations

| | |
|--------------|--|
| <i>AFM</i> | Authority for the Financial Markets |
| <i>CESR</i> | Committee of European Securities Regulators |
| <i>DBA</i> | Danish Business Authority |
| <i>DFSA</i> | Danish Financial Supervisory Authority |
| <i>EBA</i> | European Banking Authority |
| <i>EC</i> | European Committee |
| <i>EEA</i> | European Economic Area |
| <i>EECS</i> | European Enforcers Coordination Sessions |
| <i>EFRAG</i> | European Financial Reporting Advisory Group |
| <i>EIOPA</i> | European Insurance and Occupational Pensions Authority |
| <i>ESA</i> | European Supervisory Authorities |
| <i>ESMA</i> | European Securities and Markets Authority |
| <i>EU</i> | European Union |
| <i>FSAN</i> | Financial Supervisory Authority of Norway |
| <i>FSMA</i> | Financial Services & Markets Authority |
| <i>G-20</i> | The Group of 20 |
| <i>GAAP</i> | General Accepted Accounting Principles |
| <i>IAASA</i> | Irish Auditing & Accounting Supervisory Authority |
| <i>IASB</i> | International Accounting Standards Board |
| <i>IFRS</i> | International Financial Reporting Standards |
| <i>NGM</i> | Nordic Growth Market |
| <i>SEC</i> | Securities and Exchange Commission |
| <i>SFSA</i> | Swedish Financial Supervisory Authority |

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Filip Johansson

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1. Introduction

We can often read about new laws being passed, the subsequent reaction often being something like “if we have a problem all we do is to pass a new law!” This view might indicate that the regulatory answer to a problem is enough to foster compliance, since a new law is simply what is needed to deter certain behaviour (Russell, 1990). Many times we lose interest in the result of the new law. What is missing in these situations are resources and structures to mend the minds of violators and provide sufficient incentives to behave in a socially accepted way, i.e. enforcement. Looking back just two decades we have experienced two severe financial crises, reminding us that laws are just another piece in a much larger puzzle called financial regulation.

European financial market liberalisation and the creation of the single market started a process of restructuring and scale enlargement in European accounting. As a step in this process, International Financial Reporting Standards (IFRS) became mandatory for all listed firms within Europe in 2005, taking another step to connect Europe in terms of regulatory harmonization. The effects of IFRS have occupied researchers for close to a decade and in principle, IFRS has the potential to enhance the quality of financial statements (Ding et al., 2007; Bae et al., 2008), facilitate comparability across countries (Armstrong et al., 2008), lower barriers to cross-border investment (Bradshaw et al., 2004; Aggarwal et al., 2005; Yu, 2009) and promote investor confidence (Barth et al., 1999; Kavanagh, 2013).

All the above-mentioned benefits rely on the assumption that the issuers of financial statements follow the adopted rules, which has proven to be a challenging task (e.g. Berger, 2010; Pope and McLeay, 2011). Scholars argue that a common set of standards is just part of the harmonization process. Without a well-functioning enforcement system the standards will be implemented inconsistently, hampering comparability and making real convergence unachievable (Ball, 2006; Leuz, 2010; Cai et al., 2008). The Group of 20 (G-20) also acknowledges enforcement as crucial in achieving the objectives of the regulatory framework, arguing that the desired outcome is undermined without an effective enforcement mechanism: “It is thus essential that participants are appropriately monitored, that offenders are vigorously

prosecuted and that adequate penalties are imposed when rules are broken. A regulatory framework with strong monitoring, prosecution, and application of penalties provides the incentives for firms to follow the rules” (G-20 p. 57). However, there are considerable challenges in ensuring consistent enforcement across countries, considering the disparity in culture and institutional background:

“In Britain everything is permitted unless it is prohibited.

In Germany it is the opposite, everything is prohibited unless it is permitted.

In the Netherlands everything is prohibited even if it is permitted.

And in France, of course, everything is permitted especially if it is prohibited.”

(Sir David Philip Tweedie, former Chairman of IASB, 2010¹)

At the same time as Europe has grown closer in terms of financial regulation, enforcement has not experienced the same convergence, resulting in a gap between integration of the financial markets and enforcement of accounting practices. There have been numerous attempts to close the gap across Europe, but enforcement is still put in the hands of each member state. Decentralized control over enforcement does not necessarily provoke inconsistencies, however, it requires well-coordinated cooperation. Nonetheless, EU-level coordination has been struggling to promote coherent enforcement since the introduction of IFRS. Each national enforcement body has the final word in deciding how accounting standards should be enforced. It is therefore of crucial interest to examine how all member states enforcement bodies work on a daily basis, since the power to prevent and mitigate inconsistencies lie in their hands.

1.1 Problem discussion

The pursuit of harmonized financial markets induced the introduction of IFRS, with the ultimate goal of comparable financial reporting across the globe (Dewing and Russell, 2008). The adoption of a common set of standards shall, however, not be viewed independently from other features of the financial reporting infrastructure. Research has shown that, viewed separately the standards are unlikely to promote consistent reporting (Ball, 2006). Transforming accounting standards into effective and sensible reporting practices has shown to increase the pressure on enforcement, as it has the power to promote consistent application. Prior literature has acknowledged

¹ *“Accounting for financial reform”*, speech Japan Society, 7th of April 2010.

the increased importance of enforcement, as a result, the field of study has received greater attention in recent years (e.g Christensen et al., 2013; Daske et al., 2008; Berger, 2010; Brown et al., 2014). Findings of their research point towards considerable differences in how IFRS is implemented, ascribing a lot of explanatory value to differences in enforcement. Even though these studies provide evidence that enforcement systems are different, the majority of research is limited in the sense that it does not focus on actual practices. This is also recognized by Leuz (2010), who argues that systems that seem similar in terms of design and structure might still differ considerably in actual practices. A conclusion that can be drawn from the literature is that rules of the game are different in practice than how they are theoretically intended to work. In order to fully analyse the enforcement system, one has to look beyond the formal rules in order to capture the informal application, as the formal view of legal institutions might not work as predicted in practice (Siegel, 2005). With this in mind, we question whether prior literature evaluates enforcement per se, considering that actual practices have been left out. The missing link in the majority of previous studies intrigued us to examine enforcement where it is actually carried out: on national level.

1.2 Purpose and research question

Given the gap in the research area, focusing on actual practices on national a level combined with the intention of IFRS to go global, intrigued us to further develop our understanding of the enforcement system in Europe. *The purpose of this paper is to identify differences in how enforcement of IFRS is carried out on national level within Europe.*

Considering the discussion above, our research seek to answer the following question:

- How does enforcement of IFRS differ on national level within Europe?

1.3 Delimitations

In order to make this study feasible and as succinct as possible required certain delimitations. Firstly, as given in the research question, we solely examine enforcement of listed companies using IFRS. Secondly, the study only involves mandatory adopters since they are the only countries connected to the European coordination unit: European Securities and Markets Authority (ESMA). Lastly and important to note, we only identify differences in actual practices, prior research

centres much around the quality of enforcement, something that is not evaluated in this study.

1.4 Disposition



Figure 1.1 Thesis disposition model.

1.5 Contribution

Our research is motivated by the question whether current enforcement structure employed in Europe give rise to significant differences in actual practices across countries. We explore several elements of enforcement in order to uncover where countries differ in practical application. By fulfilling the purpose of this study, we will contribute to the literature in two ways. First, in conjunction to the implementation of IFRS, several scholars have examined how enforcement is carried out across Europe, coming to the conclusion that enforcement is far from harmonized (e.g Berger, 2010; Brown and Tarca, 2005; Leuz, 2010). We will expand their research by further develop the notion of enforcement in conjunction to IFRS, focusing on actual practices rather than differences ‘on paper’. Second, we identify factors of particular importance to consider when coordinating enforcement within Europe, which areas currently experiencing the largest discrepancies in terms of actual practices.

Our research will be useful to a wide audience, both practitioners and EU-level decision makers on the subject of coordination. Additionally, this type of paper will also be of interest to the Securities and Exchange Commission (SEC), considering their intention to adopt IFRS.

2. Frame of Reference

This chapter aims to bring forth relevant literature used to structure, interpreting and analysing our empirical findings. First the structure of enforcement in Europe will be described, followed by an outline of applicable theories. Lastly, we present closely related research.

2.1 Enforcement in Europe

In order to foster internal market harmonization, the IAS-regulation established a pan-European coordination unit with responsibility to ensure effective enforcement mechanisms across the union. In the following section we will describe how we came to the current structure of enforcement and the important functions that influence the European cooperation.

2.1.1 Background IFRS-enforcement

In June of 2002 the European Parliament and the European Council of Ministers passed a regulation on mandatory adoption of IFRS. From 1 of January 2005, all companies that had their securities admitted to trading on a regulated marketplace within the European Union were duty-bound to prepare their consolidated financial reports in accordance with IFRS. The European Commission gave a number of reasons for harmonizing the financial reporting system and the reasoning behind choosing IFRS. The two main reasons presented by the European Commission were: firstly, prior directives failed in ensuring the required level of transparency and comparability, which is the basis for building a smooth and efficient integrated capital market. Secondly, to ensure compliance the regulation stated that each member state was required to take appropriate measures to safeguard consistent application and promote investor confidence (Regulation (EC) No 1606/2002). In practice this meant that a rigorous enforcement mechanism should be set up at national level. As a response, the Committee of European Securities Regulators (CESR) was given a supervisory role with the objective to coordinate enforcement on a European level. In principle, CESR did not possess any power to conduct enforcement per se; their tasks were primarily focused around coordination, an advisory role for the actual enforcement bodies (Berger, 2010).

2.1.2 ESMA

From 1 of January 2011, CESR was replaced with ESMA, an independent EU authority, with purpose to foster supervisory convergence among the member states. ESMA continued the work previously carried out by CESR, adding some muscle in the form of new powers, including the ability to draft legally binding technical standards, participating in on-site inspections, more rigorous emergency powers and a new role supervising credit-rating firms (CESR, 2011). The move to ESMA formed part of a larger initiative to modernize the overall financial regulatory system. The outcome was three supervisory authorities with different agendas (European Supervisory Authorities commonly referred to as ESA): European Securities and Markets Authority (ESMA), European Insurance and Occupational Pensions Authority (EIOPA) and European Banking Authority (EBA)² (Esma.europa.eu). One major objective of this coordination effort is to establish a single rulebook for all member states, where ESMA contributes by ensuring that investors being treated in the same way across the union. Further, the goal is to reach equal conditions for companies providing financial services and for these to compete on equal footing.

2.1.3 Measures

The primary tool for ESMA to coordinate enforcement across Europe was built on the development of two standards. Standard No. 1, ‘Enforcement of Standards on Financial Information in Europe’, was passed in March 2003 and consists of 21 principles (CESR, 2003). The principles target areas such as how national enforcement bodies should be organized, stating that a national independent and competent authority should be assigned, alternatively delegated to another body under supervision from the competent authority. The process by which firms are selected for review is also regulated in Standard No. 1, stating that a mix approach should be used, combining a risk-based sample with rotation and/or a sampling approach. Sampling solely after risk is acceptable while pure rotation sampling is restricted. The appropriate action in the case of material misstatements is not well defined, stating that enforcers shall aim to take appropriate action in a timely and consistent manner (CESR, 2003). CESR Standard No. 2 ‘Coordination of Enforcement Activities’ from April 2004 consists of four principles set out to foster internal market harmonization (CESR, 2004). The principles provide specific procedures for national enforcement

² See Appendix 2 for an overview of current- and former structure.

bodies to take part in the cooperation overseen by ESMA. Important to note is that these principles are set out as minimum requirements, thus give space for interpretation.

2.1.4 EECS

Part of the harmonization process was the implementation of ‘European Enforcers Coordination Sessions’ (EECS), a forum connected to ESMA, which allows national enforcers to meet 8-9 times a year in order to discuss decisions and share experiences. The main purpose is to increase convergence among the enforcers and their activities. All national enforcers should send representatives to EECS meetings, even non-ESMA members. There are two types of cases discussed at the meetings: cases that are already issued (‘decisions’) and cases that are discussed before they are issued (‘emerging issues’). Cases where unclear interpretation is recognized are sent to IASB in order to solve inconsistencies in the interpretation of IFRS. In sum, EECS is the major forum for national enforcers to exchange experiences and discuss challenges ahead. (CESR, 2007)

2.1.5 EECS-database

National enforcers have access to a confidential database with previous cases to seek guidance in their practical work. This enables enforcers to find similar issues, and see how it has been treated by another enforcer. However, not all cases are presented, there are selection criteria to ensure that only cases with ‘accounting merit’³ are uploaded. The database is only available to enforcers connected to ESMA (Appendix 3) besides a few cases, which are made public in the form of extracts on a regular basis. The issuance of extracts aims to provide issuers and users of financial statements with similar information. The database should not be used to find the solution to an individual case, rather used as a supporting function to look for guidance. (CESR, 2007)

2.1.6 Suggested review process

As previously mentioned, ESMA does not possess enforcement authority per se, however, based on the tools and measures previously described, ESMA has outlined a general framework for how each review shall be undertaken.

³ Only cases that provide the market with useful guidance have ‘accounting merit’.

The process begins with a selection of issuers to be reviewed and as previously mentioned, a combination of risk, random sampling and/or rotation approach should be considered. ESMA emphasizes an approach where the risk is evaluated both in terms of probability of infringements and potential significance in case of detection. Other aspects to consider are more nationally oriented, e.g. complexity of financial statements and a risk profile derived from management experience.

At a second stage a choice between a complete review and partial review should be assessed. A complete review, as the word indicates, refers to an analysis of the full set of financial statements, while a partial review focus on certain high-risk areas. Partial reviews can be motivated in a number of situations: external indications of misstatements, a history of non-compliance or when IFRS is applied for the first time.

The first step when a potential infringement has been identified is to establish a formal contact with the issuer, where the matter is brought to the attention of the issuer. Additional correspondence might be needed, providing an opportunity for the enforcers to ask for further explanations or additional information. The issuer is also given the opportunity to defend the treatment, however, ultimately it is up to the enforcers to decide whether the treatment is in line with IFRS or not. As a last step, the materiality should be assessed. In principle, only cases that are labelled material shall result in enforcement actions taken against the issuer. If considered non-material, the issuer is informed through a notification letter, but further action is seldom necessary.

When it has been concluded that a treatment departs from what is acceptable according to IFRS and also considered material, there is a wide range actions available to the enforcer depending on national law. When the misstatement is considered minor, an issuer can be obliged to *'correct in the next financial statements'*, where the issuers approve the adoption of an acceptable treatment in future financial statements. The enforcer can also require the withdrawal of the current financial statement, demanding *'issuance of revised financial statements accompanied by a new audit opinion'*. Lastly, the enforcer can also issue a *'public corrective note or other type of communication to the public'*. This action entails a

press release, informing the market of the misstatement and its effect in the financial statements⁴.

National enforcers may also work proactively to facilitate future enforcement processes. ESMA provide some examples of what these activities may involve: ‘*Issuance of alerts indicating the main areas of examination*’, which refer to the situation where enforcers announce preliminary findings of the current reviews, as well as, revealing focus areas in advance of a reporting period. A second example of how enforcers may work proactively is: ‘*Pre-clearance*’, whereby issuers can obtain approval in advance of the conclusion of their accounts. In practice this means that an issuers approach the enforcers, seeking formal advice on whether a certain treatment complies with IFRS or not. (ESMA, 2013)

2.1.7 New consultation paper

In July 2013, ESMA published a consultation paper aiming to transform Standards No. 1 and 2 into guidelines. The consultation paper is extensive and contains a total of 18 guidelines. An official date for the introduction is still to be announced but it is expected to take place late 2014. Below we will present areas that will undergo changes and are of particular importance to the analysis of our empirical findings.

Selection methods will be revised, precluding the method of sampling solely after risk. Issuers shall always run the risk of being selected, thus a mixed approach will be the only acceptable method. Pre-clearance will also undergo changes; from being vaguely regulated it will now need to ‘be part of a formal process’. Further, the legal authority to request information will be expanded to include both issuers and auditors. Enforcers shall be able to request all information necessary, both from issuers and auditors and it shall not be limited to situations when suspicions exist. Moreover, market operators will no longer be allowed to carry out enforcement as a delegated authority. Furthermore, actions will be limited to three actions, namely: *restatement*, *corrective note* and *correction in future financial statements*. There will also be more guidance regarding when to use which action. Resources have also been targeted in the new guidelines, without explicitly outline how to deal with under-resources enforcers, some general factors shall be considered when allocating resources. Lastly,

⁴ The issuance can either be undertaken by the issuer or the enforcer,

Standard No. 2 will be expanded in an attempt to create a common culture towards enforcement. As part of this process, all enforcers shall participate in the EECS meetings⁵. (ESMA/2013/1013)

⁵ As of today, the delegated authorities in Sweden are not obliged to participate.

2.2 Literature review

Enforcement is a widely studied subject and in this section we aim to provide a common starting point in order to understand the concept. Certain areas within the research area will be outlined in order to understand the empirical findings, as well as, provide a foundation for the analysis.

2.2.1 Enforcement: mission and definition

Given the aim of this study, it is central to distinguish the notion of enforcement from other closely related concepts, enabling us to mark a common starting point for what is embedded in the concept.

An empirical issue is to disentangle enforcement from regulation and supervision. While the actual rulemaking is commonly referred to as regulation and the ex-ante activities to prevent noncompliance refers to supervision. Enforcement, on the other hand, is an ex-post activity, in place to detect and sanction wrongdoers. Separating enforcement and supervision is not an easy task; in practice the two are somewhat intertwined, their individual success is dependent on one another. In principle, ‘enforcement of compliance’ is a common used umbrella term to bring the two concepts together (Carvajal & Elliott, 2009). From a philosophic perspective enforcement can be said to ‘actualize the law’. By that we assume that enforcement is embedded in the word legality, it is something that contributes to law’s identity as law. It cannot be assumed to have value by itself; it depends on other constitutional grounds on which it develops value. Even though enforcement as a concept is theological, law is something created to have effect ‘in the real world’ and the role of enforcement is to ensure this demand for effect. (Kleinfeld, 2011)

In the field of accounting, the majority of scholars seem to view enforcement as a cornerstone to promote compliance, where enforcement focuses on detecting and sanctioning (May and Burby, 1998; Polinsky and Shavell, 2000; Von Stein, 2010). Enforcement can also be described in a broader context, Downs (1997) refers to enforcement as a general strategy to deter violations and prevent noncompliance from ever taking place. If a violation still manages to slip through, the actual punishment is just a tool in the overall strategy to promote compliance. CESR defines enforcement as follows: “*enforcement is monitoring compliance of financial information with the reporting framework and taking action in the case of infringements*” (CESR, 2003).

In line with the purpose of this study we will, henceforth, refer to CESR's definition of enforcement.

2.2.2 Effects of enforcement

Prior literature has found that adoption of the common set of standards is just part of the convergence process (e.g. Ball et al., 2000; Leuz et al., 2003; Soderstrom & Sun, 2007); there are still considerable differences in financial reporting and enforcement is going to play a key role in the harmonization puzzle. The aim of this section is to highlight the potential benefits of a well-functioning enforcement system, as well as the challenges it faces.

Cost of capital

Given that cost of capital is a fundamental metric for investor and managers alike, providing capital at the lowest possible rate was a major motive behind the adoption of IFRS. As Arthur Levitt, former Chairman at the SEC once said: "*The truth is, high quality standards lowers cost of capital*" (Levitt, 1998, s. 82). To this end, scholars have examined differences in cost of capital across countries, coming to the conclusion that the quality and effectiveness of securities regulation is a main driver behind cost of capital differences under IFRS (Hail and Leuz, 2006). In the same vein, Christensen et al. (2013), provide empirical evidence that improvements in enforcement are essential for positive capital-market effects, arguing that the quality of enforcement decide the outcome of IFRS.

Incentives

In respect to accounting quality, there are two branches in the literature. One branch argues that the quality of the standards determine accounting quality, whilst the second argues that reporting incentives are more important. In line with the latter branch, recent research suggests enforcement to be a key motivation to shape firms reporting incentives. Daske et al. (2008) find capital-market effects in countries with relatively strict enforcement and where the institutional environment provides strong incentives for firms to be transparent. Findings also indicate that coordination efforts within the EU have had some effect; the positive effects are greater among mandatory adopters than voluntary adopters (Hail and Leuz, 2007; Li, 2010).

Users

One of the major objectives with financial reporting enforcement is to ensure that accurate information reaches the market, thus a well-functioning enforcement system has the potential to enhance the usefulness of financial information. By comparing forecast accuracy across jurisdictions, scholars have shown that there exists a positive relationship between strong enforcement and forecast accuracy (Hope, 2003; Preiato et al., 2010). Similarly, an accurate enforcement mechanism has shown to be an essential part in achieving investor confidence (Kavanagh, 2013). Ball (2001) further adds to this notion, arguing that firms could send a credible signal to investors by cross listing in an environment with stricter enforcement. He further acknowledges that differences in enforcement could lead to ‘regulatory arbitrage’⁶ as issuers have the option to influence in which legislative environment they list.

Global convergence

Pre Enron, the main reason to adopt a common set of standards can be said to be an active step towards a harmonized system between the EU and the US (Dewing and Russell, 2008). However, the EU has struggled to reach convergence within the internal market, which has made the US hesitate to adopt IFRS. Berger (2010) argues that differences in enforcement are a contributing factor to why global convergence is yet to be reached. On the same notion, Zeff (2007) acknowledges that national variations in IFRS are a hurdle in the way of global harmonization. In answer to this, Kavanagh (2013) acknowledges that the EECS has a crucial role in coordinating national level enforcement to reach consistent enforcement across Europe.

Harmonization or upgrading

An empirical challenge that arises when talking about effects of enforcement is what is embedded in the notion ‘better enforcement’. Some scholars argue that the proper way forward is, as with the standards: harmonization. Cai et al. (2008) support this statement, arguing that poorly harmonized enforcement hampers accounting quality. The other branch of scholars believes that it is a matter of upgrading. If enforcement were to be harmonized the number of institutions with interpretational power would increase, diluting the role of the standards (Benston et al., 2006). There are examples where enforcement has been upgraded constantly for over thirty years and still not

⁶ The situation when companies capitalize on differences or loopholes in a regulatory system is commonly referred to as ‘regulatory arbitrage’.

been able to sufficiently prevent crises (Becker, 2011). This dilemma has led Leuz (2010) to consider a somewhat radical solution to deal with differences in enforcement. By creating a supra-national enforcement body, harmonization can be reached without interfering with national sovereignty. Firms should opt into this ‘Global player segment’ with authority to enforce IFRS across jurisdictions. A system like this would align both incentives and enforcement activities to enable an overall harmonization of the financial reporting system (Leuz, 2010).

2.2.3 Principles- vs. rules-based enforcement

As researchers examine pros and cons regarding principles- and rules-based accounting, there is a parallel debate regarding the enforcement between the two. Rules-based enforcement is based on the assumption that there exist qualitative standards with clear distinctions between right and wrong, covering most (if not all) possibilities, thus is very technical in nature. Further, rules-based enforcement is characterized by predictability in the sense that the extent of sanctions can easily be calculated in advance. Principles-based enforcement, on the other hand, is based around an underlying purpose, hence demanding a higher degree of judgment. In addition, principles work in favor of public values and thus less focused around the specific case. (Ford, 2008; Park, 2007)

Park (2012) distinguish the two enforcement systems in terms of cost and controversy, arguing that rules have well-defined criteria to separate right from wrong, facilitating application in specific cases, leading to lower cost of enforcement. Principles, on the other hand, require a more extensive investigation due to vague definitions, leading to higher cost. The other factor targets whether the offender easily can apprehend if a certain treatment will trigger an action or not. Rules demand for a technical violation before a significant action can be carried out. Principles, however, include generally worded regulations, which can be harder for issuers to apprehend, leading to more controversy (Park, 2012).

In contrast to the debate regarding the standards, scholars do not centre on the potential benefits of the two, the general concern is rather that principles-based standards should be accompanied with principles-based enforcement and vice-versa. When not paired up with the same ‘enforcement type’, there is a risk that the overall

purpose of a principles-based system goes lost. Ball (2009) believes that it will be a challenge for principles-based enforcement systems to stay principle-based; it simply does not cope well with the overall logic of enforcement.

2.2.4 Strong- and weak enforcement

There is for obvious reasons an empirical challenge to measure the strength of something ‘intangible’ as enforcement. Given these challenges, it is interesting to note that scholars still ascribe a lot of explanatory value to the strength of enforcement. Pope and McLeay (2011) argue that strong enforcement is crucial for the effectiveness of financial markets and weakness of enforcement is a reason for variations in IFRS. In order to measure the strength of enforcement, prior research seems to be divided into two branches, one that argues that strength is evaluated in terms of resources, while the other branch target severity of actions.

In line with the former branch, Jackson and Roe (2009) construct two categories based on resources in order to capture enforcement intensity. The first category use budgets in comparison to GDP, while the second use staff scaled to population. Findings of their research back the argument that strong enforcement has positive capital market effects. In the same vein, Carvajal and Elliott (2009) argue that the capacity of enforcement (e.g staffing, budget, political will) is vital for an effective accounting system.

Within the latter branch, Hitz et al. (2012) find that the stronger enforcement actions implemented in Germany have had unfavourable market effects. Firms, which received more severe actions, have seen a decline in investor confidence. Ernstberger et al. (2012), on the contrary, find positive effects regarding both accounting quality and liquidity effects. Even though both articles examine enforcement effects in Germany, the results are not straightforward, suggesting that strong enforcement is not necessarily one-size-fit-all solution. Other scholars are critical to research trying to explain enforcement as either strong or weak. Becker (2011, p. 1889) argues: “thinking of enforcement as strong or weak is not especially useful”. Instead he suggests that solely focus on being tougher is “a fool’s errand”, it is a matter of being more effective. In doing so, enforcement bodies must look further up the chain in

order to proactively prevent wrongdoers and identify where the system is breaking down.

2.2.5 Sanctions

In principle, there exist two distinct theories how sanctions⁷ should be used in the enforcement apparatus. Even though none of which specifically refer to securities regulation, both are still relevant in analysing how respective enforcement body uses sanctions as a tool to enforce IFRS.

The first theory is built on a study by John Braithwaite (1985) and is often referred to as “*The Enforcement Pyramid*”. It is based on the assumption that most violations are in the base of the pyramid and consequently receive gentle actions. Sanctions progressively increase while the number of offenders simultaneously decline. The idea is a system where offenders in the base will be deterred from being one of few in the top of the pyramid.

The second theory is built on a study by Gary S. Becker (1968) and based on the assumption that a wrongdoer only will engage in illegal activities when the benefits of the crime exceed the potential cost. According to Becker (1968), enforcers should set the probability of detection very low to minimize cost and use high sanctions to counter the low probability. This theory is commonly referred to as “*Low probability/high fine – combination*”.

More recent studies point to other determinants as vital for the success of the enforcement system. Becker (2011) questions whether ever increasing penalties is the right way to promote compliance. He suggests that deterrence is a matter of communication; a wrongdoer needs to be able to apprehend what actions that might lead to a certain pain. By focusing on the *certainty* and the *celerity* of sanctions, compliance can be achieved through efficiency rather than severity (Becker, 2011).

2.2.6 Strategies of enforcement

Some scholars do not determine the effectiveness of enforcement in terms of strength, instead focusing on managerial choices to distinguish one system from another. May and Burby (1998) refer to an article by John Scholz (1994), where he review the management side of enforcement. He claims that enforcement can be distinguished by strategic choices, defining three main strategies: *deterrence*, *persuasive* and

⁷ In regard to literature on enforcement, actions and sanctions are used interchangeably and will thus be analysed accordingly. However, sanctions will be presented separated from actions in the empirical findings.

educational. The strategies can be distinguished from each other by evaluating the following factors: allocation of resources, targeting, publicity, use of information and sanctions. Even though Scholz (1994) may be one of few scholars to present a straightforward concept of strategy, much of the literature is centred on different strategies without explicitly using the term strategy. As early studies as Braithwaite (1985) addresses the importance of information gathering from enforcement activities, mapping where compliance systems are breaking down and learn from prior examinations. This view is in line with what Scholz (1994) would categorize as educational.

2.3 Related empirical studies

As previously mentioned, there is a lack of studies examining differences on national level, however there are a few which have influenced the creation of this paper and the aim of this section is to bring forth these studies.

Berger (2010) examines the development and status of enforcement within Europe by reviewing enforcement on national level, providing evidence of considerable differences. The main areas of concern, presented in his paper are: *scope of assignments, actions, legal authority* and *error rate*. Without ranking the findings in his study, it is safe to say that a major finding was discrepancies in reported errors⁸. This made scholars question whether countries with fewer violations are better at promoting accounting quality or if enforcement in these countries simply is inferior in detecting misstatements. Hellman (2011) builds on this research, coming to the conclusion that there are five important factors for a well-functioning enforcement system. First, he highlights the importance of consistent procedures across jurisdictions. Secondly, the competence of the workforce is vital, questioning the use of external consultants as it may undermine the capacity to retain competence. Further, he highlights the importance of legitimacy and independency, arguing that the structure where stock markets monitor their own clients could lead to a conflict of interest. Additionally, he argues that the threat of sanctions is a necessary part of the enforcement toolbox. The last factor target resources, which constitute a prerequisite for being able to carry out enforcement in a satisfactory manner, thus insufficient resources will cause implications in other areas.

The use of proactive measures has also been discussed and especially the use of pre-clearance. EFRAG has expressed concerns that pre-clearance poses a threat to uniform interpretation and encourage regulatory arbitrage as cross-listed issuers seek pre-clearance where available (Van Helleman, 2003). Brown and Tarca (2005) find differences in how reviews are finished, where some enforcers issue publications with the name of the issuer, while others make publications anonymously. The approach to finish reviews by naming the issuer to the public is commonly referred to as '*Name*

⁸ As an example, Nasdaq OMX identified no errors for the year of 2007, while several countries had an error rate over 25%. In Ireland, 18 out of the 22 debt-issuers reviewed resulted in restatements (Berger, 2010).

and Shame'. One advantage put forward in research is that it is an inexpensive alternative to sending cases to court. The counter argument is that it may cause unnecessary damage to the reputation of the issuer. (Brown and Tarca, 2005)

Referring to the new Consultation Paper presented in section 2.1.7, the question whether enforcers should be “*able to require all information relevant for their enforcement from issuers and auditors*” has triggered reactions from the auditor profession. PwC expressed concerns regarding the possibilities to approach the auditor directly. In their view, management responsibility will be undermined if auditors would act on the request of the enforcers rather than the issuer (PwC, 2013).

This discussion reveals the difficulties faced by both IASB and ESMA in shaping a consistent approach towards enforcement on national level.

3. Methodology

3.1 A qualitative study

Jacobsen (2002) presents three characteristic features of qualitative research, which motivated us to conduct a qualitative study. Firstly, when the research area lacks similar studies, he argues that a qualitative approach is preferred. Enforcement is a common area of research, however, most of previous literature ignores to separate enforcement activities ‘on paper’ from actual practices, leaving a gap within the field of study. Daske et al. (2008) acknowledge this gap and suggest that future research should target country-level enforcement. Secondly, in order to acquire a more comprehensive and nuanced image of the research problem, a qualitative approach is superior to a quantitative. As this study endeavours to interpret and compare activities that these particular authorities are undertaking on a daily-basis, this factor is particularly relevant. Thirdly, the qualitative approach is more flexible in nature. Reflecting on the moderate initial understanding of the research problem and the lack of similar studies, allowing us to adapt the frame of reference when new ideas came to surface was essential. Given the purpose and research question presented in section 1.2, combined with the discussion above, a qualitative study was in the end the only feasible method to ensure that unambiguously data was collected.

3.2 Research design

Enforcement has shown to be a cornerstone in promoting consistent application of IFRS, yet scholars have found considerable differences across jurisdictions (e.g Berger, 2010; Daske et al., 2008; Brown & Tarca, 2005). Nonetheless, there is a lack of research focusing on how these differences take their expression in actual procedures on national level. In order to close this gap we will undertake a qualitative descriptive study, identifying differences in actual practices on national level, with a primary research approach based on semi-structured interviews, with representatives from national enforcement bodies. Descriptive studies are best suited to answer questions formulated as *what* and *how* (De Vaus, 2001), which correspond well with the research question presented in section 1.2. Significant differences were then analysed by comparing empirical findings with prior literature. The research design has developed over time as the knowledge and understanding has increased throughout the process, however, some general stages can be distinguished. The initial phase consisted of a thorough review of related literature including, but not

limited to: Background IFRS-enforcement, principle-based enforcement and national structure of enforcement. In a second phase the primary data was collected, while the last phase involved a comparison between the empirical findings and the frame of reference.

3.3 The sample

In line with the qualitative approach and the aim to acquire a nuanced image, a relative small sample was required. We requested a total of thirteen interviews and subsequently concluded nine. Among the European enforcers connected to ESMA (Appendix 3), we requested interviews with enforcement bodies in: Germany, France, UK and the Netherlands. These countries were selected for several reasons. Firstly, these countries are among the most influential economies in Europe and are commonly referred to as the four most ‘vital’ economies in Europe (Mason, 1978). Secondly, these countries are also included in the sample of two similar studies (Berger, 2010; Brown & Tarca, 2005), enabling us to make relevant comparisons. The structure of enforcement also guided our selection; Belgium and Ireland were selected on the basis of the involvement from the Central Bank. Sweden and Denmark were chosen based on their two-tier structure, dividing enforcement between several authorities. As a result, we conducted several interviews in both Sweden (three) and Denmark (two), considering that internal variations could exist. Finland and Norway were selected due to their geographic proximity to Sweden. Thus, we derived a first sample consisting of: Germany, France, Netherlands, UK, Ireland, Belgium, Sweden, Norway, Finland and Denmark. Along the research process France, UK, Germany and Finland declined to participate. Thus, our final sample consists of a total of *nine* enforcement bodies distributed over *six* countries.

| Country | Enforcement Body |
|--------------------|---|
| Sweden | Swedish Financial Supervisory Authority (SFSA), Nasdaq OMX & Nordic Growth Market (NGM) |
| Denmark | Danish Financial Supervisory Authority (DFSA) & Danish Business Authority (DBA) |
| Norway | Financial Supervisory Authority Norway (FSAN) |
| Netherlands | Authority for the Financial Markets (AFM) |
| Ireland | Irish Auditing & Accounting Supervisory Authority (IAASA) |
| Belgium | Financial Services & Markets Authority (FSMA) |

Table 3.1. Sample.

In the process of finding respondents we focused primarily on practical insight and experience of how enforcement is carried out in practice. With the research question in mind, but also considering the frame of reference and secondary data, we derived the following criterions:

- Practical insight on how enforcement is carried out in practice.
- Up-to-date expertise in relation to the enforcement of IFRS.
- Currently employed at the national enforcement body.
- Experience from attending EECS.

The process started with an abstract of the research, including the respondent criterions sent to each enforcement body, after which we got in contact with a respondent of their choosing. The number of respondents from each organization may differ due to differences in internal structures, as long as the respondent criterions were met the number of respondents were not a major concern. A brief description of respondents can be found in Appendix 4.

3.4 Data collection

The data collection process was undertaken using a five-stage approach, including both primary and secondary data. The process started with collection of background information, using secondary data from respective enforcement body's homepage and publications from ESMA. In a second stage, the interview guide was developed from an overall assessment of the research question, related research and secondary data.

Before coming to the final draft, the interview guide was tested in a pilot interview with a former employee at the SFSA⁹. The primary purpose of this interview was to assess both the quality and placement of the questions and after the interview we both added and excluded several questions. A revised interview guide was then derived with new insights collected during the pilot interview, as well as, feedback from our supervisors (Appendix 1).

When the interview guide was established, the interview process began, consisting of nine semi-structured interviews during March 2014. All interviews were conducted via Skype, in the presence of both researcher and had duration of approximately 60 minutes. The interviews were also recorded and complemented with notes from the

⁹ The data obtained from the pilot-interview has not been included in the empirical findings.

researcher not conducting the interview¹⁰. When conducting interviews, the researchers always run the risk of leading the respondent to answer in the way most suitable for the research, Svenning (2003) refers to this as the *interview effect*. To mitigate the negative effects, the same questionnaire was used in all interviews. However, international respondents received questions in English, while Swedish-speaking respondents received questions in Swedish¹¹. With this approach we aimed to utilize all the benefits of conducting semi-structured interviews, enabling for respondents to talk more openly, hence, reduce *interview effects*. In a fourth stage, secondary data was compared to primary data, considering that interviews are subjective in nature, using this approach we could increase the validity and reliability of our findings (Yin, 2008; Silverman, 2006). In a final stage, a summary from each interview was sent back to each respondent to ensure that an accurate image had been documented. New ideas also emerged along the research process, which was dealt with in complementary email correspondence.

3.5 Analysis approach

In general the analysis of qualitative data focuses on making meaning out of the data (Merriam, 2009). Considering the research design, the analysis has been an on-going cycle between *noticing*, *collecting* and *analysing data* (Seidel, 1998).

The noticing process can be separated into two levels where the first level refers to the actual observations, which have involved notes and tape-records from each interview. By consolidating notes from each interview, we created a *record of things we had noticed* (Seidel, 1998, p. 3). The record was then gone through several times, as interesting things were noticed they were given a code. An example of how the coding process was undertaken, is how we came to the labels formal and informal, presented in section 5.3 regarding 'Contact'. Based on an overall assessment of how the respondent described the contact with the issuers they were given one of the above-mentioned codes. These codes enabled us to compile the information into manageable size in order to facilitate the subsequent phase; *collecting*¹². As patterns of codes started to emerge we sorted the codes into different categories. A first categorization framework was, however, derived from related literature and used as a

¹⁰ The researchers took turns in holding interviews.

¹¹ In addition to Swedish enforcers, interviews were conducted in Swedish with: FSAN and DBA.

¹² The term *collecting* is used interchangeably with *sorting*.

benchmark throughout the process¹³. These categories were then modified, categories and groups that seemed obvious at first later turned out to be less significant, we thus added and excluded several categories as the process went on. The final structure is thus a mix of how related literature has structured their findings and significant areas derived from the coding phase. Areas added by the researchers include, but are not limited to: *contact*, *name and shame* and *resources*. As the data was categorized we started to evaluate each category, looking for similarities and dissimilarities. Within each category, we identified relationships and patterns, which were then grouped accordingly. The structure applied in the analysis follows the main topics in the empirical chapter and was applied primarily due to the purpose of the study. Given that the aim of the study was to identify differences, it was essential to keep the focus on the empirical findings rather than prior literature. Furthermore, significant differences have been connected to prior research in order to give well-reasoned suggestions to improve the enforcement system in Europe.

Even though the main objective has been to acquire an accurate image of the process as a whole, the analysis has been focusing on each activity individually. The frame of reference has been used as a benchmark for the analysis presented in chapter six. In practice this has entailed that interpretations and analytic insights have been endorsed through prior literature. However, the connection between the frame of reference and empirical findings did not have a clear point of departure. Theory has influenced the data collection, while the empirical data similarly has induced us to find new theoretical areas; this interplay is commonly referred to as the abductive approach (Dubois and Gadde, 2002).

In sum, the process of analysing data has been an iterative and reflexive process, it cannot be said to have a clear starting point, neither a certain point in time where the analysis has ceased (Stake, 1995). Lastly, given that the researchers have taken an active role in the process, the data has been under constant interpretation as feelings and reflections inevitably have been incorporated before the data has been presented.

¹³ The article by Berger (2010) has been a great inspiration for the structure applied in Chapter 5.

4. Empirical Background

In accordance with the Transparency Directive (2004) each member state should designate a national competent authority, responsible for enforcement on national level. The competent authority can delegate this task to another unit, referred to as a delegated authority (Transparency Directive, 2004/EC/109).

4.1 Sweden

The Swedish Financial Supervisory Authority (SFSA - *Swedish*: Finansinspektionen) is the independent public regulatory agency responsible for supervision of financial markets and its participants. The Ministry of Finance is the government organ under which the SFSA regulate all companies that provide financial services in Sweden. Since 2007, IFRS-enforcement is delegated to the two regulated marketplaces, namely: Nasdaq OMX (OMX) and Nordic Growth Market (NGM). The unique two-tier structure derives primarily from the provisions contained in the Securities and Market Act (2007:528) and the SFSA regulations (FFFS 2007:17)¹⁴. Thus, the regulated marketplaces are not delegated units within SFSA, they have been entrusted with supervision by law and thus have no governmental authority.

The responsibilities in regard to IFRS-enforcement can be separated between the authorities as follows: The SFSA shall supervise companies, which have Sweden as home member state but have their securities traded on another stock exchange within the European Economic Area (EEA). The SFSA is also responsible for coordinating enforcement within Sweden, as well as supervising the tasks delegated to OMX and NGM. In contrast, OMX and NGM supervise companies that have Sweden as home member state and listed on respective stock exchange. In addition they shall also assist the SFSA in the European cooperation.

4.2 Denmark

In Denmark, enforcement of IFRS is divided between two authorities, the Danish Financial Supervisory Authority (DFSA - *Danish*: Finanstilsynet) and the Danish Business Authority (DBA - *Danish*: Erhvervsstyrelsen). DFSA is responsible for periodic financial information in financial companies, while the DBA carries out the same task for non-financial companies. Both authorities are part of the Ministry of Business and Growth and carry out the secretariat function under the Financial

¹⁴ Essentially based on the CESR Standards.

Council, however, make decisions in their own name. The Financial Council act as the board for both DFSA and DBA, their mission is to “make decisions in matters of a principle nature or of far-reaching significance” (Finanstilsynet.dk). Both DFSA and DBA have extensive areas of responsibility, where auditor supervision also lies with these authorities. The DFSA monitors auditor-related provision in financial companies, while the DBA performs the same task for non-financial companies. The DFSA is also responsible for prospectuses and preparation of Danish GAAP. In respect to the European cooperation, DFSA and DBA act as a single unit.

4.3 Norway

The competent authority is the Financial Supervisory Authority of Norway (FSAN - *Norwegian*: Finanstilsynet), which is an independent government agency reporting to the Ministry of Finance. The financial stability in Norway is based upon a three-pillar system, where the Ministry of finance is at the top of the organization with ultimate responsibility for financial stability and regulation. At the next level, the Central Bank is in charge of executing monetary policy. At the third level, FSAN performs supervision of individual issuers and supports the preparation of regulation (i.e local GAAP). In respect to IFRS-enforcement, FSAN is responsible for compliance of listed companies and also represents Norway in the European cooperation (Moss, 2010).

4.4 The Netherlands

Since 2002, enforcement is divided between the Authority for the Financial Markets (AFM) and the Central Bank. The AFM is responsible for the enforcement of IFRS, while the central bank is responsible for prudential supervision. The responsibilities of AFM are extensive and include: Financial services, capital markets and stability of the financial system. The authority is further structured into five sectors and the unit responsible for enforcement of IFRS is ‘*Audit & Reporting Quality*’. The supervisory board has the objective to ensure that AFM performs its tasks in accordance with good governance and is appointed by the Ministry of Finance. In sum, AFM is the competent authority and the only enforcer to partake in the European cooperation regarding enforcement of IFRS.

4.5 Ireland

The Central Bank of Ireland is the competent authority and central administrative authority according to the Transparency Directive (2004), while the Irish Auditing and Accounting Supervisory Authority (IAASA) is a separate designated independent competent authority for accounting enforcement, hence the authority responsible for IFRS-enforcement. The responsibilities of the IAASA are divided into periodic financial reporting and financial information in prospectuses, where IAASA is in charge of the former and the Central Bank of the latter. The result of this structure is that the Central Bank is member of ESMA, while IAASA is ‘only’ an active member of EECS. IAASA is also a member of the EECS Agenda Group, which entails further responsibilities in deciding which emerging issues and decisions to discuss in plenary. The main task is examining financial statements, while other responsibilities include the development of local GAAP.

4.6 Belgium

Since 1 of April 2011, the financial supervision in Belgium is divided between the National Bank and the Financial Services and Markets Authority (FSMA). The National Bank of Belgium is responsible for prudential supervision and the FSMA for financial market supervision and consumer protection. FSMA is an autonomous public institution established by law to carry out the activities entrusted to them by parliament. The structure of FSMA is hierarchical in nature, where the ‘Supervisory Board’ oversees the operations and financing, the ‘Management Committee’ is the organ that takes all the formal decisions and consists of managers from each division (FSMA, n.d). The division ‘Supervision of financial markets and listed companies’ is the unit in charge of IFRS-enforcement. In the international context, FSMA is a member of ESMA and the only authority from Belgium to attend EECS meetings.

5. Empirical Findings

In this chapter we present our empirical findings out of the nine interviews with respondents at six national enforcement bodies, as well as secondary data gathered from homepages.

5.1 Resources

CESR Standard No.1, Principle 6 states that the competent administrative authority shall have access to sufficient resources, yet there is no definition of what ‘sufficiently resourced’ entails. Given the embedded subjectivity, resources allocation has proven difficult to map. All respondents were, however, asked whether they believed their unit has access to enough resources. Ireland was the only country to admit being under-resourced. Mr Kavanagh at the IAASA states that his unit will need another five employees, adding to the current three, in order to perform the tasks in a satisfactory manner. The availability of resources may also be reflected in the time spent per examination. Due to significant variations in both size and complexity of full examinations, the ‘initial review’ was used as a proxy to assess the availability of resources¹⁵. The time spent on the initial review ranged from five up to a hundred hours (!). Some enforcers used a minimum of forty hours, while others spent a maximum of fifteen hours. On account of granted anonymity there will be no further reference to specific enforcement body.

As mentioned above, ESMA does not provide a definition of ‘sufficiently resourced’, thus assessing the reliability of the data obtained in the first questions is for obvious reasons problematic. It is, however, interesting to note that all authorities involved in enforcement within Sweden consider the amount of resources as sufficient. Nonetheless, resource allocation was one factor put forward as a reason to abandon the current structure in a memorandum to the Ministry of Finance in 2009 (Finansinspektionen, 2009).

¹⁵ The ‘initial review’ refers to activities before making further contact with the issuer, i.e review the financial statements.

5.2 Legal authority

As stated in the frame of reference and foremost in 2.2.1, enforcement is embedded in the word legality, thus the legal authority is of uttermost importance to the underlying purpose of enforcement.

External services

Based on the extent that external services are engaged in the enforcement process, enforcers can be separated into two groups; one group that use external consultants on a regular basis (Ireland, Norway, OMX and NGM). The second group consists of enforcers, which only make use of external services in specific cases (Denmark, Belgium, SFSA and the Netherlands).

Ireland, Norway, OMX and NGM have external consultants conduct the initial review, in practice this entails that an external firm prepare cases while the enforcement unit investigates and prosecutes the case in contact with the issuer. In addition, OMX and FSAN have the ability to seek advice from an ‘expert panel’. The arguments behind the use of external consultants differ between these jurisdictions, Norway welcomes the possibility to engage external expertise as it may facilitate the decision-making process and enhance the quality. In Sweden, the limited number of IFRS specialists has compelled the enforcers to seek external expertise. In Ireland the use of external consultants is primarily due to insufficient resources. The second group of enforcers (Denmark, Belgium, SFSA and the Netherlands) normally possess all expertise in-house and seldom use external services.

Access to auditors’ working papers:

In general, issuers are obliged to disclose information on request from the enforcer and the formal correspondence is thus with the issuers. Some enforcers also have authority to request information directly from the auditor, even if it implies reviewing their working papers. The right to review auditors’ working papers is available in: Sweden (SFSA), Ireland and Belgium. Given the unique structure in Sweden, SFSA has been entrusted with certain remits by law¹⁶, while OMX and NGM only have a contractual relationship with the issuers, hence only can request information provided by the issuer.

¹⁶ Securities Market Act 23:3

Pre-clearance

As mentioned in section 2.1.6, pre-clearance refers to the situation when issuers approach the enforcer in preparation of the financial statements, seeking approval on a specific accounting treatment. The ability to provide pre-clearance is available in Denmark and Belgium. In Denmark, the process of providing pre-clearance can be both formal and informal. The formal process requires comprehensive information about the specific case and is not widely used (1-2 cases a year). Informal pre-clearance is normally dealt with over the phone and refers to less complex cases. In Belgium pre-clearance can also be obtained under strict conditions, it requires a formal statement from the auditor.

Norway, Ireland and the Netherlands do not engage in any form of pre-clearance. In Sweden, the ability to provide pre-clearance is also restricted, however, Mr Ramström at NGM implies that informal discussion sometimes occur without falling under the label pre-clearance.

5.3 Examination approach

Examining the methods and techniques to approach each individual review is an accurate way to distinguish the enforcers from each other.

Selection methods

As mentioned in 2.1.3, the member states have the opportunity to use different methods of selecting firms for review. Sweden, Norway, Belgium and the Netherlands use a mix of risk and rotation. In Sweden this implies a formal rotation cycle of five years. Norway and the Netherlands do not have a formal rotation cycle, but aim to review companies every 5-6 years. Belgium use a rotation cycle but due to confidentiality this information could not be disclosed.

Denmark and Ireland use selection methods without taking a specific rotation cycle in consideration. Ireland bases their selection on an overall assessment of risk, taking certain areas into consideration. These include, but are not limited to: *financial structure*, *industry specific issues* and *audit qualifications*. Denmark uses a combination of risk- and random sampling. According to Ms Heerup at the DFSA, the random sample is constructed in a way that all companies should get reviewed in a certain timeframe (not specified). In practice, this entails maximum of 20% of all

issuers each year, all high-risk firms are selected and if the ratio is not filled, additional issuers are selected based on random sampling. In the sample for the year of 2012, 68% of the companies were determined according to risk, while 32% were randomly selected (Finanstilsynet, 2013).

Review process

The suggested enforcement process presented by ESMA in section 2.1.6 is broadly applicable to how enforcers carry out their activities. Common for all enforcers is that the financial statement is the main working document, where the majority of reviews take its starting point. Some enforcers also have access to additional documentation, not necessarily provided by the issuer. This may entail looking at what is internationally known as the long-form audit report or other, national specific reports. In Belgium, the review is initiated by requesting an auditor report where the main areas of risk are described. In Ireland, the enforcer has access to summary report with preliminary announcements ahead of the publication of the full report. This report is used as a supplementary source of information in the overall assessment of risk. The DFSA makes use of having other areas of responsibility, tips from colleagues within the authority is not an uncommon way to initiate a review. In the Netherlands the review process is subjected to legal limitations. The system is built to remove doubt, which can only arise from publicly available information. Thus, further information regarding specific treatments can only be obtained if doubt has been documented.

Based on the available information, enforcers tend to emphasize different focus (i.e disclosures, measurement or recognition). Common for Sweden is the ambition to get away from disclosure formalities and focus more on measurement, yet Mr Jacobsson at the SFSA admits that some general checklists are utilized. The focus among the Danish enforcers goes apart; the DFSA tends to focus on disclosure, while the DBA argues that measurement is more important. Norway has a distinct focus on both measurement and recognition, Ms Svae the FSAN confirms this by stating: *“in relation to other enforcers, I would say we focus more on measurement and recognition rather than disclosure”*.

Contact

Throughout the review process, the contact with issuers can be divided into two phases. The first is when it is brought to the attention of the issuer that he is under review. The second phase is the contact necessary when enforcers identify misstatements. All enforcers use the same correspondence in the first contact, while the correspondence in the second phase differs. We categorize the enforcers into two groups: *formal* and *informal* according to an overall assessment of the contact with the issuer. The informal approach implies contact by email and phone, where the companies may discuss issues in an informal manner (Sweden, DFSA and the Netherlands). The formal correspondence, on the other hand, primarily implies written letters back and forth (DBA, Norway, Belgium and Ireland). Enforcers labelled as *formal* have a stricter attitude against the issuers, which is confirmed by Mr Nilsen at the DBA: “*The communication with the issuers is something that differs a lot between enforcers. UK for instance is more polite than us, we have a more direct tone*”.

Time-limits

The only country in our sample using a strict time limit is the Netherlands, where a review should be finished within six months after the financial statements are published. Even though the other enforcers lack a formal time limit, they still aim to finish the reviews before the next annual financial statements are issued. They argue, that the issuance of the next financial statement act as an informal time limit. Given the speed of which the market demands information, it is pointless conducting reviews after the fiscal year has ended.

Issuance of alerts indicating the main areas of examination

Relating to the definition of enforcement applied in this paper, enforcement is primarily an ex-post activity. Some enforcers also seek to encourage compliance by engaging in ex-ante activities. These activities can either take the shape of revealing upcoming focus areas or other publications, which enable issuers to consider these when preparing upcoming financial statements. OMX, NGM, Denmark, Belgium, Norway and the Netherlands, reveal upcoming focus areas in a systematic way, while the SFSA and IAASA do not engage in these activities to the same extent. FSMA and DFSA also provide more detailed guidance, the FSMA has published a study on IAS 19 and the DFSA has published papers on both materiality and measurement of loans.

5.4 Result of examination

According to Principle 21, Standard No. 1 enforcers shall periodically report to the public on their activities. Yet, it has been proven difficult to provide an accurate overview of the results from each jurisdiction.

- Ireland: Out of the 142 issuers falling under the responsibility of the IAASA in 2012, 31 examinations of periodic financial information were conducted. 24 examinations resulted in further correspondence with the issuers, 22 provided undertakings in respect of future periodic financial reports and one issuer voluntarily agreed to issue a revised report.
- Sweden:
 - SFSA: No data gathered.
 - OMX: In total 94 issuers were reviewed for the year of 2013¹⁷. Out of which 37 were full-scope reviews and 57 partial-reviews. One company was de-listed, five issuers received ‘criticism’ and 14 received a ‘comment’¹⁸.
 - NGM: In the sample for 2013, three issuers were selected for full-scope reviews (20%). In addition, interim reports for all issuers are review continuously. In eight cases the examination was finished with a ‘comment’ and in one case with a ‘remark’.¹⁹
- Norway: FSAN conducted full-scope reviews of 50 issuers. In addition, audit reports were reviewed for all listed companies. Eight cases were given closer attention.
- Denmark: In total 34 cases were concluded for the year of 2012, while 12 unfinished cases were transferred to the upcoming year. Out of the 19 reports processed²⁰, eight misstatements and one infringement were reported. Four issuers were ordered to publish corrective information and two issuers chose to publish this information by themselves before presenting the case in front of the council.
- Belgium & Netherlands: Detailed statistics is not made publicly available.

¹⁷ 36 based on rotation, 14 based on risk, 6 newly listed companies (‘one-year-follow-up’), 28 follow-ups from previous years and 10 non-finished reviews from last year.

¹⁸ See Appendix 5 for definitions of ‘criticism’ and ‘comment’

¹⁹ See Appendix 5 for definitions of ‘comment’ and ‘remark’.

²⁰ If several matters are identified in the same report, only the misstatement is recognized and disclosed.

This overview might help explain the difficulties faced when presenting activities undertaken by national enforcers.

Actions

Deciding which actions to use in case of a misstatement is ultimately a national affair. Although actions are taken on national level CESR Standard No. 1 outlines possible actions and states that national enforcers should ‘*take appropriate action*’²¹. Sweden, Norway, Ireland and the Netherlands have a tendency to prefer ‘correction in future financial statement’. The national law in the Netherlands is set up to reach informal agreements and since 2012, AFM has preferred to issue a letter of reminder contrary to formal direction. As a result, the number of issues declined from 64 in 2011 to 16 in 2012 (AFM, 2013). Similarly, Ireland promotes informal procedures rather than formal instructions. In contrast, both Denmark and Belgium have implemented a more formal policy where material misstatements should be corrected in a timely manner. Investor focus seems to be the common denominator for these enforcers, if investors need to be informed the action should not be postponed. In other words, these jurisdictions make use of the ‘public corrective notes’ to a larger extent than other enforcers in our sample. Principle 16 also states that non-material departures may also justify an action. Sweden, Belgium and the Netherlands use a formal terminology for ‘levels of non-compliance’. In practice this entails additional actions tied to non-material misstatement, in place to enhance the quality of the financial statement, rather than enforce material misstatements. In Appendix 5 we will give comprehensive presentation of the ‘levels of non-compliance’ in respective jurisdiction.

‘Name and shame’

When a review is finished with a public corrective note, there is an option to name the issuer (i.e ‘Name and shame’). This approach is available in Denmark, Norway, Ireland and Belgium. One argument put forward by enforcers in these countries is that the idea is to inform the investors and without name it would not have an effect. Sweden and the Netherlands, on the other hand, normally use publications without naming the issuer.²² It is worth mentioning that most actions do not necessarily

²¹ See Section 2.1.6

²² Although Sweden and Netherlands are labelled as ‘No’, publications with name sometimes occur. As an example, in Sweden, all disciplinary cases are published with the name of the issuer.

demand this ‘action’, for instance cases finished with the action ‘correction in the next financial statement’.

5.5 Sanctions

“Actions taken by the enforcers should be distinguished from sanctions imposed by the national legislation” (CESR Standard No. 1, Principle 17). Actions are activities from the enforcer to get the issuer to provide accurate information to the market, while sanctions refer to what the enforcer can do if the issuers refuse to cooperate.

Due to differences in national legislation, enforcers have different forms of sanctions at their disposal. The formal decision to impose a sanction is often passed forward to another body to make the final decision, which can either be within the enforcement body or a judicial authority outside the organization.²³

The two most common types of sanctions are to impose a fine or to remove the listed stock from the exchange where it is traded (i.e de-list). Ireland, Norway, SFSA and the Netherlands do not possess the power to de-list their issuers. The reasons for this differ, Ireland for instance is not a securities regulator and SFSA is in charge for issuers listed on stock exchanges outside Sweden, restricting their authority in the matter. When it comes to fines, AFM is the only enforcer not having this ability. All respondents answered in a similar manner and stated that sanctions are rarely used.

5.6 European cooperation

Throughout the interview process, all enforcers’ have underlined the importance of the EECS for uniform interpretation. A common view is that the cooperation has improved steadily in the last couple of years and that we are getting closer to a harmonized environment. Nonetheless, we have identified two areas of significance that will be presented in this section.

Firstly, frequency of cases submitted to the database and secondly, the role of the accumulated database (EECS-database). For obvious reasons, the frequency of cases submitted to the database correlate with the number of misstatements. Regardless of this, it is interesting to note that some enforcers have implemented a routine where the majority of decision shall be submitted (Denmark, Ireland and Belgium), while others seem to apply a more restrictive policy (Sweden, Netherlands, Norway). Due to the

²³ We focus on the possibility for enforcers to influence these processes, hence make no distinction which unit that is ultimately responsible for issuing the actual sanction.

moderate number of issuers and relative size, NGM are limited in the sense that the majority of cases do not reach 'accounting merit'. The DBA, on the other hand, send all cases that are not considered trivial.

As mentioned in 2.1.5, the EECS have a connected database where all discussed cases are uploaded for the members to seek guidance. The database is one of the most important tools in the European harmonization process. In general all enforcers find the database useful and an important feature in the process towards harmonization, however, the database is not applied consistently across the member states. In Ireland and Denmark the database is formally built into respective regime, requiring employees to consult the database before taking formal decisions. Belgium, Netherlands and Norway used the database as a basis for internal discussions, where cases are presented and discussed internally after each EECS meeting. Swedish enforcers do not neglect the ability to use the database, however apply it more restrictively than other enforcers. A common view presented by the latter two groups is that the database is helpful when similar cases are found, but they do not find it necessary to consult the database in each individual case.

5.7 Summary of differences

In Table 5.1 we provide a complied version of differences in tabular form. Some areas have been excluded due to difficulties in tabulating the findings.

| | <i>SWEDEN</i> | | | <i>DENMARK</i> | | <i>NORWAY</i> | <i>NETHERLANDS</i> | <i>IRELAND</i> | <i>BELGIUM</i> |
|---------------------------------------|-----------------|-----------------|-----------------|----------------|---------------|-----------------|--------------------|----------------|-----------------|
| Enforcement Body | SFSA | OMX | NGM | DBA | DFSA | FSAN | AFM | IAASA | FSMA |
| Employees ²⁴ | 3 | 2 | 3 | 5 | 12 | 8 | 12 | 3 | 15 |
| Number of issuers | 10 | 253 | 15 | 154 | 23 | 240 | 250 | 142 | 120 |
| Legal Authority | | | | | | | | | |
| External services ²⁵ | No | Yes | Yes | No | No | Yes | No | Yes | No |
| Auditor working papers' Pre-clearance | Yes | No | No | No | No | No | No | Yes | Yes |
| | No | No | No | Yes | Yes | No | No | No | Yes |
| Examination Approach | | | | | | | | | |
| Selection methods | Risk & rotation | Risk & rotation | Risk & rotation | Risk & random | Risk & random | Risk & rotation | Risk & rotation | Primary risk | Risk & rotation |
| Contact | Informal | Informal | Informal | Formal | Informal | Formal | Informal | Formal | Formal |
| Time-limit | No | No | No | No | No | No | Yes | No | No |
| Issuance of alerts | No | Yes | Yes | Yes | Yes | Yes | Yes | No | Yes |
| Result of Examination | | | | | | | | | |
| 'Name & shame' | No | No | No | Yes | Yes | Yes | No | Yes | Yes |
| Levy fine | Yes | Yes | Yes | Yes | Yes | Yes | No | Yes | Yes |
| De-list | No | Yes | Yes | Yes | Yes | No | No | No | Yes |

Table 5.1. Summary of differences

²⁴ The number of employees is based on interview material, thus it might not correlate with the 'Full Time Equivalent' (FTE) in relation to IFRS enforcement. Additionally the number of employees does not include external consultants.

²⁵ In this context 'Yes' indicate enforcers that use external services to conduct the initial review.

6. Analysis

When mapping differences in how the enforcement bodies carry out their activities, one finds that it differs in several areas. In this chapter we present seven areas, which we argue are the significant differences. These are analysed in regard to prior research presented in the frame of reference.

6.1 Structures

Relying on Hellman's (2011) factors of a well-functioning enforcement system, independency and legitimacy are two important features to consider when structuring enforcement. In respect to these factors, we find a potential risk in two countries: Sweden and Ireland. In Sweden our concerns are based on two factors. First, the structure where the two stock exchanges monitor their own clients is inevitably faced with independency and legitimacy dilemmas. Second, OMX and NGM have declared not willing to continue with the tasks entrusted to them (Finansinspektionen, 2009). The discontent is a product of several inherent weaknesses, where disparities within the internal market, difficulties to retain competence and insufficient resource allocation were put forward as arguments to abandon the current structure. In line with Hellman (2011), we are of the view that conflict of interest dilemmas of this kind may well limit their ability to carry out enforcement. In Ireland, our concerns derive from the fact that the Central Bank is a member of ESMA, while the IAASA 'only' is a member of EECS. We argue that this structure may well create independency dilemmas and impair their ability to affect EU-level decisions on the matter of enforcement.

Even though we find differences in how enforcement is structured, the alternative put forward in the literature also exhibits weaknesses. According to Leuz (2010), a solution would be to create a supra-national enforcement body to carry out enforcement across jurisdictions. We argue that the problem with this approach lies in how Leuz suggests it to be funded. When relying on membership fees, the system will give rise to the same interdependency and legitimacy dilemmas as currently experienced in Sweden. The supra-national body will oversee the activities of their own clients, given them no incentives to be as strong as theoretical desirable.

To conclude, considering that ESMA has 29 members and the fact that European authority on the matter is limited, our findings are not surprising. We, however, acknowledge a risk that structural differences might give rise to implications in other areas of the enforcement process, which will be discussed in subsequent sections.

6.2 Resources

Even though our study does not provide a comprehensive analysis of how resources differ across jurisdictions, it is still evident that both time and effort differ considerably. The strength of enforcement is usually evaluated in terms of resources (e.g Jackson and Roe, 2009) and given that scholars ascribe a lot of explanatory value to the strength of enforcement (e.g Pope and McLeay, 2011; Hope, 2003), it is alarming to conclude that resources differ to such an extent. ESMA does not possess economic muscles to support enforcement in each jurisdiction, however, the authority to set minimum requirements. Given the potential consequences of under-resourced enforcers presented by Hellman (2011), we strongly support more guidance on the subject of resources.

Furthermore, principles-based enforcement has shown to be more expensive than rules-based enforcement (Park, 2012). Consequently, enforcers that are subjected to resource limitations will not put in the time and efforts needed to make accurate judgment in specific cases. Referring to the definition of principles-based enforcement, judgment is a fundamental part, why we recognize a danger that insufficiently resourced enforcers' may, in the long run, transform into rules-based enforcers.

Relating to the discussion in the previous section, we argue that the structural issues in Sweden may cause negative spillovers, affecting their ability to allocate resources. When the cost of enforcement is passed on to the issuers and the issuer is your own client, the incentives to charge a fair amount is lowered. Furthermore, from an economic perspective, it is not optimal to divide enforcement between three different authorities. To this end and in line with Carvajal and Elliott (2009), we argue that enforcers need to strengthen their capacity, acknowledging that ESMA should consider implementing a definition of 'sufficiently resourced' in order to overcome challenges ahead.

6.3 Legal authority

Relating to the empirical findings presented in Section 5.2, we find that the use of external services can be described as a two-sided coin. On the one side, and in line with Hellman (2011), we find that enforcers, which make use of external services on a regular basis, may experience difficulties retaining competence. On the other side, enforcers that engage external expertise in ‘specific cases’ may enhance the quality of enforcement without experiencing difficulties retaining competence. Embracing a wider perspective, the use of external consultants may as well give rise to implications on European level. As external consultants are not allowed to attend EECS or access the database, the underlying purpose of sharing experiences may be hampered. However, keeping in mind the reasons why enforcers engage external consultants, it is obvious that the alternative is not superior (i.e prohibiting this ability). Much of the problems tied to external consultants have their roots in other areas, such as structural issues or insufficient resources. Acknowledging that the use of external consultants cannot be viewed independently, we argue that ESMA should focus on other areas of improvement.

Moreover, the legal authority to access auditors’ working papers is only available to a few enforcers. Even though none of which expressed that this ability is used regularly, it still may impact the overall enforcement process. Acknowledging that enforcement does not only involve activities per se, as part of the legal system, enforcement of financial reporting also relies on deterrence (e.g Downs, 1997; Becker, 1968). To this end, we argue that the possibility to request auditors’ working papers should be made available to all enforcers.

Referring to the definition of enforcement used in this paper, the question arises whether pre-clearance fall under the responsibility of the enforcers or not. The debate throughout the interview process testifies that the views go apart. Mr Jacobsson at the SFSA is of the view that “*it is not up to us to be the consultants*”, while Danish enforcers welcome the possibility to proactively enhance the quality of the financial statement. Van Helleman (2003) argues that pre-clearance is on the borderline to interpretation and, in the long run, may give rise to regulatory arbitrage. In contrast to Van Helleman (2003), we argue that pre-clearance does not poses a threat to uniform interpretation or a factor that triggers regulatory arbitrage. We base this argument on

two factors, firstly, pre-clearance is rarely provided and secondly, in practice, the assessment of pre-clearance does not differ from normal enforcement procedures.

Applying a wider perspective to the discussion, it is evident that enforcement also stretches beyond actual practices, it is as much a matter of legal authority, whether the authority is imposed or not. Mr Kavanagh at the IAASA also recognizes this: “*the threat of using our statutory powers is still there and that is probably why the issuer correct voluntarily*”.

6.4 Examination approach

Relating to the empirical findings regarding selection methods, we recognize a potential risk among those enforcers not using a rotation cycle. When sampling solely by risk and random, some issuers might never get reviewed. In line with Ball (2001), we believe that issuers might consider to cross-list in the environment most suitable to their needs. ESMA also acknowledges this loophole and in the new consultation paper, a mixed approach will be the only acceptable selection method.

Considering that the Netherlands is the only country with a formal time limit, make us question the actual requirements for efficiency among the European enforcers. In line with Becker (2011), we argue that enforcement needs to be carried out with celerity. If the information was to reach the market too late, the relative effect of more severe actions (i.e public corrective note and restatement) will be undermined. We find that the lack of formal time limits might correlate with the overrepresentation of the action ‘correction in future financial statements’.

Moreover, we find that the information available to enforcers differs significantly, which we argue could be another reason to differences in ‘error rate’. As an example, given that only publicly available information is reviewed in the Netherlands; management judgement is to a large extent not tested against that of the enforcer. Measurement is for the greater part based on management judgement, thus, the lack of information is hampering their ability to make accurate assessments of risk. In other words, being limited to certain information also limits enforcers’ ability to encounter misstatements. With this in mind and in contrast to PwC (2013), we argue that

enforcers should be able to request all information necessary, even if it implies going directly to the auditor.

In line with Becker (2011) we find that enforcers engage in proactive activities to a large extent. When considering the purpose of issuance of alerts and guidance, we argue that the extent to which enforcers engage in proactive activities may distort the possibility to compare enforcers by ‘error rate’. To this end, we question prior research using ‘error rate’ to evaluate the effectiveness without taking proactive activities in consideration (e.g Brown and Tarca, 2005; Berger, 2010).

6.5 Result of examination

According to Hitz et al. (2012), the strength of enforcement can be measured in terms of severity of actions. In this context, Denmark and Belgium would be the only countries labelled as ‘strong’, given that they make use of ‘public corrective notes’ to a larger extent. However, as pointed out by several enforcers’, informal solutions are often preferred, rather than formal direction. As a consequence the number of issues reported may not provide an accurate measure, as informal solutions are not captured by these statistics. In line with Scholz (1994), it can be argued that these enforcers have implemented a more educative approach, not necessarily implying ‘weaker’ enforcement.

When considering Brown and Tarca’s (2005) argument for the use of ‘Name and Shame’, we expected to find a relation to under-resourced enforcers. This showed not to be the case; instead we found that the enforcers’ using ‘Name and Shame’ also use a formal correspondence and are less lenient towards the use of actions.

The large number of discrepancies related to the outcome of the enforcement process, begs the questions whether ‘strict enforcement’²⁶ should be considered as positive or negative. The argument in favour of strict enforcement is built around sending a credible signal to investor and show reliability (Ball, 2001). The counter argument is that it could cause uncertainty among investors (Berger, 2010). Considering the research design applied in this paper, we are unfit to comment on which of these arguments that are valid. Nevertheless, we argue that country differences, irrespective

²⁶ In this paper we refer to strict enforcement as being less lenient towards the use of actions.

of their nature are alarming enough to be concern. In accordance with Ball (2001), we see a potential risk of ‘regulatory arbitrage’ as issuers seek to list in the environment most suitable to their needs.

6.6 Sanctions

Relying on Braithwaite’s (1985) theory on how to use sanctions, we note that all enforcers can be defined accordingly, where deterrence is built on the existence of sanctions rather than the use. These findings also correspond well with Becker’s (2011) characteristics of a deterrence system, where communication and proactive measure have developed as substitutes for sanctions.

Relating to the empirical findings, sanctions are seldom imposed among the enforcers and we find several potential reasons for this. Firstly, we note that findings regarding sanctions correlate with results in other areas. For instance examination approach shows that the majority of enforcers tend to apply the educative approach presented by Scholz (1994), where deterrence is a matter of communication rather than sanctions. Another potential explanation is that actions are enough to foster compliance, which is also recognized by several respondents.

To conclude, even though the availability of sanctions differs across jurisdiction, we find that they are used in a similar manner. We argue that the lack of sanctions is not a major concern as we provide evidence that other activities have developed as substitutes.

6.7 European cooperation

As pointed out in the empirical findings, the European cooperation has improved steadily and the majority of enforcers believe we are approaching a harmonized environment. We, however, argue that the transition towards a ‘full-European view’ is far from risk-free.

In accordance with Ball (2009) we acknowledge the risk that IFRS-enforcement will struggle to stay principles-based. In the pragmatic world of today, it may be tempting to develop systems to replicate previous decisions, which in turn would convert principles into rules. This discussion could easily be applied on the database of the EECS, which purpose is to provide guidance in complex decisions. Considering that

the database is applied inconsistently across jurisdictions and if used for the ‘wrong reasons’, we believe that a principles-based system like IFRS runs the risk of transforming into a rules-based system. In line with Park (2012), we also acknowledge that principles-based enforcement is tied to more controversy, as it is more difficult to predict the outcome. We see a potential risk that enforcers may use the database to lower the controversy by replicating previous decisions. If we are to reach consistent enforcement, ESMA might need to consider implementing a formal process how the database should be applied. This may also be called for in order to stay principles-based.

Furthermore, as outlined in the empirical findings, the benchmark applied to send cases to the database differs significantly. A quantitative measure like frequency might not entail implications in the short term, however, we recognize a danger in the long term. In principle, our concerns are based on the threat of allowing more interpretational power to a few enforcers, rather than striving for a ‘full-European view’. In other words, assuming that the database consist of a majority of decisions from a few countries, their influence on how enforcement is interpreted will inevitably be greater. In the long term, this might lead to a situation where the most active enforces becomes the role model for European enforcers without necessarily applying the best practice.

To conclude, even though the European cooperation has improved steadily, we are far from reaching a ‘full-European view’. Relating to the discussion above, we acknowledge a potential trade-off between, on the one hand, harmonization and on the other, a principles-based system.

7. Concluding Remarks

This chapter presents the conclusion of the empirical findings and the following analysis with regard to the purpose of the study. Further, potential limitations will be discussed in order to provide useful insights on future research areas.

7.1 Conclusion

The introduction of IFRS was set out to be a turning point in European accounting harmonization. Yet, there still exist questions whether IFRS is applied consistently across the union, much due to differences in how the standards are enforced. Prior research has shown that enforcement is not carried out consistently across countries, while the purpose of this study was to identify how these differences take their expression in actual practices on national level. After conducting nine interviews with representatives from six enforcement bodies around Europe, we find that, despite unified efforts to bridge the gap in enforcement, country level enforcement differ in a number of ways. The significant differences documented in this paper can be divided into seven areas and provide useful insights for improvements of the European cooperation.

- **Structures** – Sweden and Ireland are the two enforcers that are most restricted due to structural dilemmas.
- **Resources** – Ireland is the only country to openly admit being under-resourced, however, several other countries also experience difficulties.
- **Legal authority** – Having the possibility to act against the issuer has shown to be as important as what is actually being done.
- **Examination approach** – The information available to enforcers differs considerably, where amongst the Netherlands stands out by only reviewing public available information, hampering their ability to identify misstatements.
- **Results of examination** – Differences in timeliness and strictness of actions can potentially create regulatory arbitrage as issuers seek to list in the legislative environment most suitable to their needs.
- **Sanctions** – Enforcers apply the same benchmark for when sanctions shall be imposed, however, the available measures differ across countries.

- **European cooperation** – Differences in frequency of cases sent to the EECS and how the database is applied, leads to a potential trade-off between harmonization and principles-based enforcement.

These findings also highlight that differences are not limited to differences in national legislation, even when national legislation do not establish boundaries to act homogenously, differences are still evident.

In interpreting our findings, two additional findings are worth mentioning. First, differences are apparent when viewed as individual processes, however, when coupling the individual processes the results are not as prominent. These findings bring to question whether the differences actually are to be viewed as significant. Second, when viewed in the light of the European cooperation, we find that all enforcers strive towards the same goal; the significant differences only show different paths towards it.

The results of this study also bring to light some of the difficulties in separating actual practices from differences ‘on paper’. Enforcement is simply not a concept that can be described in black and white; what actually is being done is somewhat intertwined with the legal authority and the threat of acting against an issuer.

To this end, the key message of this paper is that there are significant differences in how enforcement is carried out on national level and that these differences are likely to persist. In analysing these findings, we however, question whether these differences should be viewed as a threat to uniform interpretation of IFRS.

7.2 Limitations & suggested future research

This study is limited to a homogeneous group of countries, which could be labelled as ‘small countries in northern Europe’. By excluding influential countries as UK, Germany and France it is difficult to achieve a complete image of the enforcement system in Europe, hence the availability to draw general conclusions is limited. Given this, we find it interesting to conduct a similar study including the countries mentioned above.

In line with prior literature, resources seem to be of crucial importance for proper enforcement. Due, to the scope of this study, we were not able to investigate this area to the extent necessary in order to analyse its full impact. We believe that a quantitative study measuring the availability of resources and resource allocation among European enforcers would contribute greatly to the field of research.

It is put forward in prior research that there exist several differences between the decentralized enforcement system in Europe and the centralized in US. SEC has the intention to adopt IFRS, however arguing that the decentralized structure in Europe is an obstacle in the way of global convergence. Thus, we would like to suggest a study comparing the enforcement systems in Europe and the US.

We further limited this study to mandatory adopters connected to ESMA. It would be interesting to conduct a study, comparing mandatory adopters in the EU with voluntary adopters outside the EU.

Some major differences and their potential implications discussed in this study are also acknowledged by ESMA in the consultation paper. It will be interesting to conduct a similar study after the new guidelines have been implemented in order to investigate whether the problems documented in this paper remains.

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9. Appendix

Appendix 1 – Questionnaire

Phase 1: Introduction

- Short presentation (position, tenure and job assignments)
- How is the organization structured?
 - o Tasks of the enforcement unit/area of responsibility
 - o Other tasks and responsibilities besides enforcement of financial reporting?
 - o Number of employees at the enforcement unit?
- How do you cooperate with ESMA and how is the information communicated?
 - o How is the information transformed into practical work?
- Are you involved in any bilateral collaboration? (e.g with enforcement bodies in other countries)
- Is access to resources a limitation in your work? (i.e, can you investigate the way that is most appropriate with current resources)
 - o If you had access to more resources would you investigate more companies or engage in more thorough investigations?

Phase 2: In preparation of the supervisory review

- How do you select which companies to review?
 - o Are there guidelines how often firms are to be reviewed?
 - o Are there any differences related to type of business? (e.g size, industry, level of risk)
- How do you determine focus areas? (e.g from national perspective, guidelines from ESMA, in cooperation with other regulatory bodies)
- Describe the contact with selected firms
 - o Tools during the review
- Is it possible for companies to receive pre-clearance?
- To what extent do your unit use external services? (e.g consultants to help with the initial evaluation)
- Do you have the right to request other information other than what your unit produce? (e.g auditor's reports or files)

- Are you working proactively in any specific way?
 - o Issue accounting guidance statements?
 - o National guidelines?
 - o Others?

Phase 3: During the review

- Briefly describe how the practical enforcement/supervision is carried out.
- What do you review? Which documents/factors are the most important?
 - o Where do you conduct the review? (i.e actual location)
 - o How do you contact firms during the investigation? (e.g meetings, email, letters)
- How do you describe a violation and how do you identify it?
 - o Are there differences between types of violation? (e.g violation, deviation and inadequacy)
 - Violation that require disciplinary action
 - Violation without specific action
 - Material / non-material violation
 - o If yes: how does the treatment/sanctions of these differ?
- How do you assess materiality?
 - o Where is the line between ‘correctable errors’ and errors that require public release?
- How do you proceed when you have located a violation?
 - o In contact with the issuer
- On average, how much time do you need for one initial review? (Initial refers to the first phase where the first assessment of the financial statement is reviewed)
- How is a review finished and how is it reported in conjunction with the completion?

Phase 4: After a review has been finished

- Which sanctions do you have at your disposal?
- Do you have time limits on when the supervisory review must be completed?
 - o If yes: what will be the effect if this goal is not reached?
- How is the outcome of your review implemented?
 - o "name and shame"
 - o Public announcement
 - o Request correction
 - o Direct or forward
- In practice, how do you work with follow-ups?

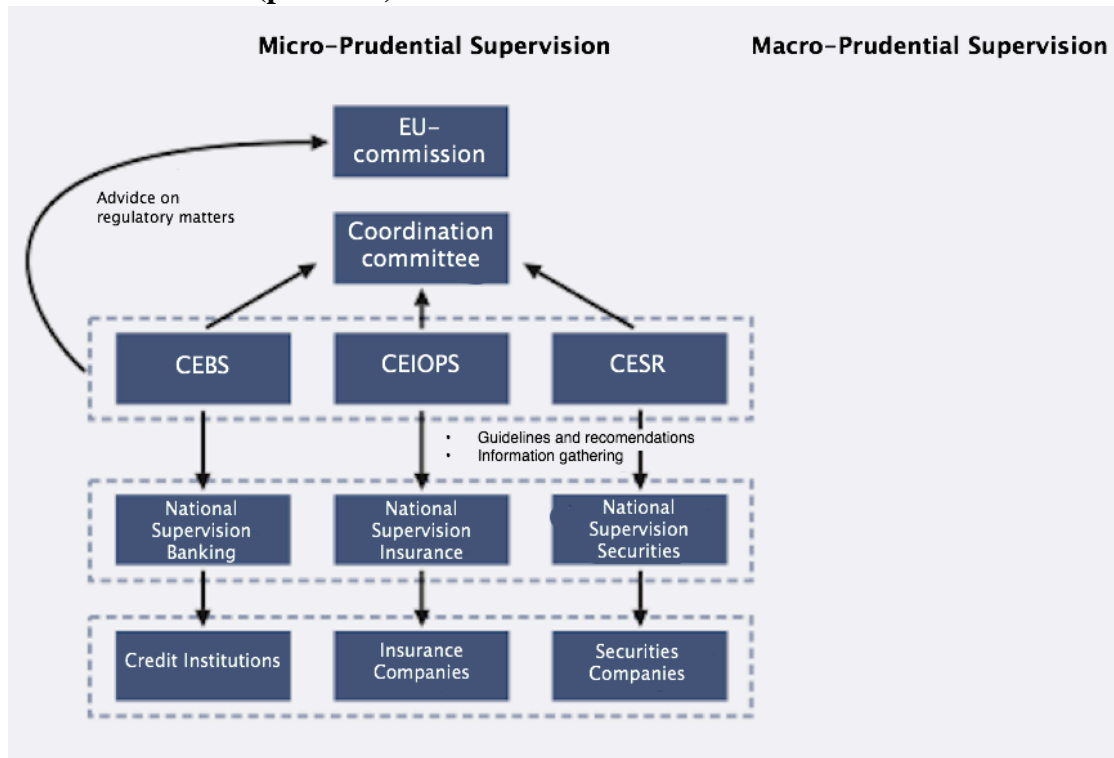
Phase 5: European Cooperation

- How do you contribute to the European Cooperation on enforcement?
 - o What types of cases do you bring to ESMA?
 - o Frequency on cases to EECS?

- What role does the accumulated database has for your interpretation and enforcement of IFRS?

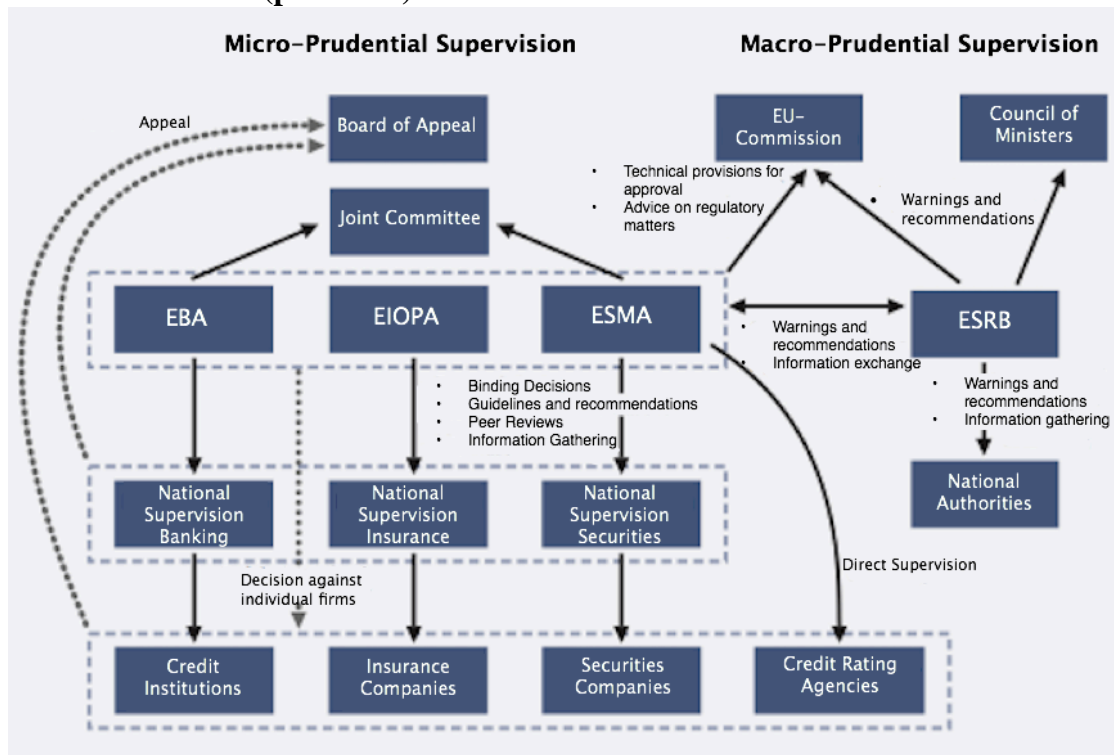
Appendix 2 – Structure of Financial Supervision in Europe

Former structure (pre 2011):



(Source: Andersson, T. (2010) *Eu:s framtida tillsyn – kommer den att fungera?. Valuta- och Penningpolitik*. Stockholm: Riksbanken, pp. 46-70 [the researchers translation].)

Current structure (post 2011):



(Source: Andersson, T. (2010) *Eu:s framtida tillsyn – kommer den att fungera?. Valuta- och Penningpolitik*. Stockholm: Riksbanken, pp. 46-70 [the researchers translation].)

Appendix 3 – List of Enforcers

| Member State | European Enforcer | |
|----------------|---|-------------------------------------|
| Austria | Financial Market Authority ²¹ | FMA |
| Belgium | Financial Services and Markets Authority | FSMA |
| Bulgaria | Financial Supervision Commission | FSC |
| Cyprus | Cyprus Securities and Exchange Commission | CySEC |
| Czech Republic | Czech National Bank | CNB |
| Denmark | Danish Financial Services Authority Danish Business Authority | Danish FSA DBA |
| Estonia | Estonian Financial Supervision Authority | EFSA |
| Finland | Finnish Financial Supervisory Authority | FIN-FSA |
| France | Financial Markets Authority | AMF |
| Germany | German Federal Financial Supervisory Authority Financial Reporting Enforcement Panel | BaFin FREP |
| Greece | Hellenic Capital Market Commission | HCMC |
| Hungary | Hungarian Financial Supervisory Authority | HFSA |
| Ireland | The Central Bank of Ireland Irish Auditing and Accounting Supervisory Authority | CBI IAASA |
| Iceland | Financial Supervisory Authority | FME |
| Italy | Companies and Securities National Commission | Consob |
| Latvia | Financial and Capital Markets Commission | FCMC |
| Lithuania | Bank of Lithuania | LB |
| Luxembourg | Financial Markets Supervisory Commission | CSSF |
| Malta | Malta Financial Services Authority | MFSA |
| Netherlands | Netherlands Authority for the Financial Markets | AFM |
| Norway | Norway Financial Supervisory Authority | NFSA |
| Poland | Polish Financial Supervision Authority | PFSA |
| Portugal | Securities National Commission Bank of Portugal Insurance Portugal Institute | CMVM BP ISP |
| Romania | Romanian Financial Supervisory Authority | CNVMR |
| Slovakia | National Bank of Slovakia | NBS |
| Slovenia | Securities Market Agency | SMA |
| Spain | Spanish Securities Market Commission | CNMV |
| Sweden | Swedish Financial Supervisory Authority The Nordic Growth Market Nasdaq OMX Stockholm | Swedish FSA NGM AB Nasdaq OMX |
| United Kingdom | Financial Services Authority Financial Reporting Review Panel | FSA FRRP |

(Source: European Securities and Markets Authority (ESMA). (2013) Activity Report of the IFRS Enforcement activities in Europe in 2012. pp. 21-22.)

Appendix 4 – Brief description of respondents

- **Sweden**
 - *SFSA (Finansinspektionen)*

Patrik Jakobsson, head of financial reporting supervision since 2007.
Background as auditor at KPMG.
Hans Hällefors (Pilot-interview), former Financial Reporting Specialist at Finansinspektionen (2010-2012).
 - *OMX*

Jan Buisman, Accounting expert and Consultant in financial reporting supervision since 2010. Background as auditor.
Anna Jansson, Financial reporting since 2009. Background as company lawyer at ‘Aktiespararna’.
 - *NGM*

Markus Ramström, head of Market Surveillance since 2010. Previously at the Market Surveillance unit at NasdaqOMX Stockholm.

- **Denmark**
 - *DFSA (Finanstilsynet)*

Mads Mathiassen, Director at Financial Reporting Division, since 2009.
Started in the Danish FSA in 2006.
Tine Heerup, Deputy Director in the same unit, been in the DFSA for 25 years.
 - *DBA*

Jan-Christian Nilsen, Chief special advisor at DBA since 1994.

- **Norway**
 - *FSAN (Finanstilsynet)*

Tine Svae, Special advisor at financial reporting. In the FSAN since 2008.
Former senior partner at PwC.

- **Netherlands**
 - *AFM*

Annemeike Keijzer-Peijffers, Senior Supervisor, has worked with market surveillance since 2005, background in auditing at Deloitte.

- **Ireland**
 - *IAASA*

Michael Kavanagh, Head of Financial Reporting Supervision since 2006.
Background as Director Professional Standards at KPMG.
Garett Ryan, Project manager in Financial Reporting Supervision unit since 2009.

- **Belgium**
 - *FSMA*

Johan Lembrecht, Coordinator at Accountancy and Finance Supervision of listed companies. Started in the FSMA in 1990.

Appendix 5 – ‘Levels of non-compliance’

- *Netherlands:*
 - **Notification:** A notification can either be informal or formal. The informal approach does not involve any correspondence with the board of supervisors. In the formal approach both the board of the company and the board of supervisors are engaged. Both types of notifications are finished with instructions to correct in future reports.
 - **Recommendation:** A material misstatement that is deemed to influence the users of the financial information. The company is requested to issue a press release in order to inform the market. If compliance is still not reached the case may go to court where all rulings are made publicly available.
- *Sweden:*
 - OMX:
 - **‘Reminder’:** Non-material misstatement. The misstatement is brought to the attention of the issuer, but no further action is required.
 - **‘Comment’:** Formal misstatements regarding disclosures. Reach a certain level of materiality without provoking severe action. All cases are finished with correction in future reports.
 - **‘Criticism’:** Material misstatement that may affect an investor. All cases are made publicly available on their website, anonymously.
 - **‘Disciplinary committee’:** If the violation is considered to cause harm to investors or otherwise be detrimental to market confidence, the matter can be handed over to the Disciplinary Committee, which have the right to give verdict containing a possible sanction.
 - NGM:
 - **‘Comment’:** Non-material disclosure formalities. The issuer is informed about the misstatement, but no further action is required.
 - **‘Remark’:** Material misstatement, used for either several deviations according to the above mentioned or one severe misstatements that could affect investors or market confidence. Future correction or if more severe, demand for the issuer to issue a press release or new annual report. These cases are made publicly available at their website, anonymously.
 - **‘Disciplinary Committee’:** Severe material misstatement that may affect the valuation of the company and/or the overall assessment of the issuer. Only used when other measures seems inadequate.
- *Ireland:*
 - The terminology used by the IAASA is **compliance** and **non-compliance**, which said there are still levels of non-compliance driving the severity of actions. In principle, the formal options available to the IAASA follow the actions outlined by ESMA.

- *Norway:*
 - FSAN use similar terminology as the IAASA, the level of materiality drives the severity of the action. In general the most common action used by the FSAN is ‘correction in the next financial statement’.
- *Denmark:*
 - **Infringement:** Departures that are more formal in nature (e.g. misplacement of disclosures) or where materiality is difficult to assess. The action tied to infringement is to correct in future financial statement.
 - **Misstatement:** Departures that are labelled as significant to investors. Material misstatement always demand immediate action, either corrective note or issuance of new information (if close to the next financial reporting period future correction is acceptable).
- *Belgium:*
 - The FSMA focuses on investors and the severity of actions is tied to the need of the investor. If a misstatement is considered vital to the market an immediate action is required (i.e. corrective note or issuance of a revised financial statement). If the misstatement, on the other hand, is considered less vital, correction in future reports is acceptable. There is no formal terminology in place, which action to use is decided in each specific case.