ACCA POLICY PAPER

Strengthening corporate reporting and its enforcement

(February 2022)

ACCA (The Association of Chartered Certified Accountants) has submitted its contribution to the European Commission (EC) consultation on **Strengthening corporate reporting and its enforcement,** revolving around 3 pillars of corporate reporting: Corporate Governance, Audit and Supervision. As the journey begins, ACCA is issuing a **series of recommendations** to constructively engage with policy and decision-makers, as well as key stakeholders to evaluate the various solutions available*,* in the public interest*.*

General remarks on the wider corporate reporting environment

- ACCA strongly supports the EC approach to consider the **three pillars of high quality and reliable corporate reporting** as part of the wider financial reporting ecosystem. Improvements on corporate governance, statutory audit and supervision should take place in a coordinated way so that all three can be mutually reinforcing towards improved quality.

- We also commend the EC's **multi-stakeholder approach**, as stakeholders for each pillar do play an important role towards the sustainable improvements of the quality of the wider financial reporting ecosystem.

- We support the **development of specific quality indicators** for corporate reporting, statutory audit and their supervision by the European Commission. We believe it could be a useful high-level mechanism for benchmarking and measurement of headline aspects for the three pillars. We recommend our reports ***Tenets of good corporate reporting*** , ***Tenets of good corporate governance*** and ***Tenets of a quality audit*** as a source of such possible indicators. Many companies and audit firms have also already developed their **own Audit Quality Indicators (AQIs)**, as an additional layer of quality indicators at the firm level, supplementing the generally accepted ones. In our view, AQIs can give a good, but not absolute, indication of audit quality, as all aspects of audit quality cannot be measured in quantitative terms.

- ACCA also agrees that improving the quality of the wider financial reporting ecosystem would support the objectives of the **European Green Deal relating to climate, energy, transport and taxation**. In this vein, ACCA's thought leadership paper 'Tax as a force for good: Rebalancing our tax systems to support a global economy fit for the future' recommends a number of actions for governments, policy makers, authorities and for businesses, such as using the tax revenues to reduce taxes on labour and expand social protection. Another recommendation is for governments to work with other countries to adopt a regional approach to achieve the same environmental and social objectives. This lays the ground for global coordination, where the EU could play a key role.

- We praise the EC's objective to place on equal footing and integrate financial and sustainability reporting, which supported by the auditor's assurance of both, provides a more trustworthy and complete picture of a company. ACCA also published several policy papers and reports linked to sustainability that supports this position, including 'Principles for Connected Corporate Reporting'; Paying the (carbon) price for Net Zero: ACCA calls for global minimum price of carbon ; *How SMEs can create a more sustainable world*; Climate action and the accountancy profession: building a sustainable future ; Rethinking risk for the future; Invisible threads: communicating integrated thinking; Professional accountants changing business for the planet: a guide to natural capital management; Mainstreaming impact: Scaling a sustainable recovery; Social and environmental value creation.

Corporate reporting / IFRS

- For ACCA, the **quality of corporate reporting and compliance with IFRS** can be improved. Our evidence suggests that the quality of corporate reporting varies significantly across Member States (MS) and that different levels of compliance with IFRS are driven by the accounting regime in place before IFRS adoption, differences in tax treatments, the size and maturity of the capital market, and cultural factors including attitudes towards compliance. Actions to improve the quality of corporate reporting will thus likely depend on the specific local circumstances. While the quality of financial reporting from large listed entities is generally good, the quality of financial reporting is poorer among smaller listed entities in some MS with limited flows of capital. We recommend further analysis on this point.

- IFRS are principles-based standards, which means that the application of certain standards requires **a high degree of judgement**. It would be necessary to review the nature of the material departures which have led to enforcement action, and differences in the interpretation of IFRS should be distinguished from fraudulent or erroneous reporting. Some inconsistencies in IFRS application arise from a lack of common practice and policies, especially among smaller accounting practices. We thus recommend to establish **common "best practices" for smaller audit firms**, especially where a global network or guidance does not exist. The quality of corporate reporting is also linked to preparers', auditors' and enforcers' **familiarity with IFRS**. **Education of accountants** is an important remedial factor.

- In addition, we have observed that giving supervisory bodies the **power to require corrective action**, such as restatement of financial statements, is particularly key to improving the quality of corporate reporting. **Transparency** about the enforcement actions taken and the circumstances giving rise to enforcement action is also very helpful as it provides preparers and auditors with a valuable point of reference to guide more consistent application of IFRS. It would be beneficial, in addition to ESMA's publication of enforcement decisions, to publish information about the subsequent impact of each enforcement decision on the entity's reporting. In addition, in some MS, the independence of the national authorities needs to be strengthened. We also suggest that **growing the number of qualified professional accountants** on the staff of the supervisory bodies could lead to more effective supervision. Action would however need to be informed by a more detailed analysis of deficiencies in the supervisory framework on a jurisdiction-by-jurisdiction level.

Corporate governance

- Despite evolution throughout the years, progress has not been consistent amongst MS, resulting in different stages of development, because of reliance on local corporate governance codes and local law rather than at an EU level. **ACCA therefore considers this is an area for improvement and supports further harmonisation at the EU level**.

- Regarding **audit committees (ACs)**, all public interest entities (PIEs) should have a separate audit committee and there should be no MS options on this requirement. We believe that it would be helpful if the 'duties' of AC are further explained and better defined, also in relation to other committees.

- We recommend giving company boards an explicit responsibility to **establish effective risk management and internal control systems** for the preparation of corporate reporting, including as regards controls for risks of fraud and going concern, to enhance the quality and reliability of listed companies' corporate reports, as well as transparency about the effectiveness of the companies' risk management and reporting on the actions undertaken during the reporting period. We do note that quality via transparency would be further enhanced if companies also report on the actions taken during the reporting period in regard to fraud and going concern.

- More clarity is equally needed around the AC's duties relative **to other stakeholders**. This also applies with how their duties and position compare to the external auditor and these other stakeholders. There should be more detailed definition of duties and engagement between the AC and investors too.

- ACCA also recommends being more specific about both directors' duties and the AC's role in **sustainable corporate governance** versus other board committees. More detail and guidance on who owns what (and why) and how they work together collectively would be helpful. There should also be more specific guidance on **qualifications for directors**, especially from the ESG perspective- we need to get the sought-for diversity, composition, and expertise right. The audit committee should have enough members competent in accounting and auditing.

- ACCA highlights the utmost importance of **alignment of the various directives and initiatives**, being mindful of overlaps or ways organisations can plan and adopt constructively. ACCA also stresses the importance of **consistency in the terminology** across boards. For example, many of the 'short-termism' references may not be used in the right context and the various time-horizons used across the directives and other initiatives become a bit confusing. So, more clarity of time horizons is needed while ensuring consistency across all proposals. ACCA would also welcome **measures to incentivise more whistle-blowers** to come forward if there is a mechanism in place that protects them.

Audit

- With regard to **auditor/audit firm rotation**, the existing EU audit regulation allowing for flexibility in its implementation has resulted in diverging rules among MS, which may create additional barriers. We therefore call for greater harmonisation and support limiting the number of MS options in the EU Audit framework to ensure consistency across the EU.

- While we welcome looking into ways to address competition and independence remaining issues, ACCA believes that there is scope for more thinking regarding the **precise definition of "non-audit services**" (NAS). Auditors are currently firmly restricted by the current EU audit legislation and the IESBA's Code of Ethics from providing non-audit services to their existing PIE audit clients as this could impair their independence. Before considering further limiting the scope for auditors to provide NAS, we recommend to carefully consider the evolving needs on reporting - and therefore assurance - over non-financial information. There are indeed some types of assurance services which are intertwined with the financial statement audits and which do not compromise auditor's independence. For example, in the case of the assurance envisaged to be provided over sustainability information as set out in the Corporate Sustainability Reporting Directive, inadvertently excluding the statutory auditor from being able to provide this service, should it be deemed "non-audit", would not be a sensible outcome.

ACCA Think Ahead

- For ACCA, there is currently insufficient evidence that **joint audits** would positively contribute to audit quality. We therefore do not support their introduction. We also believe that the focus of any audit reform proposals should aim to improve audit quality rather than purely increasing competition *per se*.

- While currently audit reports are informative, ACCA believes that there is room for improvement, particularly, in the **areas of fraud and going** concern by both management and auditors. We believe that the **role of shareholders** on corporate reporting should be strengthened. This aligns with our recommendations for governments or other relevant local bodies to consider how the communication channels between auditors and shareholders could be enhanced, which could help narrow the knowledge and expectation gap for both fraud and going concern as noted in our recently published thought leadership report Closing the expectation gap in audit: the way forward on fraud and going concern: a multi-stakeholder approach. We support auditors reporting on whether the directors' statement on material fraud is factually accurate, rather than how they have assured it, as currently stated in the consultation. We call on the EC to be mindful of the risks associated with the additional reporting requirement, and to avoid introducing a new expectation gap. There is indeed a great risk of perception that the auditor is providing a conclusion on fraud rather than reporting on the directors' statement on material fraud. This also raises questions regarding the auditor's liability and potential increase in indemnity insurance.

Supervision

- We consider that audit quality issues identified in the EU consultation can be attributed only to some extent to deficiencies in the EU legal and supervisory framework, and additional, more stringent regulation will not necessarily lead to higher audit quality and fewer deficiencies. We would rather suggest **more emphasis on the implementation and further harmonisation of the existing EU framework** and would also welcome initiatives to help increase audit quality via **learning and educational experience** within the audit profession, such as the creation of a **database of fraud case studies** at EU level.

- We believe that there is scope for the **role of the CEAOB to be developed and strengthened** to underpin greater consistency across MS in audit inspection approach and methodology**.** This would also promote a more efficient approach as those subject to supervision would not need to adjust their systems and procedures to accommodate different approaches across different MS We nevertheless recognise that bringing about a greater degree of harmonisation in audit oversight approaches would require significant focus and effort.

- We recommend the EC consider proposals such as **enhanced transparency** around the reporting of the findings of the audit inspection process, and to focus on **appropriate resourcing** of supervisors of auditors and audit firms, in support of a robust overall system of supervision.

- With regard to granting a European body the task to register and supervise PIE statutory audit firms and auditors, this does not seem to us to be a practical or cost-effective proposition, both in terms of the complexity of implementation and the timeframe. Instead, ACCA would support developments using existing national supervisory institutions, but with more EC-wide prescription over the nature of supervision and the supporting approach to be implemented, supported by strengthened oversight from the CEAOB.