May 13, 2015

Jonathan Hill, Lord Hill of Oareford
Commissioner
Financial Stability, Financial Services and Capital Markets Union
European Commission
Rue de la Loi / Wetstraat 200
1049 Brussels
Belgium

Via online submission

GREEN PAPER: Building a Capital Markets Union

Dear Lord Hill,

The International Federation of Accountants (IFAC) values the opportunity to comment on the European Commission's Green Paper: Building a Capital Markets Union (the Paper). IFAC welcomes and strongly supports the Commission’s emphasis on jobs and growth, unlocking investment and in particular, making sure the settings work to promote the needs of growing businesses and small- and medium-sized entities (SMEs). The importance of high-quality financial reporting and auditing for effectiveness, accountability, and integrity in capital markets is well documented. Effective and consistent regulation, standards and oversight of financial reporting and auditing in the European Union (EU) are essential steps toward the Capital Markets Union.

Through its current membership of more than 175 professional accountancy organizations in 130 countries and jurisdictions, IFAC represents approximately 2.5 million accountants in public practice, industry and commerce, government, and education. As such, it aims to provide the perspective of the global accountancy profession.

In accord with the Commission’s aspiration for “a single rulebook for financial services which is effectively and consistently enforced,” IFAC has over a long period spoken about the importance of consistency in standards and regulation, and the related benefits including improving the comparability of financial information, reducing the effects of systemic risks, reducing information costs, decreasing opportunities for regulatory arbitrage, providing an underpinning for a global regulatory system, and numerous additional benefits for developing and emerging economies (refer also to IFAC’s Policy Position Paper 6: Global Regulatory Convergence and the Accounting Profession, 2012).
IFAC commends the Commission on the breadth of its considerations and concurs with the logic of seeking “a range of steps, some individually modest, but whose impact will cumulatively be significant,” rather than a “single measure.” IFAC supports the Commission’s concurrent reflection on how to achieve effective and balanced regulation and market effectiveness through the areas considered in the paper, and makes the following comments focused on SMEs, Prospectuses, and Market effectiveness – the broader framework.

Small- and medium-sized entities (SMEs)

The context of SMEs and alternative markets for capital have challenged established distinctions that impact on capital market regulatory requirements, such as what entities are considered to be ‘publicly accountable’. These distinctions affect a range of regulatory requirements, for example financial reporting, auditing, and other corporate governance related requirements. SMEs naturally include entities that fall within the fringes of such distinctions and both below and above the relevant thresholds.

The Paper raises the need for a “simplified, common, and high-quality accounting standard tailored to the companies listed on certain trading venues”—referring multilateral trading facilities and, by implication, including primarily SMEs. It recognizes that a requirement for full International Financial Reporting Standards (IFRS) compliance could create an unnecessary and impractical cost burden for such entities. While IFAC concurs that balance in financial reporting requirements is crucial, we note that satisfaction of the specific need raised in the Paper may be achieved more fully by revisiting and enhancing the gradation of relevant thresholds and definitions as they apply to entities utilizing multilateral trading facilities and other alternative trading venues, than in developing a new set of accounting standards. We recognize that coordination with accounting standard setters internationally may be required to holistically achieve this and note that in considering the Paper at its recent meeting, the IFRS Trustees Foundation discussed its “willingness to co-operate with the European Commission as it considered this issue further” and that the International Accounting Standards Board has stated it “will co-operate closely with the European Commission on this important project.”

There are existing, internationally recognized financial reporting standards for publicly accountable and non-publicly accountable entities. There is also a risk that the introduction of a new set of standards could lead to further instances of divergence within and beyond the EU. IFAC recommends that IFRS for SMEs is currently an appropriate set of standards for entities that are not considered publicly accountable and that IFRS is the appropriate point of reference for entities that are publicly accountable. We recognize that the European Financial Reporting Advisory Group has previously concluded that IFRS for SMEs is in its view not compatible with the EU Accounting Directive, but also note that several member states, with insubstantial modifications, have been able to require or permit the use of IFRS for SMEs.

Addressing the higher order aspects determining what regulatory requirements apply in the context of SMEs also could enhance the Commission’s deliberations around other important areas, such as auditing requirements, governance, and prospectuses. The Commission’s efforts in this regard would also be highly relevant internationally as this is an issue facing capital markets in many jurisdictions around the world.
Prospectuses

IFAC strongly supports the Commission’s recognition of the need to address barriers faced by SMEs in gaining access to capital markets, and its efforts to enhance prospectus arrangements in the EU through its parallel consultation, Review of The Prospectus Directive. We note that many of the aspects raised in that consultation touch on matters of thresholds as discussed above.

With a view to investors’ protection, we further recommend harmonizing prospectuses (in form and content) so as to be more focused (e.g. on “useful information to a wide range of users in making economic decisions”), rather than a discussion overly-preconceived toward the minimum content of a prospectus (“short form prospectus”).

Market effectiveness – the broader framework

The Paper appropriately considers broad aspects critical to market effectiveness such as supervisory convergence, data and reporting, market infrastructure and securities law, company law, corporate governance, insolvency, taxation, and technology.

High-quality, consistent auditing is also crucial to the sound functioning, integrity, and efficiency of capital markets. IFAC believes that auditing is an important matter that might be considered in the Paper, and recommends that addressing the consistency of auditing regulation and oversight in the EU is a priority in building the Capital Markets Union and aspiring to a unified rulebook.

Audit reforms in the EU1 have been recently adopted following extensive deliberation and consultation. However, the risk of inconsistency of implementation is acute. In particular, IFAC draws attention to the importance of consistency in the implementation of measures recently adopted—matters such as the definition of Public Interest Entities (PIE), mandatory firm rotation (MFR), and non-audit services (NAS).

Different approaches to thresholds applied to determine entities that require an audit already exist; if differences arise in how EU member states implement the definition and requirements of PIEs, it has the potential to create considerable complexity. This would principally affect SMEs which, as discussed above, are naturally likely to fall on the fringes of the definitions and thresholds adopted, raising the likelihood of being classified differently in different states. This situation could have a significant impact on business decision making and costs.

There is a risk that if different approaches to MFR are adopted by member states, it could be more difficult to coordinate audits at a group level, leading to increased costs, unnecessary additional audit procedures, and possibly impacts on audit quality.

With regard to NAS rules, there are a range of services that can be reasonably provided by an audit firm while safeguarding independence, and these are often important for SMEs. Any inconsistencies in the rules at a member state level could have a heightened impact on SMEs.

IFAC commends the EU’s recognition of the International Standards on Auditing in recent audit reforms and their implementation in many member states, but notes the importance of explicit adoption of these standards across the EU area in establishing a Capital Markets Union.

IFAC recommends continued reflection on the impact and global consistency of auditing regulation and oversight in the EU as the recent reforms continue to be implemented and experienced. In addition to the general importance of auditing in capital markets and matters of consistency within the EU outlined above, global consistency is imperative to address the Commission’s objectives of attracting international investment and developing the Capital Markets Union, taking into account the wider global context.

IFAC thanks the Commission for the opportunity to provide its comments on this important initiative, and would be glad to participate and provide further input as the Commission’s initiative develops further.

Please do not hesitate to contact us should you wish to discuss any of the matters raised in this letter.

Regards,

Fayez Choudhury
Chief Executive Officer