

## CALL FOR EVIDENCE FOR AN EVALUATION AND IMPACT ASSESSMENT RUN IN PARALLEL

This document aims to inform the public and stakeholders about the Commission's work so they can provide feedback on the intended initiative and participate effectively in consultation activities.

We ask these groups to provide views on the Commission's understanding of the problem and possible solutions, and to give us any relevant information they may have, including on the possible impacts of the different options.

<b>TITLE OF THE INITIATIVE</b>	Corporate reporting – improving its quality and enforcement
<b>LEAD DG – RESPONSIBLE UNIT</b>	DG FISMA – Unit C1- PLAN/2021/11174
<b>LIKELY TYPE OF INITIATIVE</b>	Legislative Proposal for a directive of the European Parliament and of the Council Proposal for a directive amending Directive 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market, Directive 2013/34/EU on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts and Regulation (EU) 537/2014 on specific requirements regarding statutory audit of public-interest entities
<b>INDICATIVE PLANNING</b>	Adoption date planned Q4 2022
<b>ADDITIONAL INFORMATION</b>	<a href="https://ec.europa.eu/info/business-economy-euro/company-reporting-and-auditing_en">https://ec.europa.eu/info/business-economy-euro/company-reporting-and-auditing_en</a>

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### A. Political context, evaluation, problem definition & subsidiarity check

#### Political context

Corporate reporting by listed companies is the bedrock of capital markets as it gives investors the essential information they need to make sound investment decisions such as information about the financial situation of companies. Moreover, it enables stakeholders to hold companies accountable on, for instance, sustainability issues.

In the EU Member States, on average 59% of listed shares are held across borders<sup>1</sup>. This initiative is important to achieve an efficient Capital Market Union (CMU), building on reliable information disclosed by companies in the whole Union.

The quality and reliability of public reporting by listed companies rely on three main mutually reinforcing pillars: (i) corporate governance in these companies; (ii) statutory audit; and (iii) supervision and enforcement by public authorities.

Several recent failures of companies in Europe (e.g. Wirecard, Carillion) suggest that the three pillars that underpin the quality and reliability of corporate reporting by listed companies have not fully played their intended role. A Commission fitness check<sup>2</sup> also highlighted weaknesses in this framework, in particular in relation to supervision and enforcement by Member States. Other reports such as the Commission's market monitoring report<sup>3</sup> have further revealed issues with audit quality, divergent Member State approaches on supervision of auditors and the continued high level of concentration on the audit market. In light of this situation, the European

<sup>1</sup> See [Primary and secondary equity markets in the EU - Publications Office of the EU \(europa.eu\)](#)

<sup>2</sup> See [Fitness Check on the EU framework for public reporting by companies](#)

<sup>3</sup> See [Report on Audit Market Monitoring 2020 \(europa.eu\)](#)

Parliament, Member States, the European Securities and Markets Authority (ESMA), certain users of financial services and civil society have shown a clear interest in addressing the shortcomings identified<sup>4</sup>.

In view of the objectives of the 2020 CMU Action Plan, which include increased investor protection and more integration of EU capital markets, this initiative aims to strengthen corporate reporting by listed companies and the statutory audit of public-interest entities (PIEs). The latter category includes, in addition to listed companies, credit institutions, insurance undertakings and entities designated as PIEs by Member States.

In the European Green Deal Investment Plan of January 2020, the Commission reiterated the need to place sustainable finance at the heart of the financial system. In order to make sound investment decisions, investors in capital markets must have access to information about companies and financial products that includes reliable sustainability reporting. More reliable reporting will also contribute to tax transparency and tax fairness.

In the context of the Commission's preparatory work on a possible listing act, the Commission is assessing the need to simplify and ease certain listing requirements in order to reduce costs and make public capital markets more attractive for EU companies. The Commission will ensure consistency between the two initiatives, based on careful assessment of the issues in the different areas. The Commission's proposal on a Corporate Sustainability Reporting Directive aims to introduce EU sustainability reporting standards. This initiative takes that proposal fully into account and should ensure the quality of reporting by listed companies on the basis of these standards.

## Evaluation

Commission staff evaluated the corporate reporting framework in a fitness check. The fitness check not only assessed the EU corporate reporting **measures applicable to listed companies, but also those measures that apply to all limited liability companies**. However, the EU **audit framework and EU corporate governance framework** (where relevant for corporate reporting) **were not assessed** as part of the fitness check and will undergo evaluation as part of the preparation of this initiative.

The fitness check assessed primarily whether the EU framework on corporate reporting has achieved its objective of providing stakeholders with financial and non-financial information that is sufficient in quantity and quality to enable them to make informed decisions and protect their interests, make investment decisions, and hold companies publicly accountable. Its conclusion highlighted **the positive impact of the adoption of International Financial Reporting Standards in the EU for listed companies, which has improved transparency, comparability and reduced the cost of capital**. Although the fitness check found that the information provided was overall reliable, it also **noted that enforcement regimes and firms' incentives to issue high-quality financial reports played a determinant role in enhancing transparency**. The fitness check made it clear that **the enforcement practices of national supervisors on corporate reporting of listed companies differ significantly across the EU**. The Wirecard case confirmed that the EU framework has potential shortcomings and weaknesses as regards the effectiveness of enforcement practices.

Given that **statutory audit** and corporate governance are important pillars in securing the quality and reliability of corporate reporting by listed companies, the Commission will, following the new public consultation, evaluate the EU audit framework and corporate governance framework as far as relevant for reporting. This evaluation will focus in particular on the previous audit reform and the effectiveness, efficiency, relevance, coherence and added value of the EU audit framework. The evaluation will also consider potential for simplification and burden reduction.

## Problem the initiative aims to tackle

High-quality and reliable corporate reporting by listed companies is of key importance for the efficiency of EU financial markets. The recent high-profile company failures highlight the impact that fraudulent or incorrect corporate reporting can have on investors, with over EUR 20 billion of investor money lost in just a single case (Wirecard). Moreover, there are important indirect impacts such as reduced trust of investors and the loss or misallocation of investments in EU capital markets.

The drivers of these shortcomings could be the mutually reinforcing deficiencies and/or weaknesses in the three pillars that contribute to the quality of corporate reporting, i.e. corporate governance, statutory audit and

<sup>4</sup> See for instance the European Parliament's Benjumea report, *Report on further development of the Capital Markets Union (CMU): improving access to capital market finance, in particular by SMEs, and further enabling retail investor participation*, [PR\\_INI \(europa.eu\)](#).

supervision.

First, as regards corporate governance, there are concerns that boards of listed companies have insufficient responsibilities regarding the quality of corporate reporting, in particular in relation to systems of controls and the prevention of risks of fraud and going concern. Moreover, audit committees are sometimes non-existent or have a rather weak position inside listed companies. Moreover, there are concerns about the lack of transparency in their activities, and a lack of clarity about their supervision.

Secondly, the Commission's market monitoring report reveals deficiencies in the area of audit. Despite the audit reform of 2014, issues with audit quality and divergent Member State approaches on supervision of auditors reduce the contribution that statutory audits could make to the quality of corporate reporting. The audit regulatory framework also contains many options for Member States, which have been used differently across the EU and have an impact on the integrity of the single market. Moreover, there is a continued high level of concentration on the audit market, and barriers to cross-border audits for PIEs, which could lead to a lack of auditor choice. Reports of national audit oversight bodies point to significant deficiencies both in audit firms' internal quality control systems and in individual audit files. Drivers for these problems could be: (i) auditors' lack of incentives to focus on their public interest role (including due to their provision of non-audit services); (ii) the lack of competition on the PIE audit market; (iii) regulatory obstacles; and (iv) the lack of effectiveness and consistency of supervision.

Thirdly, a lack of effective and consistent supervision can also undermine the credibility of corporate reporting. Flaws in the supervision at Member State level have an impact throughout the EU. The fitness check and ESMA enforcement reports highlight a number of concerns on the supervision of corporate reporting, with significant divergences in the activities and the staffing of supervisors of reporting. This makes it difficult to ensure consistent and high-quality enforcement throughout the EU. ESMA also found a high proportion of material misstatements despite the often limited resources of supervisors.

Without a new EU intervention, it is likely that the problems will persist.

#### **Basis for EU action (legal basis and subsidiarity check)**

##### **Legal basis**

Under the Treaty on the Functioning of the European Union (TFEU), the EU has the power to lay down appropriate provisions that have as their object the establishment and functioning of the internal market (Article 114 TFEU). Depending on the results of the impact assessment – which will determine the specific objectives and content of any initiative – the relevant legal basis could be Article 50(g) on coordinating safeguards required of EU companies by Member States with a view to making such safeguards equivalent throughout the Union, and/or Article 53(1) on the taking-up and pursuing of activities by self-employed persons. Article 53(1) is already used as a legal basis for Directive 2013/14/EU (the Accounting Directive).

##### **Practical need for EU action**

The objective of this initiative (i.e. strengthening the quality of corporate reporting and its enforcement) cannot be sufficiently achieved by Member States acting independently; in this context, action at EU level is necessary for the proper functioning of EU capital markets. Although Member States could individually take action to strengthen the quality of corporate reporting and its enforcement, such measures would likely differ significantly between Member States. This would also lead to an uneven level of protection of investors. The audit regulatory framework also contains many options for Member States, which have been used differently across the EU and have an impact on the integrity of the single market. These create challenges for companies operating across borders due to excessive complexity and fragmentation.

In the context of the consultation on the fitness check in 2018, virtually all respondents considered the EU as the right level to set public reporting policies. Therefore, this initiative is considered to be in accordance with the principle of subsidiarity as set out in Article 5 of the Treaty on European Union (TEU). In accordance with the principle of proportionality, this initiative will not go beyond what is necessary to achieve its objective. In particular, to minimise the burden on companies and national authorities, this initiative would build as much as possible on the existing framework.

## **B. Objectives and policy options ]**

The objective of this initiative is **to strengthen the quality of corporate reporting and its enforcement.**

To achieve this objective, there is a need for clear roles and responsibilities for all the actors involved: companies and their boards, statutory auditors and supervisors. The initiative will thus focus on the three mutually reinforcing pillars to help ensure the quality of corporate reporting.

- Corporate governance: ensure that companies strengthen the quality of their corporate reporting and to reinforce the responsibilities of company boards and audit committees to achieve this objective. The initiative will look at the role and responsibilities of company boards for corporate reporting, their accountability and the role that internal controls can play in achieving high-quality reporting. It will also assess how audit committee can become more effective.
- Statutory audit: enhance audit quality and audit supervision by increasing auditors' incentives to focus on their public interest role, removing (potential) conflicts of interest and ensuring effective, efficient and consistent audit supervision.
- Supervision of corporate reporting: ensure effective, efficient and consistent supervision of corporate reporting. It should also increase transparency of the work of supervisors, allowing for appropriate accountability and communication to interested stakeholders and the general public.

To achieve the above objectives, the Commission will examine the current legislative framework covering the three areas above.

### **C. Likely impacts**

This initiative should create a more effective and efficient framework for high-quality corporate reporting by companies and ensure that companies report information that is relevant for stakeholders such as investors. It should further improve the protection of investors against incorrect reporting, improve their confidence and trust in financial markets and contribute to preventing company failures. Companies that are part of supply chains should also benefit from this initiative as they will be better protected from incorrect reporting or company failures. This could have significant economic impact for the EU economy as a whole by unlocking investment and funding opportunities, improving allocation of funds, and attracting a broader range of investors from within and outside the EU. Better corporate reporting by companies is also expected to lower due diligence costs for investors.

The initiative should also contribute to further competition in the audit sector and foster further cross-border investment and convergence of corporate reporting practices, thus contributing to financial integration in the Union and the deepening of the CMU.

This could also mean reinforced responsibilities for company boards and audit committees, statutory auditors and supervisors, which would imply additional costs. Given that listed undertakings can have a prominent role in the economies in which they operate and across borders, this initiative will mainly focus on large companies, i.e. undertakings whose transferable securities are admitted to trading on a regulated market. Therefore, this initiative is not expected to generate costs for SMEs, including companies listed on, for instance, SME growth markets. The Commission aims to present proportionate initiatives in order to increase effectiveness with limited additional costs. In this context, the overall benefits of such measures are expected to exceed the potential additional costs incurred.

Lastly, the initiative has potential to support the EU climate and environmental objectives and the sustainable finance agenda by contributing to making sustainability information more reliable and to tackling greenwashing. This could lead to a higher allocation of investment to sustainable activities and projects in the future. A similar indirect effect can be expected for social objectives, where these are captured in public disclosures.

This initiative aims to strengthen the quality of information that companies currently disclose to the public. Reporting obligations imposed on companies and related controls around the preparation and review of this information should strike the right balance between providing reliable information and avoiding any undue administrative burden for the actors involved.

### **D. Better Regulation instruments**

#### **Impact assessment and evaluation**

An evaluation and impact assessment are being conducted to support the preparation of this initiative and feed into the Commission's decision.

#### **Consultation strategy**

A 12-week public consultation will start with the publication of this call for evidence to hear the views of market participants and other stakeholders. Replies are possible in any official EU language. This consultation will seek input on issues including the roles and responsibilities of all the actors involved in companies' public reporting and related enforcement processes (company boards, statutory auditors and supervisors).

To complement evidence gathered through public consultation, the Commission services will further organise targeted interviews and meetings with stakeholders and organise dedicated workshops in Q1 2022 with a wide set of stakeholders including company representatives, investors and other users of public reports, statutory auditors and supervisors. The Commission services will also consult Member States through existing committees or bilaterally.

#### **Why we are consulting?**

This consultation will directly feed into an impact assessment that the Commission will prepare in 2022 with a view to: (i) assessing problems with the quality of corporate reporting; and (ii) comparing possible options to remedy these problems.

The public consultation launched in parallel with this document is divided into five parts seeking views about the overall impact of the existing EU framework for the three pillars of high-quality and reliable corporate reporting: corporate governance, statutory audit and supervision. It also seeks views about the interaction between the three pillars. Finally, the consultation contains specific questions on each of the three pillars, including on whether/what issues have been identified and whether action is considered necessary, on potential actions and their expected impact. A factual summary report will be published on the consultation page after the public consultation is closed.

#### **Target audience**

The main stakeholders identified are: (i) companies; (ii) auditors; (iii) public authorities and supervisors; (iv) asset managers; and (v) retail investors and civil society.

Other interested stakeholders are welcome to contribute.