POSITION PAPER

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CORPORATE REPORTING
Improving its quality and enforcement

Following the Commission's call for evidence and public consultation related to corporate reporting, BusinessEurope has set out its views below.

General remarks

Quality of financial reporting is high

We believe that the quality and reliability of financial reporting by listed entities in the EU is generally good. This is supported by reduced costs of capital, as well as the inflow of capital into the capital markets. BusinessEurope thus believes that the general framework for financial reporting has proven its effectiveness.

Financial reporting is part of corporate reporting in a holistic way. This comprises the financial statements of companies, their management report that includes the non-financial and corporate governance statements and country-by-country reporting. It will also include sustainability information pursuant to the proposed Corporate Sustainability Reporting Directive ("CSRD"). High quality sustainability reporting pursuant to the CSRD proposal will require sound sustainability reporting standards, related robust corporate governance, and specific assurance standards.

Evidence base is needed

It is very important that assessments of EU law are based on objective and robust evidence. We are therefore very concerned that objectives and policy options in the call for evidence already seems to assume that action at EU level is necessary.

There is no indication of systematic shortcomings in corporate reporting

The encountered difficulties are few in numbers and a result mainly of national weaknesses of some Member States which could be addressed in the current legal environment, such as better implementation of current legal provisions embedded in the various EU directives. There will - unfortunately - always be corporate failures but we consider that the Commission is jumping to the conclusion by saying that without EU intervention the problems identified will persist.

It is important to understand the root cause for problems related to corporate failures as this might not be a result of weak regulation, especially at EU level. Other plausible explanations are that the applicable rules have not been followed leading to criminal actions or that national rules might need to be reinforced in the current European framework. In order to conclude that stricter European rules are needed, it should be demonstrated that similar problems occur in several jurisdictions. Exceptional corporate failure cases cannot be a drive for new EU legislation. Accordingly, we believe the

Commission would need to undertake further research to understand whether there are weaknesses in the EU framework for corporate reporting.

Caution should be exercised with new or simultaneous legislative adjustments in the field of corporate reporting

Companies are facing multiple and constant changes in the European framework reporting rules, increasing the information required to be provided by companies and adding new items, e.g., the taxonomy reporting requirements, sustainability based on the CSRD and future European sustainability standards, the addition of items to enable the financial market participants to fulfill the requirements of SFDR's principal adverse impacts, the future directive on sustainable corporate governance etc. Sustainable finance is a high priority, and a huge effort is asked of all the stakeholders, especially companies. Evolutions in the framework are sometimes barely leaving time for companies to grasp them and adapt their reporting systems in a timely manner. It is therefore essential to provide a stable framework and not to add further EU reporting requirements on companies (or increase their complexity) than already adopted or in the pipeline.

Measures must be balanced and proportionate

Whatever rules are in place, corporate failures will also happen in the future. Any amendments of EU legislation therefore must be carefully assessed and weighted against other measures. It is very important that any measures taken must be relevant to the problem identified and proportionate. We are concerned that an EU intervention by adding more rules for corporate governance and audits, based on the Commission description of problems in the call for the evidence, might significantly increase the administrative burden for listed companies without any real benefits for stakeholders. EU Principles for Better Regulation should be applied, including the principle of one in - one out.

At what level should action be taken to improve corporate reporting?

To conclude, BusinessEurope considers that, although consistency of the corporate reporting framework across the EU should be the overall objective to assist cross border business and allocation of capital, individual Member States should be free to act if the specific situation in their market requires this. There is no necessity to change the EU legal framework to improve corporate reporting. Thus, the current European framework is sufficient. A better alignment of the existing provisions will be more beneficial than the creation of additional burdens for EU companies. At the same time, it could be useful to assess whether the existing EU framework could be improved to enhance efficiency and effectiveness, as mentioned below.

Corporate Governance

There is no systematic weakness in corporate governance

The Commission survey presumes that there is a fundamental problem with corporate governance that we do not recognize. The data in the ESMA report does not demonstrate a connection to corporate governance weaknesses on a European scale. If anything, the

report demonstrates differences on the Member State level, and it can't rule out challenges in the local implementation of the European legislation.

Current EU legislation is sufficient

BusinessEurope considers that the current EU requirements are appropriate and should not be expanded. The EU requirements around board responsibilities and audit committees are appropriate and should be retained. Implementing good practices for audit committees takes time and it is our experience that the audit committees are taking their tasks seriously and invests the time and resources needed in order to fulfill their role.

For the identified cases by the Commission, the initiatives touched upon in the survey would not make a significant difference but would add costs and complexities.

Differences in corporate governance among the EU Member States must be respected

It is also important to underline that the analysis does not take into consideration the different corporate governance systems in place in the EU. It is important to ensure that corporate governance initiatives respect the differences in the legal systems in the Member States. BusinessEurope believes that the EU current legislation strikes the right balance and do not see a need for change. The existing legal framework is already strict and reinforced by national corporate governance codes. It is up to the member states that encounter difficulties to ensure that rules and codes for corporate governance are fit for purpose. If there is any change in regulation of corporate governance at EU level, we consider that the costs will be higher than the expected benefits.

<u>Audit</u>

Competing EU policy objectives creates problems

BusinessEurope's overall view is that the EU through the audit package tried to solve a number of issues, e.g., market concentration in the audit industry, audit quality, independence etc. without acknowledging that there might be policy objectives that are incompatible with each other and that there might be unintended consequences because of this.

One example is market concentration in the audit industry vs. independence. As we already warned in the consultation leading up to the EU audit package, stricter rules on audit firm rotation (including cooling off rules) combined with tightened rules on provision of non-audit services (NAS) might lead to an even higher degree of market concentration for audit services. Therefore, it is key to focus on whether requirements are at all needed or whether they have a negative, internal correlation - and are thus not coherent.

Improvements can be made within current EU rules to address practical problems

The effects of the audit package were not fully satisfactory, especially regarding the high number of Member State's options. Companies had no other choice than adapting their functioning. It required time to be put in effect (for instance rotation rules are still entering into force until 2023), company had to cope with differences through the EU and very complex rules (caps etc.). Companies have put all those rules into effect and

implemented dedicated internal procedures. The costs incurred by companies to put the audit regulation into effect have been high and any change brought to the rules would add new costs for companies.

Having said that that, we note that there are some issues where improvements can be made within the EU audit package. Some rules are very complex and should be simplified. One example is the non-harmonization of national rules for rotation – there are different rules in different EU states which creates difficulties for multinationals firms (groups). Another example is the lack of full harmonisation in the non-audit services provisions, which creates difficulties in cross border groups. It should be easier to align the auditor in the different EU states after a rotation as it increases the audit quality.

Any change of EU law should however be carefully assessed, and our understanding is that there is no general need to amend EU law regarding auditing, rather there are local difficulties linked with national systems in some of Member States.

Take account of international standards to identify potential improvements in auditing and ethics

ISA standards from the IAASB for audits, including the new ISQM1 standard and in addition the IESBA Code of Ethics should be considered.

The IAASB and IESBA have a number of current projects on their work-plan to address concerns regarding audit related to e.g., fraud and going concern, group audits and provision of non-audit services, i.e., issues raised by the EU in the consultation. The work of the IAASB and IESBA is performed under the oversight of the Public Interest Oversight Board (PIOB), which is the global independent oversight body that seeks to improve the quality and public interest focus of the international audit and assurance, and ethics standards formulated by the International Standard Setting Boards. The EU could also further analyse the benefits of a stronger support for PIOB and the work undertaken by the IAASB and IESBA.

Audit quality is difficult to assess

BusinessEurope recognizes the importance of being able to identify (or measure) the quality of statutory audits.

However, this is a very complex issue and audit quality is very difficult to assess based on quantitative indicators. What would be the use of a quantitative indicator of the number of audit days or the number of supervision comments whereas the complexity and the importance of the file cannot be apprehended? When evaluating audit quality, the starting point should be international standards that already are applied by audit firms, i.e. ISQM 1, not any new EU rules. In any case, BusinessEurope does not favour imposing mandatory joint audits considering that the potential increase in audit quality would not justify the additional cost and difficulties in coordinating two auditors.

Supervision of Auditors and Audit Firms and Enforcement of Corporate Reporting

BusinessEurope acknowledges that the status of supervision over auditors and audit firms are different in the Member States. The same can be said regarding enforcement of corporate reporting.

It important to underline that there has to be realistic expectations regarding what e.g. enforcement of corporate reporting can achieve. Enforcement is to ensure that relevant reporting standards (e.g., IFRS) are consistently applied. Enforcement is not designed to detect fraud and is not a substitute for audits.

BusinessEurope therefore believes that before taking any action at EU level, a thorough analysis of differences in the level supervision and enforcement among Member States and eventual weaknesses in how supervisory and enforcement principles are applied is necessary.

There are measures that can be taken to mitigate weaknesses identified and improve supervisory and enforcement quality. A clear demand for adequate resources might be one measure that helps to improve supervision and enforcement. Another is better guidance on how to perform supervision and enforcement. A third is better coordination between national authorities and the work of European supervisory bodies can always be reinforced. However, all of this can be achieved without major changes to EU law.

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