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### **Practical implementation of compliance monitoring and the enforcement of accounting and audit requirements for high-quality reporting**

**Note by the UNCTAD secretariat**

#### *Executive summary*

This paper is prepared by UNCTAD to facilitate the deliberations of the thirty-third session of the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting on good practices and capacity-building for effective compliance monitoring and enforcement mechanisms to ensure high-quality corporate reporting. It highlights key issues that need to be addressed to guide countries in creating and strengthening their national compliance monitoring and enforcement mechanisms. The issues covered in this paper include the main principles that could be considered in building such mechanisms, and how these mechanisms relate to one another; the core elements to be considered in developing and implementing such mechanisms; the cross-cutting nature of the issues concerned and the need for coordination at all levels. Other issues to be considered are financial and human resource constraints, impact assessment challenges and the need for further research and cases studies on the implementation of compliance monitoring and enforcement, particularly in developing countries and countries with economies in transition. The paper also refers to specific issues relating to compliance monitoring and enforcement in areas such as non-financial reporting, public sector reporting and small-and-medium-sized-enterprise (SME) reporting.

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## I. Introduction

1. In September 2015, Member States of the United Nations adopted the 2030 Agenda for Sustainable Development, which includes 17 comprehensive far-reaching Sustainable Development Goals. The role of a dynamic private sector is vital in achieving these Goals. High-quality corporate reporting is critical in order to reflect the contribution of enterprises and to mobilize resources towards attaining the Goals. It also provides a solid foundation for financial stability, the enablement of the business and investment environment, transparency and good governance.

2. Early attempts to achieve high-quality financial and non-financial reporting were devoted to the development of robust global standards and codes. These efforts were intensified as the world economy became more integrated. As a result, a number of international standards and codes on corporate reporting were developed for the private and public sectors. These standards and codes relate to financial reporting, auditing, the education of professional accountants and ethics, as well as environmental, social and governance factors.

3. While standards and codes have been developed at the international level, practical implementation falls to regulators and enterprises at the national level. The financial crises of the last two decades have revealed a need for consistent implementation and enforcement of such standards and codes in order to reap the full benefits of their facilitating role in international investment and trade. In this respect, serving the public interest has been a key feature of the international standard-setting process, as well as of the regulation and enforcement of their implementation. Effective mechanisms of enforcement and ongoing compliance monitoring have been instrumental in driving improvement.<sup>1</sup>

4. For over three decades, the United Nations, through the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting, has been contributing to efforts to promote and implement high-quality financial and non-financial reporting by enterprises around the world. In recent years, UNCTAD and the Intergovernmental Working Group of Experts have striven to assist member States by developing a comprehensive approach to building a strong institutional foundation for high-quality corporate reporting. UNCTAD thus developed the Accounting Development Tool to help member States identify the gaps between their domestic corporate reporting requirements and international standards, codes and good practices, and to develop an action plan to bridge these gaps in a consistent and comprehensive manner. The Accounting Development Tool consists of the accounting development framework and a questionnaire with a set of quantitative indicators. The Tool has been implemented in many countries since its launch in 2012, and its application has recently been enhanced by a web-based electronic platform available in English, French, Russian and Spanish.<sup>2</sup>

5. The application of the Accounting Development Tool in different regions of the world and subsequent deliberations on relevant findings at annual sessions of the Intergovernmental Working Group of Experts indicate that many countries continue to face challenges in setting up an effective compliance monitoring and enforcement mechanism and that there is a need for guidance on capacity-building and good practices in this area. Consequently, at the request of the thirty-first session of the Intergovernmental Working Group of Experts, UNCTAD started its work on developing a guidance document on capacity-building and good practices in the monitoring of compliance and enforcement. In

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<sup>1</sup> For further information, see <http://www.ipiob.org/index.php/piob-oversight/compliance> (accessed 29 June 2016).

<sup>2</sup> See <http://adt.unctad.org> (accessed 5 August 2016).

coordination with the consultative group of experts on the monitoring of compliance and enforcement,<sup>3</sup> it prepared a working paper,<sup>4</sup> which was used as a basis for further discussion with the consultative group during preparations for the thirty-third session of the Intergovernmental Working Group of Experts. The process was enriched by the presentation of selected country case studies at its thirty-first and thirty-second sessions.<sup>5</sup>

6. The UNCTAD secretariat has incorporated comments from the consultative group in a revised draft guidance on good practices in the monitoring of compliance and enforcement for high-quality reporting for consideration by the thirty-third session of the Intergovernmental Working Group of Experts. Special attention has been paid to reflect the relevance of compliance monitoring and enforcement requirements to the 2030 Agenda for Sustainable Development. Results of the discussions of the Intergovernmental Working Group of Experts will be further incorporated into the final version of the guidance document.

7. The purpose of this paper is to facilitate discussions on agenda item 3 during the current session of the Intergovernmental Working Group of Experts. It provides a brief overview of the draft guidance focusing on the main issues raised during the intersessional consultation period. The paper discusses the key definitions, objectives and scope of an effective compliance monitoring and enforcement mechanism; the main principles on which it could be built and its core elements; key institutional issues, including organizational structures, activities, tools and methodologies; and the relevant benchmarks and means of impact assessment. It also discusses specific issues relating to the monitoring of compliance and enforcement in areas such as corporate reporting, auditing and quality assurance, and requirements for professional accountants. Finally it outlines challenges in monitoring compliance and enforcement requirements for non-financial reporting, public sector reporting and reporting for SMEs. The paper and the draft guidance should be read in conjunction with each other, as they complement one another.

8. The draft guidance provides a number of references to specific country examples to illustrate possible approaches. The discussions of the consultative group indicated a need for a larger pool of examples of good practices in compliance monitoring and enforcement mechanisms, including from developing countries and countries with economies in transition.

9. The consultative group indicated that the examples contained in the current draft document, which were drawn from developing economies, were useful. However, the examples tended to focus on national experiences concerning the implementation of segmented parts of a compliance monitoring and enforcement mechanism, rather than on the various structures and processes of the mechanism. There is a need for additional studies that elaborate on cross-institutional coordination, underscoring the complexities of implementing the many elements of a compliance monitoring and enforcement mechanism.

10. In this regard, the consultative group suggested that the elaboration of full-range case studies on the experiences of developing economies in the implementation of compliance monitoring and enforcement mechanisms would be important and should be continued by UNCTAD to help provide an understanding of the overall picture of compliance monitoring and enforcement. The consultative group noted that such examples could offer valuable lessons and encourage investment in the development and implementation of compliance monitoring and enforcement mechanisms in various

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<sup>3</sup> See annex I.

<sup>4</sup> UNCTAD, forthcoming, *Monitoring of compliance and enforcement for high-quality corporate reporting: Guidance on capacity-building and good practices*.

<sup>5</sup> Countries covered: Australia, Belgium, Canada, Germany and the United Kingdom of Great Britain and Northern Ireland (UNCTAD/DIAE/ED/2015/2).

economic settings. Ideally, additional case studies should draw on experiences from economies in Africa, the Asia-Pacific region, Latin America and the Caribbean, and Eastern Europe, for example. The case studies could also inform the process of further updating the draft guidance – a living document – which would be enhanced by progress reports and indicate the needs of specific countries in this area.

11. In its discussions, the consultative group emphasized that it was necessary to have an understanding of the local context for the implementation of a high-quality compliance monitoring and enforcement mechanism. The application of policies that were successful and efficient in one jurisdiction could prove to be problematic and costly in another, particularly if available resources and institutional maturity differed in each jurisdiction. Further, policymakers in diverse national economic and institutional contexts often found good practices in developed economies to be useful references for the design and development of their own mechanisms.

## **II. Key issues in designing and implementing effective compliance monitoring and enforcement mechanisms for high-quality reporting**

12. The objective of the draft guidance is to provide policymakers with references to good practices for consideration in designing, developing and operationalizing their national compliance monitoring and enforcement mechanisms. It could also provide useful information to other stakeholders for their understanding of the main issues and challenges relating to the monitoring of compliance and enforcement and how they could contribute to its building and functioning.

13. The draft guidance outlines key definitions, objectives and scopes concerning the mechanism. It describes the main principles and core elements of the mechanism and gives an account of institutional foundations, including activities, tools, methodologies, benchmarks and impact assessment issues. The draft guidance also identifies specific issues relating to corporate reporting requirements, auditing and assurance, and professional requirements. It addresses challenges relating to the monitoring of compliance and enforcement in non-financial reporting, as well as reporting in the public sector and by SMEs.

14. The consultative group identified a number of issues that have been incorporated in the revised version of the guidance on good practices in the monitoring of compliance and enforcement for high-quality reporting, and highlighted in this paper for further consideration by the thirty-third session of the Intergovernmental Working Group of Experts.

### **A. Definitions, objectives and scope**

15. The draft guidance stresses the importance of clear definitions in designing an effective compliance monitoring and enforcement mechanism. In this regard, it states that compliance normally is understood as the adherence to laws, regulations and rules. Monitoring of compliance refers to the supervision and investigation conducted to verify compliance, and it seeks to encourage appropriate behaviours to promote compliance. Enforcement refers to the action of obliging adherence to the respective requirements and the implementation of sanctions when violations are found. It is a disciplinary function that seeks to ensure that there are consequences to the violation of rules that involve a set of tools used to address breaches of laws and regulations; enforcement is also aimed at

deterring future violations. In some circumstances, violations of rules may lead to civil damages or criminal sanctions.

16. In this regard, the consultative group noted that in developing a compliance monitoring and enforcement mechanism, it was important to give sufficient consideration to preventive aspects of the mechanism, in order to encourage entities to meet compliance monitoring and enforcement requirements at all stages of the reporting process. The establishment of a strong and effective relationship with the market to promote appropriate attitudes and behaviours is as important as detecting those who breach the rules. The balance between the two dimensions depends on the local culture and presence of the accounting profession. Accordingly, it is important to ensure the availability of appropriate implementation guidance, relevant training materials and competent staff.

17. The draft guidance states that the objective of the compliance monitoring and enforcement mechanism is to promote high-quality, reliable reporting, thus contributing to financial stability and sustainable development through enhanced corporate transparency, investor confidence and integrity of capital markets. To achieve these objectives, it is important to establish effective compliance monitoring and enforcement mechanisms to ensure the availability of high-quality, reliable corporate reports that satisfy the common needs of external users, including investors and other capital providers, as well other decision makers and stakeholders such as Governments and the society at large.

18. The scope of an effective compliance monitoring and enforcement mechanism would need to cover the entire reporting chain. To address the issue of comprehensiveness of the reporting process, the draft guidance covers three dimensions of compliance monitoring and enforcement: corporate reporting, the audit area and professional accountants. It first addresses issues that are common across the three dimensions, followed by discussions of specific arrangements and challenges in each of the areas. Members of the consultative group wondered whether professional requirements should be part of the monitoring of compliance and enforcement mechanism, as they were not normally subject to a national legislative mechanism, unlike accounting, reporting and audit regulations. However, the consultative group agreed that the compliance monitoring and enforcement mechanism for professional accountants established by national professional accounting organizations contributed significantly to effective compliance monitoring and enforcement, as it was often the principal means of monitoring compliance with professional requirements and the enforcement thereof. For that reason, it is also included into the draft guidance.

19. The consultative group agreed that in designing a compliance monitoring and enforcement mechanism, it would be important to decide what type of companies should be covered by compliance monitoring and enforcement requirements. In this regard, discussion centred on whether public sector and SME sector reporting, and non-financial reporting would be included in the scope of the compliance monitoring and enforcement mechanism and of the guidance.<sup>6</sup>

20. The implementation of a compliance monitoring and enforcement mechanism would present specific challenges for the banking and financial supervision sectors, which could be addressed in further action.

## **B. Key guiding principles**

21. The draft guidance outlines the key principles and elements that policymakers may wish to consider in setting up national compliance monitoring and enforcement

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<sup>6</sup> For further details, see paras. 59–72 of this paper.

mechanisms. They are based on major pronouncements relevant to the monitoring of compliance and enforcement, such as the core principles for independent audit regulators of the International Forum of Independent Audit Regulators,<sup>7</sup> statements of membership obligations of the International Federation of Accountants, the code of ethics for professional accountants of the International Ethics Standards Board for Accountants, the objectives and principles of securities regulation of the International Organization of Securities Commissions, the European Securities and Markets Authority Guidelines and others.

22. The consultative group suggested the following key guiding principles:

- (a) Public interest focus;
- (b) Independence;
- (c) Transparency and accountability;
- (d) Confidentiality;
- (e) Proportionality;
- (f) Cooperation and coordination.

23. Discussions on the key guiding principles to be applied to the compliance monitoring and enforcement mechanism highlighted that it was important to ensure that the mechanism was designed in such a way as to serve the public interest. In this respect, the Public International Oversight Board is a global independent oversight body that seeks to improve the quality and public interest focus of the international standards formulated by the standard-setting boards supported by the International Federation of Accountants in the areas of audit and assurance, education and ethics. Through its oversight activities, the Board works to bring greater transparency and integrity to the auditing profession, thereby contributing to the enhanced quality of international financial reporting.

24. The principle of independence is critical to ensure a proper functioning of effective compliance monitoring and enforcement mechanisms. Following the requirements of the International Forum of Independent Audit Regulators and the European Securities and Markets Authority in this area, the draft guidance states that independence allows regulators and supervisory entities of the compliance monitoring and enforcement mechanism to conduct their activities in an objective and fair manner, free from the undue influence of regulated entities and other stakeholders and market participants. The draft guidance also refers to the International Ethics Standards Board for Accountants, which addresses the issue of independence as part of an individual's professional competencies, and in this regard, makes a distinction between two components of independence: independence of mind, which permits objective and sceptical judgment, free from the effect of external influences, and independence of appearance, which is related to the avoidance of elements that may cast doubt on the integrity, objectivity or professional scepticism of accountants.<sup>8</sup> These principles can be applied to all those tasked with the promotion of an effective compliance monitoring and enforcement mechanism.

25. Independence is closely linked with the issue of funding mechanisms for compliance monitoring and enforcement. An efficient compliance monitoring and enforcement mechanism should have a source of funding that is free from the undue influence of the regulated entities or other stakeholders. However, financial resource limitations can often hinder the implementation of compliance monitoring and enforcement mechanisms. Funding mechanisms are highly dependent on a country's specific corporate reporting

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<sup>7</sup> [www.ifiar.org](http://www.ifiar.org) (accessed 29 July 2016).

<sup>8</sup> <http://www.iasplus.com/en/binary/ifac/0612ethicsed.pdf> (accessed 29 July 2016).

environment. Mechanisms to ensure independent funding thus need to take into consideration local institutional arrangements.

26. Transparency and accountability are two other critical components of an effective compliance monitoring and enforcement mechanism. The need to build transparent and accountable institutions is reinforced by the 2030 Agenda for Sustainable Development and is explicitly highlighted as a target in one of the Sustainable Development Goals (Goal 16.6). In this regard, for example, principle 3 of the International Forum of Independent Audit Regulators states that “the audit regulator should have public accountability in the use of its powers and resources to ensure that the audit regulator maintains its integrity and credibility.”<sup>9</sup> The European Securities and Markets Authority emphasizes that enforcers should periodically provide information to the public on their enforcement activities and coordination. Transparency might also include the publication of annual work plans and activity reports, as well as the selection criteria for inspections, either on an aggregate or on an individual basis.

27. At the same time, regulators need to observe confidentiality when handling cases and reviewing information so as not to encroach on the legitimate interests of businesses. Intellectual property rights, including proprietary technology, long-term strategies or other business elements may set a limit to disclosures of a compliance monitoring and enforcement mechanism intended to promote transparency.

28. The principle of confidentiality applies both to disclosures made by entities conducting and coordinating compliance monitoring and enforcement activities, and the staff responsible for carrying out compliance monitoring and enforcement tasks.

29. According to the International Organization of Securities Commissions, it is important that regulatory agency staff observe appropriate standards of confidentiality.<sup>10</sup> Further, the International Forum of Independent Audit Regulators states in its core principles that audit regulators should ensure that appropriate arrangements prevent the public dissemination of confidential information.<sup>11</sup>

30. Striking the right balance between the principles of transparency and confidentiality is a challenge when designing and implementing an effective compliance monitoring and enforcement mechanism and depends on the specific reporting and business environment in which the mechanism is being implemented.

31. Discussions of the consultative group on the concept of materiality, which was mentioned in the context of risk-based inspection policies, led the members of the group to reflect on the importance of proportionality.

32. In this regard, the consultative group suggested that proportionality should be included as an additional principle for a high-quality compliance monitoring and enforcement mechanism. Proportionality, one of the general principles in European Union regulation,<sup>12</sup> indicates that regulatory action should be limited to what is necessary in order to achieve the objectives of European Union law. As such, the action undertaken as part of a compliance monitoring and enforcement mechanism should be proportional with the aims pursued and the potential regulatory gaps identified during oversight.

33. One of the main principles of the implementation of an effective compliance monitoring and enforcement mechanism is coordination and cooperation among a range of

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<sup>9</sup> <https://www.ifiar.org/IFIAR/media/Documents/General/Final-Core-Principles.pdf> (accessed 3 August 2016).

<sup>10</sup> <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf> (accessed 3 August 2016).

<sup>11</sup> See note 9.

<sup>12</sup> <http://eur-lex.europa.eu/summary/glossary/proportionality.html> (accessed 3 August 2016).



institutions. Coordination is important for sharing information at the national level, as well as between domestic authorities and their foreign counterparts and with regard to all dimensions of compliance monitoring and enforcement requirements. Such contacts are expected to take into consideration confidentiality issues on the information that is collected towards reaching compliance monitoring and enforcement objectives.

34. There are also situations where coordination is needed among regulators in different jurisdictions. For example, according to principle 7 of the International Forum of Independent Audit Regulators, audit regulators “should make appropriate arrangements for cooperation with other audit regulators and, where relevant, other third parties.”<sup>13</sup> Similarly, the European Group of Auditors’ Oversight Bodies had proposed a common approach for cooperation within the European Union between the relevant authorities of member States, including audit firms and auditor oversight entities.<sup>14</sup>

35. The discussions of the consultative group highlighted the need for clearer guidance and good practices on how coordination could be ensured between the different components of the compliance monitoring and enforcement mechanism, that is to say, accounting regulators, audit regulators and members of the profession. The practical experience of UNCTAD in some countries has shown that the implementation of the Accounting Development Tool may present a first instance when major decision makers and stakeholders in the reporting area gather for joint discussions and collaboration. Therefore, closer coordination – even at the national level – plays a vital role in developing and implementing an effective compliance monitoring and enforcement mechanism.

### C. Core elements

36. The draft guidance also outlines core elements to be considered in developing and implementing the monitoring of compliance and enforcement:

- (a) Legal requirements, including key standards, codes and benchmarks, as well as enforcement powers;
- (b) Institutional arrangements;
- (c) Good governance mechanisms;
- (d) Preventive, disciplinary and appeal tools, activities and methodologies;
- (e) Competent staff;
- (f) Funding models;
- (g) Monitoring arrangements and impact assessment mechanisms.

37. Discussions of the consultative group indicated that a country’s legal framework was a key element of an effective compliance monitoring and enforcement mechanism. There was a general understanding that the legal framework provided the foundation for the regulatory requirements of national Governments, the enforcement of checks and balances and the hiring of qualified staff. Such elements could be incorporated into national law and draw on international standards and codes of accounting, or on requirements relating to audit and assurance, and professional qualifications.

38. It was important to have a clear understanding of standards and codes used for compliance and enforcement purposes. In this regard the draft guidance provides references and links to key international standards and codes of accounting, financial reporting and

<sup>13</sup> See note 9.

<sup>14</sup> [http://ec.europa.eu/internal\\_market/auditing/egaob/index\\_en.htm](http://ec.europa.eu/internal_market/auditing/egaob/index_en.htm) (accessed 29 July 2016).

disclosure; audit and assurance; corporate governance; environmental, social and governance reporting and other international pronouncements and good practices relevant to the compliance monitoring and enforcement.

39. For instance, relevant institutions that develop standards used as benchmarks by member States include the International Accounting Standards Board,<sup>15</sup> the International Auditing and Assurance Standards Board<sup>16</sup> and the International Ethics Standards Board for Accountants.<sup>17</sup>

40. A country's legal framework is closely connected with its institutional settings. The legal framework has an impact on how a compliance monitoring and enforcement mechanism is organized; and on the tools and methodologies that could be made available for selecting entities for inspection, performing inspections, enforcing standards, preventing violations, promoting compliance, or raising awareness of good practices. In this regard, the draft guidance elaborates on the elements and activities carried out as part of a compliance monitoring and enforcement mechanism and discusses good practices regarding how such mechanisms may balance sanctions and incentives for compliance as a preventive mechanism.

41. An effective compliance monitoring and enforcement mechanism designates the processes and institutions responsible for monitoring, encouraging and enforcing adherence to laws, regulations and rules by companies, auditing firms and professionals, with potential recourse to inspection and disciplinary tools. Specific institutional structures of compliance monitoring and enforcement mechanisms greatly depend on the local context and capacity. However, it is important to outline clear responsibilities within the mechanism, identify reporting arrangements and allocate adequate resources.

42. A well-functioning governance mechanism is another critical element of an effective compliance monitoring and enforcement mechanism. It ensures that the relevant checks and balances are in place, that the highest standards of ethical conduct are maintained by compliance monitoring and enforcement authorities, and that suitable solutions are established to deal with conflicts of interest. The consultative group stressed the important role of the audit committees and internal control mechanisms for audit quality, and agreed that it should be reflected in the draft guidance in more detail.

43. An effective compliance monitoring and enforcement mechanism also includes a range of preventive, disciplinary and appeal tools, activities and methodologies that are discussed in the draft guidance. In this regard, the group discussed risk assessment arrangements, related methodologies and internal risk control mechanisms of entities selected for the monitoring of compliance and enforcement activities.

44. The most critical element of an effective compliance monitoring and enforcement mechanism is adequate human resources. The lack of competent staff poses a major challenge to the building of compliance monitoring and enforcement mechanisms in many countries. Capacity-building programmes are necessary to address this challenge.

45. The specific skills required of staff dealing with the monitoring of compliance and enforcement depend on their role and may include a thorough knowledge of accounting standards, relevant experience in carrying out audits and quality assurance reviews, and the necessary analytical skills for inspection, investigation and prosecution. Legal training will be required to assess the evidence of wrongdoing in the context of national legislation and regulation.

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<sup>15</sup> <http://www.ifrs.org/About-us/IASB/Pages/Home.aspx> (accessed 3 August 2016).

<sup>16</sup> <https://www.iaasb.org> (accessed 3 August 2016).

<sup>17</sup> <https://www.ethicsboard.org/about-iesba> (accessed 3 August 2016).

46. It is critical that staff involved in the monitoring of compliance and enforcement activities have appropriate professional competency and experience, and be sufficient in number. Attention should be drawn to the availability of appropriate technologies, the skills to use such technologies in an efficient way and continuous training requirements to uphold high standards of oversight as part of a compliance monitoring and enforcement mechanism.

47. Regulatory bodies often face challenges in their ability to hire personnel with the necessary expertise. This is due, among others, to skills mismatches and discrepancies in remuneration between the regulator and its regulated entities, or between the public and private sectors. In staff recruitment, a balance must be established between the experience of the reporting industry and the independence required in the monitoring role of compliance monitoring and enforcement.

48. The consultative group highlighted the importance of educational standards as a mechanism for improving staff competency. Some members of the group placed emphasis on the International Auditing and Assurance Standards Board standard of professional scepticism in the training of staff involved in the monitoring of compliance and enforcement.<sup>18</sup>

49. An effective compliance monitoring and enforcement mechanism also requires appropriate financial resources, without which it would be unable to fulfil its mandates and contribute to a high-quality reporting environment. In this regard, an appropriate funding model is also an important element of a compliance monitoring and enforcement mechanism.

50. The source of funding depends on the national regulatory landscape, but typically involves a mix of levies on listed companies, professional reporting bodies or on audit firms that operate in the country. The draft guidance provides some examples of models used in selected countries. The consultative group noted that in jurisdictions where capital markets were less developed, specific public funding might be necessary to implement compliance monitoring and enforcement requirements. With regard to funding models, there was a need to maintain the independence of the compliance monitoring and enforcement mechanism and its agents from providers of financial resources, and national good practices in this area should be identified and promoted.

51. The practical implementation of a compliance monitoring and enforcement mechanism requires impact assessment mechanisms to evaluate the impact of such a mechanism on the quality of corporate reporting in a way that is comparable and consistent over time. It should aim to ensure the efficiency, continuous improvement and capacity-building of such a mechanism along the reporting supply chain. It could include a set of indicators that would help identify gaps and priorities for further improvements and adjustments in the mechanism and its specific areas.

52. Because of the complexity and holistic impact of impact measurements on the corporate reporting landscape, such measurements are, however, often imprecise and reliant on imperfect proxy inputs. Outcomes of regulatory actions are sometimes confidential or unobservable to third parties. Limited information may be available about cases that regulators decide not to pursue as part of an overall reporting oversight strategy.

53. According to the draft guidance, first-generation measurements focused on inputs, such as the level of financial and human resources allocated to the monitoring of compliance and enforcement, and on outputs, which entail the analysis of regulatory sanctions – number, nature and monetary value – as well as the efficiency or the success

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<sup>18</sup> See note 16.

rate of enforcement actions. These measurements took into account the following data: number of cases examined, number of press notices issued on corporate reporting compliance and number of audit failures identified. However, the increased effectiveness of compliance monitoring and enforcement does not necessarily derive from increases in budget or staff count.

54. Second-generation metrics attempt to measure the outcome of action undertaken within the compliance monitoring and enforcement mechanism. These include surveys to measure how investors and other market stakeholders perceive compliance monitoring and enforcement programmes. Other relevant initiatives include “cleanliness” reports, which seek to monitor price movements ahead of and after corporate announcements and thereby establish whether market participants comply with standards on fair disclosure. The consultative group considered how the impact of high-quality reporting on macroeconomic indicators, such as foreign direct investment, could help provide a more comprehensive picture to investors and policymakers. This would help raise awareness of the importance of compliance monitoring and enforcement.

55. The Accounting Development Tool includes a series of quantitative indicators that are directly linked to the level of compliance monitoring and enforcement mechanism development. It provides indicators on factors such as independence, funding, staffing, inspection criteria, disciplinary methods and institutional coordination mechanisms and related international benchmarks or good practices. The figure in annex II provides an example of national compliance and enforcement assessment results based on the Accounting Development Tool application. It could be especially useful to identify gaps to be addressed during the design phase of the compliance and enforcement mechanism and to chart progress in its implementation over time.

56. Internal audit committees can also provide relevant inputs by assessing the effectiveness of external audit against the following performance criteria:

- (a) Comprehensiveness of audit plans;
- (b) Timeliness and quality of communications;
- (c) Competency and adequacy of external audit staff;
- (d) Adequacy of available resources for audit.

57. Discussion papers issued by the European Union underlined the importance of collecting evidence on the impact of the implementation of International Financial Reporting Standards. Some members of the consultative group suggested that additional references be included in the draft guidance, for example Reports on the Observance of Standards and Codes (World Bank),<sup>19</sup> Global Risks Perception Surveys (World Economic Forum),<sup>20</sup> and International Standards of Actuarial Practice.<sup>21</sup>

58. The consultative group agreed on the need for further research on methods to assess the impact of good compliance monitoring and enforcement practices on macroeconomic indicators to be considered at a later stage when adequate evidence of their practical usefulness would be available.

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<sup>19</sup> <https://www.worldbank.org/ifa/rosc.html> (accessed 3 August 2016).

<sup>20</sup> 2016 edition available at <http://reports.weforum.org/global-risks-2016> (accessed 29 July 2016).

<sup>21</sup> [http://www.actuaries.org/index.cfm?lang=EN&DSP=PUBLICATIONS&ACT=STANDARDS\\_ISAP](http://www.actuaries.org/index.cfm?lang=EN&DSP=PUBLICATIONS&ACT=STANDARDS_ISAP) (accessed 29 July 2016).

## D. Specific compliance monitoring and enforcement issues in non-financial reporting, public sector reporting and small and medium-sized enterprise sector reporting

### Non-financial reporting

59. To design a compliance monitoring and enforcement mechanism, it is important to consider issues of non-financial corporate reporting, including topics relating to environmental and social impact, anti-corruption, human rights, diversity, corporate governance and executive remuneration. Non-financial reporting provides useful information to a range of key stakeholders, including government regulators, investors, business partners, employees and local communities. The importance of non-financial and sustainability reporting has been significantly underscored in the 2030 Agenda for Sustainable Development and in the outcome document of the Third International Conference on Financing for Development, the Addis Ababa Action Agenda.<sup>22</sup> In particular, Goal 12.6 stresses that it is important to “encourage companies, particularly large and transnational companies, to adopt sustainable practices and to integrate sustainability information into their reporting cycle”.<sup>23</sup>

60. The growing importance of non-financial reporting is supported by the adoption in 2014 of the European Union directive on disclosure of non-financial and diversity information by certain large undertakings and groups.<sup>24</sup> The directive, which provides regulations on disclosures by European Union member States of environmental, social and governance corporate information, will become effective in 2017. It will apply to listed companies, companies with more than 500 employees, as well as banks, insurance companies, and other companies whose disclosures are deemed relevant by member States of the European Union because of their activities, size or number of employees. Such companies will have to disclose information on policies and risks concerning environmental, social and employee-related aspects of their corporate activities, including respect for human rights, anti-corruption and bribery issues, and diversity in their board of directors. The directive is expected to affect approximately 6,000 large companies and groups across the European Union.

61. Voluntary international best practice guidelines on environmental, social and governance reporting issues have been published by organizations such as the Global Reporting Initiative,<sup>25</sup> the International Corporate Governance Network,<sup>26</sup> the International Finance Corporation,<sup>27</sup> the International Organization of Securities Commissions,<sup>28</sup> the Organization for Economic Cooperation and Development,<sup>29</sup> UNCTAD,<sup>30</sup> the United Nations Global Compact<sup>31</sup> and the World Bank.<sup>32</sup> These guidelines cover a broad range of trends in environmental, social and governance issues that are relevant to corporate reporting. Other emerging institutions, such as the International Integrated Reporting

<sup>22</sup> A/RES/69/313.

<sup>23</sup> A/RES/70/1.

<sup>24</sup> <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0095&from=EN> (accessed 29 July 2016).

<sup>25</sup> <https://www.globalreporting.org/standards/Pages/default.aspx> (accessed 29 July 2016).

<sup>26</sup> <https://www.icgn.org/policy> (accessed 29 July 2016).

<sup>27</sup> [www.gcgf.org](http://www.gcgf.org) (accessed 29 July 2016).

<sup>28</sup> [https://www.iosco.org/about/?subsection=key\\_regulatory\\_standards](https://www.iosco.org/about/?subsection=key_regulatory_standards) (accessed 29 July 2016).

<sup>29</sup> <http://www.oecd.org/corporate/oecdprinciplesofcorporategovernance.htm> (accessed 29 July 2016).

<sup>30</sup> UNCTAD/ITE/IPC/2003/7, UNCTAD/ITE/TEB/2006/3, UNCTAD/ITE/TEB/2007/6 and TD/B/C.II/ISAR/78.

<sup>31</sup> <https://www.unglobalcompact.org/what-is-gc> (accessed 29 July 2016).

<sup>32</sup> [www.worldbank.org/ifa/rosc\\_cg.html](http://www.worldbank.org/ifa/rosc_cg.html) (accessed 29 July 2016).

Council,<sup>33</sup> promote the integration of both financial and non-financial reporting into a single corporate reporting framework.

62. As part of the discussion on the importance of non-financial reporting for the implementation of compliance monitoring and enforcement mechanisms, some members of the consultative group said that non-financial reporting could often help to identify the most significant risks to a business, such as lack of governance or environmental impact – and thus played an essential role in effective investment decisions.

63. The consultative group noted that, while a decade ago it had been more challenging to make the case for non-financial corporate reporting, recent research had suggested that investors increasingly valued such reporting. UNCTAD was currently conducting research on investor interest in environmental, social and governance reporting. Its findings could inform the future development of the compliance monitoring and enforcement framework.

64. In the context of compliance monitoring and enforcement, the closer integration of financial and non-financial aspects of corporate reports could present challenges with respect to the possible expansion of the scope of legal or regulatory liabilities for auditors and professional accountants in the corporate reporting supply chain.

65. In this regard, the consultative group agreed on the importance of focusing more in depth on the specific challenges of non-financial reporting where the implementation of compliance monitoring and enforcement was concerned. However, for the purpose of the draft guidance document, it was important to present non-financial information as an evolving area of reporting.

### **Public sector**

66. The consultative group indicated that in some countries, the public sector played a significant role in the economy. This might be the case, especially in developing countries and countries with economies in transition, thus warranting additional attention to compliance monitoring and enforcement for public sector reporting.

67. Further discussion was necessary on specific elements of public sector reporting and their impact on the implementation of an efficient compliance monitoring and enforcement mechanism. These included the International Public Sector Accounting Standards,<sup>34</sup> external government audit standards issued by the International Organization of Supreme Audit Institutions,<sup>35</sup> the work of the Chartered Institute of Public Finance and Accountancy on education for public sector reporting professionals<sup>36</sup> and the handbooks published by the International Federation of Accountants on international public sector accounting pronouncements.<sup>37</sup>

68. Given the lack of consensus on the topic, the monitoring of compliance and enforcement for public sector reporting would not be part of the scope of the current draft guidance. Some members of the consultative group stated that compliance monitoring and enforcement for the public sector could be considered in a separate document, once the ongoing work on the draft guidance document on compliance monitoring and enforcement for corporate reporting was completed and more case studies became available as necessary empirical evidence and a foundation for such work.

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<sup>33</sup> <http://integratedreporting.org/> (accessed 29 July 2016).

<sup>34</sup> <http://www.ipsasb.org> (accessed 29 July 2016).

<sup>35</sup> <http://www.intosai.org> (accessed 29 July 2016).

<sup>36</sup> <http://www.cipfa.org> (accessed 29 July 2016).

<sup>37</sup> <https://www.ifac.org/publications-resources/2015-handbook-international-public-sector-accounting-pronouncements> (accessed 29 July 2016).

### Small and medium-sized enterprises

69. SMEs play an important role in most countries, especially in developing economies, where they represent most formal employment opportunities.<sup>38</sup> As such, the livelihoods of most people in developing economies are dependent on the growth of SMEs, and their survival and growth are critical to the sustainability of entire economies. SMEs also play a strong role in linking markets through their involvement in global supply and distribution chains. However, reporting in the SME sector remains a challenge that limits their access to finance and potentially undermines their growth and development. SME reporting is thus a relevant factor to be taken into account in the implementation of a compliance monitoring and enforcement mechanism for high-quality reporting.

70. Despite the significant importance of SMEs in global trade, regulators face specific challenges in setting up robust guidelines for SME and microenterprise accounting, as well as in enforcing mechanisms that are both cost-effective and compliant with high-quality reporting requirements. Specific SME reporting guidelines include International Financial Reporting Standards for Small and Medium-sized Enterprises,<sup>39</sup> guidance on audit for SMEs issued by the International Federation of Accountants<sup>40</sup> and the Accounting and Financial Reporting Guidelines for Small and Medium-sized Enterprises (levels 2 and 3 guidance) issued by UNCTAD and the Intergovernmental Working Group of Experts.<sup>41</sup> Further, several countries have developed reporting regulations tailored to accommodate a wide range of non-listed companies and SMEs.

71. Specific challenges include the need to educate preparers of SME reports on the advantages of high-quality reporting, especially with regard to access to finance and enterprise development. The perception of audits as an administrative burden for SMEs also has an impact on the implementation of compliance monitoring and enforcement mechanisms in this sector.

72. In addition, setting appropriate criteria for defining SMEs, such as the number of employees or the volume of operations, is highly dependent on the specific characteristics of the economies in question.

## III. Conclusion

73. This paper has provided an overview of the guidance on good practices in the monitoring of compliance and enforcement for high-quality reporting prepared by UNCTAD in cooperation with the consultative group on the monitoring of compliance and enforcement issues. Also included are the main issues raised in the consultations on the preparation of a revised draft for the discussions at the thirty-third session of the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting.

74. With a view to assisting UNCTAD in the finalization of the document, delegates may wish to consider the following issues for deliberation:

(a) Are there other guiding principles or core elements that should be considered in the guidance on good practices in the monitoring of compliance and enforcement for high-quality reporting?

<sup>38</sup> <http://www.worldbank.org/en/topic/financialsector/brief/smes-finance> (accessed 4 August 2016).

<sup>39</sup> <http://www.ifrs.org/ifrs-for-smes/pages/ifrs-for-smes.aspx> (accessed 29 July 2016).

<sup>40</sup> <https://www.ifac.org/publications-resources/guide-using-international-standards-auditing-audits-small-and-medium-sized-en> (accessed 29 July 2016).

<sup>41</sup> UNCTAD/ITE/TEB/2003/5 and UNCTAD/ITE/TEB/2003/6.

(b) What resourcing and funding arrangements are needed to ensure the efficient building and functioning of the compliance monitoring and enforcement mechanism, without compromising its independence, especially in less developed countries that lack resources?

(c) What specific challenges need to be taken into account in the implementation of compliance monitoring and enforcement mechanisms for the reporting of non-financial information and reporting of the public sector and SMEs? Should microenterprise reporting be part of it?

(d) What good practices and key challenges in capacity-building should be considered to ensure effective compliance monitoring and enforcement, including with regard to human resources?

(e) How can global forums such as the Intergovernmental Working Group of Experts further contribute to the dissemination of good practices in the implementation of compliance monitoring and enforcement, especially for developing countries and countries with economies in transition?



## Annex I

### Members of the consultative group on the monitoring of compliance and enforcement

| <i>Name</i> | <i>Surname</i>    | <i>Title</i>  | <i>Organization</i>  |
|-------------|-------------------|---|--|
| Mario       | Abela             | Corporate Reporting and Research Director                                   | Gather   |
| David       | Barnes            | Managing Partner, Public Policy, Communication and Corporate Responsibility | Deloitte LLP   |
| Jonathan    | Bravo             | Head, Finance and Administration  | International Organization of Securities Commission            |
| Vania       | da Costa Borgerth | Controller Deputy Managing Director   | Brazilian Development Bank                                     |
| Stuart      | Diack             | Swiss Partner   | Deloitte LLP   |
| Martijn     | Duffels           | Head of Secretariat   | International Forum of Independent Audit Regulators            |
| Bruce       | Eastman           | Senior Consultant, Regulatory Development                                   | Association of Chartered Certified Accountants                 |
| Reto        | Eberle            | Professor and Member of the Executive Board                                 | Swiss Foundation for Accounting and Reporting (Swiss GAAP FER) |
| Gerard      | Ee                | President   | Institute of Singapore Chartered Accountants                   |
| Brigitte    | Eierle            | Professor, International Accounting   | University of Bamberg  |
| Marek       | Grabowski         | Board Member  | International Auditing and Assurance Standards Board           |
| Tetiana     | Iefymenko         | President, Academy of Financial Management                                  | Ministry of Finance, Ukraine                                   |
| Mats        | Isaksson          | Head, Corporate Affairs Division  | Organization for Economic Cooperation and Development          |
| Sha Ali     | Khan              | Director, Practice Monitoring   | Association of Chartered Certified Accountants                 |
| Linda       | Lach              | Director, Strategy and Development  | International Federation of Accountants                        |

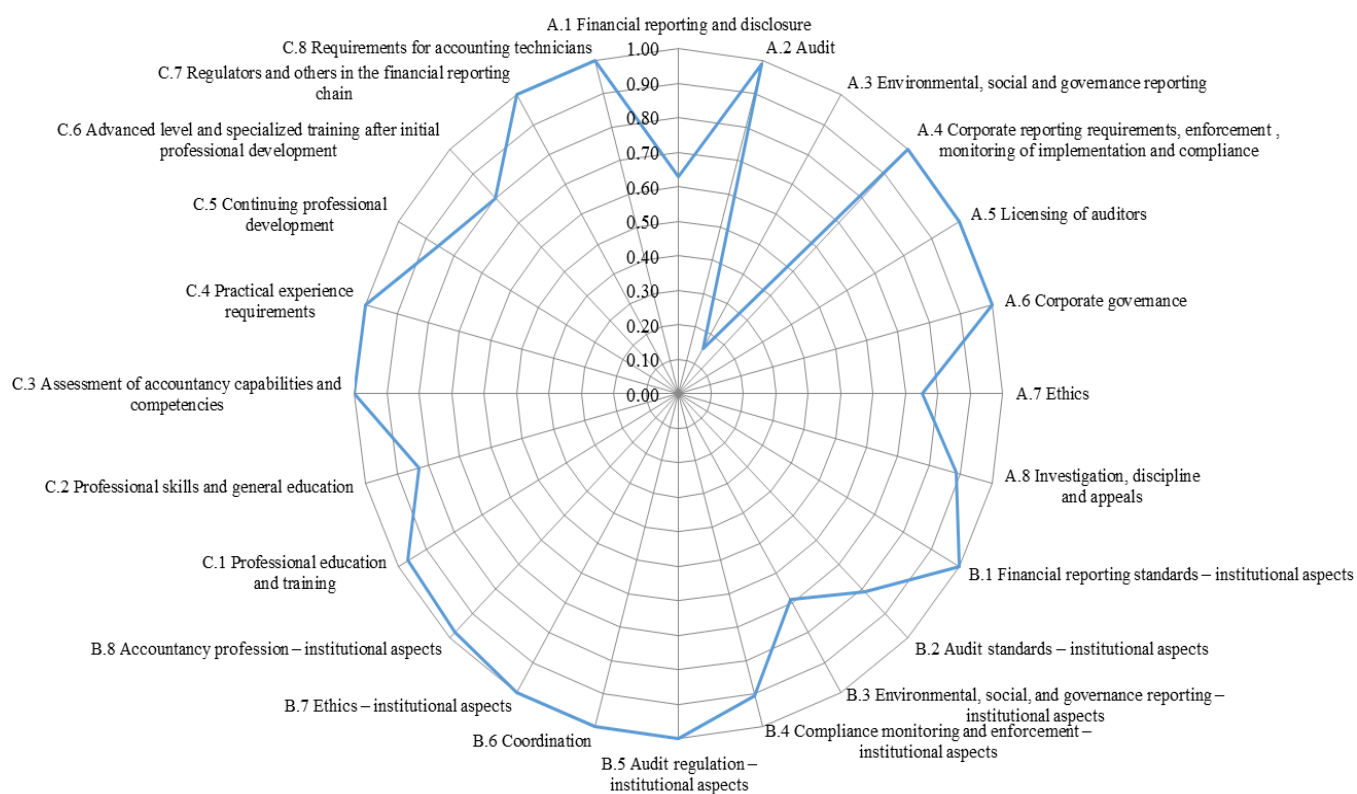
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| <i>Name</i> | <i>Surname</i> | <i>Title</i>   | <i>Organization</i>                            |
|-------------|----------------|--|--|
| Valerie     | Ledure         | Deputy Head of Unit, Directorate-General for Financial Stability, Financial Services and Capital Markets Union | European Commission                            |
| Liudmyla    | Lovinska       | Deputy Director, Academy of Financial Management   | Ministry of Finance, Ukraine                   |
| Michel      | Magnan         | Professor  | Concordia University                           |
| Jim         | Obazee         | Executive Secretary and Chief Executive Officer  | Financial Reporting Council of Nigeria         |
| Titus       | Osawe          | Directorate of Inspection and Monitoring   | Financial Reporting Council of Nigeria         |
| Gary        | Pflugrath      | Director, Public Policy and Regulation   | International Federation of Accountants        |
| Kurt        | Ramin          | Director   | KPR Associates                                 |
| Leonid      | Shneydman      | Head of Department   | Ministry of Finance, Russian Federation        |
| David       | Szafran        | Lawyer   | Law Square                                     |
| Ann         | Tarca          | Professor  | University of Western Australia                |
| Karel       | van Hulle      | Member   | Public Interest Oversight Board                |
| Michael     | Walsh          | Special Projects Consultant  | Association of Chartered Certified Accountants |

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## Annex II

### Example of results of the Accounting Development Tool application, with compliance monitoring and enforcement indicators





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**Investment, Enterprise and Development Commission**  
**Intergovernmental Working Group of Experts on**  
**International Standards of Accounting and Reporting**  
Thirty-third session  
Geneva, 4–6 October 2016  
Item 3 of the provisional agenda

**Practical implementation of compliance monitoring and  
the enforcement of accounting and audit requirements  
for high-quality reporting**

**Corrigendum**

**Left corner notation**

Geneva, 5–7 October 2016 *should read* Geneva, 4–6 October 2016

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