

REPORT

on the annual accounts of the European Securities and Markets Authority for the financial year 2012, together with the Authority's replies

(2013/C 365/28)

INTRODUCTION

1. The European Securities and Markets Authority (hereinafter 'the Authority', aka 'ESMA'), which is located in Paris, was established by Regulation (EU) No 1095/2010 of the European Parliament and of the Council⁽¹⁾. The Authority's task is to improve the functioning of the EU internal financial market by ensuring a high, effective and consistent level of regulation and supervision, promoting integrity and stability of the financial systems and strengthening international supervisory coordination in order to ensure the stability and effectiveness of the financial system⁽²⁾. ESMA was set up on 1 January 2011.

INFORMATION IN SUPPORT OF THE STATEMENT OF ASSURANCE

2. The audit approach taken by the Court comprises analytical audit procedures, direct testing of transactions and an assessment of key controls of the Authority's supervisory and control systems. This is supplemented by evidence provided by the work of other auditors (where relevant) and an analysis of management representations.

STATEMENT OF ASSURANCE

3. Pursuant to the provisions of Article 287 of the Treaty on the Functioning of the European Union (TFEU), the Court has audited:

- (a) the annual accounts of the Authority, which comprise the financial statements⁽³⁾ and the reports on the implementation of the budget⁽⁴⁾ for the financial year ended 31 December 2012, and
- (b) the legality and regularity of the transactions underlying those accounts.

The management's responsibility

4. In accordance with Articles 33 and 43 of Commission Regulation (EC, Euratom) No 2343/2002⁽⁵⁾, the

management is responsible for the preparation and fair presentation of the annual accounts of the Authority and the legality and regularity of the underlying transactions:

- (a) The management's responsibilities in respect of the Authority's annual accounts include designing, implementing and maintaining an internal control system relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies on the basis of the accounting rules adopted by the Commission's accounting officer⁽⁶⁾; making accounting estimates that are reasonable in the circumstances. The Director approves the annual accounts of the Authority after its accounting officer has prepared them on the basis of all available information and established a note to accompany the accounts in which he declares, inter alia, that he has reasonable assurance that they present a true and fair view of the financial position of the Authority in all material respects.
- (b) The management's responsibilities in respect of the legality and regularity of the underlying transactions and compliance with the principle of sound financial management consist of designing, implementing and maintaining an effective and efficient internal control system comprising adequate supervision and appropriate measures to prevent irregularities and fraud and, if necessary, legal proceedings to recover funds wrongly paid or used.

The auditor's responsibility

5. The Court's responsibility is, on the basis of its audit, to provide the European Parliament and the Council⁽⁷⁾ with a statement of assurance as to the reliability of the annual accounts and the legality and regularity of the underlying transactions. The Court conducts its audit in accordance with the IFAC International Standards on Auditing and Codes of Ethics and the INTOSAI International Standards of Supreme Audit Institutions. These standards require the Court to plan and perform the audit to obtain reasonable

⁽¹⁾ OJ L 331, 15.12.2010, p. 84.

⁽²⁾ *Annex II* summarises the Authority's competences and activities. It is presented for information purposes.

⁽³⁾ These include the balance sheet and the economic outturn account, the cash flow table, the statement of changes in net assets and a summary of the significant accounting policies and other explanatory notes.

⁽⁴⁾ These comprise the budgetary outturn account and the annex to the budgetary outturn account.

⁽⁵⁾ OJ L 357, 31.12.2002, p. 72.

⁽⁶⁾ The accounting rules adopted by the Commission's accounting officer are derived from the International Public Sector Accounting Standards (IPSAS) issued by the International Federation of Accountants or, where relevant, the International Accounting Standards (IAS)/International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board.

⁽⁷⁾ Article 185(2) of Council Regulation (EC, Euratom) No 1605/2002 (OJ L 248, 16.9.2002, p. 1).

assurance as to whether the annual accounts of the Authority are free from material misstatement and the transactions underlying them are legal and regular.

6. The audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the accounts and the legality and regularity of the underlying transactions. The procedures selected depend on the auditor's judgement, which is based on an assessment of the risks of material misstatement of the accounts and material non-compliance by the underlying transactions with the requirements in the legal framework of the European Union, whether due to fraud or error. In assessing these risks, the auditor considers any internal controls relevant to the preparation and fair presentation of the accounts, as well as the supervisory and control systems that are implemented to ensure the legality and regularity of underlying transactions, and designs audit procedures that are appropriate in the circumstances. The audit also entails evaluating the appropriateness of accounting policies, the reasonableness of accounting estimates and the overall presentation of the accounts.

7. The Court considers that the audit evidence obtained is sufficient and appropriate to provide a basis for its statement of assurance.

Opinion on the reliability of the accounts

8. In the Court's opinion, the Authority's annual accounts present fairly, in all material respects, its financial position as at 31 December 2012 and the results of its operations and its cash flows for the year then ended, in accordance with the provisions of its Financial Regulation and the accounting rules adopted by the Commission's accounting officer.

Opinion on the legality and regularity of the transactions underlying the accounts

9. In the Court's opinion, the transactions underlying the annual accounts for the year ended 31 December 2012 are legal and regular in all material respects.

10. The comments which follow do not call the Court's opinions into question.

COMMENTS ON THE RELIABILITY OF THE ACCOUNTS

11. The Authority's accounting system has not yet been validated by the Accounting Officer.

COMMENTS ON INTERNAL CONTROLS

12. During its second year of activity, the Authority took an important step with the adoption and implementation of the baseline requirements for all internal control standards. However, full implementation of the standards has not been achieved.

13. There is considerable room to improve the timeliness and documentation of procurement procedures.

COMMENTS ON BUDGETARY MANAGEMENT

14. The Authority's total appropriations for 2012 amounted to 20,3 million euro, out of which 2,8 million euro (14 %) were cancelled and 4,2 million euro (21 %) of committed appropriations were carried over to 2013.

15. The high level of cancellations results mainly from the fact that the budget was established on the basis of a fully implemented staff establishment plan at the beginning of 2012, whereas some recruitments were only made during the year. Delays in IT procurements also caused cancellations.

16. The level of committed appropriations carried over is high for title II (administrative expenditure) at 39 % and for title III (operational expenditure) at 52 %. For title II, this was mainly caused by the fact that a significant contract for works on the Authority's premises was awarded in December 2012 (0,6 million euro) and by the purchase of IT hardware (0,5 million euro), telephony equipment (0,1 million euro) and furniture (0,3 million euro) for which delivery was not completed at year-end. For title III, the high level of committed appropriations carried over results from the multi-annual nature of significant IT development projects and delays in related procurements.

17. In 2012, the Authority made 22 budget transfers amounting to 3,2 million euro (16 % of total 2012 budget), which indicates weaknesses in budget planning.

OTHER COMMENTS

18. The Authority needs to further improve the transparency of its recruitment procedures. In particular, in one audited recruitment procedure, the number of years of experience for a given position was not applied and in three audited recruitment procedures there was no evidence that thresholds for the shortlists were established before the examination of the applications.

FOLLOW-UP OF PREVIOUS YEAR'S COMMENTS

19. An overview of the corrective actions taken in response to the Court's previous year's comments is provided in *Annex I*.

This Report was adopted by Chamber IV, headed by Dr Louis GALEA, Member of the Court of Auditors, in Luxembourg at its meeting of 9 July 2013.

For the Court of Auditors
Vitor Manuel da SILVA CALDEIRA
President

ANNEX I

Follow-up of previous year's comments

Year	Court's comment	Status of corrective action (Completed / Ongoing / Outstanding / N/A)
2011	The Authority's commitments amounted to 12 841 997 euro or 76 % of the 2011 budget. The commitment rates were low especially for title III 'Operational expenditure' (47 %). This impacted on the Authority's IT objectives which were not entirely achieved. The low budget execution rates indicate difficulties in budget planning and implementation.	Ongoing
2011	The Authority's budget for the financial year 2011 amounted to 16,9 million euro. In accordance with Article 62(1) of its Founding Regulation, 60 % of the 2011 budget was financed from Member States' and EFTA countries' contributions and 40 % from the Union budget. At the end of 2011, ESMA recorded a positive budget outturn of 4,3 million euro. In compliance with its Financial Regulation ⁽¹⁾ , the full amount was then recorded in the accounts as a liability towards the European Commission.	Ongoing
2011	Weaknesses were noted as regards six legal commitments made in advance of budget commitments (483 845 euro).	Ongoing
2011	The Court identified a number of cases with a total value of 207 442 euro in which payment appropriations carried over to 2012 did not correspond to legal commitments made. These carry-overs were therefore irregular and should be cancelled.	Outstanding
2011	The Authority had not yet adopted internal control standards.	Completed
2011	There is a need to improve the Authority's management of fixed assets. For intangible assets developed by the Authority, accounting procedures and information on costs were not reliable.	Ongoing
2011	The implementing rules to the Staff Regulation had not been adopted.	Completed
2011	ESMA had not yet reached an interinstitutional agreement with the European Anti-Fraud Office (OLAF) on fraud investigations. The Authority should ensure that its Financial Regulation is fully implemented in this respect.	Completed
2011	The Authority needs to improve the transparency of recruitment procedures. The number of years of experience required for a given position was not respected, applications received after the deadline were accepted, questions for oral and written tests were not set before the applications were examined by the selection board and there was no decision of the Appointing Authority to appoint the selection board.	Ongoing

⁽¹⁾ Articles 15(4) and 16(1).

ANNEX II

European Securities and Markets Authority (Paris)

Competences and activities

<p>Areas of Union competence deriving from the Treaty</p> <p><i>(Article 114 of the Treaty on the Functioning of the European Union)</i></p>	<p>The European Parliament and the Council shall, acting in accordance with the ordinary legislative procedure and after consulting the Economic and Social Committee, adopt the measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market.</p>
<p>Competences of the Authority</p> <p><i>(Regulation (EU) No 1095/2010 of the European Parliament and of the Council and Regulation (EC) No 1060/2009 of the European Parliament and of the Council)</i></p>	<p>Tasks</p> <ul style="list-style-type: none"> — To develop draft regulatory technical standards. — To develop draft implementing technical standards. — To issue guidelines and recommendations. — To issue recommendations where a national competent authority has not applied sectoral acts or has applied them in a way which appears to be a breach of Union law. — To take individual decisions addressed to competent authorities in certain emergency situations and in settlement of disagreements between competent authorities in cross-border situations. — In cases concerning directly applicable Union law, to take individual decisions addressed to financial market participants, where: (i) a national competent authority has not applied sectoral acts or has applied them in a way which appears to be a breach of Union law and where the competent authority has not complied with a formal opinion of the Commission; (ii) in certain emergency situations where a competent authority does not comply with the decision of the Authority adopted; or (iii) in settlement of disagreements between competent authorities in cross-border situations where a competent authority has not complied with the decision of the Authority. — To issue opinions to the European Parliament, the Council or the Commission on all issues related to its areas of competence. — To collect the necessary information concerning financial market participants to carry out the duties assigned to it. — To develop common methodologies for assessing the effect of product characteristics and distribution processes on the financial position of financial market participants and on consumer protection. — To provide a centrally accessible database of registered financial market participants in the area of its competence where specified in sectoral legislation. — To issue warnings in the event that a financial activity poses a serious threat to its objectives. — To temporarily prohibit or restrict certain financial activities that threaten the orderly functioning and integrity of financial markets or the stability of the whole or part of the financial system in the Union in the cases specified and under the conditions laid down in sectoral legislation or if so required in the case of an emergency situation. — To participate in the activities of colleges of supervisors, including on-site examination, carried out jointly by two or more competent authorities. — To address any risk of disruption in financial services that is caused by an impairment of all or parts of the financial system and has the potential to have serious negative consequences for the internal market and the real economy.

	<ul style="list-style-type: none"> — To draw up additional guidelines and recommendations for key financial market participants, to take account of the systemic risk posed by them. — To conduct an inquiry into a particular type of financial activity or type of product or type of conduct in order to assess potential threats to the integrity of financial markets or the stability of the financial system and make appropriate recommendations for action to the competent authorities concerned. — To carry out tasks and responsibilities delegated by competent authorities. — To provide opinions to competent authorities. — To conduct peer reviews of the activities of competent authorities. — To coordinate between competent authorities, in particular where adverse development could potentially jeopardise the orderly functioning and integrity of financial markets or the stability of the financial system in the Union. — To initiate and coordinate Union-wide assessments of the resilience of financial market participants to adverse market developments. — To take decisions on applications for certification and registration of credit rating agencies and on withdrawal of such certification and registration. — To establish cooperation agreements with the relevant credit rating agency supervisory authorities of third countries. — To conduct investigations of and on-site inspections at the premises of credit rating agencies, rated entities and related third parties. — Where a credit rating agency has committed an infringement, to take decisions to withdraw its registration, temporarily prohibit it from issuing credit ratings, suspend the use for regulatory purposes of the credit ratings it issued, require the infringement to be brought to an end, and/or issue public notices. — Where a credit rating agency has committed an infringement intentionally or negligently, to take decisions to impose a fine.
<p>Governance</p>	<p>Board of Supervisors</p> <p><i>Composition</i></p> <p>Chairperson (non-voting); the head of the national public authority competent for the supervision of financial market participants in each Member State; one representative of the Commission (non-voting); one representative of the European Systemic Risk Board (non-voting); one representative of each of the other two European Supervisory Authorities (non-voting).</p> <p><i>Tasks</i></p> <p>Gives guidance to the work of the Authority and is in charge of taking decisions referred to in Chapter II of the founding Regulation.</p> <p>Management Board</p> <p><i>Composition</i></p> <p>Chairperson and six other members of the Board of Supervisors, elected by and from the voting members of the Board of Supervisors. The Executive Director and a representative of the Commission participate in meetings without the right to vote (though the representative of the Commission can vote on budgetary matters).</p> <p><i>Tasks</i></p> <p>Ensures that the Authority carries out its mission and performs the tasks assigned to it in accordance with the founding Regulation.</p>

	<p>Chairperson</p> <p>Representative of the Authority responsible for preparing the work of the Board of Supervisors and chairing the meetings of the Board of Supervisors and the Management Board. Appointed by the Board of Supervisors after having been heard by the European Parliament.</p> <p>Executive Director</p> <p>Appointed by the Board of Supervisors after confirmation by the European Parliament. In charge of the management of the Authority and prepares the work of the Management Board.</p> <p>Internal audit</p> <p>European Commission's Internal Audit Service (IAS).</p> <p>External audit</p> <p>European Court of Auditors.</p> <p>Discharge authority</p> <p>European Parliament, acting on a recommendation from the Council.</p>
<p>Resources made available to the Authority in 2012</p>	<p>Final Budget</p> <p>Total budget: 20,279 million euro, including:</p> <p>Union subsidy: 7,12 million euro</p> <p>Contributions from National Competent Authorities: 10,158 million euro</p> <p>Fees from supervised entities: 3,001 million euro</p> <p>Staff as at 31 December 2012</p> <ul style="list-style-type: none"> — Statutory staff: 75 temporary staff posts authorised in the establishment plan, of which recruited: 75 — Contract staff: 10 contract staff posts planned in the budget; contract staff posts actually filled at 31.12.2012: 12 — Seconded National Experts: 16 Seconded National Expert posts planned in the budget; Seconded National Experts posts actually filled at 31.12.2012: 10
<p>Products and services in 2012</p>	<ul style="list-style-type: none"> — 19 CRAs registered, one certified. — Ongoing supervision, including thematic reviews such as bank ratings. — Assessed the compliance of new proposals for MiFID pre-trade transparency waivers. — Published final guidelines on automated high-frequency trading (HFT). — Continued work on preparing for on MiFID/ MAD/ PD review. — Delivery of technical standards (both regulatory and implementing) for the regulation on OTC derivatives, Central Clearing Counterparties (CCPs) and Trade Repositories (European Market Infrastructure Regulation - EMIR). — Preparatory work for EMIR entry-into force where ESMA will take up supervision of trade repositories. — Issued technical standards on new short-selling regulation. — First opinions issued on short-selling curbs in Greece and Spain.

	<ul style="list-style-type: none">— Produced detailed rules for alternative investment fund managers' remuneration.— Contributed to development of International Financial Reporting Standards (IFRS).— Issued clarifications to firms on how to correctly apply IFRS rules (treatment of forbearance and goodwill).— Work on sharing experiences and discussing implications between national supervisors on market surveillance issues and matters relating to the Prospectus (PD) and Transparency Directives (TD), Takeover Bids, etc.— Joint work with the other ESAs.— Contributed actively to ESRB on financial stability, including through regular risk report; weekly internal briefings.— Enhanced financial consumer protection through additional rules and requirements for intermediaries and fund managers, financial advice and suitability (MiFID), disclosure rules for ETFs— Pan-European investor warning of pitfalls of online investing.— An investor day was held at ESMA premises.— Ran cross-EU database for transaction reports.— Developed successful IT solution for the publication of CRA historical ratings.— Coordinated national supervisors' responses to the financial crisis, including beefing up own risk analysis.— Conducted two peer reviews on the implementation of the Market Abuse Regime and the Prospectus Directive.
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Source: Information supplied by the Authority.

THE AUTHORITY'S REPLIES

11. The report for the validation of the accounting systems is in the process of being finalised. Prior to the preparation of the report, for validating the reliability of the output of the procedures in use the accountant applied the approach of 100 % controls of all financial transactions in place of a sampling and system testing approach.

12. ESMA set up an internal control function in 2012 and adopted a risk-based action plan on internal control that is being developed and monitored actively. At the end of 2012, ESMA had implemented 19 out of the 20 activities planned for the year. There are internal control work programmes developed for 2013 and 2014. Having due regard to the risks associated with the management environment, the internal management and control systems are suited to the performance of ESMA's duties, according to article 38.4 of the ESMA Financial Regulation.

13. ESMA in 2012 had to re-tender several contracts inherited from its predecessor, CESR. Almost the entire procurement plan was delivered, but with some delays due to a shortage of resources. In order to improve in this area, ESMA will in 2013 recruit additional staff in its procurement team, while enhancing the procedures with additional internal controls.

14. ESMA appreciates the correct explanations already mentioned in the Court's comments. Those explanations reflect the state of play in 2012.

15. The 2012 budget was prepared in January 2011, in the first month of operation of the agency. The budget was mostly prepared by the EU Commission and there was indeed no experience in the running of the agency.

16. On the management of budget represented by ESMA's IT work programme, it should be noted that the IT work programme in 2012 was based on requirements coming from legislations that were still under discussion by the EU institutions. The final negotiations of some of these legislative provisions have impacted the IT work programme as well as the procurement plan in the course of the year.

17. Since the Court's visit, ESMA has developed better processes and put controls in place that are addressing the identified matters and the budgeting and planning.

18. ESMA acknowledges the finding. Following the comment from the Court, ESMA has conducted an *ex post* review of all temporary staff recruitment procedures run in 2012, which confirmed that no other similar cases occurred. To limit the risk that similar oversights occur in the future, ESMA implemented new procedures setting up thresholds for shortlisted candidates and *ex ante* control steps on the validation of the eligibility of candidates with an electronic tool for calculation of number of years of experience.
