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ICAEW Rep38/06

Mr Bernhard Fries
European Commission
DG Internal Market and Services
C-107 5/32
B – 1049 Brussels
Belgium

Submitted by e-mail to: Markt-future-IM-policy@cec.eu.int

Dear Mr Bernhard

RE: PUBLIC CONSULTATION ON THE FUTURE OF THE INTERNAL MARKET

The Institute of Chartered Accountants in England & Wales (ICAEW) welcomes the opportunity to submit this response to the European Commission's consultation on the future priorities of the internal market. We apologise for the delay in sending this submission to you and trust that the observations made will be taken into account.

The Institute is the largest professional accountancy body in Europe, with more than 128,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA. The Institute operates under a Royal Charter, working in the public interest.

Overall, the ICAEW supports the fundamental objective of internal market policy to create an open and competitive environment of consumer choice within the European Union, with necessary and proportionate safeguards in place to protect the public interest.

Many of the questions posed in the consultation are of interest to the ICAEW although we have limited our responses to the questions of most immediate relevance and concern, given the constraints of time. The answers below have been prepared on the basis of the on-going contact we have with our members on a wide range of subjects, as opposed to a specific consultation exercise which was not possible in the timeframe available.

If you have questions on the ICAEW's responses, please do not hesitate to contact the Director of our EU Office, Martin Manuzi at martin.manuzi@icaew.co.uk (Tel 0032 2 2303272).

Yours sincerely,



Robert Hodgkinson
Executive Director, Technical



Part I The Internal Market Today: Achievements and Challenges

Question 1

Do you agree with the preliminary analysis of the current situation of the internal market and the challenges it is facing? If not, what is your analysis?

The consultation document raises many points in relation to what is clearly a very broad agenda. The ICAEW's response focuses on the first and (to a lesser degree) third bullet points on page 2.

While recognising the significant benefits cited in the consultation of internal market policy to date, the ICAEW also agrees with the observation that there are many challenges to overcome in order to make the internal market a reality. This is quite apparent in the sphere of accounting, tax and auditing services in the European Union, of which the ICAEW has very specific knowledge. It also is quite apparent that on the whole SMEs do not view the undertaking of commercial activity across EU borders in the same light as activity within their Member State of establishment. Trans-national business in the European Union is certainly not as easy as business within a home-country jurisdiction. The main question which arises from this observation is whether any of the EU's recent major policy initiatives will result in any significant change in these respects.

The ICAEW has followed closely the recent legislative initiatives at EU level designed to redress the widely recognised absence of a real market for services, for example, the Directive on Recognition of Professional Qualifications and proposed Services Directive. We believe that it is essential to closely monitor the practical impact of these Directives (assuming the Services proposal is adopted) to assess whether there is any substantial market take-up of key provisions, including those relating to cross-border service provision.

Among other matters, it will be important to assess the practicability and market demand for temporary and occasional basis service provision and the degree of availability of insurance at commercially viable cost to cover such service provision, bearing in mind different liability regimes in different jurisdictions. Detailed monitoring in these areas of practical application are critical to the assessment of the benefits of such broad-ranging horizontal initiatives. This assessment will help the formulation of further policy measures which must be focused on providing tangible internal market benefits. Legislative steps which merely establish the juridical potential for internal market development with little prospect of market take-up should be avoided; or at least it should be made clear during the adoption process at EU level what the expected take-up in practice will be. This type of impact assessment has been largely lacking in the past (for example, in relation to initiatives such as the *Societas Europaea*).

In relation to statutory audit, which is the subject of a separate and recently approved EU Directive on Statutory Audit (which does not permit cross-border service provision), we would just draw attention to the potential impact on future internal market development of the many options included in the Directive. These options, for example in relation to independence requirements and management and control rules, increase the likelihood of continuing fragmentation in the regulatory environment for auditors, which reduces in turn the capacity of the audit firms to structure in such a way as to service in a uniform manner

the internal market. It should also be noted in this area that extreme diversity across EU Member States in the treatment of auditor liability is a major inhibiting factor to the creation of pan-European audit firms. We note that the European Commission is committed to producing a report on auditor liability before the end of 2006.

With regard to business needs more generally, our own understanding, based on the work of ICAEW members in virtually every Member State of the European Union, is that the practical aspects of business management have a significant bearing on the appetite of SMEs in particular to operate in EU Member States outside of their country of establishment. The point appears particularly relevant with regard to issues such as VAT, tax and social security requirements. The absence of immediately identifiable information in these areas can constitute an important obstacle when enterprises are seeking to ascertain the costs of operating in a different Member State. The ICAEW would encourage further reflection in this area as whole, which extends far more broadly than discussion over rates of taxation (where the ICAEW does not believe that uniform rates are an appropriate solution).

Question 2

In which ways have you benefited from the opportunities offered by the internal market? Where, in your view, does it function well? Where do you see shortcomings?

The ICAEW, as a professional body, is not best placed to answer on the opportunities offered by the internal market, as these are pursued directly by ICAEW members and it was not possible in the timeframe to undertake a survey of our members.

The ICAEW is, however, able to comment on one specific area of the internal market on the freedom of movement, drawing on the experience of our members when seeking to gain professional recognition in other EU Member States. It would seem from these cases that the degree of mutual understanding between EU Member State authorities of education systems, professional training and overall regulatory requirements is still not sufficiently high to ensure the smooth working of the recognition system. Administrative bottlenecks often arise due to differing interpretations of documentation and other requirements when recognition applications are being processed. It is essential that these matters are given sufficient attention if the new Directive on Professional Recognition is to have a positive impact. Again, we would emphasise the need to assess in detail the practical market application of EU legislation: it is important that that principles laid down in the legislation are not undermined by administrative uncertainties on how individual applications should be treated under the legislation.

Part II Priorities for Future Internal Market Policy

Question 3

Do you agree with the choice of priorities? Are there others in your view?

The priorities identified in the consultation document are certainly valid although they are very broadly defined: the key challenge will be to achieve real and meaningful change in these areas.

In relation to point 1) on page 4 of the consultation document, the ICAEW strongly supports initiatives to ensure the necessary flexibility for firms to enter and exit markets, while ensuring that the necessary safeguards for the public interest are in place.

The ICAEW would particularly highlight the importance of better regulation and better implementation and enforcement, important issues on which the Institute has provided a significant contribution to policy debate in the UK and internationally.

In relation to better regulation, we believe that the EU approach to introducing regulation and measuring its impact on business needs a comprehensive review and updating. A number of Member States, most notably the Netherlands and the UK, have introduced variations of a "Standard Cost Model" to measure the impact of the administrative burden imposed by their Governments through regulation in a way that allows targets for reduction in the burden to be set and provides incentives to policymakers to pay increased attention to the administrative burden they may impose.

The ICAEW believes that until national legislators and the European Commission have a realistic model of the costs they intend imposing upon EU businesses there will not be an informed debate concerning the costs and benefits of EU legislation. There needs to be a standard cost model which applies across the EU, so that legislators and interest groups have a "reader-reckoner" by which to compute existing and proposed legislation. This would be an effective tool to enable the European Commission to measure the relative administrative burden in member states as well as to monitor progress to achieve real long term reductions in the administrative burden on EU businesses.

The ICAEW also believes that it is important that "quick-fix solutions" which appear to provide benefits to business in terms of the removal of unnecessary regulations should be subjected to as rigorous an impact assessment as a proposal for new regulations. One pertinent example in this respect is the recent decision (in the amendment of the 4th and 7th Company Law Directives) to allow Member States an option to increase by 20% the thresholds for statutory audit exemption. This was adopted on the grounds of alleviating unnecessary administrative burdens on business: however, it was undertaken without any in-depth analysis of the degree to which a statutory audit is "unnecessary" and the potential consequences of its removal for the enterprises themselves as well as for the wider public interest. It is important to emphasise that the ICAEW does not necessarily oppose the measure, but believes that every such measure should be adequately assessed for its public policy consequences.

In relation to implementation and enforcement, the ICAEW has been an active proponent over many years not only of correct but consistent application of legislation, rules and standards. The ICAEW's main policy engagement on these subjects regards financial reporting standards and related matters, but the principle of consistent application is critical to the workings of the internal market as a whole. Free movement and entrepreneurship will be enhanced by real transparency and comparability across the EU.

It is important also to acknowledge that the successful development of the internal market is dependent upon a "partnership approach" not only involving the European Commission and Member States but also professions, market participants and other stakeholders. Mechanisms of self-regulation and co-regulation are, in the ICAEW's view, key to setting in train the desired consistency of application and these can supplement and in some case replace the need for direct legislative rules.

The ICAEW fully recognises the importance of the global context in EU policy making. We have, however, limited our comments on this important topic to our responses to Questions 22 and 23.

Question 10

In your experience, are there any significant problems with the internal market preventing the development of the private equity and venture capital market on a cross-border basis? If so, what are they?

The provision of finance for SMEs, or indeed any other size of company, is a market venture in itself and it is important that regulation of both business and the provision of funding does not unnecessarily impede such ventures. It would be inappropriate and unnecessary from a public interest perspective to try to regulate this area so that it is risk free as by definition venture capital is about risk. Assessing the degree of risk is the very essence of risk capital and the regulatory framework should facilitate this without unduly impinging upon the entrepreneurial process.

Question 11

Do you think that voluntary standards for services would be beneficial? If so, in which sectors should they be introduced?

The ICAEW believes that an EU debate on the use of voluntary standards and consumer recognition thereof could prove very useful to the development of internal market policy and of an overall regulatory framework across Europe which is proportionate and conducive to enterprise. It could be useful to focus the debate in the first instance on market access. Clearly, there are many areas where voluntary standards will not be appropriate and in these areas mandatory market access rules should apply (as is the case in all EU Member States for statutory audit). Equally it would be helpful to debate the current divergence in practice between Member States applying, in relation to the same sector, mandatory rules on public interest grounds in some States and voluntary standards in others. The public interest consequences for both could be compared.

The discussion on voluntary standards could draw on the experience of regulation of many professional services in EU Member States such as the UK and the Republic of Ireland, where legislation is regarded as a “measure of last resort” as opposed to being the “default option”. Outside clearly defined areas of public interest, these Member States allow the consumer to decide between purchasing services (such as accounting and tax advice) from an unregulated/non-professionally qualified provider or from a member of professional body who is subject to education requirements, continuing professional development, monitoring and potential disciplinary sanctions by the professional body.

The ICAEW recognises the importance in such a regulatory model of consumer recognition of the advantages of using the services of a member of a professional body and the capacity of the professional body to communicate with consumers. We also recognise that in some EU Member States cultural shifts may be required before there is sufficiently widespread consumer recognition. However, these shifts can be encouraged through best-practice exchanges between Member States, as part of a broader pan-European dialogue on mandatory rules versus voluntary standards. Ultimately, the ICAEW believes that empowering consumers to make informed choices would deliver a significant boost to the internal market, as this could help remove the current patchwork of regulatory/licensing arrangements and render the internal market more of a level playing field than it is today.

Question 12 What are your views on how we carry out consultations on internal market policy? For instance, what are your views on the consultation process, and on the relevance and presentation of issues in our consultation documents?

The ICAEW values the opportunities provided by the European Commission to comment on policy development and specific initiatives. This is clearly central to a transparent and accountable decision making process. It is essential though that deadlines for comment permit sufficient time to prepare meaningful submissions. Overlaps should be avoided between different European Commission Directorate-Generals’ consultation exercises: it is already a considerable challenge for interested stakeholders, such as the ICAEW, to respond to all consultations in areas of direct interest. It is also essential to ensure that consultations are sufficiently focused: very broad questions and themes can often act as a disincentive to respond. In these cases, it can often be assumed that the questions have such broad political ramifications that submissions will have little impact on policy direction.

The launch of a formal consultation exercise by the Commission is clearly an important tool, but the ICAEW would suggest that other instruments might also be considered: for example, stakeholder group meetings at Member State level. The advantages could be to broaden the base of respondents (there may be a danger that only the well-resourced entities will respond to formal consultations launched by the Commission) and to ensure that the consultations sufficiently address current and practical market issues and obstacles.

The ICAEW also believes that it is important for the European Commission to engage, where appropriate, with market participants and other professional/economic actors in the framing of research and studies which may be pursued prior to a formal consultation exercise. This would ensure that research findings published by the Commission, which are often an extremely important point of reference for policy discussion at EU level, are sufficiently well focused on the subject matter. It is also important that consultants engaged in undertaking research work on behalf of the Commission are sufficiently well grounded from the outset in

the context/structures of the particular market or activity area so that their research efforts are expended on the specific questions to be addressed and not on acquiring a basic understanding of the market or activity area. This would assist with research methods which rely heavily on detailed questionnaires and so help avoid problems in terms of decreasing response rates, given the pressures and time constraints on market participants.

Question 13

What are your views on the way we carry out impact assessments on internal market policies? In your experience, are we using the right policy instruments to achieve the objectives?

The ICAEW fully supports the use of impact assessments, whether in relation to new regulatory proposals or the removal of, or changes in the scope of application of requirements and rules. Such assessments are central to the accurate quantification of costs and the clear analysis of benefits and we welcome the recognition of their value at EU level . This being said, and as noted in response to Question 3, it is important for there to be an accepted model for measuring the administrative burden imposed by regulations in a way that allows targets for reduction in the burden to be set. It is also important that changes in the application of requirements and rules are also given as adequate an impact assessment as the introduction of new requirements.

We also recognise that there are further impacts beyond costs and would therefore stress that impact assessments can and should take different forms. Qualitative impact assessments can in some cases have more application and use than quantitative assessments. In many instances, a quantification of costs is often neither desirable or necessary and the behavioural impacts are just as important, particularly regarding unintended consequences. Quantitative metrics are often based on estimates and can therefore often be wide of the mark, which can in turn give them a negative reputation. They need only be used sparingly where other metrics are not suitable.

Question 14

What are your views on evaluations conducted for internal market policies and the follow-up given to them?

As noted above, the ICAEW would support more focused attention on the practical market application of internal market policies. This is important in order to better target future internal market measures. The aim should be to achieve maximum market impact and to steer away from overly ambitious projects which, at best, can only hope to achieve internal market objectives on paper. Again, decisions in these regards can only be made following careful impact assessments.

Question 16

In which fields do you see the greatest need to step up cooperation between Member State authorities in order to make the internal market work?

As noted above, the ICAEW's experience in the professional recognition sphere would indicate that more can be done between authorities to understand different professional qualification and education and training arrangements.

We note that in the financial reporting sphere, Member State authorities are now working in close cooperation, which we welcome.

Question 18

What is your view on current mechanisms for enforcing internal market rules at the national level? What should be improved?

Our perception is that the mechanisms have traditionally been too slow. We note, however, that in the financial reporting sphere a concerted effort, involving Member States and the profession, is underway to assist the practical implementation of new standards. This could provide a useful model for other areas, demonstrating the importance of sufficient preparation at the implementation stage.

Question 22

On which regulatory issues and with which countries and regions should the EU strive for more international regulatory convergence or equivalence? How should this be achieved? By contrast, where do you think differing rules and standards should coexist?

The ICAEW supports global convergence, subject to the need for EU policy making to always give priority to the EU's broader economic interests in the global economy. The case of financial reporting and auditing standards demonstrate the point, reflecting as they do the degree to which the efficiency of international markets is assisted by international standards. This being said, the merits of particular equivalence and convergence programmes require regular reassessment. It is important to recognise the many challenges arising from the different legal and economic contexts of participating countries. In some areas accepting a measure of difference may well be preferable to pressing for total harmonisation.

Question 23

Where should the EU engage more strongly in either intergovernmental or nongovernmental standard-setting organisations?

Our responses to this question relate to standard-setting in the financial reporting and auditing spheres.

We welcome the recent establishment of a closer working relationship between the International Accounting Standards Board (IASB) and the European Commission and other European bodies. A greater degree of mutual understanding will help to ensure that the operation of the EU endorsement mechanism does not lead to a European version of International Financial Reporting Standards (IFRS). At the same time, the technical independence of the IASB must be respected: the confidence of investors in capital markets that require use of IFRS is likely to be damaged by decisions seen to be influenced by pressure from governmental or regulatory organisations or the lobbying of particular interest groups.

We also view increased co-operation between the EC and other European bodies with the US Securities and Exchange Commission as an essential corollary of accounting convergence.

In relation to auditing, the ICAEW maintains similar views. We believe that the EU should be sufficiently engaged and on a timely basis with the International Auditing and Assurance Standards Board (IAASB) during the standard setting process so as to avoid subsequent pressure for the adoption by the EU of International Standards on Auditing (ISAs) that are different to those promulgated by the IAASB.

Question 24

In your experience, do Member States and the EU institutions do enough to promote the opportunities presented by the internal market? Which concrete actions would you suggest for improving the situation?

Overall, it is our perception that the advantages of the internal market are not sufficiently understood. It should also be noted that expectations, due to travel and cultural exchanges, have increased exponentially so that the popular perceptions today may tend to focus more on the continuing deficiencies of the internal market, as opposed to its benefits. Still, more initiatives by the EU Institutions and Member States to raise awareness of the benefits would be welcome. This is likely to create a more constructive framework to address the current deficiencies.

For further information, please contact:

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