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## COVER NOTE

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From:	Mr Vítor CALDEIRA, President of the European Court of Auditors
date of receipt:	15 October 2015
To:	Mr Jean ASSELBORN, President of the Council of the European Union
Subject:	Report on the annual accounts of the European Securities and Markets Authority for the financial year 2014 together with the Authority's reply

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Delegations will find attached the European Court of Auditors' report on the annual accounts of the European Securities and Markets Authority for the financial year 2014.

This report is accompanied by the Authority's reply and will shortly be published in the *Official Journal of the European Union*.

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Encl.: Report on the annual accounts of the European Securities and Markets Authority for the financial year 2014 together with the Authority's reply.<sup>1</sup>

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<sup>1</sup> In English only. The other languages of this report are available on the European Court of Auditors' website: <http://eca.europa.eu/>.



EUROPEAN  
COURT  
OF AUDITORS

Report on the annual accounts  
of the European Securities and Markets Authority  
for the financial year 2014  
  
together with the Authority's reply

## **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<sup>1</sup>. 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 the integrity and stability of the financial systems and strengthening international supervisory coordination in order to ensure the stability and effectiveness of the financial system<sup>2</sup>. 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 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<sup>3</sup> and the reports on the implementation of the budget<sup>4</sup> for the financial year ended 31 December 2014, and
- (b) the legality and regularity of the transactions underlying those accounts.

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<sup>1</sup> OJ L 331, 15.12.2010, p. 84.

<sup>2</sup> ***Annex II*** summarises the Authority’s competences and activities. It is presented for information purposes.

<sup>3</sup> These include the balance sheet and the statement of financial performance, the cash flow table, the statement of changes in net assets and a summary of the significant accounting policies and other explanatory notes.

<sup>4</sup> These comprise the budgetary outturn account and the annex to the budgetary outturn account.

***The management's responsibility***

4. 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<sup>5</sup>:

- (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<sup>6</sup>; making accounting estimates that are reasonable in the circumstances. The Executive 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<sup>7</sup> 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

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<sup>5</sup> Articles 39 and 50 of Commission Delegated Regulation (EU) No 1271/2013 (OJ L 328, 7.12.2013, p. 42).

<sup>6</sup> 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.

<sup>7</sup> Article 107 of Regulation (EU) No 1271/2013.

Standards of Supreme Audit Institutions. These standards require the Court to plan and perform the audit to obtain reasonable 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. In preparing this report and Statement of Assurance, the Court considered the audit work of the independent external auditor performed on the Authority's accounts as stipulated in Article 208(4) of the EU Financial Regulation<sup>8</sup>.

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 2014 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 2014 are legal and regular in all material respects.

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

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<sup>8</sup> Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council (OJ L 298, 26.10.2012, p. 1).

### **COMMENTS ON THE RELIABILITY OF THE ACCOUNTS**

11. The amount of fees charged to supervised entities (Credit Rating Agencies and Trade Repositories) in 2014 (6 623 000 euro) appearing as revenue in the provisional statement of financial performance was based on estimated rather than actual costs of supervisory activities carried out<sup>9</sup>. Fees levied on supervised entities should be as close as possible to the actual cost incurred in this area. An Activity Based Cost modelling exercise is currently being carried out by ESMA in order to achieve this.

### **COMMENTS ON THE LEGALITY AND REGULARITY OF TRANSACTIONS**

12. When ESMA was established in 2010 it inherited a number of IT framework contracts from its predecessor body CESR (Committee of European Securities Regulators) for the hosting of its data centres as well as the development and maintenance of its IT systems. Failure to replace these framework contracts with timely calls for tender led to a situation where two of them were extended beyond their original duration. It also resulted in the Authority procuring some IT services using a French central purchasing body (Union de Groupements d'Achats Publics - UGAP). The Authority also made use of UGAP to buy furniture and stationery during the year. Total payments in 2014 amounted to 956 000 euro. The Court informed the Authority that the use of UGAP was not in compliance with the Financial Regulation and it has since ceased to do so. The Authority has now also replaced all CESR IT framework contracts with its own.

### **COMMENTS ON BUDGETARY MANAGEMENT**

13. The total cancellation rate for appropriations carried over from 2013 was high at 19 % i.e. 940 054 euro. This mainly stems from delays on the part of contractors in delivering requested services, but also the cancelled purchase of licenses for a cancelled project, difficulties encountered in implementing a contract for interim staff and in making the changeover from the previous to the new IT consultancy framework contract.

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<sup>9</sup> The need to levy fees based on actual costs is mentioned in Article 4 of Commission Delegated Regulation (EU) No 1003/2013 on Trade Repositories (OJ L 279, 19.10.2013, p. 4) supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council, and Article 19(3) of the Agency's Financial Regulation.

14. The overall level of committed appropriations increased from 93 % in 2013 to 99 % in 2014, indicating that commitments were made in a more timely manner. However, the level of committed appropriations carried over to 2015 was high for title III (operational expenditure) at 4 063 580 euro, i.e. 45 % (2013: 3 688 487 euro, i.e. 58 %). Of this amount approximately 2 million euro relate to IT and other services provided in 2014 that had not been paid for by the Authority by the year-end. Another 1,3 million euro worth of contracts had been contracted towards the year-end and related services were expected to be delivered in 2015. The remaining amount of carry-overs is explained by the multi-annual nature of the contacts signed.

#### **FOLLOW-UP OF PREVIOUS YEARS' COMMENTS**

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

This Report was adopted by Chamber IV, headed by Mr Milan Martin CVIKL, Member of the Court of Auditors, in Luxembourg at its meeting of 8 September 2015.

*For the Court of Auditors*

Vítor Manuel da SILVA CALDEIRA

*President*

Follow-up of previous years' comments

Year	Court's comment	Status of corrective action (Completed / Ongoing / Outstanding / N/A)
<b>2011</b>	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, the full amount was then recorded in the accounts as a liability towards the European Commission.	<b>negative budget result was reported in 2014</b>
<b>2011</b>	Weaknesses were noted as regards six legal commitments made in advance of budget commitments (483 845 euro).	<b>Ongoing<sup>1</sup></b>
<b>2011</b>	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.	<b>Completed</b>
<b>2012</b>	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.	<b>Ongoing</b>

Year	Court's comment	Status of corrective action (Completed / Ongoing / Outstanding / N/A)
<b>2012</b>	There is considerable room to improve the timeliness and documentation of procurement procedures.	<b>Ongoing</b>
<b>2012</b>	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.	<b>Completed</b>
<b>2013</b>	The overall level of committed appropriations increased from 86 % in 2012 to 93 % in 2013, indicating that commitments were made on a more timely basis. However, the level of committed appropriations carried over to 2014 was high for title III (operational expenditure) at 3 688 487 euro (58 %). This was caused by IT services received in 2013 but not yet paid for (0,8 million euro), IT services planned in the 2014 work programme and contracted at year-end (1,1 million euro), some delays in IT procurements (0,4 million euro) and also the multiannual nature of some IT projects.	<b>N/A</b>
<b>2013</b>	In 2013 the Authority made 12 budget transfers amounting to 5,1 million euro or 18 % of the budget (2012: 22 transfers amounting to 3,2 million euro or 16 % of the budget), which indicates continued weaknesses in budget planning.	<b>Completed</b>
<b>2013</b>	Some 27 % of payments made in 2013 for goods and services received were late. Where payments were late, they were overdue by an average of 32 days. Late interest paid in 2013 amounted to 3 834 euro.	<b>Ongoing</b>

Year	Court's comment	Status of corrective action (Completed / Ongoing / Outstanding / N/A)
<b>2013</b>	According to the Protocol on the privileges and immunities of the European Union <sup>2</sup> and the EU VAT Directive <sup>3</sup> , the Authority is exempt from indirect taxes. Total VAT charged to ESMA in the period 2011-2013 was 3,3 million euro. Following lengthy discussions with the host Member State, the Authority started claiming VAT reimbursements in the last quarter of 2012, but only 1,3 million euro had been claimed back by the end of 2013.	<b>Completed</b>
<p><sup>1</sup> In 2014 there were 15 commitments made a posteriori for a total value of 572 167,95 euro, plus 4 commitment increases made a posteriori for a total value of 1 391,72 euro.</p>		
<p><sup>2</sup> Protocol (No 7) on the privileges and immunities of the European Union (OJ C 115, 9.5.2008, p. 266).</p>		
<p><sup>3</sup> Council Directive 2006/112/EC (OJ L 347, 11.12.2006, p. 1).</p>		

**European Securities and Markets Authority****(Paris)****Competences and Activities**

<p><b>Areas of Union competence deriving from the Treaty</b></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><b>Competences of the Authority</b></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><b>Tasks</b></p> <ul style="list-style-type: none"> <li>– To develop draft regulatory technical standards.</li> <li>– To develop draft implementing technical standards.</li> <li>– To issue guidelines and recommendations.</li> <li>– 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.</li> <li>– To take individual decisions addressed to competent authorities in certain emergency situations and in settlement of disagreements between competent authorities in cross-border situations.</li> <li>– 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; (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.</li> <li>– To issue opinions to the European Parliament, the Council or the Commission on all issues related to its areas of competence.</li> <li>– To collect the necessary information concerning financial market participants to carry out the duties assigned to it.</li> <li>– To develop common methodologies for assessing the effect of product characteristics and distribution processes on the financial position of</li> </ul>

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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.
  - 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.
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	<ul style="list-style-type: none"> <li>– To authorise and supervise EU-based trade repositories and recognise non-EU clearing houses wishing to offer services to EU clients.</li> <li>– To establish cooperation agreements with the relevant derivatives supervisory authorities of third countries.</li> <li>– To conduct investigations of and on-site inspections at the premises of trade repositories, or related third parties.</li> <li>– Where a trade repository has committed an infringement, to take supervisory actions.</li> <li>– Where a trade repository has committed an infringement intentionally or negligently, to take decisions to impose a fine.</li> </ul>
<p><b>Governance</b></p>	<p><b>Board of Supervisors</b></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><b>Management Board</b></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><b>Chairperson</b></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><b>Executive Director</b></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><b>Internal audit</b></p> <p>European Commission’s Internal Audit Service (IAS).</p>

	<p><b>External audit</b></p> <p>European Court of Auditors.</p> <p><b>Discharge authority</b></p> <p>European Parliament, acting on a recommendation from the Council.</p>
<p><b>Resources made available to the Authority in 2014</b></p>	<p><b>Final Budget</b></p> <ul style="list-style-type: none"> <li>– Total budget: 33,24 million euro, including: <ul style="list-style-type: none"> <li>– Union subsidy: 11,07 million euro</li> <li>– Contributions from National Competent Authorities: 15,55 million euro</li> <li>– Fees from supervised entities: 6,62 million euro (Credit Rating Agencies 5,58 million euro; trade repositories 1,04 million euro)</li> </ul> </li> </ul> <p><b>Staff as at 31 December 2014</b></p> <ul style="list-style-type: none"> <li>– Statutory staff: 133 temporary posts authorised in the establishment plan; posts filled on 31.12.2014: 125</li> <li>– Contract staff: 32 contract staff FTE planned in the budget (beginning of the year); contract staff employed on 31.12.2014: 27</li> <li>– Seconded National Experts: 21 Seconded National Expert FTE planned in the budget (beginning of the year); Seconded National Experts employed on 31.12.2014: 16</li> </ul>
<p><b>Products and services in 2014</b></p>	<ul style="list-style-type: none"> <li>– Monitoring financial stability. Issued several periodic risk reports and trend summaries of financial markets.</li> <li>– Conducted tailored economic research and impact assessments. Published economic working papers on hedge funds and derivatives markets.</li> <li>– Contributed to ESRB work on systemic risk.</li> <li>– Reviewed the Implementation of EBA-ESMA Recommendations to Euribor-EBF.</li> <li>– Expanded work on monitoring markets and financial innovation through a financial innovation framework.</li> <li>– Conducted analysis of innovative financial products and processes.</li> <li>– Monitored and analysed retail investor trends and issued good practices for structured retail product governance.</li> <li>– Called for an EU-common approach on crowdfunding.</li> <li>– Worked on investor education, including cooperation with OECD International Network on Investor Education.</li> <li>– Advised on reinforced investor protection regime under MiFID II/ MiFIR. Prepared for future investor protection work.</li> <li>– Provided implementing rules for MiFID II on secondary markets issues.</li> <li>– Issued EU-wide investor warnings and good practices for structured retail product governance.</li> <li>– Issued guidelines on compliance for Guidelines on remuneration policies and practices (MiFID).</li> <li>– Drafted Implementing Technical Standards on main indices and recognised exchanges under the Capital Requirements Regulation.</li> </ul>

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- Strengthened its credit rating agencies (CRA) supervision.
  - Issued call for evidence on Choice and Conflicts of Interests in the CRA Industry.
  - Assessed CRA's compliance with the new requirements focusing on the disclosure aspects of sovereign ratings, pricing policies and procedures.
  - Assessed applications of central counterparties (CCPs) established in non-EEA countries.
  - Supervised EU-based trade repositories and worked on third country issues/ equivalence.
  - Prepared Technical Standards under the CSD Regulation.
  - Issued guidelines on access to a CCP or a Trading Venue by a CSD.
  - Prepared EMIR clearing obligation.
  - Issued 11 EMIR Q&As further explaining the practical implementation.
  - Defined products, counterparties and starting dates for the clearing of interest rate swaps.
  - Issued guidelines regarding the implementation of the CPSS-IOSCO Principles for Financial Market Infrastructures in respect of Central Counterparties.
  - Advised on equivalence of Japan for CCP II - Commodities CCPs.
  - Discussed Share classes of UCITS.
  - Issued guidelines on asset segregation under the AIFMD.
  - Advised European Commission on delegated acts required by the UCITS V Directive.
  - Provided Key Information Documents for Packaged Retail and Insurance-based Investment Products (PRIIPs).
  - Consulted on the implementing measures of the Regulations on EuSEF and EuVECA.
  - Consulted on major shareholders disclosures.
  - Drafted Regulatory Technical Standards on major shareholdings and indicative list of financial instruments subject to notification requirements under the revised Transparency Directive.
  - Drafted Regulatory Technical Standards on European Electronic Access Point (EEAP).
  - Responded to public consultation on the IAS Regulation.
  - Provided Guidelines on enforcement of financial information.
  - Issued Guidelines on Alternative Performance Measures.
  - Contributed to IFRS development in international for a such as IASB.
  - Reviewed supervisory practices on MiFID investor information.
  - Reviewed MiFID's Conduct of Business rules on fair, clear and not misleading information.
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*Source:* Annex supplied by the Authority.

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