

## 8. ACCOUNTING ENFORCEMENT IN THE EUROPEAN UNION: CORPORATE GOVERNANCE, AUDITORS, AND THE NATIONAL AUTHORITY

by *Alberto Quagli* and *Paola Ramassa*

### **Abstract**

This paper deals with accounting enforcement, which is currently at the centre of the debate on financial reporting within the academic community for its essential role in the accounting regulation environment. Its relevance is particularly evident in the European context, in which national differences in accounting practices and earnings quality persist, despite the common set of standards and the increasing coordination efforts by the ESMA.

Building on accounting enforcement literature, we propose to enlarge the scope of the analysis by taking a broader view of enforcement, going beyond the activity of national enforcers, which is often considered in isolation and measured with indirect and static proxies. The accounting enforcement system encompasses a wider and complex process in which professionals and authorities operate at a company and at a country level pursuing financial reporting compliance with accounting rules. This system is composed by three main subsystems: (i) corporate governance; (ii) auditing; and (iii) the national enforcement authority.

The paper proposes an organizing model that summarizes the relationships between these subsystems of the broad accounting enforcement system and financial reporting quality. Based on this organizing model, we briefly review extant accounting literature to identify gaps in the literature that can represent interesting directions for future studies on accounting enforcement and to reflect on new enforcement measures based on this wider process concept.

## 8.1. Introduction

The accounting enforcement, intended as the activities specifically aimed at avoiding irregularities in companies' financial reporting<sup>1</sup>, is a hot topic in the current debate within the accounting community, increasingly relevant for both policymakers and researchers.

The need for improving transparency in financial reporting and to enhance investors' confidence in financial markets has recently led to relevant regulatory changes aimed at improving the monitoring on financial statements, such as the introduction of national and international authorities for the oversight and enforcement of auditors (e.g. the PCAOB in the US and the CEAOB in the EU) and for the enforcement of companies (i.e. ESMA in the EU). Enforcement is also increasingly monitored by global institutions such as the United Nations Conference on Trade and Development (UNCTAD), based on the idea that high-quality reporting enhances the investment climate and fosters competitive enterprise development, but the benefits of high-quality standards can only be attained if these standards are properly implemented (UNCTAD, 2017).

Despite the growing relevance of this disciplinary function and the emergence of academic studies on the topic, many important questions are still unanswered (Amiran et al., 2018). More specifically, current research does not provide a comprehensive picture of how (and how effectively) financial misconduct is disciplined and deterred in different national contexts and extant research on financial reporting misconduct is often based on static proxies that simplify the complexity of this process.

A deeper understanding of the enforcement process seems particularly needed in the European Union (hereafter EU) context, which has been explored by accounting literature more recently (Leuz et al., 2003) and represents a very interesting setting for these studies due to the number and variety of actors involved in the enforcement function. Indeed, in the EU context, listed companies have to follow common rules to disclose information to

<sup>1</sup> “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, involving a set of tools used to punish breaches of laws and regulations, and to deter future violations. In some circumstances, violations of rules may also lead to civil damages and criminal sanctions. Enforcement could be interpreted in a narrow way, such as a disciplinary function. It could also be understood in a broader manner, including compliance in the context of the enforcement system. In this case, enforcement also considers the means by which assistance and incentives are provided to encourage greater compliance” (UNCTAD, 2017, p. 5).

markets (i.e. IFRS as a single set of accounting standards for their consolidated accounts), but the international private standard setter (IASB) has no enforcement power on the companies adopting its standards. The accounting enforcement authority is not located at the European level either, but at the level of each member country, according to the principle that the power to enforce individuals, both people and companies, is delegated to each member country (chapter 4 and 5, and art. 299 of the European Treaty). In such a scenario, the EU ruled in 2002 to adopt IFRS taking “appropriate measures to ensure compliance with international accounting standards”<sup>2</sup> and now the EU institutions act only as coordinators among national authorities through the action of the European Security Market Authority (ESMA). This coordinating effort has to deal with national peculiarities in terms of accounting traditions, differences in legal and judicial systems, and a large variety of economic systems, characterised by financial markets that are more or less developed and important for their national economies. Thus far, the objective of enforcement convergence has proven to be extremely challenging and national differences in the accounting enforcement intensity still exist, as shown by both the review carried out by the ESMA (ESMA, 2017) and the empirical literature on the topic (Brown et al., 2014).

Against this background, this paper offers reflective arguments on the complexity of the enforcement process by enlarging the scope of the analysis beyond the activity of national enforcers alone to encompass a wider context in which more professionals and authorities are involved in enforcement activities at a company level and at a country level. In this perspective, corporate governance, auditing, and the national authority represent the three main components of a wider accounting enforcement system due to their role in monitoring the compliance of financial reporting with accounting rules.

The paper proposes an organizing model that summarizes the relationships between the subsystems composing the broad accounting enforcement system and financial reporting quality. Based on this organizing model we briefly review extant accounting literature to identify gaps and some interesting directions for future studies on accounting enforcement and to reflect on new enforcement measures based on this wider process concept.

<sup>2</sup> In particular, Reg. EU 1606/2002 rules, “A proper and rigorous enforcement regime is key to underpinning investors’ confidence in financial markets. Member States, by virtue of Article 10 of the Treaty, are required to take appropriate measures to ensure compliance with international accounting standards. The Commission intends to liaise with Member States, notably through the Committee of European Securities Regulator States, notably through the Committee of European Securities Regulators (CESR), to develop a common approach to enforcement”.

The rest of the paper is organized as follows. The next section illustrates the role of the ESMA in supporting supervisory convergence among member countries, with particular reference to its guidelines on the enforcement of financial information. The third section reviews the literature on accounting enforcement by summarizing the main findings of cross-country studies and by discussing the proxies used by this stream of research to measure the level of accounting enforcement in a country. Building on this literature, the fourth section illustrates the concept of broad accounting enforcement system, based on the idea that enforcement is a complex process involving a variety of professionals and authorities that interact to monitor the compliance of financial reporting with accounting rules. The fifth section briefly reviews accounting literature based on an organizing model in line with this broad concept of accounting endorsement system, thus identifying gaps in the literature that could be addressed by future research. The sixth and final section provides conclusions indicating possible research directions in terms of un-addressed questions and improvement of measures.

## **8.2. The enforcement process in the EU and the ESMA guidelines**

The annual reports of EU listed companies are not subject to a unique European enforcement authority despite the strong need for financial statement comparability in the EU, since the European Treaty delegates enforcement to member countries (chapter 4 and 5, and art. 299 of the Treaty). Thus, national enforcers established by member countries are charged with monitoring the compliance of listed companies' consolidated financial statements with IFRS and it is on their activity that the accounting enforcement literature focused thus far.

The efforts of the national enforcers are coordinated at the European level by the ESMA with the ultimate aim of strengthening supervisory convergence through various actions (Quagli and Ramassa, 2017). Among them, three are of particular relevance: (i) the European Enforcement Coordination Sessions (EECS); (ii) the European common enforcement priorities for financial statements; and (iii) the Guidelines on the enforcement of financial information.

First, the ESMA manages the EECS, a discussion group in which the national enforcers present the most critical decisions taken and share their behaviour with the other national authorities. These discussions are aimed at harmonising both enforcement practices and IFRS application since the cases debated in the EECS are included in a semi-public database. National enforcers can access the entire database and must look at past enforcement decisions

before taking their decisions on topics already discussed during sessions, while issuers can access the database only partially as a support for application doubts. This possibility stresses the strong orientation of the ESMA towards the prevention of misreporting, in addition to its efforts to support supervisory convergence by the national competent authorities. In this perspective, every year the ESMA announces the most critical areas of financial statements that are suggested for particular scrutiny to the national authorities (i.e., the European common enforcement priorities for financial statements), which are disclosed in advance also to the issuers to foster compliance.

As to the ways to support consistency between the enforcement activities in the various member countries, first the CESR and then the ESMA put in place the “Guidelines on the enforcement of financial information”, inspired by the Transparency Directive “to establish consistent, efficient and effective supervisory practices in relation to, and ensuring the common, uniform and consistent application of, such acts” (ESMA, 2014, par. 6). The Guidelines published in December 2014 at ESMA’s initiative include 14 principles on the resources, structure and independence of the national enforcer (# 1, 2 and 3), the activity of pre-clearance (# 4), the monitoring activity (# 5 and 6), the enforcement actions (# 7, 8 and 9), the role and the procedure of the EECS (from # 10 to # 14).

In particular, Guideline 2 establishes that national enforcers “should have sufficient human and financial resources to carry out their activities in an effective manner. The manpower should be professionally skilled, experienced with the relevant financial reporting frameworks and sufficient in number, taking into account the number of issuers subject to enforcement of financial information, their characteristics, the complexity of their financial statements and their ability to apply the relevant financial reporting framework”.

Guidelines 5 and 6 concern the monitoring activity. The former solicits national enforcers to select companies for monitoring using “a mixed model whereby a risk-based approach is combined with a sampling and/or a rotation approach. A risk-based approach should consider the risk of a misstatement as well as the impact of a misstatement on the financial markets”. Guideline 6 recommends the use of two approaches to monitoring, unlimited and focused examination of financial reports by issuers, stating that: “enforcers can either use unlimited scope examination or a combination of unlimited scope and focused examinations of financial information of issuers selected for enforcement. The sole use of focused examination should not be considered as satisfactory for enforcement purposes”.

Guideline 7 defines three possible enforcement actions for the national authority in case of material misstatement: (i) the reissuance of the financial

statements; (ii) the request of a corrective note; or (iii) a correction in future financial statements with a restatement of comparatives, where relevant. ESMA also specifies the situations in which each of these actions is appropriate, highlighting that the correction in future financial statements is the less timely in correcting misreporting and its use is appropriate when market has already the information when the decision is taken or when “the decision relates merely to the way information was presented in the financial statements rather than to the substance”.

The ESMA guidelines are not limited to inputs, monitoring activity and outputs of the enforcement process to be adopted by national enforcers in their role of surveillance, but include also some general rules about the coordination and sharing of different countries’ activities, with particular regard to the EECS in which those authorities meet and discuss critical cases. In this perspective, Guideline 12 explains when cases should be debated at the EECS before the enforcement decision (emerging issues) or after the choice of the national enforcer (decisions). The emerging issues are appropriate in cases that are very important for the internal market, especially if the enforcer has not taken any previous decision on the topic under discussion or the accounting issue has not been previously discussed. Emerging issues are admitted also when the enforcer disagrees with an earlier decision on the same accounting issue, or when the enforcer foresees a risk of significantly divergent treatments between issuers in the EU markets. Enforcement decisions taken on the basis of an emerging issue should take into account the outcome of the discussion in the EECS. Additionally, Guideline 13 states that a decision should be submitted to the EECS in the following cases: (i) if the decision refers to accounting matters with technical merit; or (ii) it has been discussed as an emerging issue; or (iii) it highlights an emerging risk of significantly different accounting treatments being applied by issuers; or (iv) it is likely to have a significant impact on other issuers; or (v) it is taken on the basis of a provision not covered by a specific accounting standard; or (vi) it is apparently in contradiction with an earlier decision on the same or a similar accounting issue.

Overall, the ESMA guidelines pursue the coordination among national enforcers by addressing the key elements of their activity - in terms of input (e.g. resources), process (monitoring activity) and output (enforcement actions) - as well as the cases in which a national enforcer can exert its authority only in strict coordination with its peers from other member countries (i.e. in EECS), provided that the final enforcement decision is up to the competent national authority only.

National enforcers act within the EU common framework set by these guidelines, which can be used to identify good practices as well as areas for

improvement. The ESMA has recently completed a peer review through a targeted self-assessment questionnaire directed to all national authorities (and subsequent on-site visits to seven of them) in order to assess the compliance of the national enforcers with guidelines 2, 5 and 6, for which the ESMA expected the lower level of convergence (ESMA, 2017). The results of the Assessment Group appointed by the ESMA confirmed this expectation and found that the national enforcers “have many various ways of approaching and carrying out the enforcement of financial information” (ESMA, 2017, p.10).

This finding accords with empirical literature on the impact of accounting enforcement in the European context, in which the persistence of national differences in the quality of financial reporting is significantly dependent on a not homogenous intensity of enforcement among member countries (Daske et al., 2008; Ahmed et al., 2013).

### **8.3. Literature review**

Based on these considerations, this paper builds on the accounting enforcement literature in order to propose a broader and more comprehensive view on the enforcement process, with a particular interest on the complex European context. In pursuit of this objective, we first review the main findings of the empirical literature on the accounting enforcement, devoting a particular attention to cross-country studies using the level of accounting enforcement in a country as an explicative variable in quantitative archival analyses. Then, we focus on the proxies adopted by those studies to measure a country’s accounting enforcement and discuss the recent trends of accounting research in terms of enforcement proxies.

#### *8.3.1. The effects of accounting enforcement*

The debate on enforcement started in the Sixties and it was initially centred on the question of whether an enforcement authority is necessary for financial markets (Stigler, 1964; Benston, 1969; Stigler, 1971; Benston, 1973; Jackson, 2007, Coffee, 2007; Zingales, 2009, Mahoney, 2009). In the Nineties the accounting literature on the topic shifted the focus on the effects of enforcement on financial markets with empirical analyses referred to the US context, also thanks to the public availability of the SEC Accounting and Auditing Enforcement Releases (AAER), which disclose the name of the companies enforced and the reasons of the decisions. The first studies (Feroz

et al., 1991; Nourayi, 1994; Dechow et al., 1996; Srinivasan, 2005; Miller, 2006; Karpoff et al., 2009) showed a relevant impact of enforcement decisions on financial markets in terms of share price reductions, lower liquidity, increase of cost of capital, negative consequences for the liable managers of the enforced companies (Karpoff et al., 2008a). Karpoff et al. (2008b) decomposed the negative impact of these decisions on a company in three elements: (i) the penalties imposed through the legal system via the SEC direct sanctions, (ii) the penalties incurred through the private enforcement; and (iii) the reputational penalty, which is intended as the expected loss in the present value of future cash flows due to lower sales and higher contracting and financing costs and is the most relevant impact.

Another influential and more recent stream of research is composed of cross-country studies exploring the impact of the enforcement on the accounting quality in international comparisons (Ball et al., 2000; Ball et al., 2003; Leuz et al., 2003; Burgsthaler et al., 2006). This literature shifted the analysis from the firm level, mostly studied in the US context, to the national level with international comparisons using synthetic measures to compare the level of enforcement in different countries. The findings show that the national enforcement systems play a crucial role in determining the level of earnings management and the relevance of accounting information in domestic financial markets.

The EU decision to adopt IFRS for all the consolidated reports of companies listed in the EU financial markets from 2005 offered an excellent research setting to test the influence of national enforcement systems on accounting quality. This issue is of great interest given that the IFRS adoption did not improve accounting quality homogeneously in all the EU countries. Due to this variability, the effectiveness of enforcement is sometimes cited as even more important than accounting standards to be enforced (Ball et al., 2000; Christensen et al., 2013).

Indeed, a number of papers observed that the IFRS adoption improved markets' efficiency in terms of information relevance, liquidity, cost of capital, and analyst following only in countries where the enforcement national level is higher (Daske et al., 2008; Florou and Pope, 2012; Armstrong et al., 2010; Li 2010; Landsman et al., 2012; Christensen et al., 2013; Silvers, 2013; Bonetti et al., 2016). Other analyses conclude that the level of national enforcement intensity strongly contributed to realize the potential of IFRS in terms of accounting quality improvement by demonstrating that in case of high enforcement levels earnings management behaviours decrease (Cai et al., 2008; Houqe et al., 2012), timely loss recognition of goodwill increases



(Glaum et al., 2018) and financial disclosure improves as well (Glaum et al., 2013; Gros and Koch, 2015).

A strong enforcement is found to have positive effects in terms of accuracy of financial analysts' estimates (Byard et al., 2011; Demmer et al., 2015; Preiato et al., 2015) and is associated with an increase in the share of the institutional investors' ownership (Florou and Pope, 2012). Particularly, Daske et al. (2008) remark the crucial role of enforcement structures in enhancing the quality of reported numbers, and recent studies show that the level of enforcement is associated also with real effects in terms of investment efficiency (Gao and Sidhu, 2018) and use of earnouts in M&As (Viarengo et al., 2018).

### *8.3.2. The enforcement measures*

The international comparisons of the intensity of enforcement regimes offer important contributions to advance our understanding on the role of enforcement within the wider system of disclosure and regulation intended in a broad sense, including authorities formally creating and interpreting disclosure and reporting rules, monitoring compliance with these rules, and enforcing and imposing penalties for deviations from the rules (Leuz and Wysocki, 2016). This line of research has to deal with the challenging task of measuring the intensity of the national accounting enforcement system "to capture differences in enforcement between countries and changes in enforcement within a country over time" (Brown et al., 2014).

The growing interest in the topic favoured a rapid sophistication of measures, which can be classified into three categories (Table 1): (i) static measures, based on "law-on the-books" and implicitly assuming that the level of enforcement can be measured by the establishment of rules and the creation of supervisory authorities; (ii) dynamic measures, focused on the inputs and/or the outputs of the enforcement process (i.e. resourcing, enforcement actions, etc.); and (iii) mixed measures that consist of indexes composed by items deriving from both a static and a dynamic approach.

Table 1 – Enforcement proxies

	Proxy	Source	Used by
STATIC APPROACH	Legal system and legal enforcement	La Porta et al. (1998)	Leuz et al. (2003); Li (2010)
	Worldwide Governance Indicators (WGI) (e.g. rule of law)	Kaufmann et al. (2007, 2009, 2010, 2011 and following)	Daske et al. (2008); Ahmed et al. (2013); Bonetti et al. (2016); Anagnostopoulou (2017); Pownall and Wieczynska (2017)
	Adoption of CCSR best practices	CCSR (2007)	Van Beest et al. (2013)
	Creation of a specific national accounting enforcer after IFRS adoption	Christensen et al., (2013)	Silvers (2013); Pownall and Wieczynska (2017)
DYNAMIC APPROACH	INPUT: Resourcing of the regulators (e.g. budget, staff)	Jackson and Roe (2009)	
	OUTPUT: Sanctions issued by the national enforcer	Jackson (2007)	
MIXED APPROACH	Auditing (dynamic proxy) and legal system (static proxies)	Hope (2003)	Cai et al. (2008)
	Auditing (static proxies) and national enforcer (static and dynamic proxies)	Brown et al. (2014)	Preiato et al. (2015); Cascino and Gassen (2014); Beekes et al. (2016); Bonetti et al. (2016); Charitou et al. (2018); Gao and Sidhu (2018); Glaum et al. (2018); Viarengo et al. (2018)

Many of the earliest studies (Leuz et al., 2003; Li, 2010) used static proxies to measure a country's level of enforcement, mainly the index originally proposed by La Porta et al. (1997; 1998) that ranked a group of countries based on the level of investors' protection as resulting from the business community evaluations (i.e. strong rule of law, judicial system efficiency, degree of corruption, specific legal rules to protect creditors and minorities) or from the actors' perceptions of the national judicial system (La Porta et al., 2006)<sup>3</sup>. This kind of indexes is not specifically referred to accounting enforcement and needs frequent updating, due to rapid changes in the legal and economic systems of different countries. Indeed, Spamann (2010) demonstrated that the original index proposed by La Porta et al., (1998) could have been wrong in classifying countries with a comparison based on fresh data (Filip et al., 2015).

<sup>3</sup> This stream of studies also tried to overcome the limits of a "law-on-the-books" approach by proposing an index based on an international survey to law firms, which were asked to answer on a stylized self-dealing transaction to measure the legal protection of minority shareholders with particular reference to private enforcement mechanisms (Djankov et al., 2008; used by Glaum et al., 2013).

The Worldwide Governance Indicators (WGI) are other indexes based on a static approach (Kaufmann et al., 2011) and widely used in accounting studies (Daske et al., 2008, Ahmed et al., 2013, Pownall and Wieczynska, 2017). They measure governance, intended as the traditions and institutions by which authority in a country is exercised, and are constructed annually for 215 countries using over 30 individual data sources produced by a variety of survey institutes, think tanks, non-governmental organizations, international organizations, and private sector firms in order to combine the views of a variety of survey respondents in industrial and developing countries. These indicators are not specifically focused on enforcement and measure six dimensions of governance, including rule of law, regulatory effectiveness, control of corruption, voice and accountability, political stability and government effectiveness. Among them, the most relevant for accounting studies are: (i) the “rule of law” index, which measures the extent to which agents have confidence in and abide by the rules of society, including the quality of contract enforcement and property rights, the police, and the courts, and the likelihood of crime and violence; (ii) the “regulatory quality”, which measures the ability of the government to provide sound policies and regulations that enable and promote private sector development. These indexes have the considerable advantage of a regular update (currently from 1996 up to 2016), but they are referred to a country’s governance in a country rather than to accounting enforcement in capital markets, thus being only an indirect proxy such as the indexes introduced by La Porta et al. (1998).

Other indexes based on the static approach measure the national enforcement intensity in the European context by looking at actions taken by member countries following EU regulatory changes or recommendations. In this perspective, Van Beest et al. (2013) considers to what extent the EU countries actually adopted the CESR best practices for the monitoring of financial markets (CESR, 2007). A more recent trend of studies tried to measure the accounting enforcement system more specifically instead of using general indexes of investor protection or governance. Christensen et al. (2013) measured the enforcement intensity looking at the creation of a specific national accounting enforcer after the mandatory adoption of IFRS, which was interpreted as a substantive enforcement change (used also in Silvers, 2013; Pownall and Wieczynska, 2017).

Despite relevant differences, the static enforcement measures have attracted criticism (Holthausen, 2009; Leuz, 2010) for the inadequacy of the law-on-the-books indexes to measure the level of a national enforcer’s activity rather than the sole existence of the legal power to enforce. Then, more dynamic measures have been developed by taking into account mainly the inputs and the outputs of the activity of the national enforcer, even speci-

fically for the accounting enforcement. Examples of proxies for the input variables of the enforcement process are a national enforcer's budget or the number of its employees (Coffee, 2007; Jackson and Roe, 2009), while the total sanctions issued by a national enforcer (Jackson, 2007) are an attempt to measure the output of the same process. Such measures are very interesting as they are more strongly connected to the actual enforcement activity, however, thus far they have been mainly focused on specific aspects of the enforcement process and have been used in a limited number of accounting studies, probably due to the scarcity of public and comparable data on accounting enforcement in diverse countries.

Most recent accounting studies that include enforcement variables in their analyses adopt composite indexes based on a mixed approach that combines static and dynamic proxies. An initial comprehensive measure of enforcement is a proxy based on five country-level factors (Hope, 2003): audit spending, insider trading laws, judicial efficiency, rule of law, and shareholder protection. This measure is obtained by aggregating those factors into a score by means of a factor analysis and encompasses static factors referred to the legal enforcement (mostly drawn from La Porta et al., 1998) as well as dynamic factors such as the total national spending in audit fees, interpreted as a country's commitment to enforcement.

The idea of combining static and dynamic elements to construct a more comprehensive index has been further developed by Brown et al. (2014), who proposed an index aimed at capturing differences between countries in relation to the institutional setting for financial reporting by taking into consideration both the auditing of financial statements and the enforcement of compliance. The design of the index, which is calculated for 51 countries, is based on the idea that legal system proxies are too far from the factors actually affecting compliance, which is promoted through the activity of external auditors and national enforcers. The TOTAL index introduced by Brown et al. (2014) – and widely adopted by accounting studies afterwards – is more focused on the accounting enforcement and derives from the sum of two indexes (AUDIT and ENFORCE), which range from 0 to 32 and from 0 to 24 respectively, for a maximum value of 56. Those two indexes concern the auditing and the national enforcement system and are determined by considering nine and six items respectively (Table 2), which are given scores ranging from 0 to 2 and weights between 1 and 3. The audit system features for each country are static measures derived mainly from surveys of accountant associations (FEE, IFAC) and include, for example, the existence of quality assurance program or ongoing professional development. The measures of the national enforcer effectiveness are both static (i.e., existence of specific activity, such as the review of financial statements or the power to set

accounting and auditing standards), and dynamic (such as the level of resourcing or the existence of enforcement actions taken by the national enforcer).

Table 2 – The composition of the index proposed by Brown et al. (2014)

Item	Enforcement proxy	Data sources
AUDIT		
1	Auditors must be licenced	FEE (2001), IFAC (2011) item 76
2	More extensive licence requirements	FEE (2001), IFAC (2011) item 78
3	Ongoing professional development	FEE (2001), IFAC (2011) item 79
4	Quality assurance programme is in place	IFAC (2011) item 124
5	A audit oversight body has been set up	FEE (2001), IFAC (2011) item 111
6	A audit oversight body can apply sanctions	FEE (2001), IFAC (2011) item 111
7	Audit (firm or partner) rotation is required	FEE (2001), IFAC (2011) item 42
8	Level of audit fees	Worldscope
9	Level of litigation risk for auditors	Wingate (1997), 1 otherwise
ENFORCE		
1	Security market regulator or other body monitors financial reporting	FEE (2001), CESR (2007), IFAC (2011) items 106, 110, 123
2	The body has power to set accounting and auditing standards	IFAC (2011) item 108
3	The body reviews financial statements	IFAC (2011) item 108; CESR (2007); annual reports (2002-2008)
4	The body provides a report about its review of financial statements	Annual reports (2002-2008)
5	This body has taken enforcement actions re financial statements	Annual reports (2002-2008)
6	Level of resourcing	Courtis (2006); Jackson and Roe (2009); Horakova (2011)

*Sources of information:* FEE (2001). A description of European enforcement mechanisms. IFAC (2011). Member body compliance programme. Surveys of professional accounting bodies in each country that provides information about (a) auditor education, registration and supervision, and (b) powers and activities of securities market regulators. Available at <http://www.ifac.org/about-ifac/membership/compliance-program/compliance-responses>. CESR (2007). Reports on compliance with CESR Standard Number 1 provided by the Commission of European Securities Regulators (now ESMA). Publicly available annual reports of national securities market regulators obtained from the body's website (2002-08). The World Bank (2011) "Reports on Observations of Standards and Codes". Available at [http://www.worldbank.org/ifa/rosc\\_aa.html](http://www.worldbank.org/ifa/rosc_aa.html).

Compared to the indexes previously used in accounting studies, this measure is particularly interesting as it extends the analysis to a wider system encompassing both the national enforcer and the external auditors. Furthermore, it is more focused on the accounting enforcement rather than on the general legal setting of a country. In doing so, it combines static and dynamic items arguing that the consideration of the actual outcomes and practices - and not only of the institutional design - results in a different assessment of a country's regulatory setting (Leuz, 2010). From an operational point of view, we think that it has been extremely useful for further research that the authors decided to publish not only the TOTAL, AUDIT, and ENFORCE indexes for each country, but also all the raw data used to construct them, thus enabling researchers to employ weighted or unweighted scores, or to vary weights, or to use individual items for different research purposes.

Currently, this index is by far the most employed in accounting studies addressing research questions involving enforcement issues; however, it is to note that the relevant data used to calculate the index are drawn from an extensive survey conducted by the International Federation of Accountants (IFAC) through professional bodies and most surveys were undertaken in 2004-2005. More specifically, Brown et al. (2014) determined their index for three years (2002, 2005, 2008) based on responses received in those surveys, which provided data for 2002 and 2008 through the respondents' description of changes to past years (used for the 2002 index) and of expected future changes (used for the 2008 index). Substantial changes took place in the enforcement and in the auditing landscape in the last decade, both worldwide and in the EU, including a stronger effort for enforcement convergence by the ESMA (which began operations in 2011) and the new EU audit legislation (Directive 2014/56/EU) just to cite a few (but very relevant) examples. Consequently, we think that future studies - especially those investigating more recent time horizons - should build on this important contribution to measure the accounting enforcement trying to make progressive improvements in the proxy design rather than directly using an available dataset in their quantitative analyses.

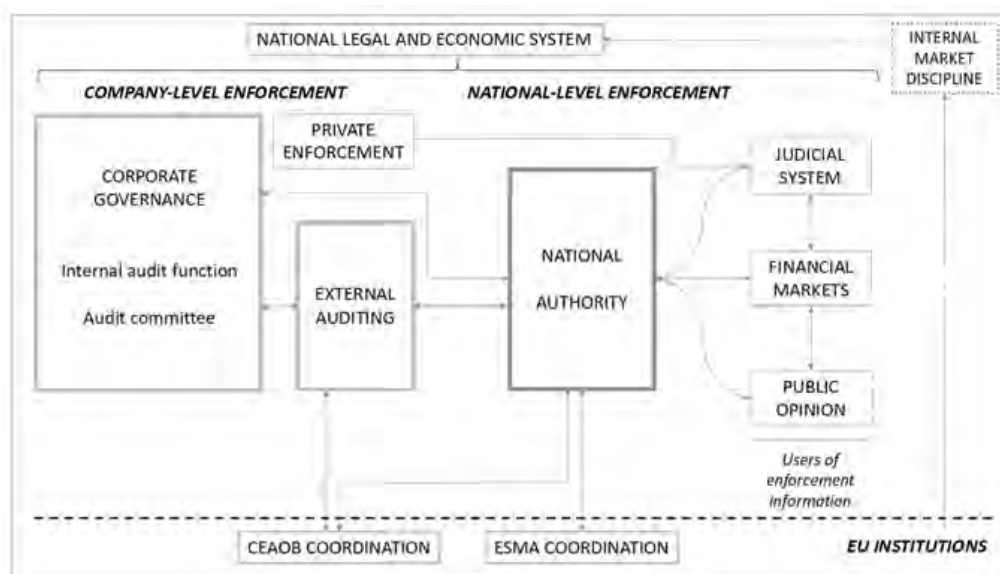
#### **8.4. Enlarging the scope of the analysis: the concept of accounting enforcement system**

The findings of empirical literature and the evolution in the proxies used to measure accounting enforcement highlight the strong connections between different kinds of monitoring on financial reporting, namely those

performed by external auditors and national enforcers. Indeed, a country's level of enforcement does not depend only on the activities of the public enforcer, whose outcome can be attributed to its original effort only partially, but is inevitably influenced by the quality of other controls, such as those performed by external auditors.

Based on this argument, we argue that enforcement research could benefit from a wider view on the complex function of accounting enforcement by taking into consideration the different kinds of professionals and authorities that operate at a company level or at a country level to ensure the compliance of financial reporting (Figure 1).

Fig. 1 – The broad accounting enforcement system



At the company level, there are two main protections against irregularities before the release of accounting information to the market, namely corporate governance and external auditors. Corporate governance controls on the compliance of annual reports include the monitoring activity, generally unobservable outside the company, of the internal audit function and the audit committee within the board of directors. External auditors review the draft of annual reports and their activities generate both private and public outputs, namely the unobservable changes to financial reports asked to managers before the issuance (private output) and their final opinion (clear or modified) which is publicly disclosed. Based on the auditor's report, then the general shareholders' meeting approves the financial reports prepared by the board.

All these professionals and bodies are not enforcers in a strict sense, due to the impossibility to impose public sanctions, but they contribute to avoiding irregularities in companies' financial reporting and are legally responsible for this. Indeed, markets generally perceive qualified or negative auditors' opinions as a risk increase on the company, with consequent negative reactions (Chen et al., 2005; Menon and Williams, 2010), thus supporting the idea that auditors can be deemed as "substantial" enforcers (Chen et al., 2005), being on the front line in order to ensure high-quality financial reporting (FEE, 2001). In particular, auditors represent a fundamental link between the company level and the national enforcer, since they have to privately notify any weakness found during their work to the national enforcement authority, which uses this kind of data as an essential input from professionals with a high technical expertise. Additionally, it is to note that controls at a company level are universally performed for each company under surveillance, while the monitoring activities performed at a country level involve a sample of companies rather than addressing the entire population of listed companies each year.

The activity of the national enforcer is the centre of the accounting enforcement at a country level and its main feature is the authority's ability to enforce accounting errors and frauds by imposing the restatement of financial reports, giving sanctions to companies and managers, and activating courts for the most serious cases. Typically, the enforcement process performed by the national authority encompasses three stages. First, the authority selects which companies to monitor (with unlimited or focused analyses) based on sampling techniques, also considering the risk of misreporting emerging from private and public auditors' outputs and other sources (i.e. press, financial market information, private enforcement actions). Second, the authority performs an initial analysis and if needed it goes further by interacting with the corporate managers and auditors to acquire additional information. Third, in case of identified irregularities, the authority takes an enforcement action, ranging from a correction in future financial reports with an eventual restatement to a corrective note, up to the reissuance of the whole report in the worst cases (enforcement of information). In the most serious cases, the authority can apply sanctions to managers, and take legal actions leading to additional consequences in the judicial system. In some jurisdictions (especially US), also private enforcers are very active subjects, originating private litigations to defend the investors' interests against the company managers responsible for accounting errors.

Financial markets, as well as the press (and ultimately the public opinion), use information from the above-described sources to assess the accounting



quality and reliability of a company's annual report and penalize companies in case of misreporting.

In this perspective, corporate governance, auditing, and the national authority represent three main components of the wider accounting enforcement system. The enforcement activities performed within these subsystems are subject to rules issued at a national and even at an international level (e.g. EU directives) and are influenced by codes that can be voluntarily adopted (e.g. national corporate governance codes). In the EU context, the auditing activity is under the public oversight of national authorities coordinated at the EU level by the CEAOB, a committee established for cooperation between national audit oversight bodies aimed at facilitating supervisory convergence to ensure an effective and consistent application of the new EU audit legislation throughout the EU. As previously illustrated, also the activity of the European national enforcers is increasingly coordinated at the EU level by the ESMA through the EECS, the enforcement priorities and the guidelines addressed to national authorities.

Overall, these considerations highlight the considerable complexity of the accounting enforcement system emerging from this wide and comprehensive view. We argue that the wide scope of this concept could be used by accounting studies that increasingly tend to recognize that accounting enforcement is not limited to the activities of the national authorities (Ewert and Wagenhofer, 2016) and also accords with the views on enforcement expressed by policy makers and practice. The EU Commission in 2000 stated that:

“Enforcement comprises a cascade of different elements including (1) clear accounting standards (2) timely interpretations and implementation guidance, (3) statutory audit, (4) monitoring by supervisors and (5) effective sanctions. Each of these must work efficiently: the system will be as strong as its weakest part in delivering strong investor and creditor protection” (EU Commission, 2000, p. 8)

This wider concept seems based mainly on the substance of the objective to pursue and is reflected also by the professionals' point of view expressed by the FEE (2001), which defines enforcement as all procedures in a country in order to assure the proper application of accounting principles and standards and identifies the following six levels of enforcement in the EU: (i) self-enforcement (preparation of financial statements); (ii) statutory audit of financial statements; (iii) approval of financial statements; (iv) institutional oversight system; (v) court (sanctions/complaints); and (vi) public and press reactions.

The strict links existing between the different subsystems are not only formally stated, but also included in the operational recommendations of the European Authority. Just to cite an example, the ESMA Guideline 5 (ESMA,

2014) deals with the selection criteria for the regular monitoring activity of the national enforcer and establishes that the risk approach implies “indications from the auditors of misstatements, whether in their reports or otherwise, will normally trigger a selection of the financial information in question for examination. Indications of misstatements provided by auditors or regulatory bodies as well as grounded complaints should be considered for enforcement examinations. On the other hand, an unqualified opinion from an auditor should not be considered as proving the absence of risk of a misstatement. Enforcement examinations should be considered where, after preliminary scrutiny, a complaint received appears reliable and relevant for a possible enforcement examination.”

### **8.5. The broad accounting enforcement system in accounting studies**

The accounting literature has investigated the main three subsystems composing the broad accounting enforcement system – namely corporate governance, auditing, and national enforcement authority – within different streams of research trying to explain their impact on financial reporting quality. This outcome is strongly connected to the general objective of the entire process, which can be summarized in ensuring that corporate financial reporting complies with the requirements of laws, regulation, and rules.

Leaving aside the complexity of the interactions between the three subsystems, investigating the effectiveness of each of them would ideally require information on the total cases of misreporting (detected and undetected) in order to understand the actual contribution of “gatekeepers” to contrast violations. Indeed, an accurate analysis of the role of company-level or country-level enforcers should consider the entire universe of misstatements, which are not strictly limited to violations discovered and enforced with public disclosure of enforcement actions.

By contrast, accounting enforcement research has to deal with the intrinsic limitation that the actual outcome of the enforcement process is uncertain and unobservable. Indeed, the universe of misreporting practices comprises a variety of cases that are publicly disclosed, privately disclosed or unknown depending on the timing of the violation discovery and on the materiality of errors and irregularities (Figure 2).

Figure 2 – Misreporting and data availability

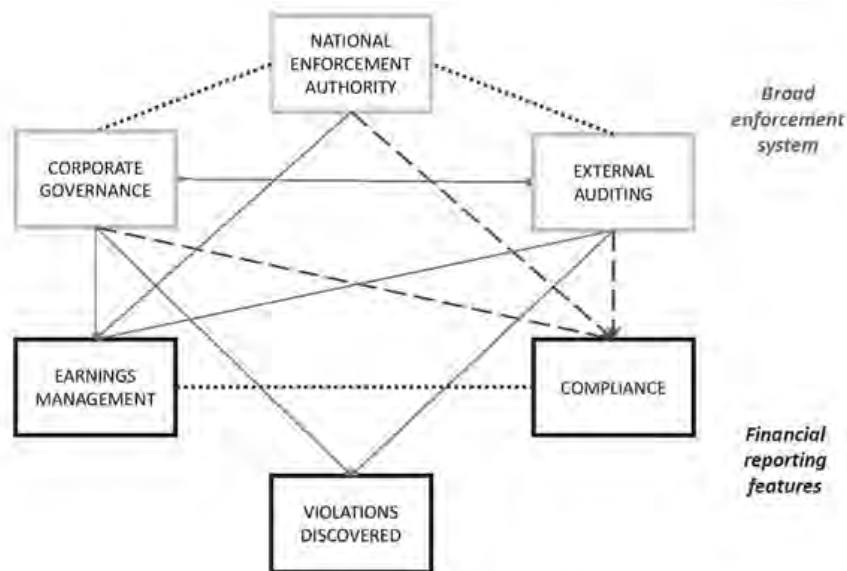
MATERIALITY OF IRREGULARITIES	<i>Material</i>	PRIVATE DATA	PUBLIC DATA (enforcement actions)	UNKNOWN
	<i>Non material</i>	PRIVATE DATA	PRIVATE DATA	UNKNOWN
		<i>Before the approval of the annual report</i>	<i>After the approval of the annual report</i>	<i>Never</i>
		TIMING OF THE VIOLATION DISCOVERY		

First, some irregularities can be corrected before the approval of the annual report thanks to the monitoring activity of one or more of the three enforcement subsystems. This can be due, for instance, to the controls performed by the audit committee, to the dialogue between management and external auditors, or to a pre-clearance by the national competent authority. This ‘tentative’ misreporting is not publicly disclosed and, even if the financial market is fairly informed, data on these occurrences would be very useful for research purposes to investigate the impact of the enforcement system. Second, not all the violations found are necessarily disclosed in public documents such as the enforcement actions or the auditor’s report. Indeed, only material irregularities are disclosed in publicly available documents, which additionally can be promptly communicated (e.g. restatements) to the market or produce consequences only in future financial reporting. In-depth analyses by the auditors or by the national enforcer can also end with the discovery of errors that are deemed as not material and are only reported in private documents (i.e. unadjusted errors found by external auditors communicated only to the national enforcer). Third, it is to recall that some cases of misreporting have not been discovered or reported by the three levels of control, which can be more or less effective, but undoubtedly cannot be completely unailing.

Consequently, accounting studies follow two different avenues of enquiry to provide insights into enforcement and its effectiveness: some of them investigate the influence of the enforcement process on the violations found, even if their number does not necessarily correspond to the entire universe of misreporting cases, while others look at the links between controls and different features of financial reporting that are implicitly used as proxies of

the overall violations. In this perspective, empirical literature investigates the association with earnings management, which approximates misreporting related to recognition and measurement issues, or with compliance, whose level is an indirect proxy for violations of rules regarding presentation and disclosure. Figure 3 illustrates a simplified organizing model aimed at reflecting on existing literature by representing: (i) corporate governance, auditing and national enforcement authority, intended as accounting enforcement subsystems; (ii) the violations, consisting in the misreporting cases found by the national enforcer; and (iii) earnings management and compliance, which represent two relevant features of financial reporting that can be affected by company-level and country-level controls. We do not represent here the market consequences of the enforcement process (briefly summarized in Section 3), which are also used by archival studies as more indirect proxies to measure financial reporting quality.

Figure 3 – The broad accounting enforcement system: an organizing model



Some of the relationships between the six blocks outlined in this figure have already been widely investigated in accounting literature (green arrows in the figure), while so far others have been under-researched (blue arrows) or rather neglected (red lines) and in our opinion are worthwhile for further research to advance our understanding of the effectiveness of the entire accounting enforcement system.

### *8.5.1. Studies on the corporate governance subsystem*

A rich corporate governance literature examines the relation between corporate governance characteristics and various accounting and auditing outcomes; overall, its findings support the idea that ‘good’ audit committee and board characteristics are associated with measures of ‘good’ accounting and auditing and with more efficient internal controls (Carcello et al., 2011)<sup>4</sup>. More specifically, the corporate governance mechanisms seem more effective in case of audit committees characterized by high financial expertise and independence (Abbott et al., 2004), and in case of a relevant percentage of independent directors in the board (Beasley, 1996; Dechow et al., 1996; Fich and Shivdasani, 2007; Zao and Chen, 2008; Beasley et al., 2010). These features are associated with a higher audit quality, measured through different proxies (e.g. auditor type, auditor fee, going concern reporting, committee-auditor cooperation), and with a higher financial reporting quality, intended as a lower level of earnings management (Klein, 2002), or the absence of fraudulent accounting (Beasley, 1996; Beasley et al., 2000) or restatements (Abbott et al., 2004). Indeed, two early studies on the link between governance structures and financial reporting misconduct (Beasley, 1996; Dechow et al., 1996) find that financial reporting misconduct (AAERs) is more likely in firms with a greater proportion of insiders on the board of directors. Additionally, misconduct is more likely when the CEO simultaneously serves as board chairman, when the CEO is also the firm’s founder, when the board does not have an audit committee, and when the firm does not have a significant outside blockholder (Dechow et al., 1996). Following the diffusion of audit committees in listed companies and the consequent reducing variation in key governance characteristics (Beasley et al., 2010), research on their effectiveness shifted the focus on the impact of the audit committee characteristics rather than of its existence (initially investigated by Beasley, 1996, Beasley et al., 2000). Empirical evidence shows that the independence and activity level of the audit committee (which approximates the audit committee diligence), as well as the presence of at least one member with financial expertise in the committee exhibit a significant and negative association with the occurrence of restatement (Abbott et al., 2004).

Some studies further explore the role of internal controls in contrasting financial misreporting, finding that misconduct is lower in firms with a formal internal audit function (Beasley et al., 2000; Coram et al., 2008) and that

<sup>4</sup> On the contrary, Larcker et al. (2007) find that key dimensions of corporate governance have little relation to a sample of accounting restatements.

misconduct firms have fewer audit committee meetings until the financial reporting misconduct but those meetings increase substantially afterwards (Farber, 2005).

A rich literature looks at the relation between corporate governance quality and earnings management, mostly measured through the accruals quality. It finds that the quality of corporate governance is negatively associated with earnings management (Klein, 2002; Bowen et al., 2008; Zhao and Chen, 2008; Naiker and Sharma, 2009, Dhaliwal et al., 2010), with a few notable exceptions providing mixed results (e.g. Larcker et al., 2007).

Looking at accounting irregularities that do not influence earnings, it is to note that the factors driving compliance or non-compliance have received considerably less attention than those influencing earnings management or voluntary disclosure, which are the *foci* of two vast streams of literature. A limited number of papers, often focusing on a selected group of standards, have investigated the corporate governance determinants of compliance finding that stronger governance firms comply more fully with accounting standards' disclosure requirements (Glaum et al., 2013; Cascino and Gassen, 2014; Verriest et al., 2013).

### 8.5.2. *Studies on the auditing subsystem*

Auditing research deals with the relation between audit quality and accounting misconduct by ascertaining whether specific auditor's features decrease the likelihood of events such as restatements or enforcement actions (AAERs). Findings support the effectiveness of industry specialist auditors (Romanus et al., 2008) and of the audit effort (Lobo and Zhao, 2013) in reducing the likelihood of restatements, as well as the idea that some non-audit fees can create an economic bond between auditor and client, thus lowering the former's independence and increasing the probability of a restatement (Kinney et al., 2004). Archival studies on AAERs show that the likelihood of irregularities decreases with higher client-specific knowledge (Carcello and Nagy, 2004), revolving door hire (Geiger et al., 2008), and BigFive (Lennox and Pittman, 2010). AAERs themselves are also used as an audit quality measure in auditing literature, even if their use in this sense is not that common, probably because they are rather infrequent (DeFond and Zhang, 2014).

An extensive auditing literature also looks at auditors' ability to reduce earnings management by examining competence-based and independence-based explanations. These studies have shown a negative relation between earnings management, mostly measured with the level of discretionary

accruals, and various proxies of audit quality (Knechel et al., 2013), such as Big N auditors (Francis et al., 1999; Kim et al., 2003), auditor specialization (Krishnan, 2003; Balsam et al., 2003; Gul et al., 2009), auditor tenure (Myers et al., 2003), audit size office size (Francis and Yu, 2009), and history of past audit failure (Francis and Michas, 2012). Other studies investigate the role of auditing in constraining earnings management using target-based measures: overall, they confirm a negative association between opportunistic reporting and audit quality proxied by auditors' industry expertise (Reichelt and Wang, 2010) and auditor tenure (Davis et al., 2009).

The relation between audit quality and compliance is addressed by a much lower number of papers, which generally focus on one or more standards. Their analyses of samples based in several national contexts show that the audit firm size (measured by BigN) is positively associated with IFRS compliance (Street and Gray, 2002; Glaum and Street, 2003; Prather-Kinsey and Meek, 2004; Glaum et al., 2013; Bepari and Mollik, 2015).

### *8.5.3. Studies on the national enforcement authority and the links between the three subsystems*

Accounting enforcement literature (briefly summarized in Section 3) is mostly focused on the US context and investigates different outcomes of such monitoring process, including market effects that are generally used as an indirect proxy for financial reporting quality. Studies looking at this relation on European samples confirm the influence of the enforcement level on the informativeness of analysts' recommendation revisions in case of an upgrade (Charitou et al., 2018) and on the information content of earnings announcements (Bonetti et al., 2016).

Looking at the relationship between accounting enforcement and financial reporting quality, the majority of studies focus on the negative association with earnings management (Cai et al., 2008; Houqe et al., 2012) and managerial discretion (Glaum et al., 2018). By contrast, there is a paucity of research on the intensity and the effectiveness of accounting enforcement in terms of compliance, especially on non-US samples (Glaum et al., 2013).

So far, accounting research seems to have devoted more attention to the relationship between one of the three enforcement subsystems and various measures of financial reporting quality than to the links existing between corporate governance, external auditing, and national public enforcement. This kind of association between subsystems has been explored in corporate governance literature to shed light on the role of different bodies involved in

corporate governance; indeed, most studies on the internal audit function (IAF) address how it provides assurance to the board, executive management, and to external auditors regarding the corporate governance practices (Anderson and Christ, 2014). In this perspective, IAF serves as a resource to each of the other three parties responsible for corporate governance (i.e., the external auditor, the audit committee and management) (Gramling et al., 2004) and the interactions such as the extent and frequency of meetings between the IAF and the audit committee is associated to corporate governance quality.

Literature and auditing standards recommend that in the relationship between IAF and external auditors, the latter evaluate the objectivity, competence, and work performed by the internal auditor when determining the IAF reliance and research suggests that these three factors interact with each other and with other elements when the external auditor decides on IAF reliance (Bame-Aldred et al., 2013).

The links between external auditors and national enforcement authorities are often acknowledged, for instance by stressing that the auditor's report is an essential input for the national enforcer and by considering the latter's proactivity (Christensen et al., 2017; Quagli et al., 2018); however, they are scarcely explored by empirical studies in terms of interactions between different kinds of enforcers. Auditing and enforcement are increasingly considered together in enforcement measures (Brown et al., 2014), but their relative weight is not based on detailed analyses of their relationships yet. Even auditing literature investigating the association between audit quality and enforcement actions uses AAERs as a proxy of financial reporting quality rather than as a measure aimed at improving our understanding of the interplay between the two actors.

The interactions between the three subsystems provide very interesting and challenging research opportunities to get a more advanced understanding of a system whose complexities are largely unaddressed by existing literature. This direction also accords with the need increasingly voiced by corporate governance literature to consider both country- and firm-level corporate governance mechanisms in the debate about the effects of governance on the quality of financial reporting (Aguilera et al., 2015; Bonetti et al., 2016).

In our opinion, another relevant unaddressed issue regards the links between different measures of financial reporting quality; for instance, the relationship between compliance and earnings management, which is considerably more studied by empirical accounting literature even if a faithful representation of economic phenomena includes both words and numbers. We also know very little about the focus of interest of the three enforcement subsystems, there is scarce evidence on whether auditors and national authorities



are devoting more attention to disclosure compliance or to irregularities influencing accounting figures. Addressing this question could provide a significant contribution to improve our understanding of the relative roles of the different subsystems in enhancing financial reporting quality.

## **8.6. Directions for future research on accounting enforcement**

This paper reflects on accounting enforcement proposing to enlarge the scope of current research on the topic to a wider system including corporate governance mechanisms, external auditing, and the national enforcement authority. This view is based on the idea that the common objective of avoiding irregularities in corporate financial reporting is pursued in different ways by each of these three subsystems, which are characterized by many specific features as well as complex interactions.

This perspective seems particularly interesting in the current European scenario, in which the three enforcement levels are increasingly influenced by supra-national regulatory and coordination efforts but national differences still exist, even after the mandatory adoption of a single set of accounting standards.

Accounting literature addressed enforcement issues initially focusing on the national enforcement authority and showing that the intensity of enforcement has relevant consequences in terms of market effects and financial reporting quality. These findings are based on enforcement measures that are increasingly taking into account dynamic proxies and the contribution of different actors to the enforcement process (i.e. external auditors, and national enforcement authorities), with an evolution that in our view has still room for further developments.

In this perspective, we propose to adopt a wider concept of accounting enforcement system – encompassing corporate governance, external auditing and national enforcement authority – to capture the complexities of the activities and interactions between actors monitoring the adherence of financial reporting to accounting regulation. This view, which seems also in line with the positions expressed by practice and policymakers on the topic, can support enforcement research by identifying gaps that could be addressed by future research and by providing useful insights to further improve enforcement measures.

In pursuit of these objectives, we briefly reviewed prior accounting studies within an organizing model consistent with this enlarged view and based on this literature we make some observations aimed at supporting future research on accounting enforcement.

We found that existing literature is mostly focused on every specific subsystem and explores its effectiveness by studying the association between its

features and financial reporting outcomes, such as financial misconduct discovered by the national enforcement authority or financial reporting quality, generally measured by earnings management proxies.

Less attention is devoted to the association with the level of compliance, as well as to the relationships between the three subsystems, which have specific inputs, activities, and outputs that are often intertwined or strictly connected. Additionally, there is a paucity of research addressing which financial reporting features are actually mostly monitored by the three subsystems (e.g. disclosure compliance or earnings manipulation). These unanswered questions provide excellent opportunities for future accounting research, which could progressively remove the simplifications adopted by early enforcement literature to account more and more for the actual complexity of accounting enforcement.

This perspective can be applied also to the enforcement measurement, which could be further improved by considering a proxy summarizing the contribution of the three subsystems to enforcement effectiveness. A more comprehensive proxy, whose components can be used also separately, could be extremely useful for comparing the level of enforcement between different countries. The construction of this proxy should build on a further development of enforcement studies in the above-described directions, given that only an improved understanding of the complexity of the system can be the basis for the proposal of new proxies. It is to point out that an evolution in enforcement measurement can be of interest not only to the academic community but also to policymakers and oversight authorities, who are increasingly interested in tools for monitoring enforcement quality and convergence.

Overall, these directions for future research highlight the need to pull research out of narrow disciplinary silos to provide a more comprehensive view of complex phenomena and to build a broader and deeper focus on challenging problems that are of crucial importance for policy-making and for the whole accounting community. This approach could seem in contrast with the progressive specialization of our studies but could be particularly helpful also considering that some methodological issues are relatively similar in different streams of literature, for instance the challenges of enforcement studies focused on the national authority recall issues that have been already addressed – and are still under investigation – by auditing research (Gaynor et al., 2016), which is characterized by a recursive relation between audit quality and financial reporting quality.

We acknowledge that some of these gaps in the literature are also due to serious issues of data availability, that cannot be completely removed due to the inherent characteristics of the enforcement process. It seems also evident

that researchers devoted more attention to topics for which more data were available, often focusing on data accessible through databases instead of data requiring hand-collection. For the future, we think that researchers could address this issue in different ways. First, in our view it is important to note that accounting enforcement is not amenable to a unique research methodology; for instance, the complexity of the relations between many actors provides opportunities also for qualitative research methods (e.g. case studies) that do not require extensive datasets on very large samples. Then, the increasing scrutiny from public authorities on the wider enforcement system is likely to have a positive impact also in terms of data availability thanks to oversight surveys and reports (ESMA, 2017). Finally, we think that researchers could engage with oversight authorities to contribute to their activity through research support, with positive consequences in terms of data availability and research impact on relevant accounting issues.

## References

- Abbott L.J., Parker S. and Peters G.F. (2004), "Audit Committee Characteristics and Restatements", *AUDITING: A Journal of Practice & Theory*, 23(1), pp. 69-87.
- Ahmed A.S., Neel M. and Wang D. (2013), "Does Mandatory Adoption of IFRS Improve Accounting Quality? Preliminary Evidence", *Contemporary Accounting Research*, 30(4), pp. 1344-1372.
- Aguilera R.V., Desender K., Bednar M.K. and Lee, J. H. (2015), "Connecting the Dots: Bringing External Corporate Governance into the Corporate Governance Puzzle", *The Academy of Management Annals*, 9(1), pp. 483-573.
- Amiram D., Bozanic Z., Cox J.D., Dupont Q., Karpoff J.M. and Sloan R. (2018), "Financial reporting fraud and other forms of misconduct: a multidisciplinary review of the literature", *Review of Accounting Studies*, 23(2), pp. 732-783.
- Anagnostopoulou S.C. (2017), "Accounting Quality and Loan Pricing: The Effect of Cross-country Differences in Legal Enforcement", *The International Journal of Accounting*, 52(2), pp.178-200.
- Anderson U. and Christ M. (2014), *Internal audit*, in Hay D., Knechel W.D., Willekens M. (eds.), *The Routledge companion to auditing*, London: Routledge.
- Armstrong C., Barth M., Jagolinzer A. and Riedl E. (2010), "Market reaction to the adoption of IFRS in Europe", *The Accounting Review*, 85, pp. 31-61.
- Ball R., Kothari S.P. and Robin A. (2000), "The Effect of International Institutional Factors of Properties of Accounting Earnings", *Journal of Accounting and Economics*, 29, pp. 1-51.
- Ball R., Robin A. and Wu J.S. (2003), "Incentives versus Standards: properties of accounting income in four East Asian countries", *Journal of Accounting and Economics*, 36, pp. 235-270.
- Balsam S., Krishnan J. and Yang J. S. (2003), "Auditor industry specialization and earnings quality", *Auditing: A journal of practice & Theory*, 22(2), pp. 71-97.

- Bame-Aldred C.W., Brandon D.M., Messier W.F., Rittenberg L.E. and Stefaniak C.M. (2013), "A Summary of Research on External Auditor Reliance on the Internal Audit Function", *Auditing: A Journal of Practice & Theory*, 32(Supplement 1), pp. 251-286.
- Beasley M.S. (1996), "An empirical analysis of the relation between the board of director composition and financial statement fraud", *The Accounting Review*, pp. 443-465.
- Beasley M.S., Carcello J.V., Hermanson D.R. and Lapides P.D. (2000), "Fraudulent financial reporting: Consideration of industry traits and corporate governance mechanisms", *Accounting Horizons*, 14(4), pp. 441-454.
- Beasley M.S., Carcello J., Hermanson D. and Neal T. (2010), "Fraudulent Financial Reporting: 1998-2007-An Analysis of US Public Companies", Committee of Sponsoring Organizations of the Treadway Commission (COSO).
- Beekes W., Brown P., Zhan W. and Zhang Q. (2016), "Corporate Governance, Companies' Disclosure Practices and Market Transparency: A Cross Country Study", *Journal of Business Finance & Accounting*, 43(3-4), pp. 263-297.
- Benston G., (1969), "The value of the SEC's accounting disclosure requirements", *The Accounting Review*, 44, pp. 515-532.
- Benston G. (1973), "Required disclosure and the stock market: An evaluation of the Securities Exchange Act of 1934", *American Economic Review*, 63, pp. 132-155.
- Bepari M.K., Mollik A.T. (2015), "Effect of audit quality and accounting and finance backgrounds of audit committee members on firms' compliance with IFRS for goodwill impairment testing", *Journal of Applied Accounting Research*, 16(2), pp. 196-220.
- Bonetti P., Magnan M.L. and Parbonetti A. (2016), "The Influence of Country- and Firm-level Governance on Financial Reporting Quality: Revisiting the Evidence", *Journal of Business Finance & Accounting*, 43(9-10), pp. 1059-1094.
- Bowen R.M., Rajgopal S. and Venkatachalam M. (2008), "Accounting Discretion, Corporate Governance, and Firm Performance", *Contemporary Accounting Research*, 25(2), pp. 351-405.
- Brown P., Preiato J. and Tarca A. (2014), "Measuring Country Differences in Enforcement of Accounting Standards: An Audit and Enforcement Proxy", *Journal of Business Finance & Accounting*, 41(1-2), pp. 1-52.
- Burgstahler D.C., Luzzi H. and Leuz C. (2006), "The Importance of Reporting Incentives: Earnings management in European Private and Public Firms", *The Accounting Review*, 81(5), pp. 983-1016.
- Byard D., Li Y. and Yu Y. (2011), "The Effect of Mandatory IFRS Adoption on Financial Analysts' Information Environment", *Journal of Accounting Research*, 49(1), pp. 69-96.
- Cai L., Rahman A.R. and Courtenay S.M. (2008), "The effect of IFRS and its enforcement on *earnings management*: an international comparison". Available at SSRN: <http://ssrn.com/abstract=1473571>.
- Carcello J.V. and Nagy A.L. (2004), "Audit firm tenure and fraudulent financial reporting", *Auditing: A Journal of Practice & Theory*, 23(2), pp. 55-69.
- Carcello J.V., Hermanson D.R. and Ye Z.S. (2011), "Corporate Governance Research in Accounting and Auditing: Insights, Practice Implications, and Future Research Directions", *Auditing: A Journal of Practice & Theory*, 30(3), pp. 1-31.

- Cascino S. and Gassen J. (2014), “What drives the comparability effect of mandatory IFRS adoption?”, *Review of Accounting Studies*, 20(1), pp. 242-282.
- CESR (2007), CESR’s review of the implementation and enforcement of IFRS in the EU. Available at: [http://www.esma.europa.eu/system/files/07\\_352.pdf](http://www.esma.europa.eu/system/files/07_352.pdf)
- Charitou A., Karamanou I. and Kopita A. (2018), “Are analyst stock recommendation revisions more informative in the post-IFRS period?”, *Journal of Business Finance & Accounting*, 45(1-2), pp. 115-139.
- Chen G., Firth M., Gao D.N. and Rui O.M. (2005), “Is China’s securities regulatory agency a toothless tiger? Evidence from enforcement actions », *Journal of Accounting and Public Policy*, 24(6), pp. 451-488.
- Christensen H.B., Hail L. and Leuz C. (2013), “Mandatory IFRS reporting and changes in enforcement”, *Journal of Accounting and Economics*, 56, pp. 147-177.
- Christensen H.B., Liu L.Y. and Maffett M.G. (2017), “Proactive Financial Reporting Enforcement and Shareholder Wealth”, Retrieved from [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2843884](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2843884).
- Coffee Jr J.C. (2007), “Law and the market: The impact of enforcement”, *U. pa. L. rev.*, 156, p. 229.
- Coram P., Ferguson C. and Moroney R. (2008), “Internal audit, alternative internal audit structures and the level of misappropriation of assets fraud”, *Accounting & Finance*, 48(4), pp. 543-559.
- Courtis N (2006), *How countries supervise their banks, insurers and securities markets*. London: Financial Publishing Limited.
- Daske H., Hail L., Leuz C. and Verdi R. (2008), “Mandatory IFRS reporting around the world: Early evidence on the economic consequences”, *Journal of Accounting Research*, 46(5), pp. 1085-1142.
- Davis L.R., Soo B.S. and Trompeter G.M. (2009), “Auditor tenure and the ability to meet or beat earnings forecasts”, *Contemporary Accounting Research*, 26(2), pp. 517-548.
- Dechow P.M., Sloan R.G. and Sweeney A.P. (1996), “Causes and consequences of earnings manipulation: an analysis of firms subject to enforcement action by the SEC”, *Contemporary Accounting Research*, 13, pp. 1-36.
- DeFond M. and Zhang J. (2014), “A review of archival auditing research”, *Journal of Accounting and Economics*, 58(2-3), pp. 275-326.
- Demmer M., Pronobis P. and Yohn T. L. (2015), “Financial Statement-Based Forecasts and Analyst Forecasts of Profitability: The Effect of Mandatory IFRS Adoption”. Available at: <http://ssrn.com/abstract=2544566>.
- Dhaliwal D.A.N., Naiker V.I.C. and Navissi F. (2010), “The association between accruals quality and the characteristics of accounting experts and mix of expertise on audit committees”, *Contemporary Accounting Research*, 27(3), pp. 787-827.
- Djankov S., La Porta R., Lopez-de-Silanes F. and Shleifer A. (2008), “The Law and Economics of Self-Dealing”, *Journal of Financial Economics*, 88(3), pp. 430-465.
- ESMA (2014), ESMA Guidelines on enforcement of financial information. October. Available at <http://www.esma.europa.eu/system/files/2014-esma-1293en.pdf>.
- ESMA (2017) Peer Review on Guidelines on Enforcement of Financial Information. Peer Review Report. Available at: [https://www.esma.europa.eu/sites/default/files/library/esma42-111-4138\\_peer\\_review\\_report.pdf](https://www.esma.europa.eu/sites/default/files/library/esma42-111-4138_peer_review_report.pdf).

- European Commission (2000), Communication from the Commission to the Council and the European Parliament EU. Available at: <https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX%3A52000DC0359>.
- Ewert R., Wagenhofer, A. (2016), “Effects of increasing enforcement on firm value and financial reporting quality”. Available at SSRN: <https://ssrn.com/abstract=2815002>.
- Farber D.B. (2005), “Restoring trust after fraud: Does corporate governance matter?”, *The Accounting Review*, 80(2), pp. 539-561.
- Fédération des Experts Comptables Européens (FEE) (2001), Enforcement mechanisms in Europe. A Preliminary Investigation of Oversight Systems, April.
- Feroz E.H., Park K. and Pastena V.S. (1991.), “The financial and market effects of the SEC’s accounting and auditing enforcement releases”, *Journal of Accounting Research*, 29, pp. 107-142.
- Filip A., Labelle R., Rousseau S. (2015), “Legal Regime and Financial Reporting Quality”, *Contemporary Accounting Research*, 32(1), pp. 280-307.
- Fich E.M. and Shivdasani A. (2007), “Financial fraud, director reputation, and shareholder wealth”, *Journal of Financial Economics*, 86(2), pp. 306-336.
- Florou A. and Pope P.F. (2012), “Mandatory IFRS Adoption and Institutional Investment Decisions”, *The Accounting Review*, 87(6), pp. 1993-2025.
- Francis J.R., Maydew E.L. and Sparks H.C. (1999), “The role of Big 6 auditors in the credible reporting of accruals”, *Auditing: a Journal of Practice & theory*, 18(2), pp. 17-34.
- Francis J.R. and Michas P.N. (2012), “The contagion effect of low-quality audits”, *The Accounting Review*, 88(2), pp. 521-552.
- Francis J.R. and Yu M.D. (2009), “Big 4 office size and audit quality”, *The Accounting Review*, 84(5), pp. 1521-1552.
- Gao R. and Sidhu B.K. (2018), “The Impact of Mandatory International Financial Reporting Standards Adoption on Investment Efficiency: Standards, Enforcement, and Reporting Incentives”, *Abacus*, 54(3), pp. 277-318.
- Gaynor L.M., Kelton A.S., Mercer M. and Yohn T.L. (2016), “Understanding the Relation between Financial Reporting Quality and Audit Quality”, *Auditing: A Journal of Practice & Theory*, 35(4), pp. 1-22.
- Geiger M.A., Lennox C.S. and North D.S. (2008), “The hiring of accounting and finance officers from audit firms: how did the market react?”, *Review of Accounting Studies*, 13(1), pp. 55-86.
- Glaum M. and Street D.L. (2003), “Compliance with the Disclosure Requirements of Germany’s New Market: IAS Versus US GAAP”, *Journal of International Financial Management and Accounting*, 14(1), pp. 64-100.
- Glaum M, Schmidt P., Street D.L. and Vogel S. (2013), “Compliance with IFRS 3- and IAS 36-required disclosures across 17 European countries: company and country-level determinants”, *Accounting and Business Research*, 43(3), pp. 163-204.
- Glaum M., Landsman W.R. and Wyrwa S. (2018), “Goodwill Impairment: The Effects of Public Enforcement and Monitoring by Institutional Investors”, *The Accounting Review*, in press.
- Gramling A.A., Maletta M.J., Schneider A. and Church B.K. (2004), “The Role of the Internal Audit Function in Corporate Governance: A Synthesis of the Extant

- Internal Auditing Literature and Directions for Future Research”, *Journal of Accounting Literature*, 23, pp. 194-244.
- Gros M. and Koch S. (2015), “Goodwill Impairment Test Disclosures Under IAS 36: Disclosure Quality and its Determinants in Europe”, Available at SSRN: <http://ssrn.com/abstract=2636792>
- Gul F.A., Fung S.Y.K. and Jaggi, B. (2009), “Earnings quality: Some evidence on the role of auditor tenure and auditors’ industry expertise”, *Journal of Accounting and Economics*, 47(3), pp. 265-287.
- Holthausen R.W. (2009), “Accounting Standards, Financial Reporting Outcomes, and Enforcement”, *Journal of Accounting Research*, 47, pp. 447-458.
- Hope O.K. (2003), “Disclosure practices, enforcement of accounting standards, and analysts’ forecast accuracy: an international study”, *Journal of Accounting Research*, 41(2), pp. 235-272.
- Horakova M. (2011), *How countries supervise their banks, insurers and securities markets*. London: Financial Publishing Limited.
- Houqe N., van Zijl T., Dunstan K. and Waresul Karim A.K.M. (2012), “The effect of investor protection and IFRS adoption on earnings quality around the world”, *The International Journal of Accounting*, 47(3), pp. 333-355.
- International Federation of Accountants (IFAC) (2011), “Member Body Compliance Program. Available at: <http://www.ifac.org/ComplianceAssessment/published.php>.
- Jackson H. (2007), “Variation in the intensity of financial regulation: Preliminary evidence and potential implications”, *Yale Journal on Regulation*, 24, pp. 253-291.
- Jackson H. and Roe M. (2009), “Public and private enforcement of securities laws: resource-based evidence”, *Journal of Financial Economics*. 93(2), pp. 207-238.
- Karpoff J., Lee S.D. and Martin, G. S. (2009), “The cost to firms of cooking the books”, *Journal of Financial and Quantitative Analysis*, 43, pp. 581-611.
- Karpoff J.M., Lee D.S. and Martin G.S. (2008a), “The consequences to managers for financial misrepresentation”, *Journal of Financial Economics*, 88, pp. 193-215.
- Karpoff J.M., Lee D.S. and Martin G.S. (2008b), “The Legal Penalties for Financial Misrepresentation”, Working Paper. University of Washington, Texas A&M University, and American University.
- Kaufmann D. (2007), *Governance matters VI: aggregate and individual governance indicators, 1996-2006 (Vol. 4280)*, World Bank Publications.
- Kaufmann D., Kraay A. and Mastruzzi M. (2009), *Governance matters VIII: governance indicators for 1996-2008*. Washington, D.C.: World Bank Policy Research.
- Kaufmann D., Kraay A. and Mastruzzi M. (2010), *The Worldwide Governance Indicators – Methodology and Analytical Issues*, The World Bank Development Research Group Macroeconomics and Growth Team, September.
- Kaufmann D., Kraay A. and Mastruzzi M. (2011), “The worldwide governance indicators: methodology and analytical issues. *Hague Journal on the Rule of Law*, 3(2), pp. 220-246.

- Kim J.B., Chung R. and Firth M. (2003), "Auditor conservatism, asymmetric monitoring, and earnings management", *Contemporary Accounting Research*, 20(2), pp. 323-359.
- Kinney W.R., Palmrose Z.V. and Scholz, S. (2004), "Auditor Independence, Non-Audit Services, and Restatements: Was the US Government Right?", *Journal of Accounting Research*, 42(3), pp. 561-588.
- Klein A. (2002), "Audit committee, board of director characteristics, and earnings management", *Journal of Accounting and Economics*, 33(3), pp. 375-400.
- Knechel W.R., Krishnan G.V., Pevzner M., Shefchik L.B. and Velury U.K. (2013), "Audit Quality: Insights from the Academic Literature", *Auditing: A Journal of Practice & Theory*, 32(Supplement 1), pp. 385-421.
- Krishnan G.V. (2003), "Does Big 6 auditor industry expertise constrain earnings management?", *Accounting horizons*, 17(1).
- La Porta R., Lopez-De-Silanes F., Shleifer A. and Vishny Robert W. (1997), "Legal Determinants of External Finance", *The Journal of Finance*, 52(3), pp. 1131-1150.
- La Porta R., Lopez-De-Silanes F., Shleifer A. and Vishny Robert W. (1998), "Law and finance", *Journal of Political Economy*, 106(6), pp. 1113-1155.
- La Porta R., Lopez-De-Silanes F. and Shleifer A. (2006), "What Works in Securities Laws", *Journal of Finance*, 61(1), pp. 1-36.
- Landsman W.R., Maydew E.L. and Thornock J. R. (2012), "The Information Content of Annual Earnings Announcements and Mandatory Adoption of IFRS", *Journal of Accounting and Economics*, 53, pp. 34-54.
- Larcker D.F., Richardson S.A. and Tuna I. (2007), "Corporate governance, accounting outcomes, and organizational performance", *The Accounting Review*, 82(4), pp. 963-1008.
- Lennox C.S. and Pittman J.A. (2010), "Big Five Audits and Accounting Fraud", *Contemporary Accounting Research*, 27(1), pp. 209-247.
- Leuz C. (2010), "Different approaches to corporate reporting regulation: how jurisdictions differ and why", *Accounting and Business Research*, 40(3), pp. 229-256.
- Leuz C., Nanda D. and Wysocki P. (2003), "Earnings management and investor protection: An international comparison", *Journal of Financial Economics*, 69(3), pp. 505-527.
- Leuz C. and Wysocki P. (2016), "The Economics of Disclosure and Financial Reporting Regulation: Evidence and Suggestions for Future Research", *Journal of Accounting Research*, 54(2), pp. 525-622.
- Li S. (2010), "Does Mandatory Adoption of International Financial Reporting Standards in the European Union Reduce the Cost of Equity Capital?", *The Accounting Review*, 85(2), pp. 607-636.
- Lobo G.J. and Zhao Y. (2013), "Relation between audit effort and financial report misstatements: Evidence from quarterly and annual restatements", *The Accounting Review*, 88(4), pp. 1385-1412.
- Mahoney P.G. (2009), "The Development of Securities Law in the United States", *Journal of Accounting Research*, 47(2), pp. 325-347.
- Menon K. and Williams D.D. (2010), "Investor reaction to going concern audit reports", *The Accounting Review*, 85(6), pp. 2075-2105.



- Miller G. (2006), "The press as a watchdog for accounting fraud", *Journal of Accounting Research*, 44(5), pp. 1001-1033.
- Myers J.N., Myers L.A. and Omer T.C. (2003), "Exploring the term of the auditor-client relationship and the quality of earnings: A case for mandatory auditor rotation?", *The Accounting Review*, 78(3), pp. 779-799.
- Naiker V. and Sharma D.S. (2009), "Former audit partners on the audit committee and internal control deficiencies", *The Accounting Review*, 84(2), pp. 559-587.
- Nourayi M.M. (1994), "Stock price responses to the SEC's enforcement actions", *Journal of Accounting and Public Policy*, 13, pp. 333-347.
- Pownall G. and Wieczynska M. (2017), "Deviations from the Mandatory Adoption of IFRS in the European Union: Implementation, Enforcement, Incentives, and Compliance". Available at: [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1919805](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1919805).
- Prather-Kinsey J. and Meek G.K. (2004), "The effect of revised IAS 14 on segment reporting by IAS companies", *European Accounting Review*, 13(2), pp. 213-234.
- Preiato J., Brown P. and Tarca A. (2015), "A Comparison of Between-Country Measures of Legal Setting and Enforcement of Accounting Standards", *Journal of Business Finance & Accounting*, 42(1-2), pp. 1-50.
- Quagli A., Avallone F., Ramassa P. and Motta L. (2018), "Measuring the Effectiveness of National Enforcers in the IFRS Context: A Proactive Approach", *International Business Research*, 11(6), pp. 151-164.
- Quagli A. and Ramassa P. (2017), *L'enforcement dell'informativa contabile*. Turin: Giappichelli.
- Reichelt K.J. and Wang D. (2010), "National and office-specific measures of auditor industry expertise and effects on audit quality", *Journal of Accounting Research*, 48(3), pp. 647-686.
- Romanus R.N., Maher J.J. and Fleming D.M. (2008), "Auditor industry specialization, auditor changes, and accounting restatements", *Accounting Horizons*, 22(4), pp. 389-413.
- Silvers R. (2013), "The Effect of Enforcement on the Market Capitalization of Earnings: Evidence from U.S. Foreign Filers", working paper, <https://business.uoregon.edu/sites/business2.uoregon.edu/files/media/roger-silvers-accounting-research-wkshop-2013-11.pdf>
- Spamann H. (2010), "The "antidirector rights index" revisited", *The Review of Financial Studies*, 23 (2), pp. 467-86.
- Srinivasan S. (2005), "Consequences of Financial Reporting Failure for Outside Directors: Evidence from Accounting Restatements and Audit Committee Members", *Journal of Accounting Research*, 43, pp. 291-334.
- Stigler G. (1964), "Public regulation of the securities markets", *Journal of Business* 37, pp. 117-142.
- Stigler G. (1971), "The theory of economic regulation", *Bell Journal of Economics and Management Science* 2, pp. 3-21.
- Street D.L. and Gray S.J. (2002), "Factors influencing the extent of corporate compliance with International Accounting Standards: summary of a research monograph". *Journal of International Accounting, Auditing and Taxation*, 11(1), pp. 51-76.

- UNCTAD (2017), *Monitoring of Compliance and Enforcement for High-quality Corporate Reporting: Guidance on Good Practices*, United Nations Publication.
- Van Beest F., Litjens R. and Vergoossen R. (2013), “Financial Reporting Enforcement and Mandatory IFRS Disclosures”, paper presented at the Annual Congress of the European Accounting Association (EAA), 6-8 May.
- Verriest A., Gaeremynck A. and Thornton D.B. (2013), “The impact of corporate governance on IFRS adoption choices”, *European Accounting Review*, 22(1), pp. 39-77.
- Viarengo L., Gatti S. and Prencipe A. (2018), “Enforcement quality and the use of earnouts in M&A transactions: International evidence”, *Journal of Business Finance & Accounting*, 45, pp. 437-481.
- Zhao Y. and Chen K.H. (2008), “Staggered boards and earnings management”, *The Accounting Review*, 83(5), pp. 1347-1381.
- Zingales L. (2009), “The future of securities regulation”, *Journal of Accounting Research*, 47, pp. 391-425.