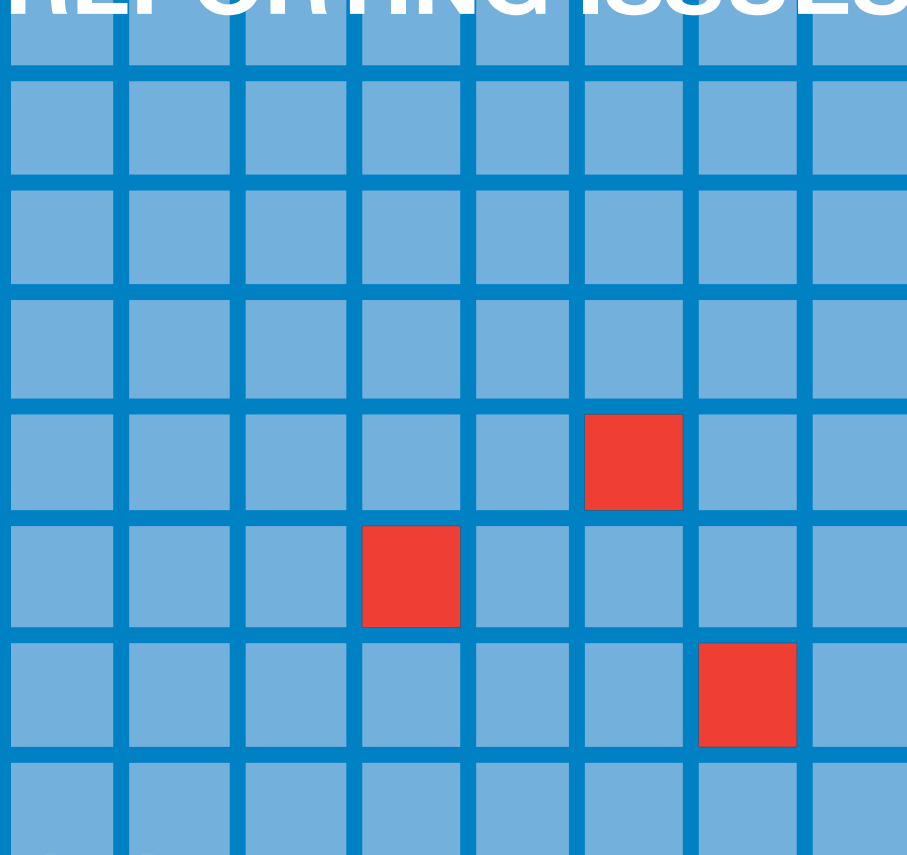




INTERNATIONAL ACCOUNTING and REPORTING ISSUES



2015 Review



**UNITED NATIONS CONFERENCE ON TRADE
AND DEVELOPMENT**

**INTERNATIONAL ACCOUNTING
AND REPORTING ISSUES
2015 REVIEW**

**Report by the secretariat
of the United Nations Conference
on Trade and Development**



UNITED NATIONS
New York and Geneva, 2016

NOTE

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PREFACE

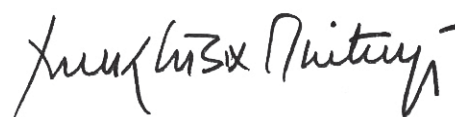
High-quality financial and non-financial reporting is essential for creating a conducive investment environment by enhancing governance, transparency and accountability. Member States of the United Nations recognized this important relationship over three decades ago by establishing, in 1982, the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) as an open and neutral forum to contribute to high-quality corporate reporting.

In September 2015, Member States of the United Nations adopted the 2030 Agenda for Sustainable Development, including seventeen Sustainable Development Goals. The agenda represents a comprehensive and far-reaching plan for global action where corporate reporting has an important role to play. The Sustainable Development Goals encourage companies – especially large and transnational companies – to adopt sustainable practices and integrate sustainability information in their reporting. Corporate reporting can serve as an important element of the monitoring and review of the Goals.

Since its creation, ISAR has supported UNCTAD member States in building the necessary regulatory, institutional and human capacity for high-quality and internationally comparable reporting by their enterprises, including financial reporting and environmental, social and governance reporting. Recently, these efforts have been further enhanced through the Accounting Development Tool (ADT), launched by UNCTAD in 2012 and since implemented in many countries around the world. The ADT provides a quantitative benchmark for assessing countries' accounting infrastructure in a systematic and consistent manner. It also assists decision makers in designing roadmaps and action plans to strengthen their reporting systems based on international standards and good practices.

Consistent application of legal requirements can only be achieved if an efficient implementation system is in place, including monitoring of compliance and enforcement mechanisms. However, building such mechanisms represents one of the major challenges for many countries. UNCTAD-ISAR has addressed this issue in several of its annual sessions and publications. Sharing good practices and lessons learned has proved to be an efficient way to show stakeholders how other countries are dealing with this issue and how such experiences can be applied or adapted in their own jurisdictions.

It is, therefore, my pleasure to present this volume of the International Accounting and Reporting Issues series, which continues UNCTAD publications on this topic and contains two extended country case studies on building mechanisms for monitoring of compliance and enforcement of regulatory requirements in the area of corporate reporting.



Mukhisa Kituyi
Secretary-General of UNCTAD

INTRODUCTION

This volume of the International Accounting and Reporting Issues series presents country case studies from Germany and the United Kingdom of Great Britain and Northern Ireland on the interrelated topics of compliance-monitoring and enforcement mechanisms in relation to corporate reporting, auditing and regulation of professional accountants within the context of achieving high-quality corporate reporting. These country case studies are a continuation of similar studies that have already been published in the 2014 volume of this series covering Australia, Belgium and Canada.

The past two decades have been characterized by a proliferation of a variety of international standards and codes of corporate reporting issued by global standard-setters. It is important to highlight that, although these standards and codes are being articulated at the global level, implementation, compliance monitoring and enforcement remains under the control of national authorities. The series of standards have posed considerable challenges for member States in terms of achieving consistent implementation and enforcement.

Over the past five years, UNCTAD-ISAR has been working over the past five years to assist member States in achieving high-quality corporate reporting. To this end, ISAR has conducted extensive deliberations at its annual sessions as well as at round tables held in different regions of the world. ISAR reinforced its work on this topic with the publication of ADT, which is intended to assist member States in developing a comprehensive and integrated approach to capacity-building. ADT is founded on four pillars: legal and regulatory, institutional, human capacity and capacity-building processes. ADT recognizes the importance of effective compliance monitoring and enforcement of corporate reporting standards and codes. This is reflected in the different pillars and indicators of ADT. ISAR has conducted in-depth deliberations at its annual sessions – including its most recent thirty-second session – on various aspects of ADT.

To facilitate sharing of experiences among members States and also to provide practical examples of compliance-monitoring and enforcement mechanisms in relation to international corporate reporting standards and codes, the UNCTAD secretariat, in cooperation with leading experts on these topics, have prepared country case studies that are presented in the 2014 volume of this series and the present volume. The case studies of Germany and the United Kingdom presented here provide an overview of the general economic settings and corporate reporting environments of the countries. They extensively elaborate on compliance monitoring and enforcement of the corporate reporting framework, audit and assurance standards, and codes of professional conduct and other applicable professional membership requirements. Although the case studies focus on mature markets, they address issues that are highly relevant for developing countries aiming to introduce good practices. An analysis of the main findings of all the case studies presented in the 2014 and 2015 volumes is contained in chapter III.

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Yoseph Asmelash conceptualized the publication, coordinated the research and drafting of the country case studies and prepared the manuscript. Isabel Garza provided useful comments on earlier versions of the country case studies. Vanessa McCarthy provided valuable administrative support. Editing in English was performed by John Rogers.

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ACRONYMS

ACCA	Association of Chartered Certified Accountants (United Kingdom)
ADT	Accounting Development Tool (UNCTAD)
AIM	Alternative Investment Market
AOC	Auditor Oversight Commission (Germany)
BaFin	Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht) (Germany)
CAI	Chartered Accountants Ireland
CIMA	Chartered Institute of Management Accountants (United Kingdom)
CIPFA	Chartered Institute of Public Finance and Accountancy (United Kingdom)
CPD	continuous professional development
EAIG	European Audit Inspection Group
EFRAG	European Financial Reporting Advisory Group
EGAOB	European Group of Auditor's Oversight Bodies
ESMA	European Securities and Markets Authority
FinDAG	Act Establishing BaFin (<i>Finanzdienstleistungsaufsichtsgesetz</i>) (Germany)
FCA	Financial Conduct Authority (United Kingdom)
FRC	Financial Reporting Council (United Kingdom)
FREP	Financial Reporting Enforcement Panel (Deutsche Prüfstelle für Rechnungslegung) (Germany)
GAAP	Generally Accepted Accounting Principles
IAASB	International Auditing and Assurance Standards Board
IASB	International Accounting Standards Board
ICAEW	Institute of Chartered Accountants in England and Wales
ICAS	Institute of Chartered Accountants of Scotland
IDW	Institute of Public Auditors in Germany
IESBA	International Ethics Standards Board for Accountants
IFAC	International Federation of Accountants
IFIAR	International Forum of Independent Audit Regulators
IFRS	International Financial Reporting Standards
IOSCO	International Organization of Securities Commission
ISA	International Standards on Auditing
ISAR	Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (UNCTAD)
ISDX	ICAP Securities and Derivatives Exchange
PCAOB	Public Company Accounting Oversight Board (United States of America)
PRA	Prudential Regulation Authority (United Kingdom)
RQB	recognized qualifying body
RSB	recognized supervisory body
WpHG	Securities Trading Act (<i>Wertpapierhandelsgesetz</i>) (Germany)
WPK	Chamber of Public Accountants (Wirtschaftsprüferkammer) (Germany)

CHAPTER I. CASE STUDY OF GERMANY

This chapter presents a case study conducted in Germany on compliance-monitoring and enforcement mechanisms in relation to corporate reporting.¹ Section A provides an introduction to the economic setting and general corporate reporting environment of the country. Section B discusses financial reporting enforcement and the roles of the supervisory bodies – the Financial Reporting Enforcement Panel (FREP) (Deutsche Prüfstelle für Rechnungslegung) and the Federal Financial Supervisory Authority (BaFin) (Bundesanstalt für Finanzdienstleistungsaufsicht). Section C contains a presentation of compliance-monitoring and enforcement systems pertaining to auditing and the accountancy profession. A summary, conclusions and lessons learned are contained in section D.

A. INTRODUCTION

1. General economic setting of Germany

In 2013, with a gross domestic product of €2,737.6 billion, Germany was the biggest economy in Europe.² The most dominant sectors in Germany's economy are shown in table I.1.

2. German capital market

Measured by equity market capitalization, Germany is ranked ninth largest in the world.³ Based on data from

¹ This case study was prepared for UNCTAD by Brigitte Eierle, Professor, International Accounting, and Miriam Schleicher, both of the University of Bamberg, Germany. A longer version of this chapter is available at http://unctad.org/meetings/en/Presentation/ciisar31_1610PM_BEierle_en.pdf (accessed 15 January 2016).

² Deutschland in Zahlen, 2014, *Deutschland in Zahlen – Das Statistikportal des IWK Köln*, 4 August, available at <http://www.deutschlandinzahlen.de/> (accessed 16 January 2016).

³ See World Federation of Exchanges, 2013 WFE market highlights, available at <http://www.world-exchanges.org/home/index.php/files/18/Studies%20-%20Reports/6/2013%20WFE%20Market%20Highlights.pdf> (accessed 1 February 2016).

Table I.1. Dominant sectors in Germany

Dominant sectors in Germany [gross value added in € billions]	2012	Δ [%]	2013
Manufacturing	534.36	0.2	535.18
Public services, education and health	438.11	2.9	450.75
Trade, tourism and travel	347.48	2.3	355.55
Real estate, renting and business activities	289.29	3.2	289.59
Company service providers	264.51	6.3	281.12
Building industry	111.32	4.0	115.80
Other service providers	108.72	3.3	112.35
Real estate, financial and insurance services	94.42	4.4	98.55
Information and communication	96.02	0.5	96.52
Goods producing sector (not including the building industry and manufacturing)	82.58	9.3	90.30
Agriculture, forestry and fishing	19.98	-3.6	19.27
Total	2 386.79	2.8	2 453.98

Source: *Deutschland in Zahlen*, see <http://www.deutschland-inzahlen.de/> (accessed 15 January 2016).

July 2013, there were in total 877 companies listed on the regulated market in Germany; of these, 129 are foreign companies listed in Germany. Most foreign companies are based in Austria, Jersey (Channel Islands), Luxembourg and the United States.⁴ From the DAX 30 companies, six are cross-listed abroad in Luxembourg, Switzerland, the United Kingdom or the United States. Twenty companies have American Depositary Receipts and two have their shares listed in the United States. The regulated market in Germany is an organized market, meaning that admission and follow-up requirements for the companies listed in that market, as well as the respective trading organizations, are subject to legal regulations. The regulated market is divided into two listing segments: (a) the General Standard and (b) the Prime Standard.

⁴ See BaFin, *Liste der durch das Enforcement zu prüfenden Unternehmen*, available at http://www.bafin.de/Shared-Docs/Downloads/DE/Liste/dl_li_fis_enforcement.html (accessed 1 February 2016).

General Standard companies have an option to prepare their consolidated financial statements either in accordance with the International Financial Reporting Standards (IFRS) or the United States Generally Accepted Accounting Principles (United States GAAP),⁵ publish ad-hoc announcements and provide one interim report. In addition to General Standard requirements, the Prime Standard calls for quarterly reports and ad-hoc announcements in English, maintenance of a company calendar, and at least one analyst conference per year. Companies that want to be included in one of the Frankfurt Stock Exchange indices, namely DAX, MDAX, SDAX or TecDAX, must be listed in the Prime Standard. DAX is the key German stock index which tracks the 30 largest German companies traded on the Frankfurt Stock Exchange, the so-called “blue chips”.⁶

3. German professionals and auditing firms

In Germany there are 14,390 public accountants (*Wirtschaftsprüfer*) and 3,211 sworn auditors (*vereidigte Buchprüfer*).⁷ There are a total of 2,821 public audit firms plus 110 firms of sworn auditors. Ninety-eight public accountants and three sworn auditors are foreign but registered in Germany.⁸ The four biggest public audit firms, the so-called “big

four”, are PricewaterhouseCoopers AG, KPMG AG, Ernst and Young GmbH and Deloitte and Touche GmbH. All DAX 30 companies are audited by one of these four audit firms. Table I.2 gives an overview of these four firms together with the following 10 largest audit firms in 2012, ranked according to their revenue and the number of public-interest entities engagements they had. In accordance with article 319a of the German Commercial Code, these are capital-market-oriented companies, having either debt or equity securities, that have been admitted to a regulated market in the European Union (publicly traded companies). In total there were 97 audit firms/practices that audited public-interest entities in 2012.

Audit firms are also allowed to merge into international networks (for example, Nexia, Moore Stephens).⁹

4. Regulation of accounting and auditing in Germany

Germany is a code law country for which financial reporting requirements are generally regulated in the German Commercial Code. Except for very small sole traders, all businesses recorded in the commercial register have to prepare individual financial statements in accordance with the Code.¹⁰ However, firms can also prepare an additional set of individual financial statements in accordance with European Union-endorsed IFRS for publication purposes (article 325 IIa and IIb of the German Commercial Code). The consolidated financial statements of publicly traded entities (in line with the European Union IFRS Regulation No. 1606/2002) must be prepared in accordance with European Union-endorsed IFRS (article 315a III of the German Commercial Code), whereas non-publicly traded entities for their consolidated financial statements have an option either to use European Union-endorsed IFRS or apply the accounting

⁵ Due to the requirements of the German Commercial Code, German companies with listed securities are, however, required to apply IFRS in their consolidated financial statements (see section A.4: Regulations of accounting and auditing in Germany).

⁶ See Deutsche Börse Group, 2014, Glossary, 4 August, available at http://deutsche-boerse.com/dbg/dispatch/en/kir/dbg_nav/about_us/30_Services/40_Know_how/10_Stock_Exchange_A_Z?horizontal=page (accessed 16 January 2016). MDAX tracks the so-called “mid caps”. It comprises the 50 largest companies stemming from classic industry sectors. MDAX is followed by SDAX, which features 50 small and medium-sized companies, the so-called “small caps”. The German TecDAX is the stock index that consists of the 30 largest German companies from the technology sector.

⁷ Public accountants are authorized to carry out the statutory audits for all companies irrespective of their size and capital-market orientation; sworn auditors are licensed in public practice and are authorized to perform statutory audits only of medium-sized German limited-liability companies. Since 2005, it is no longer possible to get access to the profession of sworn auditors.

⁸ See Wirtschaftsprüferkammer, *Mitgliederstatistik der WPK* (stand 1, January 2014), available at http://www.wpk.de/fileadmin/documents/WPK/Organisation/WPK-Statistiken_Januar_2014.pdf (accessed 16 January 2016); pp. 3 forward.

⁹ See Lündendonk, *Führende Wirtschaftsprüfungs und Steuerberatungs-Gesellschaften in Deutschland 2013*, available at http://lueendonk-shop.de/out/pictures/0/lue_wp_liste_pi_f300614%281%29_fl.pdf (accessed 18 January 2016).

¹⁰ For income taxation purposes companies have to comply with the requirements in the tax law that provide that the financial statements prepared in accordance with the German Commercial Code form the basis for taxation (German Income Tax Act, 2014, article 5 I). All limited liability companies have to lodge their financial statements with the Federal Gazette, which also monitors the lodgements of the annual reports.

Table I.2. Audit market concentration in Germany

Rank	Audit firm	Revenue 2012 (€ thousands)	Mandates of publicly traded entities in 2012
1	PricewaterhouseCoopers AG WPG	1 500 800	145
2	KPMG AG WPG	1 207 624	123
3	Ernst and Young GmbH WPG	1 158 112	101
4	Deloitte and Touche GmbH WPG	657 800	50
5	BDO AG WPG	170 194	38
6	PKF Fasselt Schlage Partnerschaft WPG StBG	63 200	2
7	RBS RoeverBroennerSusat GmbH and Co. KG WPG StBG	62 000	7
8	Warth & Klein Grant Thornton AG WPG	54 107	13
9	Rölfs RP AG WPG	53 135	7
10	Rödl and Partner GmbH WPG StBG	49 158	7
11	Ebner Stolz Mönning Bachem GmbH and Co. KG WPG StBG	43 979	26
12	KPMG Bayerische Treuhandgesellschaft AG WPG StBG	38.197	10
13	Mazars GmbH WPG	33 900	3
14	Bansbach Schübel Bröstl and Partner GmbH WPG StBG	23 230	2

Source: N Ratzinger-Sakel, 2013, *Aktuelle Entwicklungen auf dem WP-Markt in Deutschland: Umsätze und Mandate der WP-Praxen nach Transparenzberichten, Betriebs Berater*, 68.

Table I.3. Applicable accounting standards

	Publicly traded entities	Non-publicly traded entities
Individual financial statement	Mandatory application of the accounting rules of the German Commercial Code Additional IFRS financial statement permitted for publication purposes only since 01.01.2005	
Consolidated financial statement	Mandatory application of IFRS since 01.01.2005	Application of IFRS permitted since 01.01.2005

Source: AG Coenenberg, A Haller and W Schultze, 2014, *Jahresabschluss und Jahresabschlussanalyse*, 23 (Stuttgart, Schäffer-Poeschel, 2014), p. 14.

requirements of the German Commercial Code (table I.3).¹¹

Apart from European Union-endorsed IFRS and the accounting rules included in the German Commercial Code, the following regulations are relevant for accounting purposes:

- Uncodified principles of proper accounting;¹²
- German Accounting Standards;¹³

¹¹ See AG Coenenberg, A Haller and W Schultze, 2014, *Jahresabschluss und Jahresabschlussanalyse*, 23 (Stuttgart, Schäffer-Poeschel, 2014), p. 12 forward.

¹² They are obligatorily applicable when financial statements are prepared in accordance with the German Commercial Code and are developed via accounting practice and court decisions (see AG Coenenberg, A Haller and W Schultze, 2014, *Jahresabschluss und Jahresabschlussanalyse*, 23 (Stuttgart, Schäffer-Poeschel, 2014) pp. 39 forward).

¹³ They are developed by the German Accounting Standards Board and are assumed to represent principles of

- Rules of the German Corporate Governance Code.¹⁴

In Germany, all large and medium-sized companies (stock companies, private limited companies and limited partnerships with a limited liability company

proper accounting for consolidated financial statements prepared in accordance with the German Commercial Code after the standards have been publicly announced by the Ministry of Justice (see AG Coenenberg, A Haller and W Schultze, 2014, *Jahresabschluss und Jahresabschlussanalyse*, 23 (Stuttgart, Schäffer-Poeschel, 2014) pp. 49 forward).

¹⁴ They are developed by the Government Commission German Corporate Governance Codex. Listed corporations are obliged to comply with the rules of the German Corporate Governance Codex or explain any departure from it (article 161 of the Stock Corporations Act) and provide information where the declaration regarding compliance with the Corporate Governance Codex has been published in the notes of their financial statements (see <http://www.dcgk.de/en/home.html> (accessed 18 January 2016)).

as general partner),¹⁵ as well as large unlimited-liability companies regulated by the Publicity Act (*Publizitätsgesetz*),¹⁶ are required to be audited. The audit function is regulated in Germany via the following major sources:

- Audit rules included in the German Commercial Code;¹⁷
- Provisions of the Public Accountant Act;¹⁸
- Promulgations by the Institute of Public Auditors in Germany (IDW);¹⁹
- International Standards on Auditing (ISA).²⁰

B. FINANCIAL REPORTING ENFORCEMENT

1. German two-stage enforcement system

Based on the European Union Regulation (EC) No. 1606/2002 (IFRS Regulation)²¹ and the European Union Directive 2004/109/EC (Transparency Directive),²² both requiring European Union member

¹⁵ According to article 267 of the German Commercial Code a company is small/medium-sized if two of the following criteria are met in two consecutive years: balance sheet total \leq €4,840,000/€19,250,000; revenue \leq €9,680,000/€38,500,000; number of employees \leq 50/250.

¹⁶ An unlimited-liability company is subject to the Publicity Act if it meets two of the following criteria in three consecutive years: balance sheet total $>$ €65,000,000; revenue $>$ €130,000,000; number of employees $>$ 5,000.

¹⁷ They are codified in articles 316 to 324a of the Commercial Code regulating the requirements for statutory audits and must be applied by all auditors conducting statutory audits.

¹⁸ These regulate the auditing profession and are obligatory for all members of the Chamber of Public Accountants (WPK) (Wirtschaftsprüferkammer). For further details regarding membership see section C.2.A.

¹⁹ See section C.1 – The enforcement on professional duties is done by the Auditor Oversight Commission (AOC) and WPK.

²⁰ Currently, ISA are not adopted by the European Union but the European Union has announced its intention to do so. As soon as ISA are accepted by the European Union, these are due to be referenced in the German Commercial Code (article 317 V), obligatorily applicable to all statutory audits. Until then, IDW auditing standards are applicable. Due to the European Union's delayed decision on ISA adoption, IDW has started and will continue to transpose ISA in its auditing standards.

²¹ See the European Parliament and Council Regulation (EC) No. 1606/2002, 19 July 2002, on the application of international accounting standards, recital 16.

²² See the European Parliament and Council Directive 2004/109/EC, 15 December 2004, on the harmonization

States to ensure the appropriate application of the relevant accounting standards, in October 2004 the German legislator passed the Financial Reporting Compliance Act (*Bilanzkontrollgesetz*). This Act formed the basis for the German financial reporting enforcement regime.²³

The principal characteristic of the German enforcement system is that it comprises a two-stage system, with the first stage featuring FREP as a privately organized agency and the second stage involving the public security regulator, BaFin.

(a) Organization of the German Financial Reporting Enforcement Panel

The structure of FREP is shown in figure I.1. The following discussion focuses on the organizational structure of the Enforcement Panel itself, which is the relevant body responsible for examining financial reporting of companies.

Members of the FREP Enforcement Panel are required to be accounting professionals with sufficient expertise in IFRS. They are elected by a Nomination Committee for a term of four years and may be re-elected several times. The Enforcement Panel consists of 16 full-time members plus the President and the Vice-President. The President (represented by Vice-President) is responsible for managing the Enforcement Panel and representing it externally.²⁴

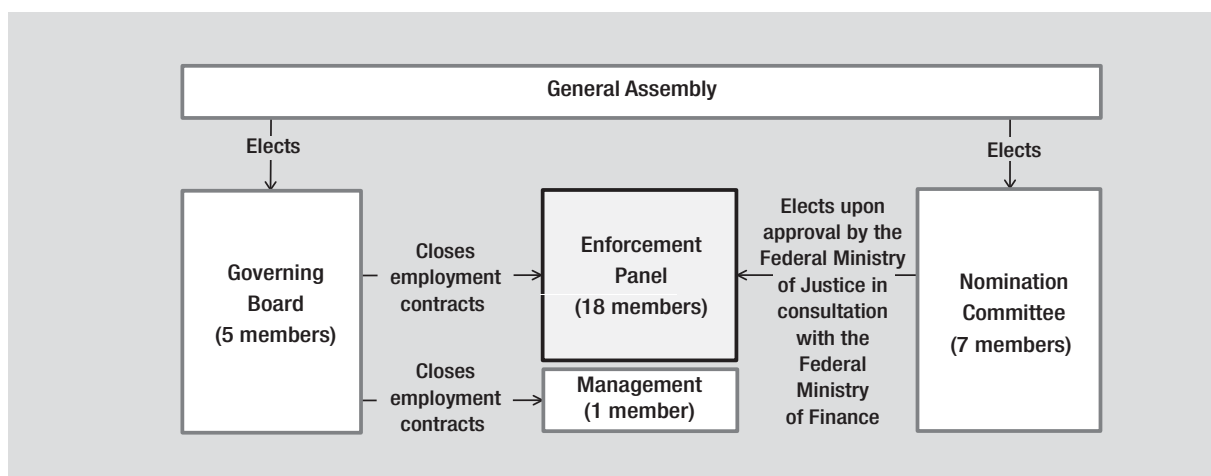
The final judgment on examination findings is taken by subunits of the Enforcement Panel, known as chambers. Each chamber consists of the President, the Vice-President and one additional member of the Enforcement Panel. The chambers are chaired either by the President or the Vice-President. There are as many chambers as there are members of the Enforcement Panel (excluding the President and Vice-President).

For each enforcement examination the designated chamber selects an examiner-in-charge who, as

of transparency requirements in relation to information about issuers whose securities are admitted to trading in a regulated market, article 24.4h.

²³ See the Act on the Enforcement of Accounting Regulations for Company Financial Statements, 15 December 2004.

²⁴ See FREP, Enforcement Panel's Code of Procedures, 24 August 2005, article 1. For a comprehensive overview of the actual Presidential Board, see FREP, Presidential Board, 30 July 2014, available at http://www.frep.info/ueber_uns/praesidium_der_pruefstelle_en.php (accessed 27 January 2016).

Figure I.1. Organization chart of FREP

Source: FREP, see http://www.frep.info/struktur_der_dpr/organigramm_en.php (accessed 18 January 2016).

a member of the Enforcement Panel, is made responsible for conducting all enforcement examination activities. The examiner-in-charge is not a member of the chamber responsible for this particular case but performs its examinations in close cooperation with the chamber. Besides the examiner-in-charge, the chair of the designated chamber also selects a particular member of the Enforcement Panel to be the quality-control panel member who is herself/himself not a member of the designated chamber. The quality-control panel member's responsibility is to conduct a critical review of enforcement documentation prepared by the examiner-in-charge. On conclusion of this work, the quality-control panel member forwards his/her report to the chair of the chamber.²⁵

(b) Organization of the Federal Financial Supervisory Authority

Based on article 37n and onward of the German Securities Trading Act (WpHG) (*Wertpapierhandelsgesetz*), BaFin forms the second stage of German enforcement. It also shares banking supervision with the Deutsche Bundesbank. Mindful of BaFin supervision guidelines, the Deutsche Bundesbank analyses bank reports and returns, assessing the adequacy of their capital and risk

management procedures.²⁶ The supervision of insurance undertakings in Germany is divided between the Federal Government and the respective federal state. On behalf of the Federal Government, BaFin supervises those private insurance undertakings that are of material economic and financial significance, as well as public insurance undertakings operating across the borders of any federal state.²⁷ BaFin is a public authority, part of the federal administration and subject to legal and technical oversight by the Federal Ministry of Finance.²⁸ Currently, it has in total 2,398 employees, the majority of whom are public officials.²⁹

²⁶ See BaFin, 2014, Banks and financial services providers, 8 August, available at http://www.bafin.de/EN/Supervision/BanksFinancialServicesProviders/banksfinancialservicesproviders_node.html (accessed 18 January 2016).

²⁷ See BaFin, 2014, Insurance undertakings and pension funds, 28 August, available at http://www.bafin.de/EN/Supervision/InsuranceUndertakingsPensionFunds/insuranceundertakingspensionfunds_node.html (accessed 18 January 2016). Supervisory authorities of the federal states are responsible for supervising public insurers whose activities are limited to a particular federal state and private insurers of lesser economic and financial significance.

²⁸ See FinDAG, 2014, article 1 and BaFin, 2014, Legal bases and organization, 30 July, available at http://www.bafin.de/EN/BaFin/Organisation/organisation_node.html (accessed 18 January 2016).

²⁹ See FinDAG, 2014, articles 9 forward; see also BaFin, 2014, BaFin staff, 30 July, available at http://www.bafin.de/EN/BaFin/Organisation/BaFinStaff/bafinstaff_node.html (accessed 18 January 2016); see also BaFin, 2012, *Jahresrechnung 2012* (enforcement), available at http://www.bafin.de/SharedDocs/Downloads/DE/Bericht/Haushalt/Haushaltsrechnungen/dl_jahresrechnung_2012_enforcement.pdf?__blob=publicationFile&v=2 (accessed 18 January 2016), p. 2 forward.

²⁵ See FREP, Code of Procedures of the Enforcement Panel, available at http://www.frep.info/docs/rechtl-iche_grundlagen/20050816_verfahrensordnung_pruefstelle_en.pdf (accessed 18 January 2016), articles 4 forward.

(c) Financing

Enforcement expenses of FREP and BaFin not covered by other sources³⁰ of income are allocated to those entities whose securities are traded on the regulated market as of 1 July each year in accordance with allocation arrangements set out in the Act Establishing BaFin (FinDAG) (*Finanzdienstleistungsaufsichtsgesetz*). The revenues and expenditures relating to financial reporting enforcement have to be reported separately in the budget of BaFin. In 2013, its budget for enforcement was €8.1 million, of which €5.4 million were for FREP.³¹

(d) Scope

In accordance with article 342 b of the German Commercial Code, FREP examines, for entities whose securities are accepted for trading on a regulated market within a domestic stock exchange:³²

- The most recently approved annual individual financial statements as well as the related management report; and/or
- The most recently approved annual consolidated financial statements together with the group management report; as well as
- Interim financial statements, together with the related interim management reports.

However, examination by the Enforcement Panel is limited to specific focus areas and not comparable to the scope of an external audit.

Additionally, since November 2009 FREP provides the opportunity for pre-clearance inquiries. These inquiries can be put forward by companies that are subject to the financial reporting enforcement of FREP and are free of charge. To make a pre-clearance inquiry a company must submit relevant

documents from which the Enforcement Panel decides whether or not the proposed accounting treatment is acceptable. Those documents include: (a) a precise description of the accounting issue; (b) the proposed accounting treatment; (c) an opinion from the auditors of the company. It is important to note that the pre-clearance opinion of FREP is not binding in a potential subsequent enforcement investigation by the Enforcement Panel.³³

(e) Causes for examinations

An examination can be initiated by the Enforcement Panel for the following three reasons:

- Examination with cause – if there are specific indications of an infringement in financial reporting requirements;
- Examination at the request of BaFin;
- Random sampling examination.³⁴

Random sampling is based on a combined-risk approach that is carried out in two stages. During the first stage, based on publicly available information, the Enforcement Panel looks at publicly traded companies (within the scope of FREP) that are subject to special risk (for example, because they are listed for the first time, have extraordinary transactions, and the like). From these companies the Enforcement Panel randomly selects 30 per cent. During the second stage the Enforcement Panel applies a stratified random sampling technique, thereby distinguishing between companies listed in the stock segments DAX, SDAX, MDAX and TecDAX, whose financial reporting is examined every four to five years, and all other entities within the scope of FREP, whose financial information is investigated only every eight to ten years.³⁵ If appropriate,

³⁰ These are primarily reimbursements from companies for examinations conducted by BaFin in cases where a company does not accept the findings of FREP (but the FREP decision was proven right) or a company does not cooperate with FREP (FinDAG, 2014, articles 14 forward and 17d).

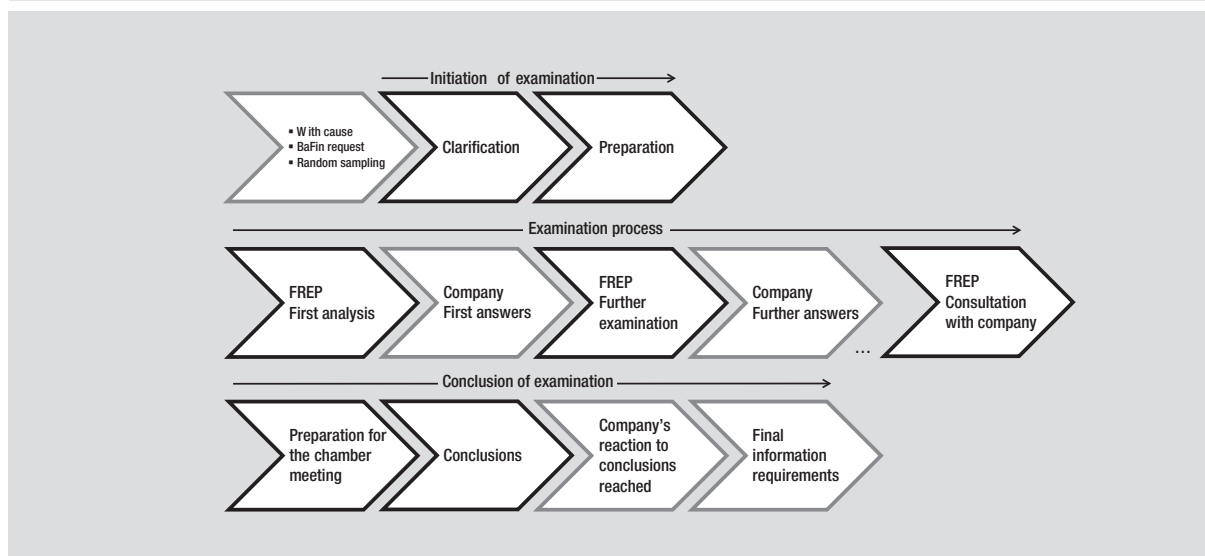
³¹ See FinDAG, 2014, article 14 forward and 17d, and also Bilanzkontrollkosten-Umlageverordnung, 2013, which determine that the allocation is based on stock exchange turnover.

³² See the German Commercial Code, article 342b II (1). The respective article of the German Commercial Code was introduced by the Bilanzkontrollgesetz in 2004. The examination of abbreviated financial statements is established by the German Transparency Directive Implementation Act based on the Transparency Directive.

³³ See FREP, Pre-clearance inquiries of the FREP, available at http://www.frep.info/docs/fallbezogene_voranfragen/info_fallbezogene_voranfragen_en.pdf (accessed 18 January 2016), pp. 1 forward.

³⁴ See the German Commercial Code, article 342b II (3). Interim financial statements and the interim management report are examined only on request of BaFin or if there are specific indications of an infringement. For random sampling investigations in the field of credit institutions and insurance companies, BaFin is allowed to call for an examination of the financial statements (article 37p I (4) of WpHG).

³⁵ See FREP, 2009, *Grundsätze für die stichprobenartige Prüfung gemäß § 342b Abs. 2 Satz 3 Nr. 3 HGB*, 20 April, available at http://www.frep.info/docs/rechtliche_grundlagen/20090420_grundsätze_stichprobenartige_pruefung.pdf (accessed 18 January 2016), pp. 3 forward.

Figure I.2. The FREP examination process

Source: FREP, see http://www.frep.info/docs/pruefverfahren/schema_ablauf_pruefverfahren_en.pdf (accessed 18 January 2016).

the Enforcement Panel can base its selection on specific focus areas. To avoid double checking, an enforcement examination will not occur if an action has been filed to declare the financial statements void or if, in accordance with article 142 (special audits related to the formation of a company, capital procurements or capital reductions) or article 258 (special audits due to impermissible undervaluation) of the German Stock Corporation Act (*Aktiengesetz*), a special auditor has been involved.³⁶

(f) Sanctions

Incorrect material financial reporting is sanctioned by, following an order from BaFin, the publication of the error.³⁷

2. The financial reporting enforcement process in Germany

The financial reporting enforcement process in Germany is divided into two stages. The first stage involves the examination by FREP and the second stage concerns BaFin.

³⁶ See FREP, Information relating to the examination process of the Financial Reporting Enforcement Panel, available at http://www.frep.info/docs/pruefverfahren/info_ablauf_pruefverfahren_en.pdf (accessed 18 January 2016), p. 2.

³⁷ Ibid, p. 5. For further details see section B.2.(b).

(a) Examination process of the Enforcement Panel

The examination process of the Enforcement Panel which normally lasts from two to seven months is depicted in figure I.2.

(b) BaFin enforcement activities

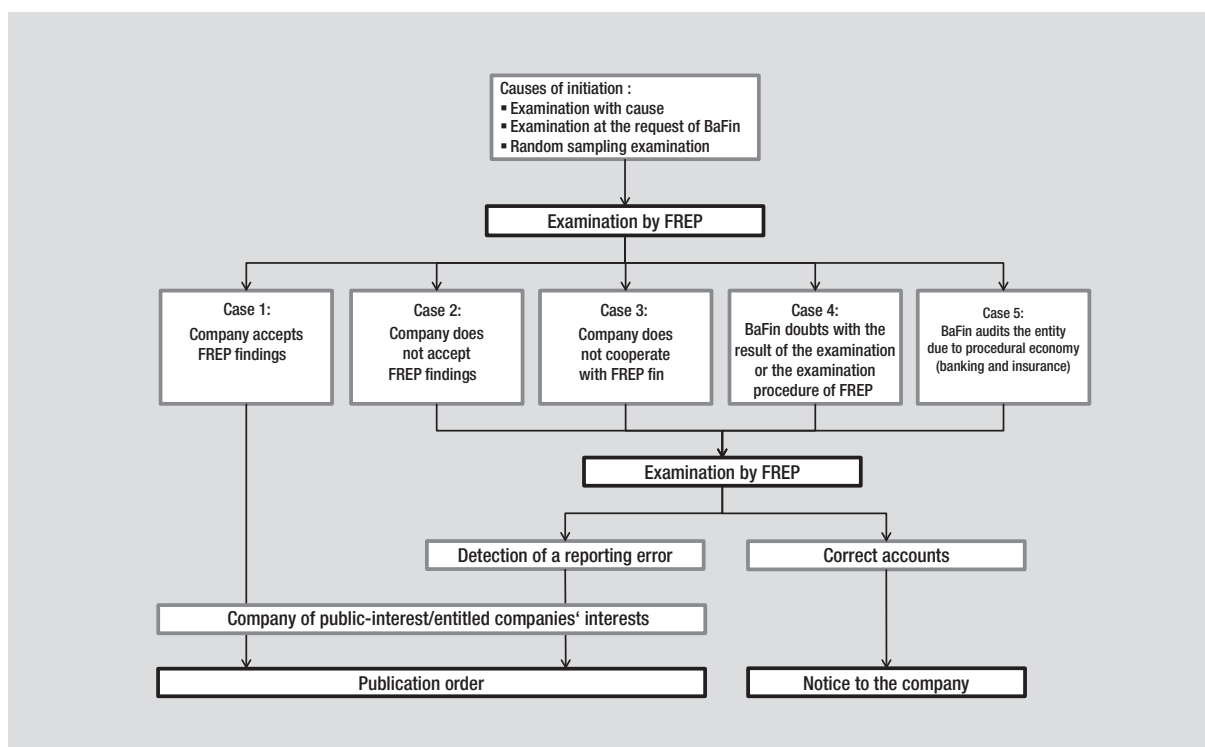
The enforcement activities of BaFin are shown in figure I.3. They start subsequent to the FREP examination process.

If the Enforcement Panel finds a company's financial reports to be erroneous and the company accepts these findings, BaFin will order publication of the accounting error. There are four circumstances that may then trigger a subsequent examination by BaFin: (a) the company does not accept the findings of FREP; (b) the company does not cooperate with FREP; (c) BaFin has doubts about the examination result or procedure of FREP; (d) BaFin takes over the examination due to procedural economy.³⁸ If the company does not cooperate with BaFin, this is considered to be a legal offence that is punishable by a fine of up to €50,000.³⁹ Similar to the process of the Enforcement Panel, the BaFin examination is only a partial review – it does not cover all accounting issues in the financial reports. BaFin finishes its examination either with a notification

³⁸ To investigate companies from the banking and insurance sectors.

³⁹ See WpHG, 2014, articles 39 III No. 1 and 39 IV.

Figure I.3. The two-stage accounting enforcement in Germany



Source: Deloitte, *Enforcement der Rechnungslegung – DPR-Leitfaden für Vorstände und Aufsichtsräte*, available at https://www2.deloitte.com/content/dam/Deloitte/de/Documents/audit/DPR_2015_komplett_safe.pdf (accessed 18 January 2016), p. 37.

to the company that the examination did not result in any objections, or with the declaration of an error.⁴⁰

If the Enforcement Panel decides that certain accounting action is erroneous and the company concurs with these findings, or if BaFin detects in its examination a material infringement, BaFin will order publication of the error provided that the company is one of public interest.

The company has to publish the infringement immediately in two types of communication media: (a) the electronic *Federal Gazette*; (b) a multi-regional financial newspaper or an electronic business wire service.⁴¹ The announcement has to include the

accounting error with relevant parts of the explanatory memorandum of BaFin. The company is, thereby, not allowed to add any additional information or weakening statements. The following box shows an example of an error announcement of Adidas AG regarding its financial report 2011.

Since there are no further sanction mechanisms, the German financial reporting enforcement system relies solely on the capital market participants to punish erroneous reporting themselves. If the company does not publish the accounting error or violates the error publication, BaFin is allowed to threaten a penalty payment of up to €250,000 or carry out publication at the company's expense. Non-compliance with the rules for the error publication is, in addition, an offence that can be punished with a fine of up to €50,000.⁴²

⁴⁰ See BaFin, *Emittentenleitfaden der Bundesanstalt für Finanzdienstleistungsaufsicht*, available at http://www.bafin.de/SharedDocs/Downloads/DE/Leitfaden/WA/dl_emittentenleitfaden_2013.pdf?__blob=publicationFile&v=5 (accessed 18 January 2016), pp. 182 forward.

⁴¹ See WpHG, 2014, article 37q II and BaFin, *Emittentenleitfaden der Bundesanstalt für Finanzdienstleistungsaufsicht*, available at http://www.bafin.de/SharedDocs/Downloads/DE/Leitfaden/WA/dl_emittentenleitfaden_2013.pdf?__blob=publicationFile&v=5 (accessed 18 January 2016), p. 187.

⁴² *Ibid*, pp. 186 forward. Penalties collected by BaFin are included in its budget. See also BaFin, *Haushaltsplan 2013 (Enforcement)*, available at http://www.bafin.de/SharedDocs/Downloads/DE/Bericht/Haushalt/Haushaltsplaene/dl_haush_2013_enforce.pdf?__blob=publicationFile&v=2 (accessed 18 January 2016).

Box 1. Adidas AG, Herzogenaurach Announcement pursuant to Article 37q II (1) of the German Securities Trading Act (Wertpapierhandelsgesetz – WpHG)

The German Financial Reporting Enforcement Panel (FREP) has determined that the consolidated financial statements of adidas AG, Herzogenaurach, as at the reporting date December 31, 2011, are erroneous.

The discovery of fraudulent acts at Reebok India Company, a subsidiary of adidas AG, Herzogenaurach, led to the identification of errors in the consolidated financial statements for the year ending December 31, 2011, and for previous financial years, inter alia due to inappropriate recognition of sales, a failure to book sales returns and a failure to correctly post credit notes to accounts receivable. As a consequence of these errors, shareholders' equity at December 31, 2011, was overstated by a total of EUR 203 million and net income for 2011 was overstated by EUR 62 million. Basic and diluted earnings per share were both overstated by EUR 0.27.

Assets at December 31, 2011, were overstated by a total of EUR 143 million and liabilities were understated by EUR 60 million. The incorrect recognition of assets primarily related to:

- accounts receivable in an amount of EUR 112 million, which, contrary to IAS 39.63 et seq., were not stated at the recoverable amount or their legal validity could not be proved;
- goodwill in an amount of EUR 27 million, which, contrary to IAS 36.90 et seq., was not stated at the recoverable amount;
- non-recognized inventories of EUR 20 million for which, contrary to IAS 2.34 in conjunction with IAS 18.14 et seq., no sale or disposal had occurred.

The incorrect recognition of liabilities related to, inter alia:

- current provisions of EUR 42 million, primarily for onerous contracts, which, contrary to IAS 37.66 et seq., were not recognized;
- other current financial liabilities of EUR 10 million which, contrary to IAS 1.32, were netted against receivables.

As a result of the fraudulent acts, in the statement of cash flows

- the positive cash flow generated from operating activities, contrary to IAS 7.6 in conjunction with IAS 7.13 et seq., was understated by EUR 15 million;
- the negative cash flow from financing activities, contrary to IAS 7.6 in conjunction with IAS 7.17, was understated by EUR 9 million; and
- cash and cash equivalents at January 1, 2011, contrary to IAS 7.6, were overstated by EUR 6 million.

Herzogenaurach, May 2013

adidas AG

The Executive Board

Source: Adidas AG, see http://www.adidas-group.com/media/filer_public/2013/07/31/37q_04082011_en_1.pdf (accessed 18 January 2016).

There are very rare circumstances in which an error publication does not occur:

- BaFin refrains from an error publication due to a lack of public interest;⁴³
- The company files an application to block publication of the accounting infringement on the grounds that it is likely to damage its legitimate interests.⁴⁴

⁴³ This is the case where the infringement is not significant – petty offences.

⁴⁴ See WpHG, 2014, article 37q II; see also BaFin, *Emitentenleitfaden der Bundesanstalt für Finanzdienstleistungs-*

aufsicht, available at http://www.bafin.de/SharedDocs/Downloads/DE/Leitfaden/WA/dl_emitentenleitfaden_2013.pdf?__blob=publicationFile&v=5 (accessed 18 January 2016), pp. 185 forward. A legitimate interest exists only in cases where the company's interest in confidentiality outweighs the capital market investors' interest in receiving information. Reasons for preventing an error publication are, therefore, only cases of existential threats or atypical circumstances not directly related to the erroneous financial reporting. Consequences that typically result from public error announcements, such as a loss of trust in the company's reporting by the investors and negative effects for the reputation of the company or the valuation of its securities, do not give rise to a legitimate interest.

- (c) Activities of the higher regional court in Frankfurt

If the company does not accept the examination result of BaFin, it has the opportunity to take the case to the higher regional court in Frankfurt (Oberlandesgericht Frankfurt am Main) within one month of notification by BaFin.⁴⁵ Both German enforcement institutions consider only material infringements in their decisions to prompt a public error announcement. In accordance with the jurisdiction of the higher regional court, materiality occurs if both the following conditions are met: (a) there is one or more infringement(s) of accounting standards and (b) these are individually or in total material. Thereby, not only is the value of the infringement relevant but also whether or not the infringement

is likely to be influential for investors' assessment of the company in regard to the capital market. Additionally, qualitative aspects could, therefore, have an impact on the enforcement institution's decision. Furthermore, intentionally caused infringements can result in a public error announcement regardless of their value as well as absent disclosures that, taken separately, may not be material or absent information in the management report.⁴⁶

3. Analysis of the examinations

When randomly examining a company, the Enforcement Panel focuses on company-specific critical issues or areas with significant risk of error. In addition to company-specific examination areas,

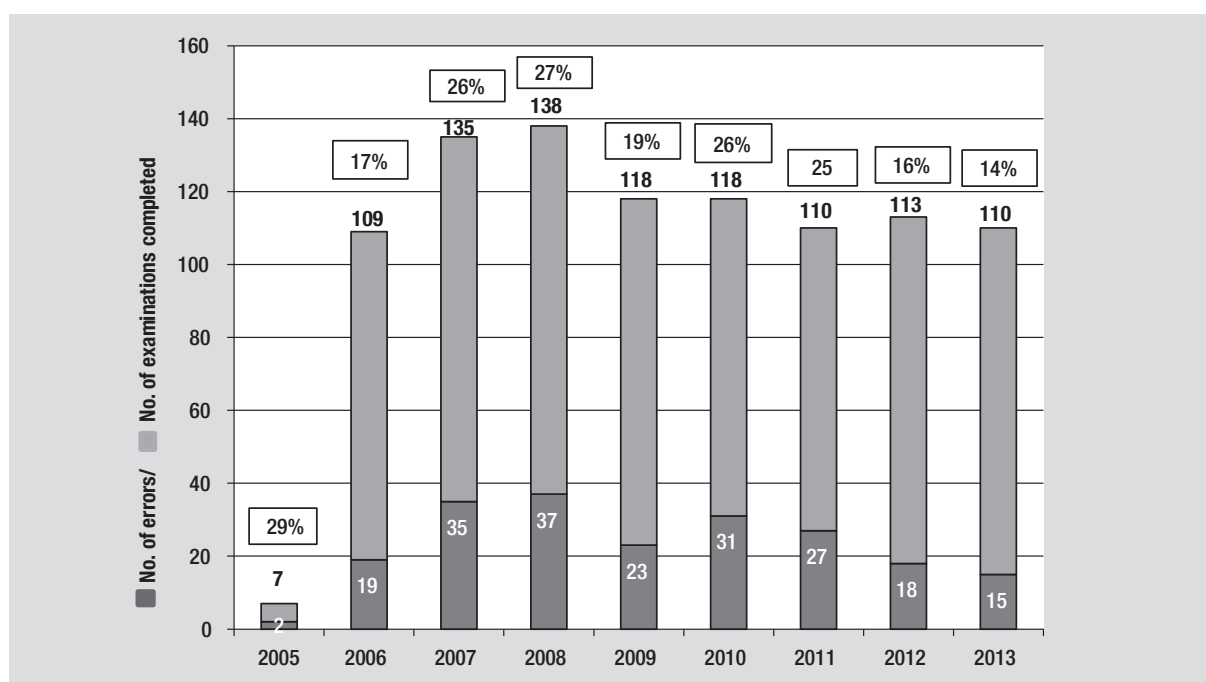
⁴⁵ See WpHG, 2014, article 37t and *ibid* (previous footnote), pp. 195 forward. So far only four cases have been brought to the Oberlandesgericht Frankfurt am Main. In all of these cases the higher regional court confirmed the decisions from the Enforcement Panel or BaFin.

⁴⁶ See Oberlandesgericht Frankfurt am Main, 2009, *Beschluss vom 22. Januar 2009, Az. WpÜG 1/08, WpÜG 3/08*; see also N Kumm, *Fehlerfeststellung und Fehlerveröffentlichung im Enforcement-Verfahren, Der Betrieb*, 62:1636 forward.

Table I.4. Main focus areas of FREP (2006–2014)

2006	2007	2008	2009	2010	2011	2012	2013	2014
Development costs	Business combinations	Business combinations	Business combinations	Business combinations	Business combinations	Business combinations	Pension obligations	Business combinations
Goodwill	Valuation of assets	Impairment testing	Impairment testing	Impairment testing	Recoverability of assets including goodwill	Impairment testing	Impairment testing	Impairment testing
Discount rate used in pension accrual calculation	Deferred tax	Consolidated entities	Measurement of financial instruments	Recognition and measurement of financial instruments	Recoverability of financial instruments	Measurement of investment properties	Non-cash income and expenses	Accounting for defined benefit pension obligations
Convertible debt	Composition of cash equivalents	Related party disclosures	Segment reporting	Segment reporting	Recoverability of investment properties	Financial instruments affected by debt crisis	Correction of errors	New consolidation standards
Share-based payments	Share-based payments	Management report	Risk reporting in the management report	Group management report	Group management report	Group management report	Group management report	Group management report
Deferred tax asset relating to loss in carryforwards	Risk and opportunities report	Valuation of asset-backed securities	Restructuring provision	Note disclosures on measurement assumptions	Distinction between equity and liability			
	Management/ auditor compensation		Consolidation of special-purpose entities	Presentation and description of financial covenants	Assumptions of estimation uncertainty			

Source: FREP, main focus areas, see http://www.frep.info/pruefverfahren/pruefungsschwerpunkte_en.php (accessed 18 January 2016).

Figure I.4. Error rates (2005–2013)

Source: FREP, annual activity reports 2005–2013, see http://www.frep.info/presse/taetigkeitsberichte_en.php (accessed 19 January 2016).

Table I.5. Most common recommendations to companies examined: Application challenges of IFRS (2005–2013)

Application challenges of IFRS	2005	2006	2007	2008	2009	2010	2011	2012	2013	Total
Business combinations and disposals/goodwill	1	3	17	24	11	16	7	8	5	92
Financial instruments		3	10		10	5	4	7	8	47
Current and deferred taxes		3	8	12	5	4				32
Cash-flow statement		2	7	6			4		4	23
Revenue recognition					3	8	5			16
Consolidation			7	4	3			2		16
Impairment of assets								5		5
Cost of equity transactions				5						5
Fixed assets									6	6
Leases						4				4
Investment property measurement				3						3
Provisions		2								2
Incorrect accounting for barter transactions	1									1
Total	2	13	49	54	32	37	20	22	23	252

Source: FREP, annual activity reports 2005–2013, see http://www.frep.info/presse/taetigkeitsberichte_en.php (accessed 19 January 2016).

Table I.6. Most common recommendations to companies examined: Disclosure errors (2005-2013)

Notes/management report	2005	2006	2007	2008	2009	2010	2011	2012	2013	Total
Note disclosures, etc.	2	10	10	16	10	5	7	6	8	74
Management report		3	3	6	4	4	4	2	4	30
Segment reporting		3	2	2	3	3	1			14
Interim financial statements							2	1		3
Total	2	16	15	24	17	12	14	9	12	121

Source: FREP, annual activity reports 2005–2013, see http://www.frep.info/presse/taetigkeitsberichte_en.php (accessed 19 January 2010).

all random-sample examinations each year include different focus areas to the extent that they are relevant to the particular company examined.⁴⁷ Table I.4 shows the main focus areas of the Enforcement Panel since it commenced its work in 2005.⁴⁸

Since the introduction of a financial reporting enforcement system in Germany, 204 public error announcements have been published.⁴⁹ In the following figures/tables are detailed error rates

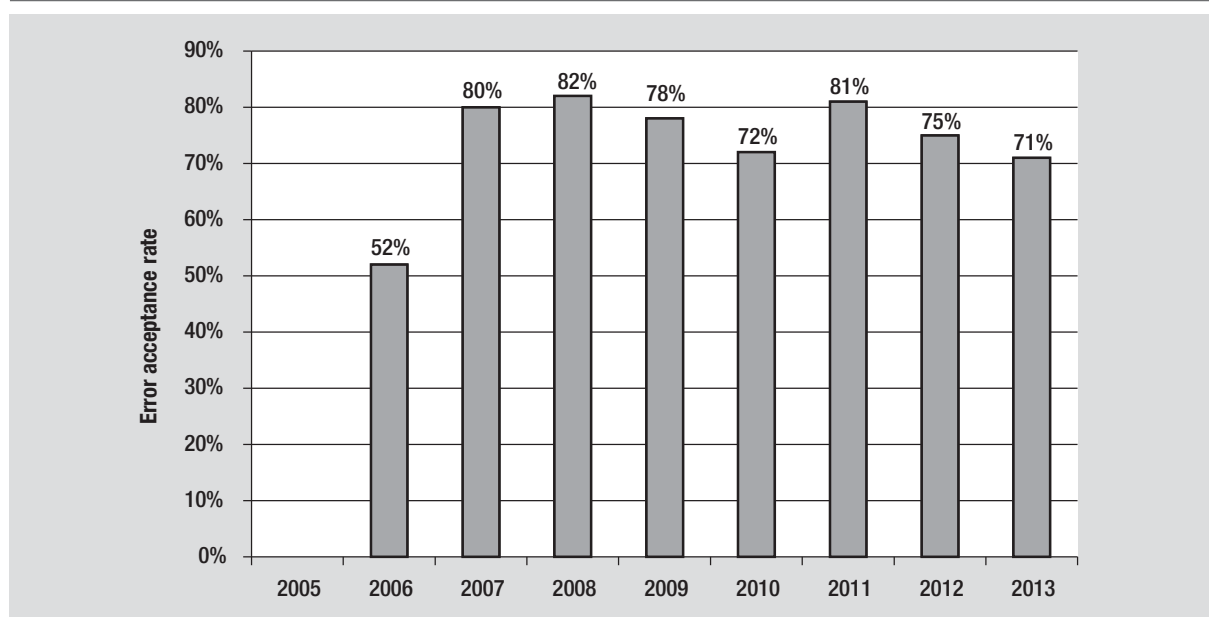
⁴⁷ See FREP, Annual Activity Report 2006, available at http://www.frep.info/docs/jahresberichte/2006/2006_tb_en.pdf (accessed 18 January 2016), p. 6.

⁴⁸ The same priority is given to all focus areas announced.

⁴⁹ All public error announcements can be downloaded from the Internet via https://www.bundesanzeiger.de/ebanzwww/wexsservlet?global_data.language=en&nosession=true&page.navid=gotolastpage (accessed 1 February 2016).

(figure I.4), the most common recommendations to companies examined (tables I.5 and I.6) and the error acceptance rates (figure I.5) based on activity reports from 2005 to 2013.

In summary, it can be seen that the error rate (figure I.4) declined from 2006 to 2013, which, according to FREP, is due to the following reasons: (a) most of the companies have already been investigated once, so that many are now familiar with the enforcement process; (b) many supervisory boards and audit committees are now aware of enforcement issues; (c) the economic situation has improved for many and thus the incentive to overstate earnings has decreased; (d) the proportion of smaller companies in the population subject to the financial reporting enforcement has declined due to voluntary delisting; (e) several companies have been delisted

Figure I.5. Error acceptance rates (2005–2013)

Source: FREP, annual activity reports 2005–2013, see http://www.frep.info/presse/taetigkeitsberichte_en.php (accessed 19 January 2010).

from the regulated market; (f) discussions with the audit firms themselves have brought about general improvements.

These results provide a first indication of deterrence resulting from the existence of an enforcement system. An analysis of the error acceptance rate (figure I.5) shows that from 2006 to 2013 on average 74 per cent of the investigated companies with material infringements in accounting standards accepted the results of the Enforcement Panel's examination. This consistently high acceptance rate can be attributed to the quality of the Enforcement Panel's work.⁵⁰

4. Cooperation of the Financial Reporting Enforcement Panel/Federal Financial Supervisory Authority with national and international organizations and regulators

Both FREP and BaFin cooperate with the audit oversight bodies AOC and the Chamber of Public Accountants (WPK) (Wirtschaftsprüferkammer) in cases of material infringements by informing both institutions about the result of the examination. In addition, if an examination gives rise to the suspicion of a criminal activity relating to a company's financial reporting, FREP or BaFin will notify the relevant prosecution authority. Furthermore, BaFin collaborates in its enforcement process with the German Federal Bank, the Federal Cartel Office and trade supervision and other domestic oversight bodies.⁵¹

Additionally, within Europe FREP cooperates with the European Securities and Markets Authority (ESMA) and various standard setters. To ensure high-quality enforcement and consistent application of IFRS in Europe, ESMA coordinates enforcement activities for European enforcers primarily through the European

Enforcers Coordination Sessions, which are held about nine times per year. Within Europe, FREP intensively exchanges information on enforcement decisions with other regulatory bodies through the European Enforcers Coordination Sessions database and meetings. The German Enforcement Panel regularly participates in these sessions, which include discussion of IFRS application issues with other national enforcers. In addition, FREP submits information to the database. The German Enforcement Panel participates actively in ESMA coordination activities.⁵²

⁵² See FREP, Annual Activity Report 2013, available at http://www.frep.info/docs/jahresberichte/2013/2013_tb_en.pdf (accessed 19 January 2016), pp. 14 forward.

Table I.7. BaFin memorandums of understanding concerning securities supervision

Country/territories/authorities	Year
Argentina	1998
Australia	1998
Brazil	1999
Canada	2003
China	1998
Hong Kong	1997
Taiwan	1997
Croatia	2008
Cyprus	2003
Czech Republic	1998
Estonia	2002
France	1996
Hungary	1998
Italy	1997
Luxembourg	2004
Monaco	2009
Poland	1999
Portugal	1998
Qatar	2008
Republic of Korea	2010
Russian Federation	2001/2009
Singapore	2000
Slovakia	2004
South Africa	2001
Spain	1997
Switzerland	1998
Turkey	2000
United Arab Emirates	2008
Dubai	2006
Guernsey	2011
Jersey	2012
United States Commodity Futures Trading Commission	1997

Source: BaFin, see http://www.bafin.de/EN/International/BilateralCooperation/MemorandaOfUnderstanding/memorandaofunderstanding_node.html (accessed 19 January 2016).

⁵⁰ See FREP, Annual Activity Report 2013, available at http://www.frep.info/docs/jahresberichte/2013/2013_tb_en.pdf (accessed 19 January 2016), pp. 3 forward.

⁵¹ See WpHG, 2014, articles 6, 7, 8 and 37 r and s; see also BaFin, *Emittentenleitfaden der Bundesanstalt für Finanzdienstleistungsaufsicht*, available at http://www.bafin.de/SharedDocs/Downloads/DE/Leitfaden/WA/dl_emittentenleitfaden_2013.pdf?__blob=publicationFile&v=5 (accessed 19 January 2016), pp. 188 forward; see also FREP, Code of procedures of the Enforcement Panel, available at http://www.frep.info/docs/rechtliche_grundlagen/20050816_verfahrensordnung_pruefstelle_en.pdf (accessed 19 January 2016), article 19.

In addition, BaFin is a member of the International Organization of Securities Commission (IOSCO). IOSCO plays a key role in developing international standards for securities supervision and fosters cooperation between national securities regulators. As IOSCO recommendations often impact European and national legislation as well as market structures, BaFin is represented at all decision-making levels and working committees for developed capital markets of IOSCO. In addition, BaFin is a voting member in the executive committee of the International Association of Insurance Supervisors, which sets the international standards for insurance supervision.⁵³

Furthermore, BaFin is an active member of:⁵⁴

- The Financial Stability Board;
- The Basel Committee;
- The International Organization of Pension Supervisors;
- The Financial Action Task Force on Money Laundering.

In addition, BaFin maintains close contacts and signed memorandums of understanding with many foreign supervisory authorities (see table I.7), helping it to have access to and exchange information necessary to supervise global securities firms and oversee markets.

C. AUDITING AND QUALITY-ASSURANCE REQUIREMENTS FOR PROFESSIONAL AUDITORS

1. The Institute of Public Auditors in Germany

The Institute of Public Auditors in Germany is a private, not-for-profit professional body serving the interests of its members who include both public auditors and public audit firms.⁵⁵ It represents

⁵³ See BaFin, 2014, International cooperation, 30 July, available at http://www.bafin.de/EN/International/InternationalCooperation/internationalcooperation_node.html (accessed 19 January 2016).

⁵⁴ Ibid.

⁵⁵ Apart from IDW, there are other smaller organizations representing public auditors' interests such as, for example, the

the professional interests of its members on a national and international level, issues technical norms – for example, IDW issues audit standards or recommendations – as well as providing training courses and support to members on technical issues. Membership of IDW is voluntary. As of 1 July 2014, IDW had 13,237 members, including about 84 per cent of all public auditors and 37 per cent of all public audit firms.⁵⁶

The structure of IDW is shown in figure I.6. Its technical committees promulgate detailed auditing and other assurance standards, practice statements and other guidance. The responsibility for issuing standards on auditing lies with the Auditing and Accounting Board (Hauptfachausschuss) and specialized technical committees for particular industry sectors.⁵⁷ Members are required to observe the technical norms issued by IDW in the context of their own responsibilities.⁵⁸ If an auditor fails to observe these standards without an acceptable explanation, this could count against her/him in the event of any claims or proceedings of a professional or criminal nature.⁵⁹ The Honorary Committee investigates serious violations of the articles of incorporation of IDW by members and supports members in resolving disputes. Among members' responsibilities, according to the IDW articles of incorporation, are observation of promulgations by IDW technical committees and participation in professional development measures (at least 40 hours per year of relevant continuous professional development (CPD)). If the Honorary Committee becomes aware of a member's violation related to his/her professional activities, it may issue a reprimand or, in serious

wp.net.

⁵⁶ See IDW, 2014, *Über uns*, 28 August, available at <http://www.idw.de/idw/portal/n281334/n379162/index.jsp> (accessed 19 January 2016).

⁵⁷ See IFAC, 2014, Compliance responses and action plans: Germany, part 1 attachment, 28 August, available at <http://www.ifac.org/about-ifac/membership/compliance-program/compliance-responses> (accessed 19 January 2016), p. 7 forward.

⁵⁸ See K-U Marten, R Quick and K Ruhnke, 2011, *Wirtschaftsprüfung*, (Stuttgart, Schäffer-Poeschel), pp. 70 forward; see also IDW, 2014, *Our services*, 4 August, available at <http://www.idw.de/idw/portal/n589244/n589314/index.jsp> (accessed 19 January 2016).

⁵⁹ See IFAC, 2014, Compliance responses and action plans: Germany, part 1 attachment, 28 August, available at <http://www.ifac.org/about-ifac/membership/compliance-program/compliance-responses> (accessed 19 January 2016), p. 7 forward.

cases, recommend the Board of Directors to exclude the accused member from IDW.⁶⁰ Further sanctions (for example, disciplinary proceedings) for infringements of professional duties are within the responsibility of WPK, which will transfer more severe cases of misconduct to special divisions of the criminal court.⁶¹

In response to international developments, IDW actively represents the profession's interest internationally. It is a member of the International Federation of Accountants (IFAC) and the Fédération des Experts Comptables Européens. In addition, it is a sponsoring organization for the International Auditing and Assurance Standards Board (IAASB), the International Accounting Education Standards

Board, the International Public Sector Accounting Standards Board and the IFAC Small and Medium Practices Committee.⁶²

2. Disciplinary oversight through the Chamber of Public Accountants

(d) Institutional setting

The Chamber of Public Accountants is a professional body founded in 1961 with enactment of the Public Accountant Act.⁶³ Following implementation of the Wirtschaftsprüfer's Amendment Act, 2000, remit of WPK was extended to include monitored peer reviews.⁶⁴

⁶⁰ See IDW, Articles of incorporation of the Insitut der Wirtschaftsprüfer in Deutschland e.V, available at <http://www.idw.de/idw/portal/n589244/n589356/index.jsp> (accessed 19 January 2016), articles 4, 11 and 5 V.

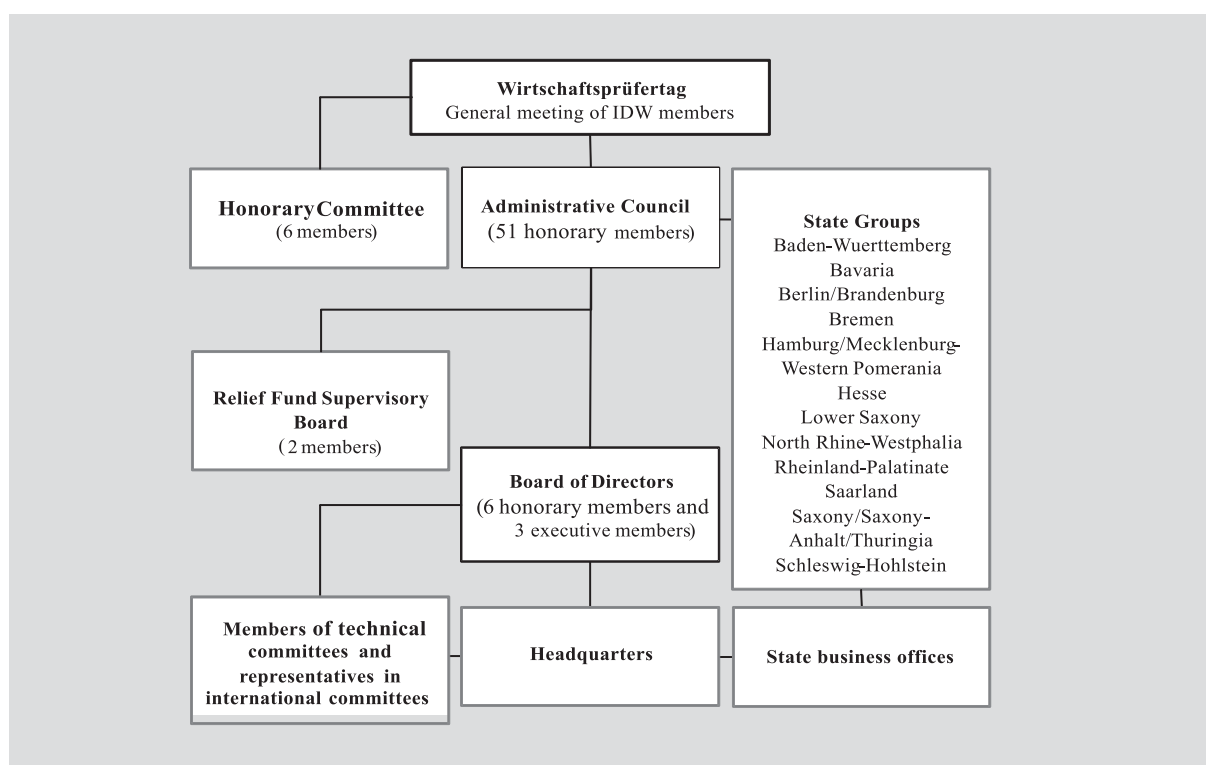
⁶¹ See IFAC, 2014, Compliance responses and action plans: Germany, part 1 attachment, 28 August, available at <http://www.ifac.org/about-ifac/membership/compliance-program/compliance-responses> (accessed 19 January 2016). For details on the disciplinary oversight and quality assurance through WPK, see section C.2.

⁶² See IDW, 2014, About the IDW, 4 August, available at <http://www.idw.de/idw/portal/n589244/n589356/index.jsp> (accessed 19 January 2016).

⁶³ See WPK, 2014, General remarks, 4 August, available at <http://www.wpk.de/eng/wpk/general-remarks/> (accessed 19 January 2016).

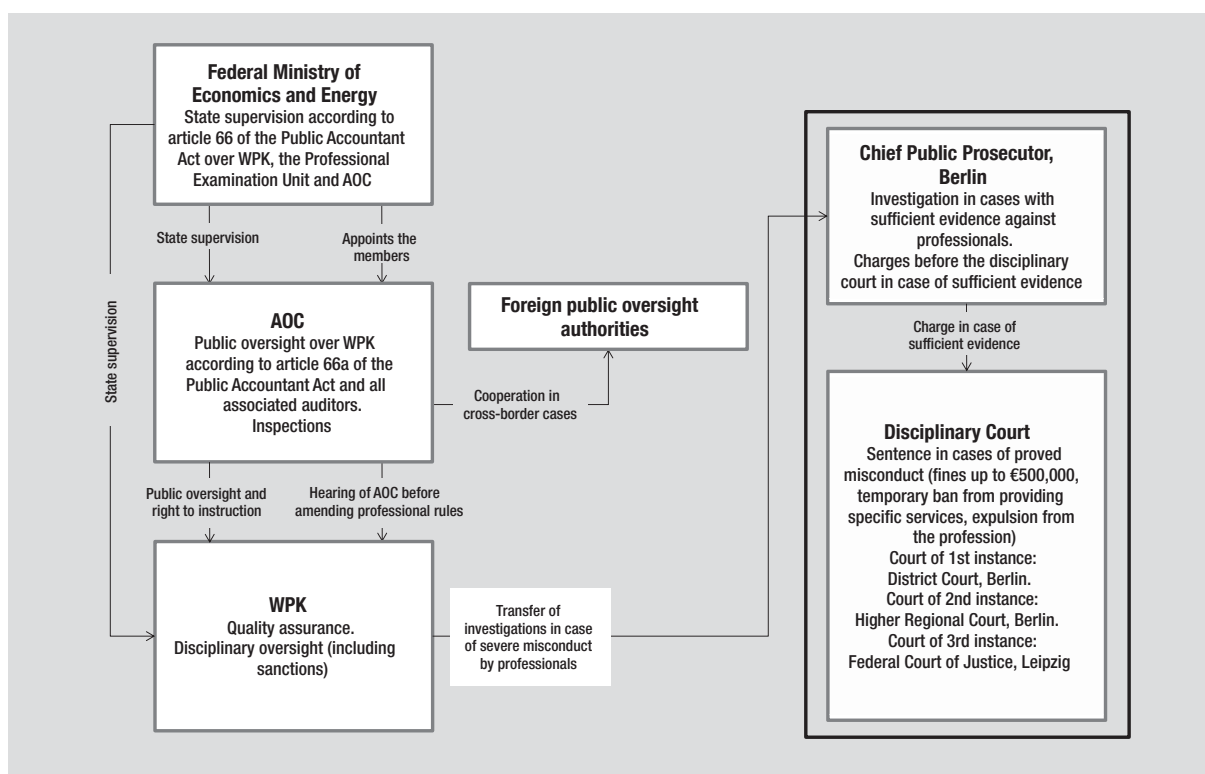
⁶⁴ See Wirtschaftsprüfungsordnungs-Änderungsgesetz, 2000, and the Public Accountant Act, 2013, article 57a – h.

Figure I.6. Organization of IDW



Source: IDW, see <http://www.idw.de/idw/portal/n589244/n589356/n589390/index.jsp> (accessed 19 January 2016).

Figure I.7. The system of auditor oversight in Germany



Source: AOC, see http://www.apak-aoc.de/english/apak/auditor_oversight_germany.asp (accessed 19 January 2016).

(i) Organization of WPK

WPK is a public corporation (a government agency). Its activities are overseen by AOC and the Federal Ministry of Economics and Energy (see figure I.7).⁶⁵

Members are officially appointed by WPK, who may be public accountants, sworn auditors and public audit firms, and also directors, managers and unlimited-liability partners of audit firms who are not auditors themselves.⁶⁶ Currently, WPK has more than 21,000 members throughout Germany. Membership expires if an auditor's leave of absence – for example to exercise

an activity incompatible with his/her profession⁶⁷ – exceeds three successive years.⁶⁸

To become a public accountant in Germany, an official appointment as auditor via state examination and admission procedures by WPK (article 1 of the Public Accountant Act) is necessary. People from European Union member States, treaty nations in the European Economic Area or Switzerland fulfilling the requirements for carrying out statutory audits in their home countries can be appointed as public accountants after completing an aptitude test.⁶⁹ All members are required to comply with the provisions of the Public Accountant Act, further specified in the professional charter of WPK regulating general professional duties, including ethical requirements aligned to the code of the IFAC International Ethics Standards Board for Accountants (IESBA). Concerning CPD requirements, the professional charter of WPK also specifies a minimum annual obligation of 40 hours

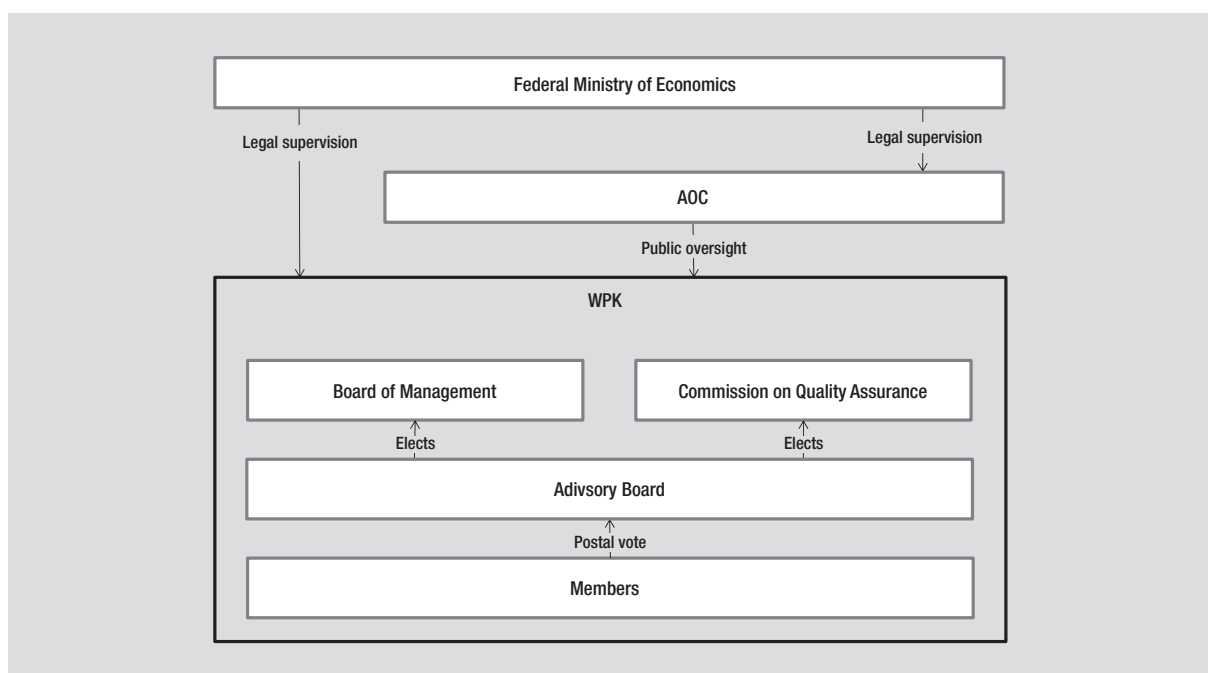
⁶⁵ See WPK, 2014, General remarks, 4 August, available at <http://www.wpk.de/eng/wpk/general-remarks/> (accessed 19 January 2016); see also WPK, Satzung der Wirtschaftsprüferkammer Körperschaft des öffentlichen Rechts – Lesefassung, available at http://www.wpk.de/pdf/Satzung_WPK.pdf (accessed 19 January 2016), articles 1 and 9.

⁶⁶ See the Public Accountant Act, 2013, article 58; and *ibid* (previous footnote). Audit firms can have limited or unlimited liability (WPK, Merkblatt für die Errichtung und Anerkennung einer Wirtschaftsprüfungsgesellschaft, available at <http://www.wpk.de/pdf/merkblatt-wpg.pdf> (accessed 19 January 2016)).

⁶⁷ Incompatible activities are, for example, commercial activities, or an activity as employee, civil servant or judge (Public Accountant Act, 2013, article 43a II).

⁶⁸ *Ibid*, articles 20 II No. 1 and 46.

⁶⁹ *Ibid*, article 131g.

Figure I.8. Organization of WPK

Source: WPK, see <http://www.wpk.de/wpk/organisation/> (accessed 20 January 2016).

CPD in professional skills, 20 hours of which must be fulfilled by participating in ongoing training events.⁷⁰

As detailed in figure I.8, WPK consists of three major bodies: the Advisory Board, the Board of Directors and the Commission for Quality Assurance. The Advisory Board is legally responsible for: (a) adopting the professional charter; (b) adopting the charter for quality assurance; (c) electing members of the Commission for Quality Assurance; (d) electing the Board of Directors, (e) electing the president of WPK, (f) reporting annually to members of WPK; (g) adopting the charter of WPK; (h) determining the subscription schedule regulating the fees members are required to pay.⁷¹ Members of the Advisory Board (in total 57) are elected for a term of four years. After the election, Advisory Board members choose a chair and two deputies. WPK is headed by the Board of Directors consisting of 13 board members, including the president and two deputies, all elected by the Advisory Board. The president represents WPK in and out of court. The Commission for Quality Assurance,

consisting of at least nine members, is responsible for all quality-assurance issues, especially monitoring peer reviews. It reports annually to AOC, the WPK Board of Directors and the Advisory Board on the results of its reviews.⁷² Members of the Commission for Quality Assurance elected by the Advisory Board for four years must be registered as quality-assurance reviewers in accordance with article 57a of the Public Accountant Act, and must be neither part of the Board of Directors nor the Advisory Board. The chair represents the Commission for Quality Assurance in and out of court and may be represented by the chair's two deputies.⁷³ Measured as full-time equivalents, WPK had 122.75 employees in 2013.⁷⁴

⁷⁰ Ibid, article 43; see also WPK, Satzung über die Rechte und Pflichten bei der Ausübung der Berufe des Wirtschaftsprüfers und des vereidigten Buchprüfers, available at <http://www.wpk.de/pdf/bs-wpvbp.pdf> (accessed 19 January 2016), article 4a.

⁷¹ Ibid, article 57 forward.

⁷² See WPK, Satzung der Wirtschaftsprüferkammer Körperschaft des öffentlichen Rechts – Lesefassung, available at http://www.wpk.de/pdf/Satzung_WPK.pdf (accessed 20 January 2016), articles 7 forward; see also WPK, Satzung für Qualitätskontrolle (§ 57c WPO), available at <http://www.wpk.de/pdf/qk-satzung.pdf> (accessed 20 January 2016), article 14.

⁷³ See WPK, Satzung der Wirtschaftsprüferkammer Körperschaft des öffentlichen Rechts – Lesefassung, available at http://www.wpk.de/pdf/Satzung_WPK.pdf (accessed 20 January 2016), article 8a.

⁷⁴ See WPK, Wirtschaftsplan 2014, available at http://www.wpk.de/uploads/tx_templavoila/WPK_Magazin_4-2013_Beilage_WPK_Wirtschaftsplan_2014.pdf (accessed 20 January 2016), p. 10.

(ii) Financing

In accordance with article 61 of the Public Accountant Act, the activities of WPK are financed by (a) compulsory subscriptions from all WPK members ranging from €516 per year for personal members to €258 per year for an auditor's/audit firm's branch office;⁷⁵ (b) an additional due from members who conducted statutory audits of public-interest entities; (c) fees for the provision of special facilities or services.⁷⁶ For the audit of public-interest companies, members have to pay an additional €1,900 for each audit plus €5.10 per €1,000 of the total audit fee (or parts thereof). In 2013, the total budget of WPK (including the AOC budget for inspections) amounted to €18.6 million.⁷⁷

(iii) Scope

The legal tasks of WPK are: (a) professional examination; (b) aptitude tests for qualified auditors from foreign countries; (c) appointments; (d) licensing of auditors and audit firms; (e) revocation of licences; (f) registration of auditors and audit firms; (g) disciplinary oversight; (h) quality assurance; (i) adoption of professional standards.⁷⁸ Apart from revocation proceedings in accordance with articles 20 and 34 of the Public Accountant Act,⁷⁹ the legal

⁷⁵ See WPK, Beitragsordnung der Wirtschaftsprüferkammer (in der Fassung des Beiratsbeschlusses vom 22. November 2013), available at http://www.wpk.de/uploads/tx_templavoila/WPK-Beitragsordnung.pdf (accessed 20 January 2016), article 5 III.

⁷⁶ See the Public Accountant Act, 2013, article 61; see also WPK, Beitragsordnung der Wirtschaftsprüferkammer (in der Fassung des Beiratsbeschlusses vom 22. November 2013), available at http://www.wpk.de/uploads/tx_templavoila/WPK-Beitragsordnung.pdf (accessed 20 January 2016), article 2.

⁷⁷ See WPK, Beitragsordnung der Wirtschaftsprüferkammer (in der Fassung des Beiratsbeschlusses vom 22. November 2013), available at http://www.wpk.de/uploads/tx_templavoila/WPK-Beitragsordnung.pdf (accessed 20 January 2016), article 5 III; see also WPK, Wirtschaftsplan 2014, available at http://www.wpk.de/uploads/tx_templavoila/WPK_Magazin_4-2013_Beilage_WPK_Wirtschaftsplan_2014.pdf (accessed 20 January 2016), p. 7.

⁷⁸ See the Public Accountant Act, 2013, articles 66a I and 4 I.

⁷⁹ In 2013, a total of 96 revocation proceedings were initiated. Sixty-five proceedings were initiated due to missing evidence regarding professional liability insurance. A further 18 proceedings were initiated due to disorderly financial situations or a financial collapse. One auditor did not maintain a professional business establishment and in two cases the appointment had to be reviewed due to health reasons. In eight cases the work activities were incompatible with the profession and in two cases the requirements for being registered as a German public audit firm were no longer met. As a result, in seven cases appointments were revoked, whereas 61 proceedings were terminated.

disciplinary oversight of WPK encompasses the following areas:⁸⁰

- Inspections in accordance with article 62b of the Public Accountant Act involving auditors that carry out statutory audits of public-interest companies – AOC is the competent authority for conducting these inspections and they are, therefore, discussed in section C.3, below;
- Investigations with cause as disciplinary proceedings in accordance with article 61a (2) No. 1 of the Public Accountant Act;
- Audit reviews in accordance with article 57 I of the Public Accountant Act.

Furthermore, WPK is also responsible for quality assurance in accordance with article 57a of the Public Accountant Act, including the monitored peer review.

*(b) Disciplinary oversight**(i) Investigation with cause*

An investigation with cause is initiated if there is any concrete evidence supporting a violation of professional duties.⁸¹ That evidence can result, for example, from findings of audit reviews, notices of FREP or BaFin, and complaints or media reports.⁸² If WPK investigations reveal a breach of professional duty, WPK will impose sanctions or initiate disciplinary measures.

(ii) Audit review

For disciplinary oversight purposes, without there being any suspicion of misconduct, WPK also randomly reviews the following:⁸³

The other proceedings are still in progress. See WPK, Bericht der Berufsaufsicht 2013 über Wirtschaftsprüfer und vereidigte Buchprüfer, available at http://www.wpk.de/uploads/tx_news/WPK_Berufsaufsicht_2013.pdf (accessed 20 January 2016), pp. 19 forward.

⁸⁰ See WPK, 2014, Disciplinary oversight, 4 August, available at <http://www.wpk.de/eng/wpk/duties/disciplinary-oversight/> (accessed 20 January 2016).

⁸¹ See WPK, Bericht der Berufsaufsicht 2013 über Wirtschaftsprüfer und vereidigte Buchprüfer, available at http://www.wpk.de/uploads/tx_news/WPK_Berufsaufsicht_2013.pdf (accessed 20 January 2016), p. 5. Investigations with cause due to a violation of the professional duties have existed since the beginning of WPK in 1961.

⁸² See AOC, Tätigkeitsbericht der Abschlussprüferaufsichtskommission 2013, available at http://www.apak-aoc.de/pdf/APAK-AOC--Taetigkeitsbericht_2013.pdf (accessed 20 January 2016), p. 24.

⁸³ See WPK, Bericht der Berufsaufsicht 2013 über Wirtschaftsprüfer und vereidigte Buchprüfer, available at http://www.wpk.de/uploads/tx_news/WPK_Berufsaufsicht_2013.pdf (accessed 20 January 2016), pp. 15 forward.

- Annual individual as well as consolidated financial statements prepared in accordance with German GAAP or IFRS published in the *Federal Gazette*, as well as related auditors' opinions issued by WPK members;
- Annual reports published in the *Federal Gazette* in accordance with the Investment Law (*Investmentgesetz*) as well as related auditors' opinions;
- Annual reports of political parties and related auditors' opinions.

These so-called audit reviews concentrate on the following areas: (a) compliance with legal requirements of the Commercial Code and professional principles relevant for issuing audit opinions; (b) compliance with disclosure requirements (for example, classification of the balance sheet); (d) completeness of the disclosures provided; (e) conclusiveness of the data disclosed in the financial statements or annual reports. Any infringements detected in the financial reports and audit opinions reviewed are first discussed with the auditors responsible. If there is the suspicion of a breach of duty, the review can also lead to formal sanctions and disciplinary proceedings. In case of capital-market-oriented companies, WPK also informs FREP on any infringements identified.⁸⁴

(iii) Sanctions

Disciplinary oversight of the audit profession is organized in a two-tier system. Minor violations are sanctioned by WPK and cases of severe misconduct (for example, intentional breaches of duty) are handed over to professional jurisdiction (the Chief Public Prosecutor in Berlin). Infringements of professional duties (for example, detected in audit reviews or investigations with cause) are sanctioned by WPK via an advice, an instruction, a reprimand that can be accompanied by a fine of up to €50,000 or disciplinary measures imposed via court decisions.⁸⁵ Decisions made by WPK are subject to the approval of AOC. Disciplinary measures for more severe infringements in accordance with article 68 of the Public Accountant Act include: (a) a fine of up to €500,000; (b) prohibition from certain types of activities for a duration of one to five years; (c) an employment ban for one to five years;

⁸⁴ Ibid. For the investigations of FREP, see section II.

⁸⁵ See the Public Accountant Act, 2013, article 63; see also AOC, Verfahrensordnung der Abschlussprüferaufsichtskommission für die Durchführung der Untersuchungen nach §§ 61a Satz 2 Nr. 2, 62b Abs. 1 WPO (stand: 18.04.2013), available at http://www.apak-aoc.de/images/pdf/APAK_Verfahrensordnung_Sonderuntersuchungen.pdf (accessed 20 January 2016), article 20.

(d) definitive exclusion from the profession. Sanctions (a), (b) and (c) can be imposed simultaneously.⁸⁶

In contrast to the sanctioning of companies by FREP or BaFin, which are publicly announced, the sanctioning of auditors remains anonymous.

(c) Quality assurance

The WPK quality-assurance system is maintained to ensure that professional practices conducted by WPK members are subject to regular and preventative monitoring.⁸⁷ Accordingly, public accountants and sworn auditors conducting statutory audits are obliged to have their audit firms monitored by an independent external auditor (peer auditor) for quality-assurance purposes every six years. If companies of public interest are audited, monitoring every three years will apply. These monitored peer reviews are within the remit of the Commission for Quality Assurance of WPK. The monitored peer review is not a second audit. It involves rather an evaluation as to whether or not an audit firm's internal quality control system is appropriate and effective. In addition, the peer auditor also investigates selected audit engagements (engagement quality control review) to evaluate if the audit firm has carried out audits in an orderly manner and ensured the internal follow-up.⁸⁸ If the peer auditor finds an infringement, the Commission for Quality Assurance can require the company to remedy the deficiencies, order a special review or revoke a certificate already issued, confirming the company's participation in the peer review. If an audit firm/practice fails to have a monitored peer review, it is no longer allowed to perform statutory audits. As AOC oversees WPK, it has the opportunity to participate in quality-assurance reviews and is supported by WPK in gaining more information on reviews. Additionally, if an audit firm fails the peer review, AOC is informed by the Commission for Quality Assurance.⁸⁹

⁸⁶ See WPK, Bericht der Berufsaufsicht 2013 über Wirtschaftsprüfer und vereidigte Buchprüfer, available at http://www.wpk.de/uploads/tx_news/WPK_Berufsaufsicht_2013.pdf (accessed 20 January 2016), pp. 5 forward.

⁸⁷ This quality-assurance system has existed in Germany since 2001.

⁸⁸ See the Public Accountant Act, 2013, article 57a; see also WPK, 2014, Quality assurance procedure, 4 August, available at <http://www.wpk.de/eng/wpk/duties/quality-assurance-procedure/> (accessed 20 January 2016); see also RJ Niehus, 2000, Peer review in der deutschen Abschlussprüfung, *Der Betrieb*, 63, pp. 1133 forward.

⁸⁹ See WPK, 2014, Quality assurance procedure, 4 August, available at <http://www.wpk.de/eng/wpk/duties/quality-assurance-procedure/> (accessed 20 January 2016); see also RJ Niehus, 2000, Peer review in der deutschen Abschlussprüfung, *Der Betrieb*, 63, pp. 1133 forward.

Table I.8. Sources of investigations with cause (2007–2013)

Sources of investigations with cause	2007	2008	2009	2010	2011	2012	2013	Total
Other notification (e.g., from the public prosecution office, etc.)	134	148	79	77	51	72	82	643
Complaints	122	132	148	119	89	98	101	809
Notification from audit reviews	97	100	122	84	55	51	58	567
Notification from quality assurance reviews		7	14	4	4	1	5	35
Notification from FREP/BaFin	49	54	38	45	55	33	18	292
Notification after inspections		10	44	25	4	33	21	137
Media coverage	38	38	28	14	12	10	8	148
Total	440	489	473	368	270	298	293	2 631

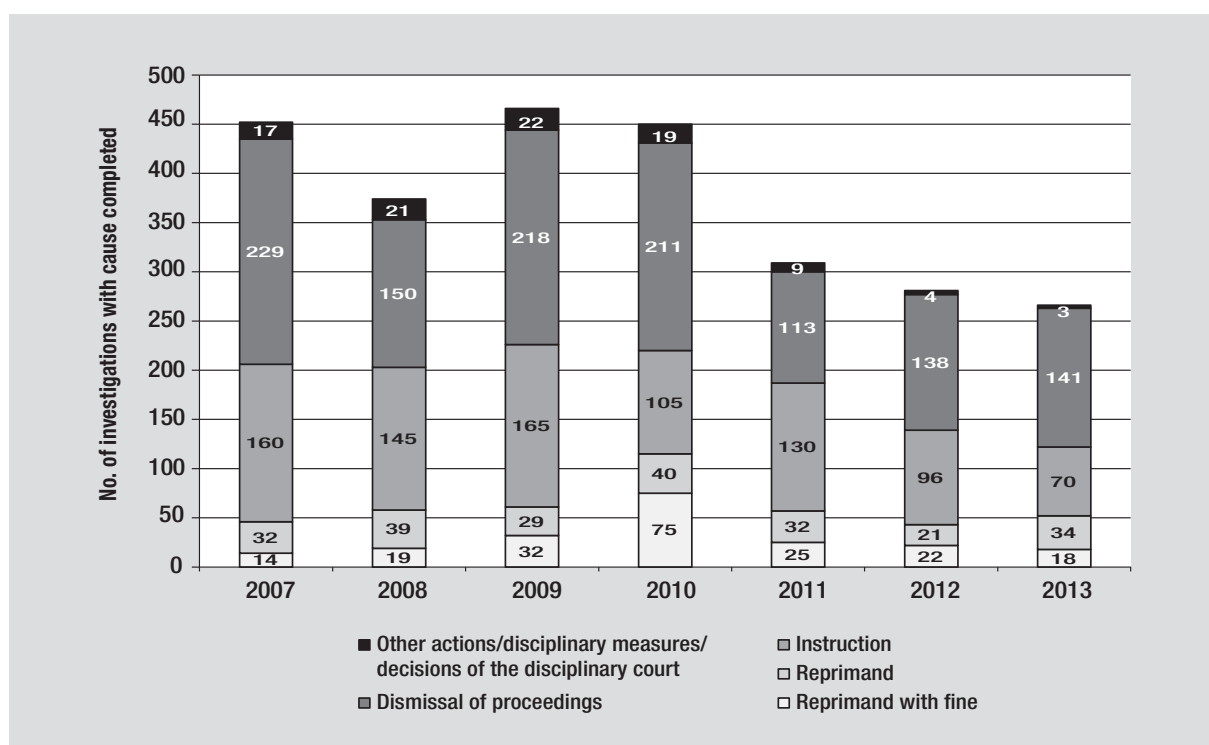
Source: WPK, *Berichte der Berufsaufsicht (2007–2013)*, see <http://www.wpk.de/oeffentlichkeit/berichte/berufsaufsicht/> (accessed 20 January 2016).

(d) Analysis of the examinations

(i) Examination results of investigations with cause

As mentioned above, evidence for investigations with cause can be drawn from different sources.

The sources of the investigations conducted by WPK since 2007 are shown in table I.8, the results of the investigations with cause are depicted in figure I.9.

Figure I.9. Results of investigations with cause (2007–2013)

Source: WPK, *Berichte der Berufsaufsicht (2007–2013)*, see <http://www.wpk.de/oeffentlichkeit/berichte/berufsaufsicht/> (accessed 20 January 2016).

Table I.9. Number of audit reviews conducted (2007–2013)

Number of conducted audit reviews	2007	2008	2009	2010	2011	2012	2013
Annual individual financial statements of public-interest companies	707	250	315	285	265	206	225
Annual consolidated financial statements of public-interest companies	575	265	251	224	214	219	177
Subtotal (public-interest companies)	1 282	515	566	509	479	425	402
Annual individual financial statements of large companies, banks and insurance companies	475	624	571	399	400	263	264
Annual individual financial statements of medium-sized companies	202	535	920	596	433	197	207
Annual consolidated financial statement	275	237	327	320	335	235	243
Subtotal (non-public interest companies)	952	1 396	1 863	1 315	1 168	695	714
Statements of accounts according to the Investmentgesetz	85	77	70	63	57	29	32
Parties' statements of accounts	26	25	32	29	34	31	30
Publication in the register	785						
Financial statements in electronic form from other sources	33	9	3	7	1	1	1
Financial statements in paper edition	2 424						
Subtotal (financial statements)	3 353	2 022	2 534	1 923	1 739	1 181	1 179
Additionally reviewed audit opinions of companies of public interest		1 052	846	826	756	767	693
Total of all reviewed audit opinions	5 587	3 074	3 380	2 749	2 495	1 948	1 872

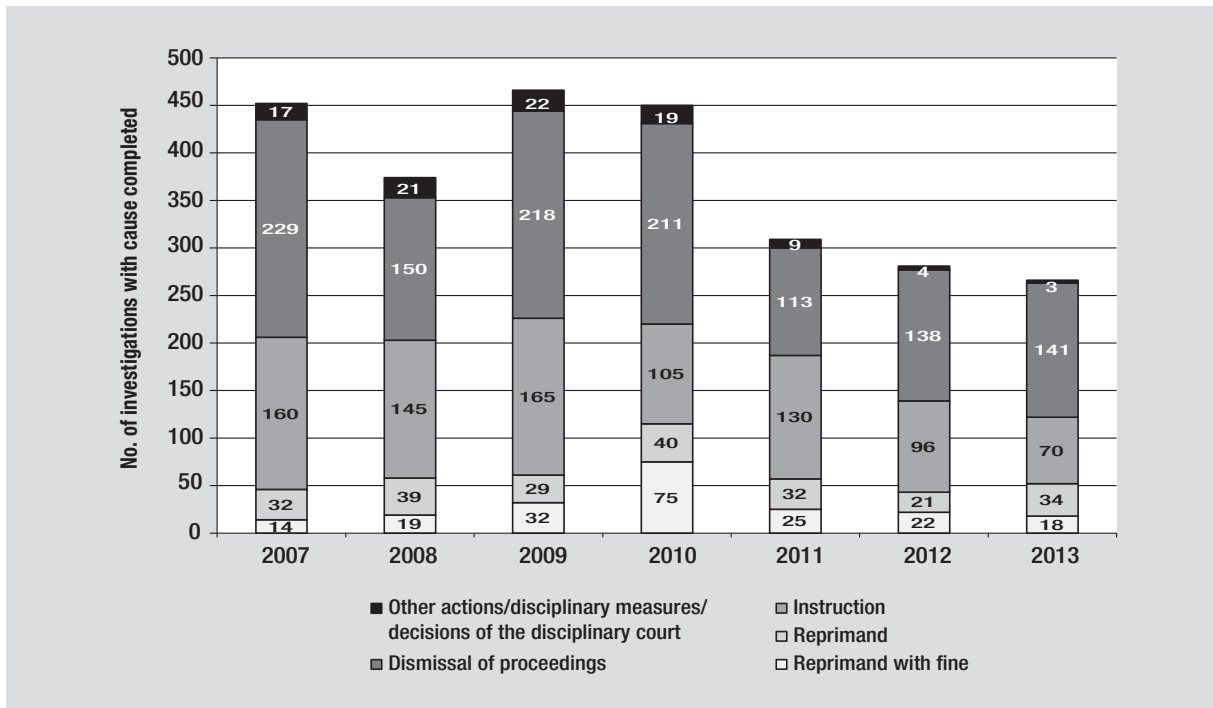
Source: WPK, *Berichte der Berufsaufsicht (2007–2013)*, see <http://www.wpk.de/oeffentlichkeit/berichte/berufsaufsicht/> (accessed 20 January 2016).

Table I.10. Reasons for sanctions (2007–2013)

Reasons for disciplinary proceedings	2007	2008	2009	2010	2011	2012	2013	Total
Missing certificate of participation on the quality assurance system		13	49	22	6	6	3	99
Significant accumulation of errors/significant single errors in financial statements according to the German Commercial Code	10	16	15	9	11	10	6	77
Significant accumulation of errors/significant single errors in financial statements according to IFRS	17	22	7	2	3	3	2	56
Insufficient presentation of the opportunities and risks in the management report	14	8	6	4	5	3	11	51
Missing disclosures concerning remunerations	2	3	12	3	10	9	3	42
Missing qualification or refusal of the audit opinion	8	9	4	4	4	1	3	33
Non-response to WPK enquiries		3	6	9		3		21
Violation of independence and absence of bias		3	1	3	1	1	11	20
Insufficient disclosures concerning audit fees	10	9						19
Missing cash-flow statements and equity statements in financial statements according to German Commercial Code	6	2						8
Inadmissible signing of audit opinions	3		5					8
Organizational aggregation within disciplinary proceedings						3	3	6
Inadmissible announcements concerning the audit opinion by partnerships	2	1		1		1		5
Clarification of conspicuous audit fees						1	3	4
Inadmissible formulation of audit opinions					1			1
Total	72	89	105	57	41	41	45	450

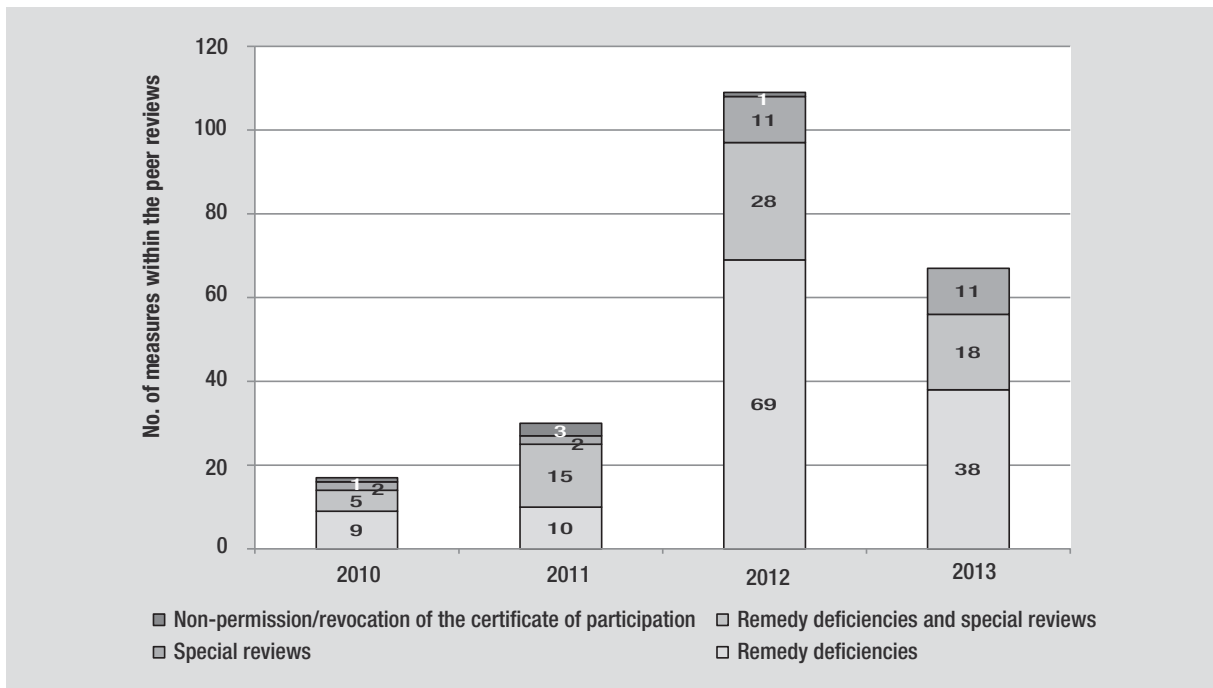
Source: WPK, *Berichte der Berufsaufsicht (2007–2013)*, see <http://www.wpk.de/oeffentlichkeit/berichte/berufsaufsicht/> (accessed 20 January 2016).

Figure I.10. Results of quality-assurance reviews (2010–2013)



Source: AOC, annual reports 2012 and 2013, see http://www.apak-aoc.de/english/publications/annual_reports.asp (accessed 20 January 2016).

Figure I.11. Measures within quality assurance (2010–2013)



Source: AOC, annual reports 2012 and 2013, see http://www.apak-aoc.de/english/publications/annual_reports.asp (accessed 20 January 2016).

(ii) Examination results of the audit reviews

The number of audit reviews conducted as well as the reasons for sanctions since 2007 are detailed in tables I.9 and I.10, respectively.⁹⁰

(iii) Results of the examination of quality assurance

Figure I.10 shows the quality-assurance reviews (monitored peer reviews) conducted since 2010 and the cases in which measures of the Commission for Quality Assurance (requiring remedy of the deficiencies, order of a special review or revoking a certificate already issued) mentioned above are taken. An overview of the measures since 2010 is given in figure I.11.

(e) Interaction with other national and international organizations and regulators

As mentioned above, WPK cooperates with AOC, which publicly oversees WPK – for example, AOC is allowed to participate in meetings of WPK.⁹¹ Additionally, WPK cooperates with the following institutions: (a) professional associations of public accountants and sworn auditors; (b) the Insurance Office for Financial Auditing and Trusteeship and other providers of professional indemnity assurance; (c) related legal and tax accounting professions and the Association of Liberal Professions (Bundesverband der freien Berufe); (d) IFAC.⁹² For international cooperation, WPK is a member of IFAC, which is the global organization for the accountancy profession. One of the ways in which IFAC aims to serve the public interest is by contributing to the development of high-quality standards, and to the development of strong professional accountancy organizations and high-quality practices by professional accountants. As a member of IFAC, WPK has an obligation to comply with IFAC requirements and has, therefore, aligned its regulations accordingly.⁹³

⁹⁰ Only audit reviews since 2007 are analysed due to the requirement to publish in the Federal Gazette coming into effect in that year.

⁹¹ See the Public Accountant Act, 2013, article 66a III and IV.

⁹² See WPK, 2014, Miscellaneous tasks, 4 August, available at <http://www.wpk.de/eng/wpk/duties/miscellaneous-tasks/> (accessed 20 January 2016).

⁹³ See IFAC, 2014, Organization overview, 4 August, available at <http://www.ifac.org/about-ifac/organization-overview> (accessed 2016).

3. Public auditor oversight through the Auditor Oversight Commission

(a) Institutional setting

In 2004, the German legislator adopted the Auditor Supervision Act (*Abschlussprüferaufsichtsgesetz*) amending the Public Accountant Act, which is the legal basis for the enforcement of auditing standards and codes in Germany.⁹⁴ The Auditor Supervision Act is consistent with the European Union Audit Directive (2006/43/EC) that specifies the requirements for auditors in the European Union and their public oversight.⁹⁵ In contrast to WPK, AOC is completely independent from the auditing profession.

(i) Organization of AOC

In accordance with article 66a of the Public Accountant Act, AOC publicly monitors WPK and all auditors associated with it (these are auditors and audit firms authorized to carry out statutory audits). AOC and WPK are in turn under the supervision of the Federal Ministry of Economics and Energy.⁹⁶

The Commission has between six and ten honorary members who are supported by employees from the department's inspections team (21 employees) and the AOC secretariat (five employees). The honorary members of AOC have been active in the fields of accountancy, finance, economy or law (see figure I.12). To ensure their independence, the members must not have been members of WPK for a minimum of five years prior to their appointment.⁹⁷ Members of AOC are appointed by the Federal Ministry of Economics and Energy for four years, terminable prematurely in exceptional cases. The leadership function of AOC is assumed by the chair and vice-chair, who are elected by the members of

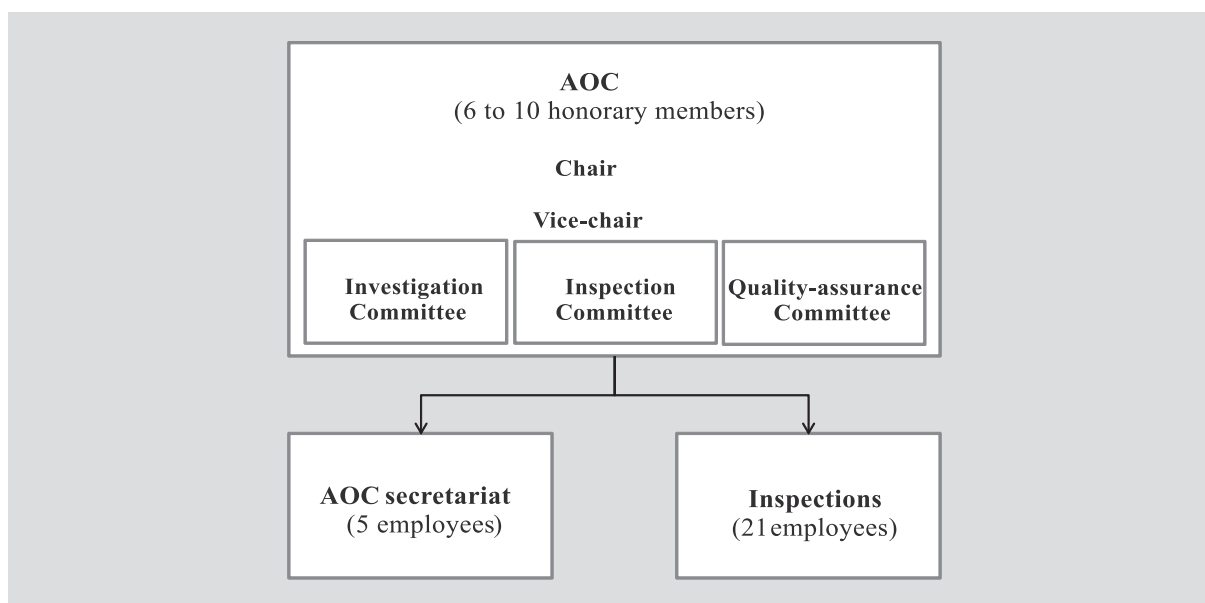
⁹⁴ See the Auditor Supervision Act, 27 December 2004.

⁹⁵ See the European Parliament and Council Directive 2006/43/EC, 17 May 2006, on statutory audits of annual and consolidated accounts, recital 20.

⁹⁶ See the Public Accountant Act, 2013, article 66.

⁹⁷ *Ibid.*, article 66a II; see also AOC, 2014, Objectives and remits, 5 August, available at http://www.apak-aoc.de/english/apak/objectives_remits.asp (accessed 20 January 2016); for a comprehensive overview on the actual members of AOC, see AOC, 2014, Commissioners, 5 August, available at <http://www.apak-aoc.de/english/apak/commissioners.asp> (accessed 20 January 2016) and AOC, Organigram, available at <http://www.apak-aoc.de/pdf/APAK-Organigramm.pdf> (accessed 20 January 2016).

Figure I.12. Organizational chart of AOC



Source: AOC, see <http://www.apak-aoc.de/index.php/en/about-aoc/organisational-chart> (accessed 1 February 2016).

AOC. In accordance with its rules of procedures approved by the Federal Ministry of Economics and Technology, AOC is allowed to establish committees with decision-making power. Currently, AOC has three such committees:⁹⁸ the Investigation Committee, the Inspection Committee and the Quality-assurance Committee.⁹⁹

To promote enforcement, AOC is directly responsible for conducting random inspections, in the absence of any indication of infringement, of auditors that carry out statutory audits of public-interest companies. These inspections are conducted by teams from the Inspection Committee whose employees are qualified as auditors with several years of auditing experience in large corporations.¹⁰⁰ Each inspection team consists of an examiner-in-charge and a deputy responsible for the technical and organizational performance of the inspection, as well as other members assigned

to them.¹⁰¹ During their membership of the inspection team, members are neither allowed to conduct or contribute to statutory audits nor to work for an audit firm or an auditor conducting statutory audits for public-interest companies. Other reasons for exclusion include a suspicion of bias, especially if there are business, financial or personal relationships with the audit firm examined.¹⁰²

(ii) Financing

In accordance with article 66a VII of the Public Accountant Act, AOC is financed by WPK and, therefore, ultimately by the compulsory contributions from all members of WPK. Additionally, inspections by AOC are financed via fees from auditors/audit firms conducting statutory audits of public-interest companies. In 2013, AOC received in total €3.6 million for carrying out inspections.¹⁰³

⁹⁸ See the Public Accountant Act, 2013, article 66a II and VI; see also AOC, 2009, Geschäftsordnung der Kommission für die Aufsicht über die Abschlussprüfer in Deutschland (Abschlussprüferaufsichtskommission) in der Fassung vom 9. November, available at http://www.wpk.de/fileadmin/documents/WPK/Rechtsvorschriften/WPO_English.pdf (accessed 1 February 2016), article 10.

⁹⁹ See AOC, 2014, Organizational chart, 4 August, available at http://www.apak-aoc.de/english/apak/organisational_chart.asp (accessed 20 January 2016).

¹⁰⁰ See AOC, 2014, Inspections, 4 August, available at <http://www.apak-aoc.de/english/inspections/inspections.asp> (accessed 20 January 2016).

¹⁰¹ See AOC, *Verfahrensordnung der Abschlussprüferaufsichtskommission für die Durchführung der Untersuchungen nach §§ 61a Satz 2 Nr. 2, 62b Abs. 1 WPO* (stand: 18.04.2013), available at http://www.apak-aoc.de/images/pdf/APAK_Verfahrensordnung_Sonderuntersuchungen.pdf (accessed 1 February 2016), article 4.

¹⁰² *Ibid.*, article 7.

¹⁰³ See the Public Accountant Act, 2013, article 66a VII; see also AOC, 2014, *Finanzierung und Ausstattung*, 4 August, available at http://www.apak-aoc.de/apak/finanzierung_ausstattung.asp (accessed 20 January 2016); see also WPK, *Wirtschaftsplan 2014*, available at http://www.wpk.de/uploads/tx_templavoila/WPK_Maga-

(iii) Scope

The Auditor Oversight Commission performs a public professional oversight function over WPK covering all of its remits. AOC is, thereby, responsible for all auditors and audit firms that are authorized to conduct statutory audits. To ensure that WPK performs its tasks adequately, AOC (a) participates in the meetings of WPK; (b) has the right to request information; (c) can participate in WPK quality-assurance reviews; (d) may instruct WPK to conduct disciplinary investigations in cases of breaches in professional duties as the result of inquiries from foreign oversight boards and randomly where there is no indication of misconduct; (e) can refer decisions back to WPK together with the reasons for requiring a second evaluation; (f) ultimately has the power, if WPK does not revise its decisions, to overrule WPK. Additionally, prior to issuing regulations regarding professional practice, WPK must seek the opinion of AOC and present it to the Federal Ministry of Economics and Energy.¹⁰⁴

To detect breaches of duties, AOC itself also performs random inspections. However, these are limited to audit firms conducting statutory audits of public-interest companies (that is, companies whose equity or debt instruments are traded on a regulated market). In 2012, there were 97 audit firms or practices that conducted statutory audits of public-interest entities.

Inspections by AOC are aimed at evaluating whether or not an auditor or audit firm has, in the areas inspected, complied with professional requirements related to statutory audits of public-interest companies. It assesses especially:¹⁰⁵

- The adequacy and effectiveness (of particular areas/issues) in an auditor's/audit firm's internal quality control;
- For selected audit engagements (of public-interest companies), the compliance with professional obligations and the information given in the most re-

zin_4-2013_Beilage_WPK_Wirtschaftsplan_2014.pdf (accessed 20 January 2016), p. 7.

¹⁰⁴ See the Public Accountant Act, 2013, article 66a.

¹⁰⁵ See AOC, *Verfahrensordnung der Abschlussprüferaufsichtskommission für die Durchführung der Untersuchungen nach §§ 61a Satz 2 Nr. 2, 62b Abs. 1 WPO* (stand: 18.04.2013), available at http://www.apak-aoc.de/images/pdf/APAK_Verfahrensordnung_Sonderuntersuchungen.pdf (accessed 1 February 2016), article 3; see also AOC, 2013, *Tätigkeitsbericht der Abschlussprüferaufsichtskommission 2013*, available at http://www.apak-aoc.de/images/pdf/APAK-AOC--Taetigkeitsbericht_2013.pdf (accessed 1 February 2016), pp. 24 onward.

cent transparency report of the auditor/audit firm under inspection based on the findings of the inspection.¹⁰⁶

Auditors/audit firms without any prior indication of misconduct that are subject to inspections are selected randomly using a combined-risk approach. Risk factors that are considered in the sampling process are, for example, specific industry sectors, stock exchange segments or technical aspects of the companies investigated. AOC reviews auditors/audit firms every three years. Audit firms that have had more than 25 audit engagements of public-interest entities in the previous year are examined annually.¹⁰⁷

(iv) Sanctions

For sanctioning purposes, infringements of professional duties are referred to WPK, which then decides whether the owner of the audit firm or the auditor responsible will be disciplined via an advice, an instruction, a reprimand (which can be accompanied by a fine of up to €50,000) or via disciplinary measures subject to professional jurisdiction (the Chief Public Prosecutor in Berlin).¹⁰⁸

(b) Analysis of the inspections

In accordance with article 66a VI of the Public Accountant Act, each year AOC publishes its work programme. Table I.11 depicts the AOC work programmes since 2005.

¹⁰⁶ In accordance with article 55c of the Public Accountant Act, auditors and audit firms who conduct at least one audit of public interest have to publish an annual transparency report. That report should include a description of the legal structure, network involved and internal quality-control system, together with the date of the last certificate of participation on the peer review, a list of entities for which a statutory audit was performed, a declaration of the measurements to maintain independence and information on the scheme for remunerating members of the firm and the managers.

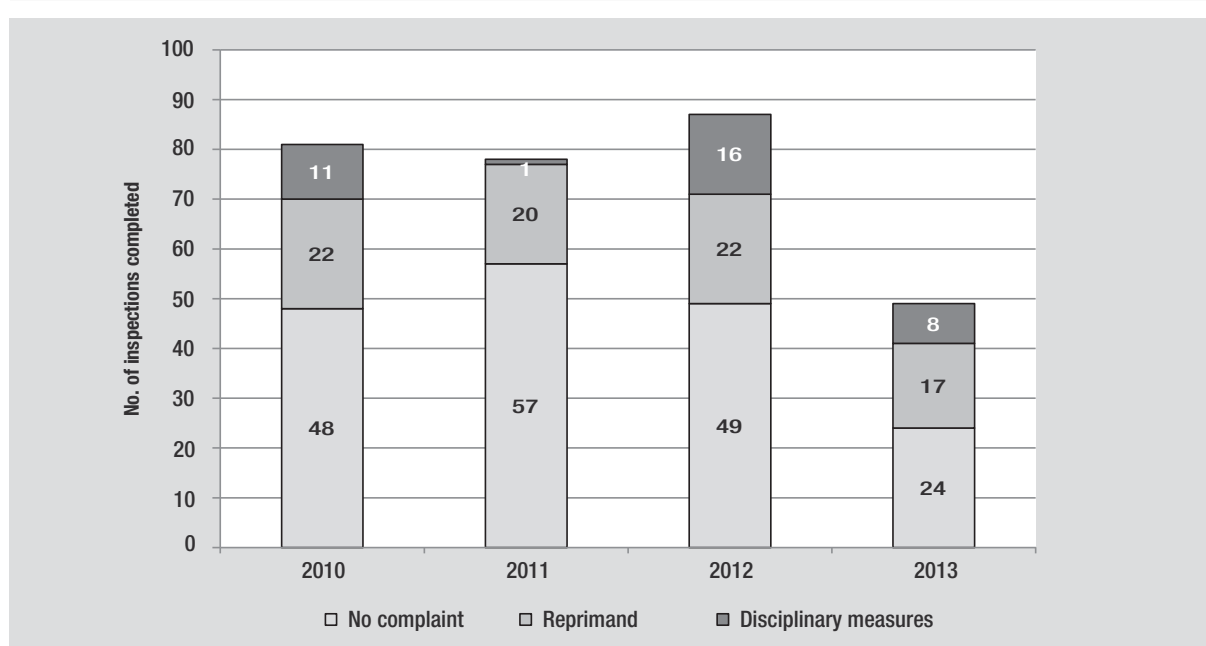
¹⁰⁷ See AOC, *Verfahrensordnung der Abschlussprüferaufsichtskommission für die Durchführung der Untersuchungen nach §§ 61a Satz 2 Nr. 2, 62b Abs. 1 WPO* (stand: 18.04.2013), available at http://www.apak-aoc.de/images/pdf/APAK_Verfahrensordnung_Sonderuntersuchungen.pdf (accessed 1 February 2016), articles 10 forward.

¹⁰⁸ See the Public Accountant Act, 2013, article 63; see also AOC, *Verfahrensordnung der Abschlussprüferaufsichtskommission für die Durchführung der Untersuchungen nach §§ 61a Satz 2 Nr. 2, 62b Abs. 1 WPO* (stand: 18.04.2013), available at http://www.apak-aoc.de/images/pdf/APAK_Verfahrensordnung_Sonderuntersuchungen.pdf (accessed 1 February 2016), article 20.

Table I.11. Work plans of AOC (2005–2014)

2005	2006	2007	2008–2012	2013–2014
Foreign auditors	Registration	Quality assurance	Investigation with cause	Inspection
Registration	Quality assurance	Disciplinary oversight	Inspection	Disciplinary oversight
Disciplinary oversight	Disciplinary oversight	Berufsauf-sichtsreform-gesetz	Quality assurance	Quality assurance
Quality assurance	Amendment of the Public Accountant Act	National cooperation	National cooperation	Projects
Adoption of professional rules	Professional standards development	International cooperation	International cooperation	National cooperation
	International cooperation			International cooperation

Source: AOC, *Work plans 2005–2014*, see http://www.apak-aoc.de/english/publications/work_plan.asp (accessed 21 January 2016).

Figure I.13. Actions taken as a result of the inspections (2005–2013)

Source: AOC, *annual reports 2012 and 2013*, available at http://www.apak-aoc.de/english/publications/annual_reports.asp (accessed 21 January 2016).

The actions taken as a result of the inspections, the most common complaints regarding the quality-assurance systems of auditors/audit firms examined and the most common complaints regarding the audit process of individual audit engagements of audit firms/auditors examined are detailed in figure I.13 and tables I.12 and I.13, respectively.

- (c) Cooperation with national and international organizations and regulators

Besides the interrelation between AOC and WPK, AOC can legitimately cooperate and exchange information with competent authorities both within and outside the European Union. Among European Union member States, mutual recognition exists concerning

admission to the profession, disciplinary oversight and quality assurance. Multiple investigations are, therefore, avoided in the European Union. If AOC receives an indication that a member of the profession from another European Union country has violated European Union requirements on statutory audits, it will inform the competent authority in the home member State. On the other hand, if AOC is informed by the competent authority from another European Union member State on breaches of duties, it will take appropriate action and inform the other authority about the outcome.¹⁰⁹ Auditors and audit firms from non-European Union countries carrying out statutory audits

¹⁰⁹ See the Public Accountant Act, 2013, article 66a IX.

Table I.12. Most common complaints regarding the quality-assurance systems of auditors/audit firms examined (2011–2013)

Most common complaints regarding the quality assurance systems	2011	2012	2013	Total
Order acceptance and independence	23	22	12	57
Order accompanying quality assurance	13	10	10	33
Completion of the order documentation and archiving	5	11	8	24
Total	41	43	30	114

Source: AOC, annual reports 2012 and 2013, available at http://www.apak-aoc.de/english/publications/annual_reports.asp (accessed 21 January 2016).

Table I.13. Most common complaints regarding the audit process of individual audit engagements of audit firms/auditors examined (2011–2013)

Most common complaints regarding the audit process	2011	2012	2013	Total
Inadequate implementation of the risk-oriented auditing approach	31	37	36	104
Deficiencies regarding the audit of accounting estimates and fair values	27	35	32	94
Deficiencies concerning the detection of irregularities	31	26	21	78
Complaints regarding the receipts of confirmations from third parties	16	22	14	52
Total	105	120	103	328

Source: AOC, annual reports 2012 and 2013, available at http://www.apak-aoc.de/english/publications/annual_reports.asp (accessed 21 January 2016).

of non-European Union companies listed in Germany are required to be registered in Germany and are, therefore, subject to German professional disciplinary oversight and provisions of quality assurance. However, registrations and their consequences are waived under the following two conditions:

- On the basis of reciprocity if the auditors or audit firms are subject to a public authority with quality assurance as well as disciplinary oversight in their home country that has equivalent requirements;
- In cases where the European Union has, for a transitional period, declared equivalence of a country's systems of public oversight, quality assurance, investigation and penalties.¹¹⁰

¹¹⁰ Ibid, article 134. Decisions on equivalence are a matter for the European Commission and the member States. As long as the European Commission has not issued a decision on the equivalence of a specific oversight system, the Federal Ministry of Economics and Technology may evaluate and certify the equivalency itself taking into account the evaluations of other member States. To date, no third-country oversight system has been recognized

Currently, AOC cooperates on a reciprocal basis by exchanging audit working papers and other relevant documents, including personal data, with supervisory bodies from Canada (the Public Accountability Board) and Switzerland, whose oversight systems have been declared as equivalent on a reciprocal basis. In addition, based on a letter of intent with the United States Public Company Accounting Oversight Board (PCAOB) to cooperate with the objective of mutual confidence in oversight systems, AOC carries out two joint inspections with PCAOB.¹¹¹ Furthermore,

as equivalent by the European Commission. However, there are exemptions for a transitional period for certain third countries. The assessments for these countries were conducted together with the European Group of Auditors' Oversight Bodies using the criteria set out in articles 29, 30 and 32 of Directive 2006/43/EC: see AOC, 2014, Registration of third country auditors, 21 October, available at <http://www.apak-aoc.de/english/foreign/registration.asp> (accessed 21 January 2016).

¹¹¹ See AOC, *Tätigkeitsbericht der Abschlussprüferaufsichtskommission 2013*, available at http://www.apak-aoc.de/images/pdf/APAK-AOC--Taeigkeitsbericht_2013.pdf (accessed 1 February 2016), pp. 30 forward.

since 2013, AOC, having been requested by a foreign supervisory body, is also allowed to inspect the non-statutory-audit engagements of capital-market-oriented companies that are not normally within the remit of AOC examinations.

Furthermore, AOC is closely engaged in the work of the European Group of Auditors' Oversight Bodies (EGAOB), which is the European Union's advisory body in statutory audit matters. The European Audit Inspection Group (EAIG) serves as a forum for exchanging experiences and findings from inspections with other European audit supervisory bodies. To contribute to and promote consistent decisions across Europe, in 2013 EAIG initiated an internal pan-European database to collect and exchange findings from the inspections of auditors and audit firms from European audit regulators and oversight bodies. On the initiative of AOC and other national supervisory authorities, in 2013 EAIG started a project to develop consistent procedures for audit inspections (Common Audit Inspection Methodology) to improve cross border cooperation and the comparability of inspection results. In addition, responding to the emergence of European-wide audit firms, AOC participates in the college of regulators founded to facilitate efficient inspection processes across European audit firms. To coordinate supervisory issues at an international level, AOC plays a leading role in the activities of the International Forum of Independent Audit Regulators (IFIAR), which coordinates the auditor oversight activities of national supervisory bodies that are members of IFIAR and maintains close contacts

with organizations such as IOSCO and the Basel Committee.¹¹²

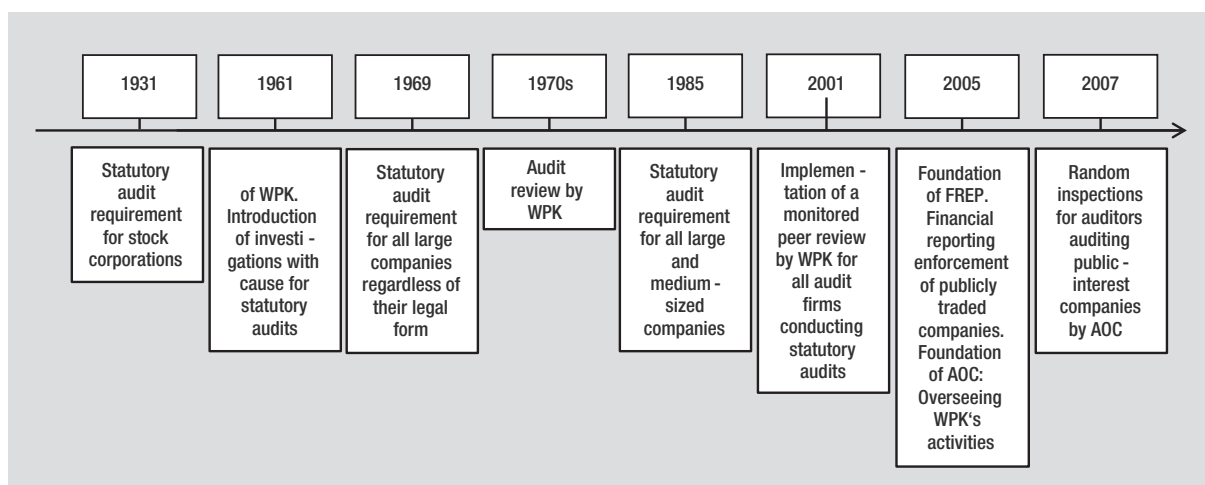
D. CONCLUSION

The enforcement of financial reporting and auditing requirements has undergone substantial changes since the implementation of a statutory audit requirement for stock corporations in 1931 (see figure I.14).

The most recent changes have resulted from new European Union legislation that have responded to international developments. For instance, FREP was founded following the European Union's IFRS Regulation requiring member States to implement effective enforcement mechanisms. The foundation of AOC followed the establishment of PCAOB and related discussions in the European Union that led to the development of the European Union Audit Directive (2006/43/EC) requiring member States to organize an effective system of public oversight for statutory auditors and audit firms. Since 2005, stricter enforcement requirements have applied in the case of publicly traded companies and statutory auditors of publicly traded companies, so-called public-interest entities. While companies are subject to the FREP enforcement only if they are publicly traded,

¹¹² Ibid, pp. 29 forward. To increase the quality of audit supervision, the European Union has decided to establish a Committee of European Auditing Oversight Bodies that will also involve a reorganization of the professional oversight and quality control in the individual European Union member States.

Figure I.14. Changes in the financial reporting and auditing requirements since 1931



Source: AOC, annual reports 2012 and 2013, available at http://www.apak-aoc.de/english/publications/annual_reports.asp (accessed 21 January 2016).

Table I.14. Summary of the auditor oversight bodies' competencies

	WPK			AOC
	Inspections with cause	Audit reviews	Monitored peer review	Inspections without cause
Auditors/audit firms conducting statutory audits	X	X		
Auditors/audit firms conducting statutory audits of publicly traded companies	X	X		X
Audit practices/audit firms conducting statutory audits			Every six years	
Audit practices/audit firms conducting statutory audits of publicly traded companies			Every three years	

all auditors and audit firms conducting statutory audits are subject to WPK enforcement activities (audit reviews, inspections with cause, and the like). Additionally, auditors and audit firms of publicly traded companies are also subject to AOC random inspections. Furthermore, audit practices and firms conducting statutory audits need to have monitored peer reviews at least every six years, whereas those with public-interest engagements need to have more frequent three-yearly reviews (see table I.14).

When evaluating the German financial reporting enforcement system, the following observations can be made:

- On one hand, the hybrid FREP/BaFin enforcement model has the benefit of combining the advantages of both enforcement systems: enforcement by state-regulated institutions and private-sector bodies. While state-regulated institutions have a higher degree of acceptance and assertiveness, private-sector organizations are able to pay more competitive salaries and are, therefore, more likely to attract highly qualified employees. On the other hand, the enforcement process is more complex in a two-stage system.
- The audit frequency of FREP (companies listed in the major stock segments are examined every four to five years; all other publicly traded companies are investigated only every eight to ten years) seems roughly in line with international practice.
- The sanctions available to BaFin for punishing erroneous reporting are rather weak. By requiring public error announcements solely for infringements detected in financial statements, the German enforcement system relies instead on participants in capital markets themselves to punish management's erroneous reporting. Empirical studies show that FREP examinations have become well established in the governance system of publicly

traded companies. Even though companies nowadays perceive the impact of error announcements on the capital markets as less dramatic, the FREP examinations and findings command great respect among companies' managers, and even examinations without error findings regularly prompt managers to change their accounting practice.¹¹³

- Empirical studies analysing the effect on the capital market following financial reporting enforcement actions in Germany show that public error announcements lead to significant and abnormal negative returns, abnormal trading volumes and abnormal bid-ask spreads. The magnitude of the market value discount is, as a consequence, positively associated with the severity of the error, the threat of subsequent litigation and the number of cases in which the company did not agree with the Enforcement Panel's error findings. Additionally, negative stock market reaction is lower for profit-decreasing errors and higher for entities that have been listed for longer.¹¹⁴
- Empirical studies analysing the impact of the German financial reporting enforcement system on the degree of earnings management show that the Enforcement Panel is very efficient in detecting earnings management of companies examined. However, in the year following the public error an-

¹¹³ See FREP, Annual Activity Report 2013, available at http://www.frep.info/docs/jahresberichte/2013/2013_tb_en.pdf (accessed 21 January 2016), pp. 18 forward.

¹¹⁴ See J-M Hitz, J Ernstberger and M Stich, 2012, Enforcement of accounting standards in Europe: Capital-market-based evidence for the two-tier mechanism in Germany, *European Accounting Review*, 21:253 forward; see also R Hecker and A Wild, The market effects of the German two-tier enforcement of financial reporting, Working paper available at <https://publikationen.uni-tuebingen.de/xmlui/bitstream/handle/10900/47996/pdf/334.pdf?sequence=1&isAllowed=y> (accessed 21 January 2016), pp. 1 forward.

nouncement, earnings management still exists,¹¹⁵ indicating a so-called “bomb crater” effect that states that firms’ managers may consider the probability of subsequent investigations in the year after being investigated to be marginal.

- As FREP and BaFin examine together all companies listed in Germany, a foreign-listed company may exceptionally be investigated multiple times in accordance with both German requirements and also those of its home country if the enforcement system of the country where the company is domiciled is based on a home-country principle. This means that, in any case, all companies headquartered in this particular country are examined.

When evaluating the German professional auditor oversight system, the following observations can be made:

- The compliance of statutory auditors’ professional duties is subject to several monitoring mechanisms: (a) monitored peer reviews organized by WPK for all statutory auditors; (b) audit reviews conducted by WPK for all statutory auditors; (c) investigations with cause carried out by WPK. In addition, AOC monitors the effectiveness of internal quality control systems as well as the compliance with professional obligations of public-interest companies’ auditors via inspections. Furthermore, an additional layer of control results from FREP/BaFin investigations into the audited financial statements of listed companies. Accordingly, there are multiple levels of control and enforcement, especially for auditors of public-interest companies.
- Independence from the auditing profession is ensured by AOC oversight activities.
- The frequency of inspections (annual inspections for audit firms/practices with more than 25 public-interest entities’ engagements and every three years for all other audit firms/practices with public-interest entities engagements) are comparable with international practice.
- With regard to resources, the AOC Inspection Committee when compared with other countries seems to be well staffed, with 26 members being

responsible for the inspections of 97 audit firms/practices.

- Together, AOC and WPK have developed a broad range of sanctions to punish misbehaviour (advice, instruction, reprimand – which can be accompanied by a fine of up to €50,000 – or disciplinary measures). However, in comparison with PCAOB in the United States, AOC/WPK sanctions are in some respects less strict and diverse. Under the PCAOB enforcement regime, for example, inspection reports as well as disciplinary sanctions imposed are reported to the public,¹¹⁶ inducing a name and shame effect that may provide added value in terms of deterrence.
- Among European Union member States, mutual recognition exists concerning admission to the profession, disciplinary oversight and quality assurance. Multiple investigations are, therefore, avoided in the European Union. For non-European Union audit firms, the mandatory requirement to register in Germany (and the resulting consequence of being subject to the German oversight and quality-assurance system) is waived only on the condition of reciprocity (mutual confidence in the equivalence of the oversight systems currently exists only for Canada and Switzerland) or in cases for which the European Union has for a transitional period declared equivalence of a country’s public-oversight, quality-assurance, investigation and penalty systems. Other non-European Union countries need to be registered if they wish to carry out statutory audits in Germany and are, therefore, in addition to the monitoring system of their home country, subject to AOC/WPK disciplinary oversight and assurance measures.
- In summary, it can be concluded that since implementation of the FREP/BaFin enforcement regime and the AOC oversight activities, the German accounting and audit enforcement regime has been significantly strengthened. This is also confirmed by empirical studies showing that through the country’s enforcement reforms (the foundation of FREP and AOC) earnings management activity has been reduced.¹¹⁷

¹¹⁵ See H-J Böcking, M Gros and D Worret, Enforcement of accounting standards – How effective is the German two-tier system in detecting earnings management? Working paper, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1755122 (accessed 21 January 2016), pp. 1 forward.

¹¹⁶ See the United States Sarbanes-Oxley Act, 2002, sections 104g and 105d.

¹¹⁷ See J Ernstberger, M Stich and O Vogler, 2012, Economic consequences of accounting enforcement reforms: The case of Germany, *European Accounting Review*, 21:217 forward.

CHAPTER II. CASE STUDY OF THE UNITED KINGDOM

This chapter discusses compliance-monitoring and enforcement systems in the United Kingdom pertaining to corporate reporting, auditor oversight and regulation of the accountancy profession.¹¹⁸ Section A provides a brief overview of the economy and capital markets of the United Kingdom. It also describes how the accounting profession is structured in the country and summarizes the applicable accounting, auditing and other corporate reporting standards. Section B presents some key aspects of the way the United Kingdom monitors compliance with financial reporting standards, the applicable enforcement mechanisms and the types of sanctions available. It also highlights key findings and trends. Section C discusses key aspects of the way in which the United Kingdom monitors compliance with auditing standards, the applicable enforcement mechanisms and the types of sanctions available. It also highlights key findings and trends. Section D discusses how the United Kingdom monitors compliance with codes of professional conduct and other applicable membership requirements (including certification and CPD requirements), together with related enforcement mechanisms. Section E concludes.

A. INTRODUCTION AND BACKGROUND INFORMATION

General economic setting¹¹⁹

The United Kingdom – which has a population of around 64 million – is a member of both the Organization for Economic Cooperation and Development and the G20 group of advanced economies. Its economy is the sixth-largest in the world measured by nominal gross domestic product. In line with most other major

economies, the majority of the United Kingdom's output comes from the service sector, which contributes around 79 per cent of gross domestic product. The financial services industry is particularly important and London is one of the world's largest financial centres.

As a member of the European Union, the United Kingdom benefits from access to a single market that, in 2012, accounted for 7 per cent of the world's population and 23 per cent of world gross domestic product.¹²⁰ The United Kingdom is not, however, a member of the eurozone, having opted to retain sterling as its national currency.

The United Kingdom economy is recovering from the recession that followed the 2008/2009 global financial crisis, which saw the largest reduction in economic output (7.2 per cent in real terms) since the end of the Second World War. In 2013, the United Kingdom experienced its fastest growth since 2007 and is currently the fastest growing major developed economy. This growth has been broad-based, with the construction, manufacturing and services sectors all expanding. Unemployment has fallen to its lowest level since the financial crisis. On current estimates, the United Kingdom economy has now reattained its prerecession peak, and the latest economic forecast published by the Institute of Chartered Accountants in England and Wales (ICAEW) predicts that the United Kingdom economy will grow by 3.4 per cent in 2014. However, the economy still faces a number of challenges that may slow recovery.

Stock exchanges and listed companies¹²¹

The main market of the London Stock Exchange is a truly global market, home to some of the largest and best known companies in the world. A listing

¹¹⁸ This case study was prepared for UNCTAD by Nigel Sleigh-Johnson, Head of Financial Reporting Faculty, ICAEW. The report provides a selective overview of key features of the enforcement regime in the United Kingdom. It is not intended to be comprehensive. Any views expressed are those of ICAEW.

¹¹⁹ Unless otherwise stated, numbers in this section are taken from www.ons.gov.uk (accessed 22 January 2016).

¹²⁰ Taken from Eurostat, The EU in the world in thirteen statistical themes, published in September 2014, see <http://ec.europa.eu/eurostat/en/web/products-press-releases/-/1-19092014-AP> (accessed 22 January 2016).

¹²¹ Unless otherwise stated, numbers in this section are taken from www.londonstockexchange.com (accessed 22 January 2016).

on the main market provides companies with a high profile and increased liquidity. It also comes with high standards of disclosure, governance and regulation.

In addition to the main market, the London Stock Exchange operates the Alternative Investments Market (AIM). As AIM is an exchange-regulated market, companies listed on it do not have to comply with many of the mandatory provisions of European Union directives and other rules applicable to companies listed on the main market. AIM provides smaller and growing companies from around the world with a means of raising the capital they need for expansion. It aims to offer such companies the benefits of a world-class public market within a balanced approach to regulation designed specifically to meet their needs.

In June 2014 there were 1,310 companies from over 60 countries listed on the main market with a total market value of £4.1 trillion, and 1,104 companies listed on AIM with a total market value of £77 billion.

The ICAP Securities and Derivatives Exchange (ISDX), an independent United Kingdom stock exchange, provides another source of equity finance for small and medium-sized companies wishing to raise money from investors to finance and grow their businesses. Some 150 companies are currently listed on ISDX with a total market value of around £2 billion. A small number of financial instruments are also listed on other minor markets.

United Kingdom listed companies are the primary focus of this report.

Regulatory framework

The following regulatory bodies – which share intelligence and work together as appropriate – are central to the United Kingdom’s regulatory framework:

- The Financial Reporting Council (FRC) – An independent regulator responsible for promoting high-quality corporate reporting in the United Kingdom. It sets standards and also monitors and enforces them. It also oversees the regulatory activities of the professional accountancy bodies. It is not, however, a securities or financial services regulator. The role and activities of FRC are discussed in more detail in subsequent sections of this chapter.
- The Financial Conduct Authority (FCA) – Responsible for regulating firms and financial advisors so that markets and financial systems remain sound, stable and resilient.
- The Prudential Regulation Authority (PRA) – Responsible for the prudential regulation and supervision of the banks, building societies, credit unions, insurers and major investment firms in the United Kingdom.

Regulatory requirements for specific business sectors, notably the financial services sector, are beyond the scope of this case study.

Compliance and enforcement have many aspects. The credibility of the legal system and an independent judiciary are also important factors, as are the existence of rights to sue directors and auditors. While the threat of litigation by shareholders is not as an important part of the enforcement system in the United Kingdom as it is in other countries, for example, the United States, it nonetheless remains a key component. This case study, however, focuses primarily on just three aspects of United Kingdom enforcement activity: financial reporting, auditing and codes of professional conduct.

Corporate governance

The United Kingdom is considered to have very high standards of corporate governance. This helps to underpin long-term company performance and makes the United Kingdom market attractive to new investment.

The United Kingdom Corporate Governance Code (“the Code”) published by FRC sets out standards of good practice in relation to board leadership and effectiveness, remuneration, accountability and relations with shareholders. It is updated every two years to reflect the latest best practice in corporate governance. All companies with a premium listing of equity shares in the United Kingdom are required under the listing rules to report on how they have applied the Code in their annual report and accounts, and to explain why in the case that they have not complied (often referred to as the “comply or explain” approach).

Since its introduction more than 20 years ago, the Code has made a significant difference to the United Kingdom’s corporate culture and has succeeded in raising the standard of financial reporting and accountability generally. In 2012, a significant change to the Code required directors to ensure that, overall, the annual report and accounts are “fair, balanced and understandable”. In other words, the annual report should accurately reflect not only the good but also

the bad news about a company's performance and there should be consistency between the financial statements and the narrative information in the front half of the report. The aim is to provide investors with greater insight into what company boards are doing to promote investor interests, and to provide them with a better basis of engagement.

Recent changes to the Code – made in September 2014 and applicable to accounting periods beginning on or after 1 October 2014 – include requirements to publish a “viability statement” in addition to the statement of “going-concern” basis for accounting and to link remuneration more closely to the long-term success of the business.

*Audit firms*¹²²

At the close of 2013, the overall number of registered audit firms in the United Kingdom stood at 6,962. More than 50 per cent of the firms were sole practitioners. The total number of registered audit firms fell by 11.2 per cent between 2009 and 2013 and by a further 3.8 per cent during 2013. One key factor underlying this decline is the increase in the proportion of United Kingdom companies now exempt from statutory audit (currently 1,567,900 or 88.5 per cent of non-dormant United Kingdom companies do not have their individual accounts audited).¹²³ Audit exemption for small companies (as defined in United Kingdom law) was first introduced in the United Kingdom in 1994 when provisions permitted under European Union law were first adopted.

As in many other jurisdictions, the largest firms in the audit market are Deloitte, Ernst and Young, KPMG and PricewaterhouseCoopers; 98 per cent of the FTSE 100 (the 100 largest listed companies) and 96 per cent of the FTSE 250 (the next largest 250 companies) were audited by these firms with respect to financial years ending in 2013. The leading firms in the market for auditing AIM companies are BDO and Grant Thornton. Between them, these two firms audit almost as many AIM companies as Deloitte, Ernst and Young, KPMG and PricewaterhouseCoopers combined. However, overall around 71 per cent of

the total fee income of United Kingdom audit firms is attributable to the four largest firms.

*Major accountancy bodies*¹²⁴

The major accountancy bodies in the United Kingdom and Ireland¹²⁵ are:

- The Association of Chartered Certified Accountants (ACCA);
- The Chartered Accountants Ireland (CAI);
- The Chartered Institute of Management Accountants (CIMA);
- The Chartered Institute of Public Finance and Accountancy (CIPFA);
- ICAEW;
- The Institute of Chartered Accountants of Scotland (ICAS).

Each of these bodies was formed by Royal Charter. On 31 December 2013 they had a total of over 326,000 members located in the United Kingdom and Ireland (of which over 120,000 were ICAEW members) and a total of over 460,000 members worldwide.

The term “accountant” does not have the same legal protection in the United Kingdom accorded to other professions such as medical doctors and lawyers. As a result, anyone can describe themselves as an accountant. However, only members of ICAEW, ICAS or CAI can refer to themselves as “chartered accountants”.

A collective voice is provided by ACCA, CAI, CIPFA, ICAEW and ICAS for much of the United Kingdom profession by them working together in the public interest on matters affecting the profession and the wider economy under the auspices of the Consultative Committee of Accountancy Bodies.¹²⁶

Accounting standards

Reporting entities in the United Kingdom apply accounting standards according to their nature

¹²² Unless otherwise stated, numbers in this section are taken from *Key Facts and Trends in the Accountancy Profession*, published in June 2014, available at <https://www.frc.org.uk/Our-Work/Conduct/Professional-oversight/Key-Facts-and-Trends-in-the-Accountancy-Profession.aspx> (accessed 22 January 2016).

¹²³ Companies House, Statistical Tables on Companies Registration Activities 2012/13, table F2.

¹²⁴ Numbers in this section are taken from *Key Facts and Trends in the Accountancy Profession*, FRC, published in June 2014, available at <https://www.frc.org.uk/Our-Work/Conduct/Professional-oversight/Key-Facts-and-Trends-in-the-Accountancy-Profession.aspx> (accessed 22 January 2016).

¹²⁵ The United Kingdom and Ireland share a number of regulatory institutions; reference is therefore made to the latter throughout this report where appropriate.

¹²⁶ CIMA withdrew from the Consultative Committee of Accountancy Bodies in 2011.

and size. There is an overriding and very important requirement in the statute for accounts to show a “true and fair view”.¹²⁷

In line with their counterparts in other European Union member States, United Kingdom companies listed on regulated securities markets – including the main markets of both the London Stock Exchange and ISDX – have been required to use European Union-adopted IFRS in their consolidated accounts since reporting periods beginning on or after 1 January 2005, in accordance with the European Union’s 2002 International Accounting Standard Regulation.

Companies listed on AIM have been required under stock exchange rules to follow European Union-adopted IFRS in their consolidated accounts since 1 January 2007. Almost all other entities, including subsidiaries of both listed and AIM companies, have a choice between preparing their accounts under United Kingdom standards issued by FRC or under European Union-adopted IFRS. FRS 102 – The Financial Reporting Standard Applicable in the United Kingdom and Ireland – a new standard based on the International Accounting Standards Board (IASB) IFRS for small and medium-sized enterprises, forms the cornerstone of a new United Kingdom reporting regime that has been effective from 1 January 2015 and replaces all existing standards.

Eligible small companies may for the time being continue to apply the Financial Reporting Standard for Smaller Entities, a simplified version of United Kingdom standards. Microentities as defined in European Union law can also choose to apply the recognition and measurement requirements of this standard while simultaneously taking advantage of legislation that, since 2013, allows them to prepare a highly simplified balance sheet and profit and loss account, and exempts them from preparing all but a handful of notes to the accounts.

The United Kingdom is currently in the process of implementing a new European Union Accounting Directive. This will increase harmonization across European Union member States by, among other things, restricting the number of notes that can be required by member States in small company financial statements. Consequently, FRC proposed in September 2014 that, from 2016, the Financial

Reporting Standard for Smaller Entities should be withdrawn and small companies brought within the scope of FRS 102, albeit with reduced disclosures. It is, at the same time, proposing to introduce a new standard specifically for companies choosing to apply the accounting exemptions available for microentities.

Auditing standards

The International Standards on Auditing issued by IAASB were adopted in the United Kingdom and also Ireland as ISA (United Kingdom and Ireland) for audits of financial statements for periods ending on or after 15 December 2010. Limited amendments are made to IAASB standards to address specific United Kingdom and Irish legal and regulatory requirements and to provide additional guidance appropriate to the national legislative, cultural and business context.

ISA 700 – Forming an Opinion and Reporting on Financial Statements – as issued by IAASB has not been adopted in the United Kingdom. This means that the reports of United Kingdom and Ireland auditors are not aligned exactly with the format of auditors’ reports prepared in line with IAASB standards. In June 2013, FRC issued new requirements for enhanced auditor reporting.

Other corporate reporting standards

Additional corporate reporting requirements are included in the Companies Act, 2006. The Act includes requirements about financial statements and requires companies to produce separate directors’ reports and strategic reports alongside the annual accounts.

The United Kingdom public sector applies accounting guidance that is broadly consistent with IFRS and International Public Sector Accounting Standards. These requirements are beyond the scope of this report.

B. FINANCIAL REPORTING

Regulatory basis

The Financial Reporting Council is responsible for monitoring the quality of strategic reports, directors’ reports and accounts published by publicly traded and large private companies to confirm that they comply with the relevant reporting requirements, including accounting standards (both IFRS and United Kingdom GAAP) and the overriding requirement for accounts to

¹²⁷ As per the Companies Act, 2006. The meaning of “true and fair” is discussed in various legal opinions and statements issued by FRC that can be found on the FRC website at www.frc.org.uk (accessed 22 January 2016).

give a true and fair view. FRC also keeps under review interim reports of all listed issuers and annual reports of certain other non-corporate listed entities.

The remit and powers of FRC in respect of corporate reporting review are derived primarily from the Companies Act, 2006, and the Companies (Audit, Investigations and Community Enterprise) Act, 2004. It has undertaken these activities since July 2012 through its Conduct Committee. It is the role of the Conduct Committee to enquire into cases where it appears that the requirements have not been followed – primarily where it appears that there may be a question as to whether the strategic report, directors' report or accounts have complied with the requirements of Companies Act, 2006, and, by implication, with financial reporting standards.

Monitoring and enforcement

Selecting accounts for review

Most FRC resources are directed at companies of economic significance where a material error could have implications for the market as a whole. As FTSE 100 companies represent a substantial proportion of total investment in United Kingdom companies, FRC aims to review their reports and accounts at least once every three years. FTSE 250 companies are reviewed at least once every four years.

Reports and accounts are selected for review in a number of ways:

- Entities may be selected from specific sectors of the economy, particularly from those regarded as under particular stress. The sectors considered to present the greatest risks are determined annually. The "focus sectors" for 2013/14 were "support services" (a broad category encompassing, for example, business support services, industrial suppliers and waste and disposal services), retail, natural resources/extractive industries and construction. For 2014/15 the focus sectors were support services and information technology, including software companies.
- Reviews may be prompted by specific topical accounting issues that may give rise to issues of increased subjectivity, judgment and risk of misstatement in corporate reporting.

- Reviews may be prompted by complaints from the public, the press or the financial markets.
- Reviews may be undertaken on a rotational basis to satisfy the considerations relating to the corporate reports of FTSE 100 and FTSE 350 companies, as described above.

Selection is based on the Conduct Committee's assessment of the risk of non-compliance and the risk of significant consequences if there proves to be non-compliance.

Initial consideration

Once an entity's accounts have been selected for review, it will be undertaken by members of the FRC Corporate Reporting Review Team. If the review raises concerns about whether the accounts comply with the requirements of the Companies Act, 2006, a letter will be sent to the chair of the entity setting out the relevant issues and requesting further information or explanations. This letter is also copied to the audit committee chair and the finance director. A substantive response is normally expected within 28 days.

Depending on the issues involved, there may be several exchanges of correspondence with the entity. In some cases an informal technical meeting is held with the entity and its advisors. This initial consideration may identify possible breaches of reporting requirements or areas for improvement in an entity's corporate reporting that can be rectified by the entity without the need for further review or action. A formal enquiry will be launched where it is concluded that there may be a case to answer as to whether the accounts are defective in a material respect and revision of the accounts may be necessary.

This enquiry will be undertaken by a review group of up to five members of the Financial Reporting Review Panel – a body operating under the auspices of the Conduct Committee – including the chair and one of the deputy chairs. Financial Reporting Review Panel members are qualified accountants or lawyers who specialize in company law and who hold or have held senior positions in their chosen field. Recruited by public advertisement, they are unpaid, other than the chair. The underlying principle of a formal Financial Reporting Review Panel enquiry is that companies are reviewed by their peers. This ensures that the Conduct Committee's approach is practical and takes note of business considerations.

The review group enquiry

The Financial Reporting Review Panel chair will write to the entity on behalf of the review group explaining its concerns. There may again be a number of rounds of correspondence, and meetings may be held between the entity and the review group.

As defective accounts could mislead the public, whenever possible the procedures need to allow for timely rectification. The review group aims to reach agreement with the directors by persuasion. If it is satisfied by the company's explanations and is of the view that no remedial action is required beyond that proposed by the entity, the case is closed.

Voluntary revision

Where the directors agree to take remedial action, the Conduct Committee may issue a press notice, but it will not comment on or discuss its conclusions further. Press notices are considered appropriate where FRC intervention results in immediate changes to a company's annual report and accounts, or in commitments to make significant changes or improvements in the future that need to be brought to the attention of the market.

Where a press notice is not issued, FRC engagement with companies may be evidenced by references in financial statements to the intervention of the Conduct Committee in what are known as "committee references".¹²⁸ These are required where FRC considers that a company should disclose the fact that the changes it is making to its reporting were prompted by the FRC review.

If no press notice is issued or committee reference made, the fact that an enquiry was made will remain confidential.

Applying to the court

Having heard the entity's explanations, the review group may not agree with the entity and may conclude that the matter represents a breach of accounting and

reporting requirements that should be pursued. The review group will write to the entity explaining that it is intending to report to the Conduct Committee recommending that they make an application to the court. The entity will be given a further opportunity to respond and put forward proposals for corrective action or clarification. The threat of court action may prompt responses from previously uncooperative entities.

If the entity's explanations and proposals still do not satisfy the review group, it will send a final letter to the entity. If the group is not satisfied by any response, it will refer the matter to the Conduct Committee. The Conduct Committee will consider the report produced by the review group and may resolve to apply to the court for an order requiring the directors to prepare revised accounts or a revised report. Other authorities will be informed of the application, as appropriate, and normally a public announcement will be made.

A legal costs fund of £2 million is maintained by FRC for the purpose of securing revisions through the court. It is important to note, however, that it has not been necessary to apply to the court on any occasion, as companies have agreed to accept FRC findings, not least perhaps because directors of companies can be made personally liable for the costs of the action and any subsequent revision of the accounts.

Trends*Level of activity and outcomes achieved*

The FRC *Corporate Reporting Review Annual Report 2014*, published in October 2014, provides a summary of activity undertaken during the year to 31 March 2014.

In 2013/14, FRC reviewed 271 sets of reports and accounts (compared to 264 in 2012/13 and 326 in 2011/12) and wrote to 100 companies (91 in 2012/13; 130 in 2011/12). In addition to its proactive reviews, FRC responded to complaints about reports and accounts and to referrals from fellow regulators, resulting in 16 reviews (eight in 2012/13; nine in 2011/12: nine).

Most FRC enquiries result in the agreement of the company concerned to make some change in its next reports and accounts. These range from the less significant, for example, changing the language used to describe an accounting policy, to the amendment of

¹²⁸ Even though committee references have always been in the public domain, until recently they were generally known only to those who read the specific set of accounts in which they appeared, as no further publicity was sought. In October 2014, FRC changed its operating procedures so that, henceforth, the names of companies that have published such references will appear in the FRC corporate reporting review annual report.

figures in the primary statements or the correction of other significant data, such as earnings per share. The improvements may include commitments to enhance disclosures, either by including additional explanation or reducing unnecessary information to focus on what is deemed to really matter to investors.

Based on the work it undertook in 2013/14, FRC concluded that the quality of corporate reporting by large public companies – particularly FTSE 350 companies – was generally good, although there were some issues of concern involving unusual or complex transactions, difficult judgements and particularly subjective estimates.

However, FRC also noted that they continue to see a higher number of poorer quality accounts produced by smaller listed and AIM companies than by their larger counterparts. The FRC annual report noted such entities often struggle to account for complicated transactions. In response to these concerns, FRC has set up a project

aimed at driving a step change over three years in the overall quality of reporting by companies in this part of the market. The initial phase of this project involves gathering and assessing evidence of the root causes of issues and exploring ways in which FRC can support companies to make improvements. Subsequent phases will see FRC implementing possible supporting actions and, finally, assessing whether the quality of reporting has improved as a result.

Commonly raised concerns

The FRC *Corporate Reporting Review Annual Report 2014* identified several areas of corporate reporting that are commonly raised with companies (table II.1).

Although some of these issues had been raised in similar reports in previous years, in most of these instances FRC reported that improvements had been made, often following in the wake of the publication of its concerns.

Table II.1. Common areas of challenge

Area	Issues
Business reviews and strategic reports	Some business reviews (which until September 2013 were a part of the directors' report, but which are now subsumed into the strategic report) were found to focus too much on good news, and thus were not balanced and comprehensive. Others failed to provide sufficient information on non-recurring items.
Pensions	Some companies' policies in respect of the recognition of pension fund surpluses as assets or recognizing liabilities for minimum funding requirements were found to be unclear. A very small number of pension schemes were found to have been structured to achieve a particular accounting effect.
Exceptional and similar items	A number of concerns were identified including: poorly described or missing accounting policies for exceptional items; recurring or immaterial items described as exceptional; a lack of symmetry, with more "bad" news than "good" news described as exceptional items; a lack of comparative information.
Critical judgements	In some instances it was not sufficiently clear what the precise nature of the judgement was or how it affected the financial statements. In other instances this disclosure was found to simply repeat or refer to the relevant accounting policy.
Clear and concise reporting	FRC has for some time been encouraging companies to cut clutter as a step towards clearer and more concise reporting. While FRC welcomed the cutting of extraneous material from company reports, it also warned that doing so involves judgement and that there must be a basis for concluding that certain items no longer warrant disclosure.
Principal risks and uncertainties	Some companies continue to produce voluminous lists of generic risks rather than focussing on those that are their principal risks and uncertainties. While an increasing number of companies now explain how they manage and mitigate risks, some still fail to do so.
Accounting policies, particularly revenue	Some companies continue to produce "boilerplate" descriptions of policies that are not tailored to the facts and circumstances of their businesses. Revenue recognition policies in particular were found to lack an appropriate level of granularity.
Impairment	Asset impairment calculations and disclosures have been a common area of challenge since the onset of the recent financial crisis. While FRC saw continuing improvement in companies' disclosures, it continued to raise questions about, for example, key assumptions, and discount and growth rates.
Taxation	A number of concerns were identified including: not recognizing deferred tax on acquired intangibles in a business combination; failing to disclose why deferred tax assets were considered recoverable; missing information in relation to the reconciliation of the tax charge to the accounting profit multiplied by the effective tax rate.
Cash flow statements	FRC identified instances where cash flows were misclassified or inappropriately netted-off and where non-cash movements were reported as cash flows.

Table II.2. FRC press notices 2011–2014

Company	Details
Pendragon Plc	The principal issue related to the company's presentation of cash flows from its contract hire vehicle operations. The directors ultimately corrected this error by reclassifying net cash outflows of £31.3 million from investing activities to operating activities (although there was no net effect on cash flows).
WH Smith Plc	The principal issue related to the company's decision not to recognize as a liability in its financial statements certain amounts payable by a subsidiary to the company's pension trustee under a minimum funding requirement. The directors ultimately agreed to recognize this liability, leading to a reduction in net assets from £149 million to £95 million and a reduction in profit after tax of £4 million.
Anglo-Eastern Plantations Plc	The principal issue related to the company's use of historical rather than current data to estimate the fair value of palm oil trees, recognized in the balance sheet as biological assets. The directors ultimately agreed to switch to using current market data, leading to a reduction in the value of its biological assets from \$245 million to \$208 million and a reduction in profit after tax of \$1.6 million.

Press notices and committee references

In 2013/14, FRC issued two press notices (in relation to WH Smith Plc and Anglo-Eastern Plantations Plc) and 10 committee references were published. In 2012/13, it issued one press notice (in relation to Pendragon Plc) and, again, ten committee references were published in the period since the publication of the previous annual report. No press notices were published and seven committee references were issued in 2011/12. As in previous years, all cases were settled without referral to the court (table II.2).

Generic public announcements

In addition to entity-specific public announcements, the Conduct Committee may report on its findings on more general areas of corporate reporting. Such reports may, for example, highlight findings on a particular area of corporate reporting and how improvements may be made in line with the relevant legal and accounting requirements. Announcements may also be made to highlight the challenges to preparers that may arise from the introduction of new reporting requirements.

Recently, such announcements have challenged the reporting of companies classifying pension liabilities as equity, sought consistency in the reporting of exceptional items and highlighted the challenges in the reporting of principal risks and uncertainties.

Interaction with other bodies

Audit quality review

The FRC Corporate Reporting Review and Audit Quality Review Teams work together closely. They share both information and findings, and select reports and audits for review using a common approach to

risk and similar industry focus areas. More detail on the work of audit quality review is found below.

International and regional cooperation

The Financial Reporting Council engages extensively with European Union and international organizations. It works closely with its European counterparts, meeting regularly with them to discuss enforcement decisions and common reporting issues, and seeks to comply with the requirements of the standards of enforcement issued by ESMA.

The European Securities and Markets Authority has an important role in encouraging consistency in enforcement across the European Union. It coordinates a coherent approach by European Union national enforcers through, among other things, the publication of summaries of enforcement decisions, the reporting of results of thematic reviews, and the establishment of common enforcement priorities.

The European Securities and Markets Authority also sets enforcement priorities that are designed to achieve a high level of harmonization in enforcement and to contribute to consistency in the application of IFRS across the European Union. ESMA believes that listed companies and their auditors should pay particular attention in the areas of consolidated financial statements, joint arrangements and valuation of deferred tax assets when preparing and auditing their 2014 IFRS financial statements.

The European Securities and Markets Authority also encourages coordination and cooperation and issues best-practice guidelines after consultation with constituents, and publicly available reports that list those national bodies that do not comply, together with the reasons for non-compliance. It does not have the power to issue penalties.

The Financial Reporting Council is not a securities regulator and is not a member of IOSCO. The United Kingdom's representative on IOSCO is FCA.

Interaction with other regulators

The Financial Reporting Council liaises with other regulators where it considers that the matters that have come to its attention could be of significance to them in the discharge of their responsibilities. For example, it meets with FCA on a monthly basis and shares with it detailed outcomes of its enquiries into listed company accounts.

Interaction with financial reporting standard-setters

The wide-ranging remit of FRC includes setting United Kingdom financial reporting standards. In its role as a standard-setter, FRC works with other bodies, including:

- The International Forum of Accounting Standard Setters, an informal group of organizations committed to working in the public interest for the improvement of financial reporting;
- The European Financial Reporting Advisory Group (EFRAG), which advises the European Commission on IFRS in Europe.

The new governance structure of EFRAG is effective from 31 October 2014. In the meantime, EFRAG has established a nominating committee to facilitate the selection of members of the new board. An FRC nominee will be a full member of the new board of EFRAG.

As well as producing its own material, FRC responds to relevant external consultations. It responds to consultations from IASB and other bodies such as EFRAG, ESMA and the International Public Sector Accounting Standards Board.

The FRC Financial Reporting Lab

In 2011, FRC established its Financial Reporting Lab as a vehicle for encouraging companies to communicate better by restructuring the information in their financial statements, while still complying with the relevant financial reporting standards.

Since its launch, the Financial Reporting Lab has provided an environment where investors and companies can come together to develop pragmatic solutions to current reporting needs, a learning space where companies can use the Lab to test new reporting formats with investors and a hub to

support innovation in reporting. The Lab has worked with companies and investors to produce a number of non-mandatory guidelines and reports, the latest, at the time of writing, on the topic "Towards clear and concise reporting".

The work of the Lab reflects a United Kingdom tradition of complementing formal enforcement activity with efforts to encourage high-quality reporting by highlighting good practice, encouraging innovation and continuous improvement, and seeking to promote an environment where preparers and auditors routinely exercise professional judgement.

C. AUDIT AND ASSURANCE

Regulatory basis and scope of work

The Companies Act, 2006, sets out the requirements for the regulation of auditors in the United Kingdom. Both FRC and the professional accountancy bodies have a role in the regulation of audit practitioners and firms.

Powers are delegated to FRC by statute for the recognition, supervision and derecognition of bodies known as recognized supervisory bodies (RSBs). In turn, these RSBs have the power to register and supervise auditors.

Four of the six major accountancy bodies and one other accountancy body are recognized by FRC as RSBs.¹²⁹ It is only these bodies that can authorize their members to carry out audits. Under the Companies Act, 2006, a firm can only accept an appointment as an auditor if it is a registered auditor under the rules of an RSB.

Recognized supervisory bodies must have in place, among other things, effective arrangements for registering, monitoring and disciplining auditors. They are responsible for monitoring the quality of audits of incorporated companies and certain other entities that have no securities listed on the main market of the London Stock Exchange and whose financial condition is not otherwise considered to be of major public interest.

Recognized supervisory bodies are subject to independent oversight, with FRC conducting regular inspection visits to ensure that they are discharging

¹²⁹ CIMA and CIPFA are not RSBs.

their responsibilities appropriately. FRC also has the power to sanction RSBs.

In addition to the quality assurance and monitoring undertaken by RSBs, FRC is responsible for monitoring and reporting publicly on the quality of the auditing of listed and other major public-interest entities. Its Audit Quality Review Team undertakes this work.

Registration

A firm that wishes to undertake regulated audit work must become a registered auditor.¹³⁰ This is achieved through applying for registration with an RSB, which is then responsible for determining whether the firm is fit and proper to carry out regulated audit work.

Once a firm is registered, it must comply with the Audit Regulations and Guidance and the Professional Indemnity Insurance regulations. Each firm must nominate at least one individual who will be responsible for signing audit reports. Each such responsible individual must hold an appropriate audit qualification. All registered firms are subject to monitoring activities of an RSB.

In the case of ICAEW, an Audit Registration Committee is responsible for considering and determining applications for audit registration. The Audit Registration Committee is also responsible for taking any regulatory action required as a result of information obtained during the monitoring visits to registered firms affecting its area of responsibility. It may impose restrictions or conditions on a registered auditor or withdraw registration.

Monitoring – listed and other major public-interest entities

Scope of the work of the FRC Audit Quality Review team

The Audit Quality Review Team is responsible for monitoring the audits of listed and other major public-interest entities. Audits of the following entities were within the scope of the team's work in 2014/15:

- All United Kingdom incorporated companies with listed equity and/or listed debt;
- All incorporated companies not in the European Economic Area with listed equity and/or listed debt audited by a United Kingdom registered auditor;

- AIM- or ISDX-quoted companies incorporated in the United Kingdom with a market capitalization in excess of £100 million;
- United Kingdom unquoted companies, groups of companies, limited-liability partnerships or industrial and provident societies with group turnover in excess of £500 million;
- United Kingdom incorporated banks not already included in any other category;
- United Kingdom building societies;
- Private-sector pension schemes with either more than £1,000 million of assets or more than 20,000 members;
- Charities with incoming resources exceeding £100 million;
- Friendly societies with total net assets in excess of £1,000 million;
- United Kingdom open-ended investment companies and United Kingdom unit trusts managed by a fund manager with more than £1,000 million of United Kingdom funds under management;
- Mutual life offices whose "with-profits" fund exceeds £1,000 million.

The Audit Quality Review Team will normally review the most recently completed audit of an entity. Over the last five years, the team has inspected 413 audits, including the audits of 72 FTSE 100 companies, 106 FTSE 250 companies and 149 other fully listed and AIM companies.

In response to a report issued by the United Kingdom's Competition and Markets Authority, from 2014/15 onward FRC plans to gradually increase the number of FTSE 350 audits inspected as part of a phased programme that will ultimately see inspections of all such companies on average once every five years.

The Audit Quality Review Team also monitors the policies and procedures supporting audit quality at the major United Kingdom audit firms. A "major firm" is one with more than ten audits within the scope of the work of the Audit Quality Review Team. There are currently nine such firms, each of which is subject to regular inspections, which include a review of their policies and procedures supporting audit quality.

The largest four audit firms are subject to inspection on an annual basis and the other major firms on a

¹³⁰ This is generally, but not exclusively, audit work in relation to a company.

cycle of two or three years. From 1 April 2013, the inspections of firms with 10 or fewer entities in scope have been delegated in full to the professional bodies, subject to FRC oversight and supervision.

Audit inspections

The Audit Quality Review Team applies a risk-based approach to selecting individual audits for review, utilizing a risk model covering main market and AIM entities. This model takes account of the same “focus sectors” used by the FRC Corporate Reporting Review Team when selecting reports for review. In recent years the Audit Quality Review Team also has – and continues to have – an additional focus on the audit of banks and building societies. In 2013/14, the Audit Quality Review Team accorded particular emphasis to the audit of “letterbox” companies.¹³¹

The Audit Quality Review Team’s reviews of individual audits place emphasis on the appropriateness of key audit judgements made in reaching the audit opinion and the sufficiency and appropriateness of the audit evidence obtained. Its reviews of firm-wide procedures are wide-ranging in nature and include an assessment of how the culture within firms impacts audit quality.

The work of the Audit Quality Review Team includes confirming that registered auditors are complying with the requirements of the audit regulations issued by the relevant accountancy bodies. The audit regulations inter alia encompass compliance with auditing standards, ethical standards and quality-control standards for auditors. The Audit Quality Review Team identifies areas where improvements are required and agrees an action plan with each firm inspected, designed to achieve those improvements. The team then assesses periodically the adequacy of progress made by the firm towards addressing these findings.

Each year, the Audit Quality Review Team issues public reports on their overall findings and details of the reviews of individual major audit firms. It will also from time to time publish the results of separate thematic reviews, the most recent of which have considered materiality and fraud risks.

¹³¹ “Letterbox” companies are groups or companies that have little more than a registered office in their country of registration, with management and activities based elsewhere. In such situations, the auditor is usually based in the country of legal registration, rather than where management is based.

Level of activity and outcomes achieved

The Audit Quality Review Team’s review of individual audits focuses on the sufficiency and appropriateness of audit evidence obtained to support the key audit judgments made in reaching the audit opinion. As the review focuses on how an audit was performed, an assessment concluding that improvements are needed does not necessarily mean that an inappropriate audit opinion was issued or that the financial statements failed to show a true and fair view.

The FRC *Audit Quality Inspections Annual Review 2013/14* was published in May 2014, providing a summary of activity undertaken during the year to 31 March 2014. During that period the Audit Quality Review Team inspected 81 audits¹³² (2012/13: 85; 2011/12: 84). Overall, the quality of auditing was found to be generally good and continues to show improvement, most notably in relation to the largest listed companies.

More detailed findings included:

- Sixty per cent of all audits were assessed as either good or requiring only limited improvements, maintaining the significant improvement in the grading of audits observed in 2012/13;
- Nineteen per cent of audits received the highest grading (2012/13: 13 per cent; 2011/12: 11 per cent), although the increase was particularly influenced by the results at one firm;
- Audits assessed as requiring significant improvements accounted for 15 per cent of all audits. This was unchanged from 2012/13, although the number of FTSE 350 audits requiring significant improvements increased from two to four;
- Eighty-six per cent of the FTSE 100 audits were assessed as either good or requiring limited improvements. Only one FTSE 100 audit was assessed as requiring significant improvements (the same number as in 2012/13 and 2011/12);
- Four of the audits requiring significant improvements related to “letterbox” companies.

Looking at longer-term trends, the average grade of all audits inspected has improved gradually over the last five years. The audits of FTSE 350 score the highest, with 62 per cent rated as good or in need of

¹³² Excluding public-sector, third-country auditors and follow-up reviews.

limited improvements, and only 8 per cent in need of significant improvement. Conversely, only 46 per cent of the audits of other fully listed and AIM companies were rated as good or in need of limited improvements, with 17 per cent in need of significant improvement. There is also considered to be scope for improvement in the banking sector, which has resulted in a separate thematic review.

Over the same period, a total of 58 audits – 14 per cent of all audits inspected – were rated as in need of significant improvement. Only 14 of these lowest-ranked audits came from FTSE 350 companies, with 27 being other fully listed or AIM companies and the remainder being other unlisted entities. There appears to be some correlation between the size of the entity and the overall quality of the audit, with a higher proportion of smaller entity audits in need of significant improvement.

In response to these trends, in 2014/15 the Audit Quality Review Team is undertaking reviews of progress made by the major firms in improving the auditing of banks and building societies and the quality of financial reporting in smaller listed and AIM companies. These thematic reviews – which will look at specific issues across all firms – supplement the team's routine audit inspections.

Discipline

Following amendments to the Companies Act, 2006, the auditor regulatory sanctions procedure came into effect in November 2013 for registered audit firms subject to independent monitoring by the Audit Quality Review Team. It provides FRC with the power to impose regulatory sanctions where a registered auditor fails to comply with the regulatory framework for auditing, including auditing and ethical standards. Previously, FRC had to refer the matter to the relevant RSB, which would decide whether or not to take action.

Regulatory sanctions include the imposition of restrictions or conditions, regulatory penalties (that is, fines) and the suspension or withdrawal of audit registration.

Monitoring – other entities

The role of ICAEW as an RSB

As the largest RSB currently in the United Kingdom, ICAEW registers around 3,600 audit firms, ranging

from sole practitioners with no staff to most of the top-20 audit firms. This section of the case study focuses on the monitoring and enforcement activities undertaken by ICAEW. Similar procedures are also undertaken by other RSBs but these are not detailed in this case study.¹³³

Monitoring visits

Although ICAEW monitors the quality of individual audits at all the firms registered with it, as discussed above, the audits of listed clients and others designated as major public-interest clients fall within the remit of FRC. ICAEW is also responsible for monitoring firm-wide procedures at its regulated firms, except for the very largest, where again this responsibility rests with FRC.

The monitoring involves examining a firm's procedures, processes and controls to ensure that audits comply with professional standards and that the firm meets the requirements of the audit regulations. The focus is on the most risky and difficult areas of an audit to facilitate a thorough assessment of the quality of important audit judgements.

There is a statutory requirement for ICAEW to visit each registered audit firm at least once every six years, although some firms are visited more frequently. The programme of work is regularly discussed and refined with FRC and its Audit Quality Review Team. Since 2012, the overall quality of audit delivery has been assessed by looking at individual audits rather than firms as a whole. This parallels the approach used by the Audit Quality Review Team.

Level of activity and outcomes achieved

In 2013, audit reviewers from the Quality Assurance Department of ICAEW visited 670 audit firms and reviewed 1,127 audits. The department found that 74 per cent of the audits that were reviewed were either satisfactory or generally acceptable, 19 per cent required improvement and 7 per cent required significant improvement.¹³⁴ The figures for 2012 were

¹³³ See FRC *Key Facts and Trends in the Accountancy Profession*, published in June 2014, available at <https://www.frc.org.uk/Our-Work/Conduct/Professional-oversight/Key-Facts-and-Trends-in-the-Accountancy-Profession.aspx> (accessed 22 January 2016) for a summary of activities undertaken by the other RSBs.

¹³⁴ Even where significant improvement is required this does not necessarily imply that the financial statements were materially incorrect or incomplete, or that an inappropriate opinion was issued.

70 per cent, 30 per cent and 10 per cent, respectively. There was therefore a slight improvement in audit quality in 2013 compared to 2012, but overall the findings did not change significantly.

The vast majority of Quality Assurance Department visits are closed without regulatory action. Where some follow-up action is needed, firms may be asked to provide further information, such as the results of external reviews of completed engagements or details of training plans. In a small number of cases, where more serious or extensive issues are identified, the Quality Assurance Department writes a detailed report for the Audit Registration Committee so that this committee can decide what action to take.

Disciplining

In response to a detailed report, the Audit Registration Committee may decide to impose one of the following:

- Withdraw audit registration (in the most serious cases);
- Impose conditions and restrictions;
- Offer a regulatory penalty (that is, a fine);
- Refer the firm to the Professional Conduct Department of ICAEW for further investigation.

In 2013, eight firms had their registration withdrawn while four firms voluntarily withdrew their registration after an adverse Quality Assurance Department visit. Conditions and/or restrictions were imposed on a further 56 firms.

The Audit Quality Project

The Audit Quality Project of ICAEW was launched in 2010 to enhance contact with firms between monitoring visits and to help them keep abreast of developments and maintain audit quality. The aim is to encourage firms to improve and maintain high standards of audit quality rather than waiting for the Quality Assurance Department to identify deficiencies. The project is undertaken with the full support of FRC.

As part of this process, in 2013 ICAEW contacted 92 firms to discuss a range of topics and delivered two webcasts on the requirements relating to registered auditors. In 2014, a Quality Assurance Department webinar on audit quality expanded on the key points from its 2013 audit monitoring report.

Interaction with other bodies

Working with other parts of FRC

As noted above, the Audit Quality Review and Corporate Reporting Review Teams work closely together, sharing information and findings, using a common approach to risk and directing their attention towards similar industry focus areas.

In particular, if the Audit Quality Review Team identifies a matter where it considers there is sufficient doubt as to whether an accounting treatment adopted and/or disclosures provided comply with the applicable accounting framework, it will draw the matter to the attention of the Corporate Reporting Review Team. The Audit Quality Review Team also utilizes its accounting technical expertise to support its review of the conduct of the audit and the appropriateness of the audit opinion.

Through its work the Audit Quality Review Team gains an overall understanding of how firms are interpreting and applying the requirements of auditing, ethical and quality control standards. It provides regular feedback to the FRC Codes and Standards Division on issues arising from its inspections in relation to the application of standards in practice and how they might be improved.

International cooperation

As the body that sets United Kingdom auditing standards, FRC is an active contributor to the work of IAASB and responds to all of its consultations. The FRC Director of Audit Policy is an IAASB board member.

The Financial Reporting Council also meets regularly with other audit regulators and participates in IFIAR plenary meetings, working groups and inspection workshops. The findings of the Audit Quality Review Team are also shared with IFIAR.

At European level, FRC is a member of EGAOB, which promotes cooperation between European Union auditors oversight bodies. Under revisions to the European Union Directive and a new audit regulation, EGAOB will be replaced by a Committee of European Auditing Oversight Bodies, which will be chaired by a regulator. Its tasks will include facilitating the exchange of information, expertise and best practices of public oversight and contributing to the improvement of cooperation mechanisms. This new body is expected

to contribute to greater consistency of oversight across the European Union. EGAOB is taking forward the transition to the new Committee, which under the regulation will come into being in June 2016.

The Financial Reporting Council is also a member of the steering group of EAIG, which includes audit regulators from all European Union member States. EAIG facilitates the sharing of information between regulators, has developed a database to share inspection findings between members and is in the process of developing a common inspection methodology. There continues to be considerable commonality between FRC's inspection findings and those of audit regulators in other major jurisdictions.

Interaction with other regulators

The Financial Reporting Council meets regularly with PRA to discuss areas of mutual interest. FRC also provides PRA with feedback on the issues arising from the audits of the banks, building societies, insurers and investment management companies that it reviews, including a copy of its report on each of these reviews. If a review suggests that the audit requires significant improvements, PRA discusses the FRC findings with both the auditors and the company. In turn, PRA shares intelligence from its supervisory enquiries that might have a bearing on the external audit, as well as the output from its bilateral and trilateral meetings with auditors and management. These discussions inform, for FRC, both its selection of audits for review and the specific areas of the audit work to focus on.

In addition, auditors are required to cooperate with PRA and FCA (not just when working as a statutory auditor) by attending meetings and supplying information that is reasonably requested to enable the regulators to discharge their functions under the law. The regulators will review and use information contained within the financial statements. This would be one aspect of the evidence used were the regulators to take enforcement action.

D. PROFESSIONAL CONDUCT

Regulatory basis and scope of work

The major accountancy bodies have primary responsibility for the supervision of their members acting in their professional capacity. At the same time, the bodies are subject to independent oversight by FRC.

As discussed in the previous section, oversight in relation to audit work is provided on a statutory basis. In addition, by agreement with the six major accountancy bodies, FRC provides non-statutory oversight of the regulation by these bodies of their members beyond those that are statutory auditors. Certain key regulatory functions must, however, be carried out independently of the profession. FRC is responsible for monitoring the audits of listed and other major public-interest entities. It also has responsibility for disciplining auditors in relation to such cases.

Membership requirements

Becoming a member

The Financial Reporting Council has statutory powers delegated to it by the Government for the recognition and supervision of those accountancy bodies responsible for offering audit qualifications. It currently recognizes five of the six¹³⁵ major accountancy bodies and one other accountancy body as recognized qualifying bodies (RQBs).

Each accountancy body offers its own professional qualification. These qualifications are only open to those who have attained university entrance level or have a sufficient period of professional experience. Members are admitted only after passing examinations and undergoing a period of relevant work experience within a body approved by an RQB. Approved RQBs are typically – but not exclusively – professional audit firms. Entry routes, syllabuses and methods of assessment vary between the bodies, but in all cases examinations must test not only theoretical knowledge but also the ability to apply that knowledge in practice. Some RQBs also have reciprocal membership arrangements that allow members of certain overseas accountancy bodies to join their membership provided certain criteria are met.

Each RQB must have effective monitoring arrangements in place to ensure that both their examinations and the practical training meet the rigorous standards set out in the Companies Act, 2006.

The Financial Reporting Council periodically assesses whether qualifications offered by the RQBs continue to meet the requirements of the Companies Act, 2006. It also has the power to sanction them.

¹³⁵ The status of CIPFA as an RQB is currently in abeyance.

Continuing membership

Members of the major accountancy bodies are required to undergo CPD throughout their careers to develop and maintain the technical skills and ethical knowledge to enable them to perform competently within their professional environment.

Continuous professional development can be gained by attending training courses, seminars, conferences and online workshops and by undertaking other, less structured activities, such as technical reading, research and meeting with experts. Learning at work can also make a valuable contribution to a member's CPD. Regardless of what activities are undertaken, what is important is that they are relevant to the individual's role and responsibilities.

Each of the major accountancy bodies has its own CPD requirements. These vary from body to body. Some require a certain number of hours of CPD each year. For example, most ACCA members are required to complete 40 hours of CPD each year, of which at least 21 hours must be verifiable. Other bodies allow individual members to apply their own professional judgement when determining how much CPD they need. For example, ICAEW operates an outputs-based system centred on the effectiveness of learning and development that asks its members to reflect on the knowledge and skills required for their role and to undertake whatever actions are needed to ensure they keep up to date and remain fully competent.

Each year the accountancy bodies seek verification of some of their members' CPD compliance by asking for evidence of the activities they have undertaken. The evidence submitted is reviewed to identify how the member has become or remained competent to undertake his or her responsibilities. Each of the major accountancy bodies has its own review procedures. For example, each month ICAEW examines the records of a random sample of members making compliant declarations. It also scrutinizes a selection of CPD records as part of its audit regulatory visits.

Continuing membership also depends on members obeying the rules and regulations of the professional body and paying an annual subscription fee.

Additional requirements for members in public practice

Members who wish to engage in public practice and provide accountancy services to the public must hold a

practising certificate. A practising certificate is needed by those who wish to be a responsible individual for audit purposes or to become a licensed insolvency practitioner.

Each accountancy body has its own requirements for obtaining a practising certificate, but the overarching aim in all instances is to show that the member has maintained appropriate levels of education and work experience to enter public practice. For example, ICAEW members seeking a practising certificate must:

- Have been a member of ICAEW for at least two years;
- Have completed an application form and accompanying questionnaire designed to assess their readiness to practise;
- Have complied with ICAEW requirements on CPD for the two years preceding their application;
- Understand the fundamental principles in the ICAEW code of ethics, in particular on professional competence and due care;
- Comply with the ICAEW professional indemnity insurance regulations;
- Be a fit and proper person to hold a practising certificate (by reference to the disciplinary records of ICAEW);
- Pay the annual practising fee (which includes a practising certificate fee and the annual practice assurance fee).

The practising certificate is renewed annually.

All member firms and practising certificate holders must act in accordance with ICAEW practice assurance standards, which are designed to ensure that firms have high standards of quality and manage their risks well. The Quality Assurance Department conducts monitoring reviews of firms that fall within the scope of the practice assurance scheme.

Ethics

The IESBA code of ethics

Members of the major accountancy bodies are expected to demonstrate the highest standards of professional conduct and their codes of ethics take public interest into consideration. Ethical behaviour plays a vital role in ensuring public trust in financial

reporting and business practices and upholding the reputation of the profession.

The IESBA code of ethics for professional accountants establishes ethical requirements for professional accountants around the world. It applies a principles-based approach that describes the fundamental values and qualities that members should embody and provides a conceptual framework for applying those principles.

The IESBA code of ethics sets out five fundamental principles that guide members' behaviour:

- Integrity;
- Objectivity;
- Professional competence and due care;
- Confidentiality;
- Professional behaviour.

Members are responsible for assessing threats to complying with these principles and for implementing safeguards where those threats are significant. The code includes a number of sections covering situations that members might be likely to encounter and suggests, or in some cases – particularly around auditor independence – requires, specific courses of action.

Application in the United Kingdom

The IESBA code of ethics does not apply directly to members of the major accountancy bodies either in Ireland or the United Kingdom. However, in common with the main accountancy bodies throughout the world, the ethical codes in both countries must at least comply with the principles and other requirements of the IESBA code.

To achieve this, the code of ethics of ICAEW, for example, uses the IESBA code directly and also includes additional guidance in areas that have been found to be of particular relevance to ICAEW members in the past or that reflect the particular environment in the United Kingdom. The ICAEW code applies to members, students, affiliates, employees of member firms and member firms, in their professional and business activities, remunerated or voluntary, and is enforced through disciplining those who do not meet reasonable ethical and professional expectations of the public and other members (see below for more details).

Financial Reporting Council Ethical Standards for Auditors

Auditors in the United Kingdom and Ireland must also comply with the Ethical Standards for Auditors of FRC. These standards – which apply to all audit firms and to all audits – contain basic principles and essential procedures, together with related guidance in the form of explanatory and other material.¹³⁶ Ethical Standards 1 to 5 cover integrity, objectivity and independence for auditors and apply in the audit of financial statements. They address matters such as:

- How audit firms set policies and procedures to ensure that the audit firm and all those who are in a position to influence the conduct and outcome of an audit act with integrity, objectivity and independence;
- Financial, business, employment and personal relationships;
- Lengthy association with the audit engagement;
- Fees, remuneration and evaluation policies, litigation, gifts and hospitality;
- Non-audit services provided to audited entities.

A separate Ethical Standard for Reporting Accountants applies to firms carrying out certain engagements relating to investment circulars.

Disciplinary action

Background

Members of the major accountancy bodies must comply with technical and ethical standards, regulations, guidance and bye-laws of their professional body, and company law. A breach of or departure from any of these may render a member liable to disciplinary action by FRC or the member's professional body.

Major public-interest cases

The Financial Reporting Council is the independent disciplinary body for accountants and accountancy

¹³⁶ The standard will have to be updated to reflect the implementation of the recently passed European Union Audit Regulation and Directive (Regulation 537/2014 and Directive 2014/56/EU, available at <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32014R0537> and <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32014D0537>, respectively (accessed 25 January 2016)).

firms in the United Kingdom. Under its accountancy scheme, it deals with cases of potential misconduct that raise or appear to raise important issues affecting the public interest. All other cases of potential misconduct are dealt with by the accountancy bodies. FRC can initiate a case itself, start a disciplinary investigation because a professional body has referred a case to it, or call in a case – after consultation with the relevant body – if it considers it is appropriate to do so. It will consider each case identified or referred to it and decide whether or not the criteria for an investigation have been met.

The Financial Reporting Council will investigate where conduct of an individual or firm appears to have fallen short of the standard reasonably to be expected of members or member firms of the relevant professional body and, where appropriate, will bring disciplinary proceedings against them via a disciplinary tribunal.

If the disciplinary tribunal finds that misconduct has occurred and upholds the complaint, it can impose a number of sanctions, including reprimands, conditions, waiver or repayment of client fees, fines and withdrawal of an individual's or firm's practising certificate. It can also order the individual or firm to pay all or part of the costs of the investigation and disciplinary hearing. It cannot, however, order compensation to be paid to victims of the misconduct. If, on the other hand, the disciplinary tribunal dismisses the complaint, it can order FRC to pay all or part of the legal costs of the individual or firm concerned if it is satisfied that FRC behaved unreasonably in bringing or pursuing the complaint.

An accountant or accountancy firm can seek leave to appeal against a finding of misconduct and/or order imposed by the disciplinary tribunal on certain grounds.

Transparency is provided for at various stages of the disciplinary process. All decisions are publicized unless doing so would not be in the public interest. Details of past and present cases can be found on the FRC website.

Other cases

In general, complaints about individual accountants and accountancy firms should, in the first instance, be addressed to the body of which that individual or

firm is a member.¹³⁷ Each accountancy body has its own complaints investigation process.

The following provides an overview of how ICAEW handles complaints:

- All complaints are assessed to decide whether there appears to be a case to answer. Some complaints will be closed at the assessment stage (for example, because the matter is no more than a minor error) while others will be resolved through conciliation. Those that remain are referred to a case manager for investigation.
- A case manager will consider all the evidence. If evidence suggests there may be a case to answer, the complaint is referred to the investigation committee.
- If the investigation committee finds there is a case to answer, it has a number of options, including inviting the member or firm to agree to an unpublicized caution, inviting the member or firm to consent to an order and, in more serious cases, referring the complaint to the disciplinary committee.
- Any complaints referred to the disciplinary committee are considered formal complaints. In such cases a tribunal will hear the case, normally in public. If the tribunal finds the case proved, it can impose penalties including reprimands, fines, the removal of a member's practicing certificate and exclusion from membership of ICAEW. The tribunal can also order the member or firm to pay costs. Members and firms can appeal against a decision or order of the tribunal.
- If the tribunal dismisses the case, that is the end of the matter as far as ICAEW is concerned. In exceptional circumstances, a tribunal can order ICAEW to contribute to a member's or firm's costs.
- Appeals against the decision of the disciplinary committee are heard by the appeals committee.
- Details of members and firms who have been disciplined are publicized on ICAEW's website and through its monthly magazine, *Economia*.

Details of other professional accountancy bodies' complaints procedures can be found on their websites.

¹³⁷ Complaints about insolvency work should be made to the Insolvency Service. If an individual or firm is authorized by FCA to give investment advice, complaints should be addressed to them.

According to *Key Facts and Trends in the Accountancy Profession* of FRC, ACCA, CAI, ICAEW and ICAS received a combined total of 182 audit-related complaints in 2013 (2012: 140; 2011: 160). Of these cases, 70 were passed onto the individual body's investigation and/or disciplinary committee for further investigation (2012: 62; 2011: 92).¹³⁸

E. CONCLUSION

This section presents some lessons learned from the United Kingdom's experience and considers future developments.

Lessons learned

An integrated oversight body

The United Kingdom's regulatory model recognizes the powerful connections between the issues of corporate governance, auditing, corporate reporting and the professionalism of members of the major accountancy bodies. A single body, FRC, is responsible for:

- Promoting high standards of corporate governance;
- Setting standards for corporate reporting;
- Monitoring and enforcing accounting standards;
- Monitoring and enforcing auditing standards;
- Overseeing the regulatory activities of the professional accountancy bodies;
- Operating disciplinary arrangements for public-interest cases;

There is a strong view in the United Kingdom that the breadth of responsibilities of FRC serves to enhance its effectiveness through facilitating a comprehensive approach to monitoring, enforcement and oversight activities. One illustration of this is the way in which the FRC Corporate Reporting Review and Audit Quality Review Teams work closely together and direct their attention towards similar risks and industry focus areas.

The Financial Reporting Council is not, however, a securities regulator. It is doubtful whether in practice one body could take on such a wide remit without adverse consequences for the style and quality of its activities.

The balance of power

From 1990, responsibility for promoting good financial reporting through the setting and enforcing of accounting standards has lain with FRC and its subsidiary bodies. Although the role of FRC originally focused only on the promotion of good-quality financial reporting, its remit was extended such that by 2004 it was the single independent regulator of the United Kingdom accounting and auditing profession.

As highlighted above, the existence of such a holistic, independent oversight body has advantages. There is, however, an ongoing debate about where the regulatory boundary should lie between FRC and the major accountancy bodies. This will be taken forward in the context of the United Kingdom implementation of the new European Union Audit Directive and Regulation, which strengthen the requirements for independent regulation of auditors while still allowing for an extensive role for the professional accountancy bodies.

Working together

A distinctive feature of the regulatory model in the United Kingdom is perhaps its focus on prevention rather than punishment.

Regulators and the major accountancy bodies work closely with auditors and preparers of financial statements to ensure that best practice is widely communicated and promulgated. The emphasis is on encouraging organizations to get it right first time rather than simply taking action against those who get it wrong. For example, FRC prefers to use its powers of persuasion to encourage directors to voluntarily revise defective accounts rather than rushing to apply for a court order requiring them to do so.

This approach has resulted in a high degree of compliance. Disciplinary and enforcement powers are, as an essential corollary to this approach, rigorous and used robustly where necessary.

Code-based best practice works better than more prescriptive regulation

The United Kingdom Corporate Governance Code encourages companies to comply with agreed best practice or explain why they have failed to do so, rather than requiring rigid adherence to detailed rules. In doing so, it recognizes that good corporate governance is as much about relationships, trust and transparency as it is about punitive regulations.

¹³⁸ In 2011, two cases were also passed directly to the professional discipline team of FRC.

It is widely recognized that since its introduction more than 20 years ago, the United Kingdom's "comply or explain" approach has improved standards of corporate governance. It has been instrumental in a number of important developments, such as the introduction of audit committees long before European Union law made them a statutory requirement and making it unusual for United Kingdom companies to combine the role of chair and chief executive. Its use of aspirational language, for example on diversity in the boardroom, has also been a driver for change.

The prize is a vibrant capital market in which visible, strong corporate governance practices tend to attract international investors and reduce the cost of capital.

A principles-based approach

The United Kingdom has a long tradition of principles-based accounting, auditing and ethical standards, reflecting a strong view that this is the most effective way to achieve high-quality financial reporting. As discussed below, for such an approach to continue, international standard-setters will need to resist the temptation to issue an increasing number of detailed requirements and interpretations, which may over time dilute the principles-based nature of their standards.

There is also a view in the United Kingdom that national and supranational regulators seeking to enforce standards could do so in a manner that risks stifling the exercise of professional judgement that underpins such principles-based standards or encourages the unnecessary disclosure of immaterial items in financial statements. Avoiding these unintended outcomes is seen by many as a high priority in the context of the United Kingdom and European Union enforcement regimes.

Timeliness

The importance of timeliness of enforcement action throughout the enforcement process is also seen as important during procedures, actions, consultation on accounting issues and decisions.

A protracted review process may delay the delivery of transparent financial information to market participants. If enforcement action means that a restatement is required, for example, it should be possible in terms of timing for issuers to implement this in the next set of annual financial statements.

Ethical behaviour as a badge of honour

Ethical behaviour plays a vital role in ensuring public trust in financial reporting and business practices and in upholding the reputation of the accountancy profession.

The United Kingdom vigorously upholds standards of ethical behaviour by all market participants. Each of the major accountancy bodies has its own code of ethics based on the IESBA code. Furthermore, auditors in the United Kingdom and also Ireland must comply with the FRC Ethical Standards for Auditors. These standards – which apply to all audit firms and to all audits – contain basic principles and essential procedures, together with related guidance in the form of explanatory and other material.

These deep-seated ethical standards are generally regarded as important as technical standards. They are embedded within the major accountancy bodies' examination and CPD requirements – so much so that many members of these bodies see them as a badge of honour. This mindset helps set the tone for the conduct of financial reporting in the United Kingdom.

Future developments

Smaller listed companies

As noted above, while FRC has concluded that the quality of corporate reporting by larger companies is generally good, it believes that the quality of reporting by smaller listed and AIM companies could be improved. The annual plan and budget of FRC for 2014/15 announced the launch of a project to evaluate and plan how it might assist smaller listed and AIM companies to address the quality of their reporting. This responds to concerns expressed over a number of years about the quality of reporting in this sector.

The first phase of the three-year project will gather and assess evidence of the root causes of the challenges and explore ways in which FRC can support companies to make improvements. The second phase will look to implement possible supporting actions and the final phase will be to assess whether the quality of reporting has improved as a result.

To identify the root causes, FRC is carrying out a number of different activities:

- Reviewing a sample of annual reports under its normal operating procedures;

- Reviewing the audit procedures at relevant audit firms with respect to the processes and procedures for reviewing smaller companies' financial statements;
- Meeting with key stakeholders, including investors, fund managers, banks, non-executive directors and preparers of reports;
- Consideration of governance arrangements at smaller companies.

As noted above, in 2014/15 the Audit Quality Review Team is undertaking a thematic review of the quality of financial reporting in smaller listed and AIM companies.

New European Union Accounting Directive

A new European Union Accounting Directive was approved in June 2013 and it was implemented in the United Kingdom in 2015. Its requirements had to be transposed into United Kingdom company law by July 2015 and in force for accounting periods commencing on or after 1 January 2016.

The most significant changes relate to the size criteria for small, medium-sized and large companies and to the United Kingdom small companies reporting regime. More companies will qualify as "small" and those that do will only need to provide a limited number of disclosure notes in their financial statements, subject to the overarching requirement of providing a true and fair view. As a result of the pending legislative changes, FRC is proposing that the Financial Reporting Standard for Smaller Enterprises is withdrawn and that small companies are brought into the scope of FRS 102.

New European Union Audit Regulation and Directive

A new European Union Audit Regulation and Directive – which together seek to reform the European audit market – came into force in June 2014. The new requirements will become applicable in European Union member States from June 2016. The aim of the new regime is to improve audit quality, provide for a robust framework for auditor independence and strengthen corporate governance.

The key requirements of the new legislation, which applies to public-interest entities, are:

- Empowering the European Commission to adopt ISA within the European Union;

- Expanding auditor reporting requirements to enhance investors' understanding of the audit process, including critical judgments made during the audit;
- Strengthening the role of independent audit committees;
- Introducing additional restrictions preventing auditors from providing non-audit services to audit clients;
- Mandating audit firm rotation.

A number of these changes echo requirements already introduced in the United Kingdom. For example, as discussed above, United Kingdom auditing standards are based closely on ISA and enhanced auditor reporting requirements are already in place. Strengthening the role of independent audit committees also mirrors United Kingdom practice. The introduction of similar requirements in the United Kingdom for periods commencing on or after 1 October 2012 has generally been viewed as a positive step, likely to enrich discussions with audit committees and improve dialogue between companies and their investors. However, as noted above, some constituents would have preferred to see a system of code-based best practice introduced rather than regulation; there is a sense that, as more and more elements of the United Kingdom's Corporate Governance Code become mandated by European legislation, the United Kingdom's "comply or explain" approach is under threat.

Coordinated enforcement activities: The spread of IFRS

The adoption of common global standards brings challenges for enforcers, as decisions are subject to wider scrutiny and have ramifications beyond national boundaries.

As the use of IFRS continues to spread around the globe, regulators will need to work together more closely to exchange information, share perspectives and experiences and ensure enforcement is consistent. There is, of course, already some international coordination through securities regulators such as IOSCO globally and ESMA at a European level, both of which have agreed a set of protocols for working with IASB, under which they cooperate on developing and implementing IFRS on a consistent basis.

At the same time, it seems likely that effective enforcement in the United Kingdom will continue to depend on the operation of a strong national enforcement body that understands the specific requirements of the national regulatory framework and as a result is best placed to

tailor its enforcement approach accordingly. Calls for regional or global guidance designed to promote more consistent enforcement of financial information will need to continue to pay due regard to the diversity of local markets and enforcement regimes.

CHAPTER III. MAIN FINDINGS OF THE COUNTRY CASE STUDIES ON MONITORING OF COMPLIANCE AND ENFORCEMENT OF CORPORATE REPORTING REQUIREMENTS

A. OVERVIEW

The five countries on which the case studies (published in this volume and in *International Accounting and Reporting Issues 2014 Review*) have been conducted are among the top 24 countries around the world when ranked in terms of their gross domestic product for 2013: Germany – 4th; United Kingdom – 6th; Canada – 11th; Australia – 12th; and Belgium – 24th.¹³⁹ All five countries have at least one regulated stock exchange. They also have at least one professional accountancy organization that is a full member of IFAC. In terms of their legal and regulatory traditions, Australia, Canada (with the exception the province of Quebec) and the United Kingdom fall into the category of common law countries, while the continental European countries – Belgium and Germany – belong to the code-law group of countries. Furthermore, a commonality among Belgium, Germany and the United Kingdom is the fact that they are members of the European Union and as such they are required to transpose into national law European Union directives, including in the area of corporate reporting. The case studies of these three countries provide useful illustrations of regional coordination mechanisms with respect to monitoring of compliance and enforcement of corporate reporting requirements.

Another common element among the case-study countries is the prominence of IFRS as the basis for the preparation of consolidated financial statements of listed companies in their respective jurisdictions. As members of the European Union, Belgium, Germany and the United Kingdom implemented as early as 2005 IFRS endorsed in the European Union. Australian Accounting Standards have been converged to IFRS since 2005. Canada started to adopt IFRS from 2011. In terms of auditing standards, Belgium and the United Kingdom apply ISA that are issued by IAASB, while Australia, Canada and Germany apply national auditing standards and laws. Canada's strategic plan is to fully apply ISA in the coming years. As indicated

¹³⁹ Taken from the World Bank World Development Indicators database, as updated on 16 December 2014.

above, all of the case-study countries have at least one professional accountancy organization that is a member of IFAC. Thus, compliance with the Statements of Membership Obligations of IFAC is mandatory for the respective professional accountancy organizations in the case-study countries.

B. FINANCIAL REPORTING FRAMEWORK

The case studies indicate that the respective countries have provided regulatory bases for compliance and monitoring with applicable financial reporting requirements. For example, in Australia, the Corporations Act, 2001, and the Securities and Investment Act, 2001, provide the legal basis for compliance and monitoring of financial reporting. In anticipation of the implementation of the International Accounting Standards Directive in the European Union, in October 2004 the legislative body in Germany passed the Financial Reporting Compliance Act. This Act formed the basis for the German financial reporting enforcement regime. In the United Kingdom, the Companies Act, 2006, and the Companies (Audit, Investigations and Community Enterprise) Act, 2004, provide regulatory backing for compliance monitoring over financial reporting.

The institutional arrangements with respect to monitoring of compliance over financial reporting considerably vary among the case-study countries. In Australia, the body responsible for this function is the Australian Securities and Investment Commission. In Belgium, the Financial Securities Market Authority and the National Bank carry out this oversight activity. In contrast to Australia, in Canada the responsibility rests with multiple provincial authorities rather than a single institution at the national level. In Germany, the arrangement involves two institutions – the Financial Reporting Enforcement Council and the Federal Financial Supervisory Authority. On the other hand, in the United Kingdom compliance monitoring and enforcement are consolidated within FRC. The compliance-monitoring institutions in the respective

case-study countries finance their operations either by placing a levy on the companies they oversee (for example, Germany and the United Kingdom) or through appropriations received from their Governments (for example, the Securities and Investment Commission of Australia).

With respect to prudential regulation, the country case studies indicate that in most cases such regulatory activities are carried out by institutions that are specifically mandated. For example, in Australia the Prudential Regulation Authority regulates banks, credit unions, building societies, insurance companies and superannuation funds and is funded largely by the industries it supervises. Similarly, in the United Kingdom PRA is responsible for the prudential regulation and supervision of banks, building societies, credit unions, insurers and major investment firms.

The case study of Canada indicates that the compliance-monitoring and enforcement institutions in the country may not have all the necessary skills they need to fully carry out their duties. Therefore, they work in cooperation with other law-enforcement institutions. For example, in Québec the Autorité des Marchés financiers has entered into a partnership with the Sûreté du Québec's Financial Crime Market Unit (a provincial police force responsible for criminal investigations), while in Ontario the Ontario Securities Commission has set up a joint serious offences team that works closely with police agencies and the Ministry of the Attorney General. The British Columbia Securities Commission formed its Criminal Investigation Team in 2007 and has since worked on numerous cases with police agencies.

In general, the respective institutions in the case-study countries consider a number of factors and seem to be taking a risk-based approach to selecting financial reports for compliance monitoring. They focus on larger entities that could have significant impact on investors. For example, in Germany the Enforcement Panel of FREP applies a combined-risk approach. The panel identifies publicly traded companies that are especially at risk and then randomly selects 30 per cent of the companies that fall into this category. In the United Kingdom, FRC considers the FTSE 100 companies economically significant, that is, a material error could have implications for the market as a whole. Thus, FRC aims to review reports and accounts of the FTSE 100 at least once every three years. In a similar manner, the Australian Securities

and Investment Commission reviews the financial statements of the largest 500 listed companies once every three years. A common element among the compliance-monitoring institutions in the case-study countries is that they provide a means for the investing public to communicate concerns about the respective entities under their purview.

Another common pattern in the case studies is that the compliance and monitoring institutions require companies to publish corrections to their financial statements in case a review reveals material errors. The case studies also indicate possible exceptions to publishing corrections in situations where such a publication could be detrimental to the future survival of the company concerned, or where there is no public interest in publishing such corrections. The enforcement institutions are mandated to oblige companies to comply with applicable requirements, including by initiating legal proceedings in the relevant courts. It is interesting to note in the case study of the United Kingdom that while FRC has the mandate and funding to pursue cases in court, so far companies have been complying with applicable requirements and this has not been necessary. In terms of trends, the case study of Germany provides a comprehensive presentation of trends corrections requested on financial statements and the extent of acceptance by preparers. It also elaborates on topical areas that the Enforcement Panel of FREP focuses its reviews on.

The case-study countries maintain fully operational accounting standard-setting boards. Most of these boards operate outside the remit of the relevant compliance-monitoring and enforcement institution. However, in the case study of the United Kingdom, the Accounting Standards Board operates under the umbrella of FRC. The boards responsible for setting national accounting standards contribute towards the development of IFRS by supporting the standard-setting activities of IASB. They also develop national accounting standards for entities that don't use IFRS. The case studies provide examples of how national accounting standard setters interact with compliance-monitoring and enforcement institutions, for example by means of reciprocal representation on committees and boards.

As members of the European Union, the compliance-monitoring and enforcement institutions in Belgium, Germany and the United Kingdom interact with ESMA – the competent authority at the European Union

level. One of the main objectives of such interactions is to achieve consistency of implementation and enforcement at the European Union level. One of the primary enforcement coordination mechanisms established by ESMA is the European Enforcers Coordination Sessions, which are held nine times a year, and for which a database of members' enforcement decisions is maintained with a view to promoting consistency.

At the global level, the compliance-monitoring and enforcement institutions discussed in the case studies interact with IOSCO – again with a view to achieving consistency in implementation and enforcement at a global level. Similar to ESMA, IOSCO also maintains a database of enforcement decisions received from its members.

C. AUDITING AND ASSURANCE FRAMEWORK

Legislators in the case-study countries have passed pertinent laws and related amendments that provide regulatory bases for monitoring compliance and enforcement of applicable auditing and assurance standards. The developments are similar to those relating to financial reporting. Some examples of regulatory developments are: amendments to the Corporations Act of Australia in 2005; amendments in 2007 to Belgian law establishing the Chamber of Disciplinary Transfer and Indictment as an audit oversight body; legal instruments in Canada establishing the Canadian Public Accountability Board in 2003; the adoption of the Auditor Supervisory Act in 2004 in Germany; and, as discussed above, the Companies Act adopted in the United Kingdom in 2006.

As would be expected, the institutional settings of the bodies responsible for oversight of the audit function vary from one case-study country to another. For example, in Australia, the Securities and Investment Commission is responsible for audit oversight. In Germany, this function is carried out by AOC. The case study of Canada illustrates an interesting contrast between oversight of financial reporting and the audit function. As discussed, review of financial statements of public-interest entities is conducted by competent authorities at the provincial level while the Canadian Public Accountability Board has oversight responsibility on audit at the national level.

It is also worth noting that in Australia and the United Kingdom, financial reporting and audit oversight are consolidated within the same institution – the Australian Securities and Investment Commission and FRC, respectively.

There are also variations in terms of the sources of financing for the audit oversight functions of the respective institutions. For example, in Australia funding is provided through government appropriations, while in the United Kingdom FRC places levies on companies and the accountancy profession. In Germany, AOC finances its activities through funds it receives from WPK, which in turn collects the funds from firms and auditors under its supervision.

The respective audit oversight institutions in the case-study countries use a risk-based approach to select audit firms and audits for review. In general, they focus on audit firms that conduct audits of larger public-interest entities. For example, the Canadian Public Accountability Board audits all firms that conduct more than 100 audits a year. This covers more than 99.5 per cent of the total market capitalization of Canada. The Australian Securities and Investment Commission inspects the four largest accounting firms every 1.5 years, while FRC in the United Kingdom inspects these firms on an annual basis. The case study of the United Kingdom illustrates an interesting coordination between teams responsible for review of annual reports and audit inspections in terms of identifying risk factors.

The oversight authorities that have been discussed are mandated to take a range of corrective actions on auditors and audit firms that fail to comply with applicable standards and codes. For example, the Canadian Public Accountability Board's actions could take the form of a requirement, restriction or sanction. In the United Kingdom, the Companies Act, 2006, was amended in 2013 to include the audit regulatory sanctions procedure, empowering FRC to impose regulatory sanctions, including imposition of restrictions or conditions, regulatory penalties, and the suspension or withdrawal of audit registration. In this respect, the oversight authorities work closely with the pertinent professional accountancy organizations to ensure that applicable disciplinary actions are carried out to the full.

The case studies illustrate bilateral, regional and international efforts aimed at conducting audit oversight in a consistent and cost-effective manner.

For example, oversight authorities in Australia and Canada have bilateral agreements. Given the global prominence of the Sarbanes Oxley Act and PCAOB in the United States, the case studies of Australia, Canada and Germany indicate respective bilateral arrangements they have entered into with PCAOB. In parallel to the coordination mechanism at the European Union level relating to financial reporting, the audit oversight bodies in Belgium, Germany and the United Kingdom also participate in the activities of EAIG and the recently formed Committee of European Oversight Bodies. The coordination mechanism includes utilization of a database of inspection findings intended to facilitate sharing of experiences with a view to achieving oversight consistency in the European Union. Furthermore, EAIG is in the process of developing a common inspection methodology. It is also important to note that all of the audit oversight institutions operating in the respective case-study countries are members of IFIAR. This is likely going to be a growing trend in the coming years.

D. CODES OF PROFESSIONAL CONDUCT AND OTHER APPLICABLE PROFESSIONAL MEMBERSHIP REQUIREMENTS

As discussed above, the case-study countries have multiple professional accountancy organizations operating in their jurisdictions catering to the needs of their members who provide accountancy services to different sectors. Almost all of these professional organizations are members of IFAC. They provide or facilitate professional education of prospective candidates in fulfilling qualification requirements to become professional accountants. The professional organizations play a key role in monitoring compliance with their respective codes of professional conduct and other membership requirements. With respect to CPD requirements, the case studies indicate that the respective professional organizations monitor compliance with such requirements, including by reviewing a sample of CPD compliance declarations submitted by their members. In general, the case studies indicate that the professional accountancy organizations develop their own respective codes of professional conduct while taking into account the Code of Ethics for Professional Accountants published by IESBA. It is also worthwhile to note

that, in addition to the code of ethics established by the professional organizations, regulatory authorities such as FRC in the United Kingdom also establish ethics codes for professional accountants under their purview.

The case studies provide various examples of coordinated regulation of the accountancy profession between oversight authorities and professional organizations. In Canada, quality review of audits of non-public-interest entities is delegated to professional organizations operating at the provincial level. In Australia, accountancy organizations conduct quality-review programmes on professional accountants who hold certificates of public practice and are registered as company auditors. In Germany, WPK, through its Commission for Quality Assurance, coordinates monitored peer reviews for quality-assurance purposes. The peer-review cycle is every three years for auditors engaged in providing assurance on financial statements of public-interest entities. In a similar manner, professional accountancy organizations in the United Kingdom monitor the quality of audits of their respective members. In general, after conducting quality reviews, the common practice among the various professional organizations discussed in the case studies appears to be to require firms to develop action plans to address deficiencies identified through the review. Follow-up reviews would be conducted more frequently than the normal cycle to ensure implementation of the action plan developed. It is important here to note that, in Germany, the actions (including sanctions) proposed by WPK need to be approved by AOC.

The case studies also illustrate how professional accountancy organizations enhance the compliance-monitoring and enforcement function by responding to complaints they receive from the public. For example, a significant number of the investigations WPK in Germany conducted from 2007 to 2013 were initiated by complaints. United Kingdom professional organizations also conduct investigations to follow up on complaints. However, the number of complaints received and investigated seems to be relatively smaller for United Kingdom professional organizations in comparison to the number investigated by WPK (for 2013, 101 for WPK versus 72 for four United Kingdom-based professional organizations combined). Furthermore, the trend at WPK appears to be that the number of complaints received surged following the financial crisis from 2007 to 2009.

E. CONCLUSION

The country case studies presented in this volume as well as in the previous issue of the series, *International Accounting and Reporting Issues 2014 Review*, are a very rich resource for understanding in a concrete manner the various compliance-monitoring and enforcement mechanisms and institutional arrangements that need to be in place to support high-quality corporate reporting and to foster stakeholders' confidence in the corporate reporting supply chain and in financial markets. While the case-study countries exhibit certain differences owing to their legal traditions and business environment, they all share the common objectives of achieving efficient financial markets on the foundation of high-quality corporate reporting supported by effective compliance-monitoring and enforcement mechanisms.

The case studies are a useful supplement to facilitate application and follow-up on ADT developed by UNCTAD-ISAR. Policymakers can find in the case studies a range of options to address compliance-monitoring and enforcement needs in relation to financial reporting, auditor oversight and regulation of professional accountants. Regardless of the differences in the forms of institutional arrangements and sources of funding for compliance-monitoring and enforcement operation, the priority needs to be focused on ensuring effective implementation of corporate reporting standards and codes. Financial markets around the world are continuously integrating. In this respect, the need for cooperation at the bilateral, regional, and international levels is evident. Global forums such as UNCTAD-ISAR will continue to play a critical role in facilitating understanding and cooperation.
