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**Key foundations for high-quality reporting: Good practices  
of monitoring and enforcement, and compliance**

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# Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting – 31<sup>st</sup> session in Geneva

Monitoring of Compliance and Enforcement of International Corporate  
Reporting Standards and Codes – Case Study of Germany

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# Agenda

- 1 Country overview
- 2 Financial Reporting Enforcement in Germany through the Financial Reporting Enforcement Panel (FREP) and the Federal Financial Supervisory Authority (BaFin)
- 3 Disciplinary oversight over statutory auditors through the Chamber of Public Accountants (WPK)
- 4 Enforcement of listed companies' statutory auditors' professional activities through the Auditor Oversight Commission (AOC)
- 5 Conclusion



# 1 Country overview

- GDP 2,737.6 bn. Euros (in 2013)
- Dominant sectors:
  - Manufacturing
  - Public services, education and health
  - Trade, tourism and travel
  - Real estate, renting and business activities
  - Company service providers
  - Building industry
  - Other service providers
- Code law country
- Currency: Euro → 2<sup>nd</sup> most traded currency (in 2014)
- Equity market: 9<sup>th</sup> largest domestic equity market capitalization in world (in 2013)
- 877 companies are listed on the regulated market (in 2013)
- 14,390 public accountants (Wirtschaftsprüfer) and 3,211 sworn auditors (vereidigte Buchprüfer) (in 2014)



## 2 German two-stage enforcement system through FREP and BaFin

### Second stage

**Federal Financial Supervisory Authority (BaFin)**

Authorisation to carry out  
enforcement actions

Sanctioning

### First stage

**Financial Reporting Enforcement Panel (FREP)**

Financial reporting  
enforcement

**Capital market-oriented companies**



## 2 German two-stage enforcement system through FREP and BaFin

### Scope:

Capital-market oriented companies

Examination of:

- 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
- interim financial statements together with the related interim management reports.

### Causes for examinations:

- (1) examination with cause – if there are specific indications of an infringement in financial reporting requirements
- (2) examination at the request of the BaFin or
- (3) random examination based on a combined-risk-approach (DAX/MDAX/SDAX/TecDAX companies are examined randomly every four to five years, all other entities every 8 to 10 years).



## 2 German two-stage enforcement system through FREP and BaFin

### **Sanctions:**

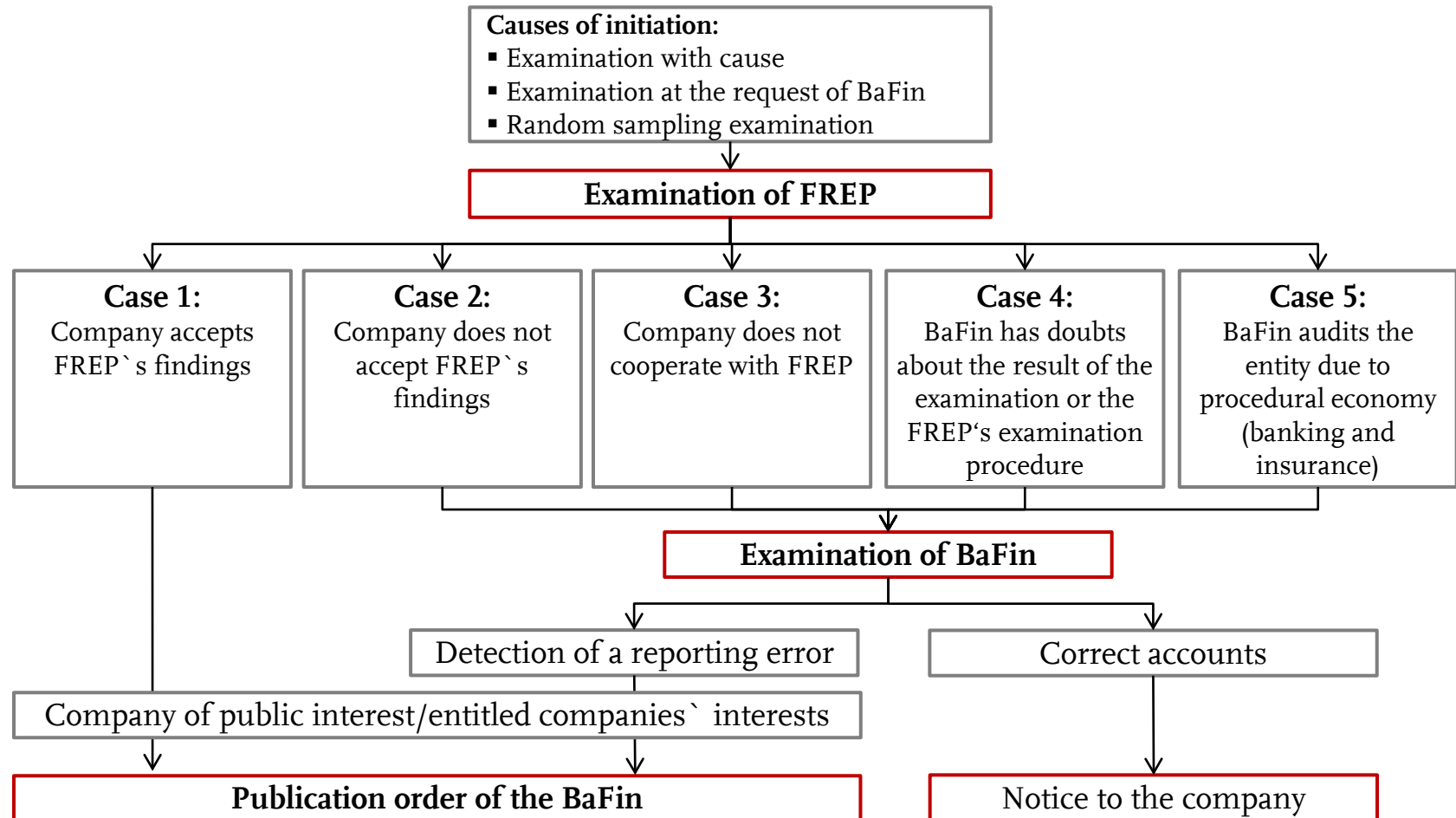
Material errors are sanctioned by the publication of the error.

### **Resources and financing:**

- FREP consists of 16 full time members plus the president and the vice president.
- BaFin has in total 2,398 employees, the majority of who are public officials.
- Enforcement expenses of the FREP and BaFin are allocated to those entities whose securities are traded on the regulated market.



## 2 German two-stage enforcement system through FREP and BaFin Examination process





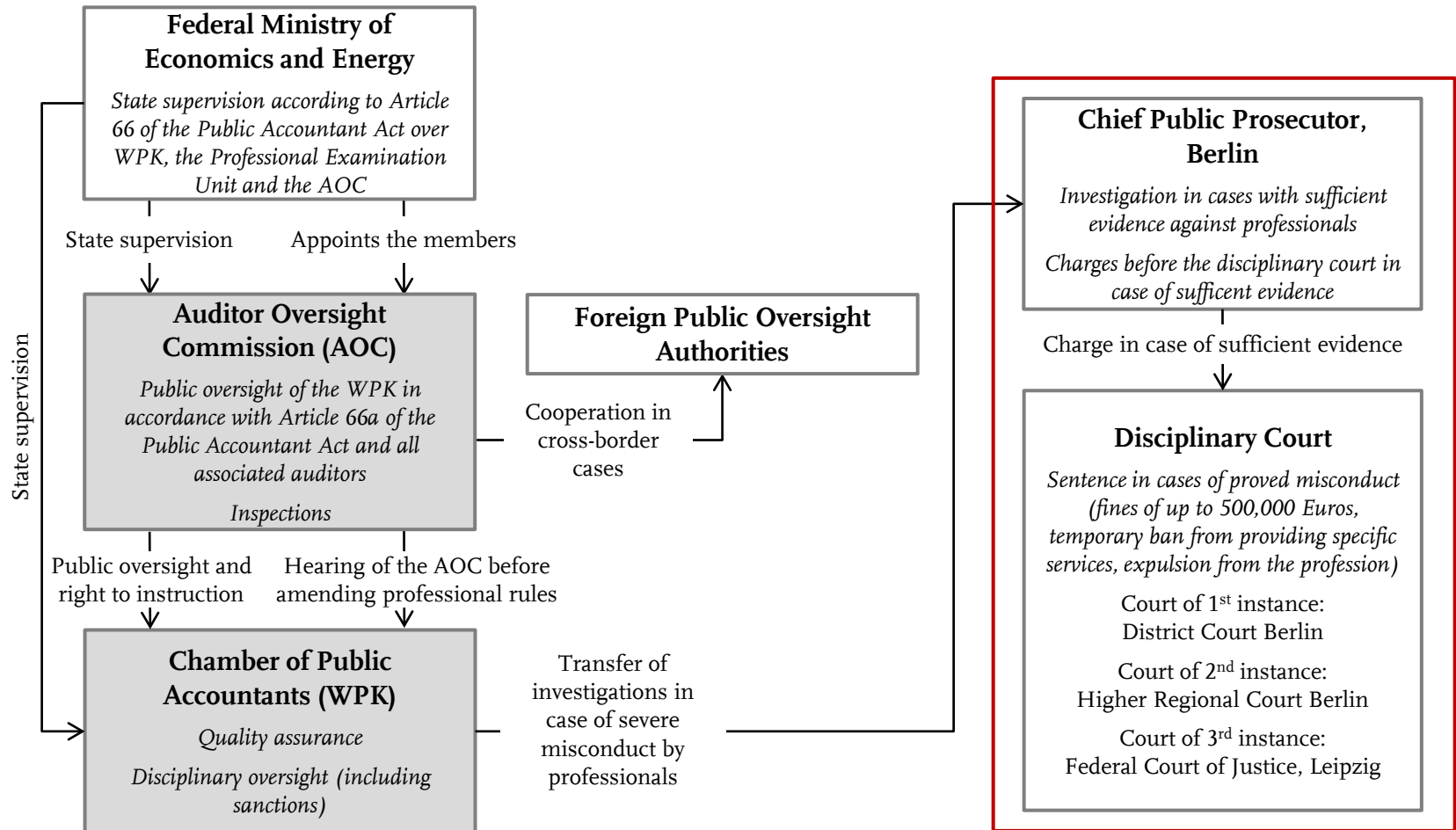
## 2 German two-stage enforcement system through FREP and BaFin

### Major national/intern. cooperation with other enforcement bodies

- **FREP/BaFin** cooperate with the AOC/WPK in cases of material infringements by informing both institutions about the result of the examination.
- **FREP** participates at ESMA's European Enforcers Coordination Session (EECS).
- **BaFin** maintains close contacts and signed memoranda of understanding (MoUs) with the following foreign supervisory authorities:  
Argentina, Australia, Brazil, Canada, China, Croatia, Cyprus, Czech Republic, Dubai, Estonia, France, Guernsey, Hong Kong, Hungary, Italy, Jersey, Korea, Luxembourg, Monaco, Poland, Portugal, Qatar, Russia, Singapore, Slovakia, South Africa, Spain, Switzerland, Taiwan, Turkey, United Arab Emirates, USA.



### 3 Disciplinary oversight over statutory auditors through the WPK



### 3 Disciplinary oversight over statutory auditors through the WPK

#### Scope:

WPK carries out the following enforcement measures:

- **Investigations with cause** in cases of concrete evidence supporting a violation of professional duties.
- **Audit reviews** for auditors/audit firms conducting statutory audits: WPK randomly reviews without suspicion of misconduct annual individual as well as consolidated financial statements prepared in accordance with German GAAP or IFRS published in the Federal Gazette and related auditors' opinions issued by WPK members.
- **Monitored peer-reviews** have to be carried out every six years for auditors/audit firms conducting statutory audits; every three years for auditors of public interest companies.



### 3 Disciplinary oversight over statutory auditors through the WPK

#### **Sanctions for violations detected by investigations with cause and audit reviews:**

- Sanctioning subject to the WPK:  
Advice, instruction, reprimand (which can be accompanied by a fine of up to 50,000 Euros)
- Disciplinary measures subject to professional jurisdiction (only in extremely severe cases):  
(1) a fine of up to 500,000 Euros, (2) a prohibition from certain types of activities for one to five years, (3) an employment ban for one to five years or ultimately (4) exclusion from the profession; thereby measures (1), (2) and (3) can be imposed simultaneously.

#### **Additional sanctions for monitored peer reviews:**

- Sanctioning subject to the WPK's commission for quality assurance:  
(1) requiring remedy of the deficiencies, (2) ordering a special review or (3) revoking a certificate already issued.
- Information of the WPK via a fulfilment report → if the firm does not implement the sanctions: fine of up to 25,000 Euros.
- Revocation of the WPK's certificate of participation in the quality assurance system if the audit firm fails to comply with the measures imposed by the commission for quality assurance.



### 3 Disciplinary oversight over statutory auditors through the WPK

#### Resources and financing:

- The WPK had 122.75 employees in 2013 (measured as full time equivalents).
- The WPK's activities are financed by a) compulsory subscriptions from all WPK members, b) an additional fee from members who conducted statutory audits of public interest entities and c) fees for the provision of special facilities or services.



## 4 Enforcement of listed companies' statutory auditors through the AOC

### Scope:

- Public oversight of the WPK
- Random inspections for auditors of public interest companies including
  - an assessment of an auditor's/audit firm's internal quality control and
  - for selected audit engagements, compliance with professional obligations.

Random inspections are conducted every three years; annual inspections for auditors/audit firms that have had more than 25 audit engagements of public interest entities in the previous year.

### Sanctions:

Sanctioning is subject to the WPK.



## 4 Enforcement of listed companies' statutory auditors through the AOC

### Resources and financing:

- The AOC has between 6 and 10 honorary members who are supported by employees from the department's inspections team (21 employees) and the AOC secretariat (five employees).
- The AOC is financed by the WPK and, therefore, ultimately by the compulsory contributions from all members of the WPK. Additionally, inspections by the AOC are financed via fees from auditors/audit firms conducting statutory audits of public interest companies.



## 4 Enforcement of listed companies' statutory auditors through the AOC

### Major international cooperations with other oversight bodies

- **AOC** cooperates with the competent authorities within the EU
- Cooperation with regulators from non-EU countries on a reciprocal basis: Canada, Switzerland
- Joint audit inspections with the PCAOB
- **WPK** is member of IFAC





## 5 Conclusion

### Enforcement through the FREP/BaFin:

- Hybrid enforcement model has the advantages of both enforcement systems: state regulated institutions that have a higher degree of acceptance and assertiveness and private sector bodies that are able to pay more competitive salaries and are, therefore, more likely to attract highly qualified employees.
- The disadvantage of the two-stage system is that the enforcement process becomes more complex.
- The sanctions available to the BaFin for punishing erroneous reporting are rather weak: empirical studies for Germany show however that public error announcements lead to significant negatively abnormal returns, abnormal trading volumes as well as abnormal bid-ask spreads.
- Possibility of multiple crossborder investigations of foreign listed companies



## 5 Conclusion

### Enforcement through the AOC/WPK:

- Multiple levels of control/enforcement (monitored peer-reviews organised by the WPK, audit reviews conducted by the WPK and investigations with cause carried out by the WPK, additionally for public interest companies' auditors inspections of the AOC) can be over-burdensome.
- Sanctions are imposed anonymously by the WPK, so that a 'name and shame' effect is not existent.
- Multiple crossborder investigations are avoided in the EU. For third country audit firms, reciprocity exists only with Canada and Switzerland. Auditors from other third countries are in addition to their home country monitoring system, subject to the WPK's/AOC's disciplinary oversight and assurance measures.

Empirical studies provide evidence that since the strengthening of Germany's accounting and audit enforcement regime (foundation of the FREP and AOC in 2005) earnings management activities of managers have decreased.

