

31 January 2022

Commissioner McGuinness
Directorate-General for
Financial Stability
Financial Services and
Capital Markets Union
European Commission
B-1049 Brussels

Submitted electronically via the EU Commission's website

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Re: EU Commission Consultation: Public consultation on strengthening the quality of corporate reporting and its enforcement

Dear Commissioner McGuinness

The Institut der Wirtschaftsprüfer in Deutschland e.V. [Institute of Public Auditors in Germany, Incorporated Association] (IDW) is pleased to provide its views concerning the EU Commission Consultation: Public consultation on strengthening the quality of corporate reporting and its enforcement (hereinafter referred to as "the Consultation").

The IDW represents over 11,000 Wirtschaftsprüfer [German Public Auditors], which is approximately 85 % of all Wirtschaftsprüfer in Germany. Our members are from the only profession in Germany to have been entrusted with the performance of statutory audits of the financial statements of all entities that are legally required to have their financial statements subject to audit in Germany. Our members have a keen interest in strengthening corporate reporting, corporate governance and audit, and their respective enforcement mechanisms.

General comments

We share the Commission's view that high quality and reliable corporate reporting is of key importance for healthy financial markets, business investment and economic growth. The EU regulatory framework for reporting should support companies publishing the right amount and quality of relevant

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Prof. Dr. Klaus-Peter Naumann,
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information that allows investors and other interested stakeholders to assess the company's performance and governance and to take decisions based thereon. We therefore understand the Commission's decision to look at each of the most relevant aspects of the entire corporate reporting ecosystem and, equally importantly, the Commission's recognition of the need to look at the potential for enhancing the interactions of all these various parties' actions in achieving improvements.

Our members acknowledge the Commission's stance that – if any – “smarter” as opposed to “heavier” regulation makes sense. In this context, we anticipate that better harmonization across all Member States will bring efficiencies for EU companies and audit firms with cross border activities (e.g., harmonizing mandatory auditor rotation at 10 years and allowed non-audit services), but caution that regulatory burdens should not result in disincentives leading audit firms to leave or not join the PIE audit markets in the EU.

In answering the question of whether the EU regulatory framework should be further developed, it is also important for the EU Commission to acknowledge that the ongoing improvements to auditing and quality management standards and ethical requirements play a significant role in enhancing audit quality and we would like to underline the fact that some recent changes are still “in the pipeline” so certain issues arising in the past may not demand specific attention from the EU Commission.

Our responses to the detailed questionnaire largely reflect the IDW's perspectives as outlined in the IDW Position Paper “Further Development of Corporate Governance and Controls – First Lessons Learned from the Wirecard Case” issued in 2020:

<https://www.idw.de/blob/124612/cfbb7df12ed31cd1be579bda4aa78431/download/positionspapier-wirecard-englisch-data.pdf>

We would also like to emphasize that the demise of Wirecard in 2020 is an isolated, albeit a highly prominent and significant, corporate failure. We do not consider this case to be indicative of a systemic failure in the standards and requirements applicable to the performance of statutory audits.

We are aware that some parties are suggesting that the Wirecard case provides the justification to change the regulatory framework for statutory PIE audits. However, the information available in respect of ongoing investigations and known facts pertaining to this case so far, suggest that the Wirecard case was a very particular case of fraud; it is not representative, nor does it prove systemic shortcomings within the audit profession serving public interest entities. Shortcomings identified in the national regulatory framework are regularly rooted

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in an incomplete transposition of the Audit Regulation and the application of Member State options, e.g., the establishment of audit committees and nomination of a competent authority according to Article 7 of the Audit Regulation. The German legislator has only recently filled in these regulatory gaps.

Specific Comments

The consultation asks respondents to rate specific issues on a scale of 1-5 and to provide comments on five aspects contributing to the quality of corporate reporting. We outline the IDW's main points in each section as follows:

Part I – The EU framework for high quality and reliable corporate reporting

We acknowledge the undeniably significant role of corporate reporting in the EU and note that serious issues in relation to corporate reporting are rare. We observe that financial statement users appreciate and use the information provided in corporate reporting currently. Academic studies confirm that corporate reporting influences the markets e.g., the interest rates and rates of return on capital.

In our view, requiring companies and auditors to take action to address quality-related issues related to corporate reporting is preferable to developing further rules at EU or jurisdictional level, as it allows them to tailor actions to their individual circumstances rather than to merely follow rules set by others – i.e., it enhances stringency by forcing management to “own” their responsibility as opposed to adopting a largely box-ticking mentality.

As suggested in our letter to yourself concerning the EU Commission's Proposal for a CSRD, a stepped approach to the introduction of sustainability reporting and monitoring (as well as assurance) is needed to ensure all affected parties have sufficient time to address new reporting requirements appropriately. In this context, we also stress again the imperative to improve the connectivity between the financial statements and sustainability reporting considerably. We further suggest that with regard to the issue of intangibles, requirements will urgently need to address how to deal with digital business models.

We would certainly welcome measures to ward off unfair tax competition and enhance tax transparency provided they:

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- meet the requirements of EU law (in particular the principle of the free movement of capital) as well as the national constitutional principles of certainty and proportionality,
- are limited to cases worthy of sanction and, in particular, not include business relationships that are not based on tax motivation, and
- are coordinated internationally in order to ensure sufficient efficiency.

Part II – Corporate governance

If the EU Commission deems it necessary to implement reforms, our members see considerable benefit in terms of both strengthening corporate governance and enhancing the usefulness of corporate reporting, if the Commission were to require management to specifically establish internal control systems, especially anti-fraud related control systems coupled with a requirement for management to report on its systems, and also to report on its assessment of going concern.

We also suggest such fraud and going-concern related measures ought to be strengthened by flanking them by assigning related legal duties to the entity's supervisory body (e.g., supervisory board or non-executive directors, as applicable – incl. audit committee) and requiring the auditor to cover these aspects in the audit work on the annual financial statements.

To strengthen the effectiveness of the role of supervisory bodies (incl. audit committees), their legal duties and composition should be subject to clear and consistent requirements across the EU, including prescribing independence requirements and obligation to cooperate appropriately with the auditor. It should be mandatory for PIEs to have a suitably qualified audit committee, by ensuring in particular that an audit committee has adequate accounting and auditing competencies, as well as ESG reporting competence.

Part III - Statutory audit

Our members note that overall, the EU regulatory framework is effective and consistent. In particular, the rules for independence at EU Level are robust and the issue of auditor independence does not appear to have been seen as a contributory factor in the recent Wirecard case in Germany.

Indeed, in view of the numerous financial statements of entities in the EU that are audited, financial statement audits overall are being performed reliably and – subject to further comments below and elsewhere in our letter as to the specification of the auditor's role in regard to fraud and going concern in line

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with enhancements of both management and supervisory roles in these areas – statutory auditors do fulfil an appropriate role.

The role of the statutory auditor for public interest entities could be improved, by requiring auditors to also play a role in regard to entity's internal control systems for fraud prevention and detection, as well as related management reporting thereon. Were management to be required to report its own assertion about the entity's ability to continue as a going concern for the foreseeable future, we see merit in assigning the auditor a role. In both cases we suggest that requiring appropriate public reporting from management, from those charged with governance and from the auditor would add transparency and may also add stringency.

In this vein and for the same reasons, we also suggest that the auditor should also be preredquired to obtain assurance in respect of entity's corporate governance statements.

Whilst we maintain that neither additional measures nor new regulation is needed to further safeguard auditor independence, we would urge the EU Commission to take appropriate action to ensure harmonization amongst Member States of the current requirements for the period of mandatory audit tenure (e.g., at 10 years in all Member States, which would also allow companies to streamline their auditor engagement process) and on the definition of non-audit services. In this context, we note that suitable rules are already in place to prevent undue fee dependency and to address self-review threats. Harmonizing the definition of a non-audit service would be beneficial, provided such definition does not inappropriately curtail the ability of the auditor to provide necessary assurance services to complement or support the audit function or would negate necessary synergies. The different Member States' interpretation of requirements pertaining to the auditor's role in regard to ESEF is another example where harmonization would be beneficial, as currently there is, in our view, inconsistent implementation of the ESEF European legislation in EU Member States.

There is no threat to auditor independence when the auditor provides further assurance engagements to an audit client. Indeed, performing other assurance engagements (such as engagements on compliance management systems, internal control, internal audit, risk management systems and CSR reporting) provides more information upon which auditors of financial statements can draw when performing their audits. This gives rise to considerable synergies which also improve the quality and reliability of audits and potentially the assurance engagement. Thus, it would be counterproductive to either ban such services or

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to include these services under "non-audit services" for the purposes of the provisions of fee caps. To the extent that some of these engagements are currently performed on a voluntary basis, there would be no additional costs to the reporting entities; mandating such assurance would bring benefits in terms of an increase in the quality and reliability of statutory audits.

The IDW agrees that Audit Quality Indicators (AQI) are useful for internal use within audit firms in managing and monitoring audit quality, improving quality management systems, and as a basis for communication between the auditor and governance bodies such as the audit committee. The IDW has recently issued a position paper on auditor communication of audit quality, in which we set forth proposals for communication that includes AQIs:

<https://www.idw.de/blob/133786/9a50ccbed68f9c8207bea20c64ab9de8/download/positionspapier-komm-pruefungsqualitaet-data.pdf> . (Note: This paper is

available only in German language currently). However, an externally defined (standardised) set of AQIs is not appropriate as it would be unable to address the individual circumstances and environments encountered in practice. The public is already well informed of audit quality aspects as firms serving the PIE audit market are required to publish transparency reports.

In Germany, we observe that only in very specific situations did audit clients experience a limited choice of PIE-auditors. However, the reason for this limitation is seen in regulatory measures that prevent new PIE-auditors from entering the market or force incumbent ones to leave. In particular, these measures are the provisions on mandatory external rotation and on the prohibition of non-audit services. Further regulatory measures would therefore risk limiting the choice further. Indeed, our discussions with potential challenger firms have revealed that – due to the existing regulatory framework – they may already be unwilling to enter the market or be deterred in doing so by increased regulation on top of all the other challenges facing them, including the need for sizeable further investment in IT and training in various areas to cover the myriad of new standards. In our view, opening up the upper end of the PIE audit market is likely the most difficult issue to address successfully given the global complex business models of the largest business entities.

The majority of our members rather disagree with the statement, that joint audits contribute to the quality of audit. Notwithstanding the very specific and particular situations where an audit committee reasonably decides to voluntarily request a joint audit, the majority of our members does not see that a mandatory joint audit would have any positive impact on audit quality. Most within the profession also do not perceive joint audit as an effective means to enhance market choice.

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However, the German profession is prepared to join the debate on possible alternative measures, such as public procurement.

We are aware that some parties are suggesting that the Wirecard case provides justification to change the regulatory framework for statutory PIE audits. However, the information available in respect of ongoing investigations and known facts pertaining to this case so far, suggest that the Wirecard case was a very particular case of fraud; it is not representative, nor does it prove systemic shortcomings within the audit profession serving public interest entities. Shortcomings identified in the national regulatory framework are regularly rooted in an incomplete transposition of the Audit Regulation and application of Member State options, e.g., the establishment of audit committees and nomination of a competent authority according to Article 7 of the Audit Regulation. The German legislator has only recently filled in these regulatory gaps.

We also suggest that EU legislation should ensure that the proposed rights for supervisors relating to whistleblower information also apply to the auditor.

Finally, we would like to stress that the IAASB has recently issued new and revised standards on quality management, risk assessment and the audit procedures for accounting estimates, which will soon be in force. Further projects on audit evidence are ongoing. Thus, in regard to audit performance we suggest that additional action by the EU Commission is not required in this regard.

Part IV – Supervision of PIE statutory auditors and audit firms

The current legal framework at EU level is well defined, whereby national legislators are asked to ensure an appropriate framework at national level. Therefore, we see no evidence of a need for further changes to the framework.

In our opinion, improvements to auditor oversight should focus on achieving a harmonized approach to minor violations of professional duties which do not threaten professional independence, as this would improve the efficiency of supervision. In this context, the Commission's report gives little insight into the actual audit quality since it is overly focused on formal aspects. In the long run, audit supervision that focuses overly on compliance with formal aspects instead of material aspects of audit quality can lead to a formally perfect audit (box ticking mentality) that may even have a detrimental impact on audit quality. We therefore suggest that harmonized transparency amongst Member States' supervision authorities would help improve the efficiency of supervision. Using

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root cause analysis of inspection findings to foster improvements where needed would also enhance the value and impact of supervision.

Part V – Supervision and enforcement of corporate reporting

We agree that the proposed increase in powers for national competent authorities is appropriate in principle, however we caution that resources must be used appropriately (no double audits - auditors and supervisors). Banking secrecy, tax secrecy, etc. must be taken into consideration when implementing such measures.

In addition, it is not sufficient to merely improve cooperation between EU member states as the interconnectedness of international corporations and economic activities does not end with the borders of EU Member States.

Measures to increase transparency as to national authorities' enforcement activities are generally to be welcomed. However, consideration should be given to also making the counter-opinions of the parties concerned transparent.

We do not perceive a need to further strengthen the role of ESMA in the enforcement of corporate reporting.

We trust that our suggestions will be received in the constructive spirit in which they are intended. We would be pleased to discuss any aspects raised in this letter or in our input to the Consultation, should you require further clarification.

Yours sincerely

Klaus-Peter Naumann
CEO