

**“The Public Oversight System  
for Statutory Auditors in Germany”**

Robert Leners, AOC Germany

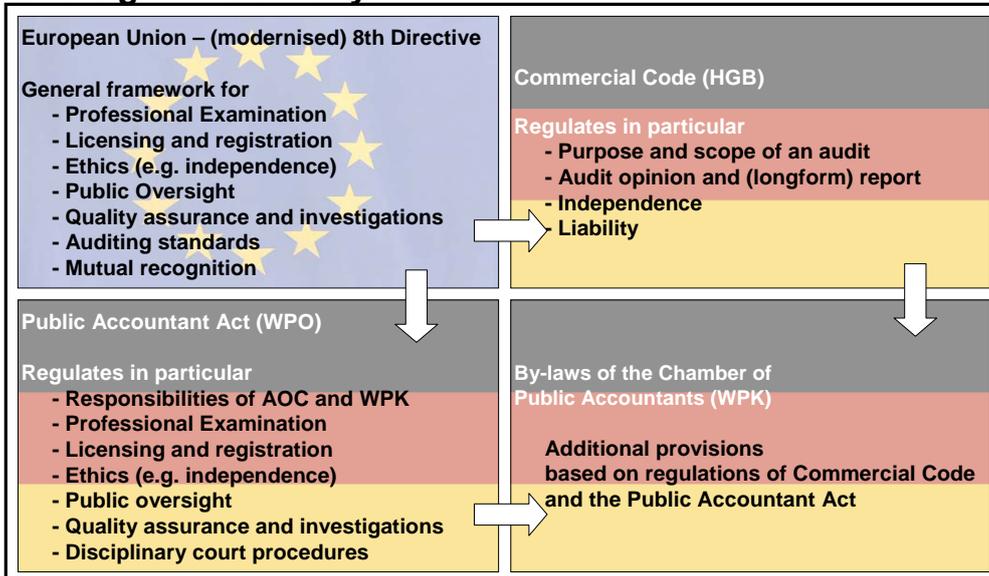
*Workshop on Quality Assurance Techniques  
Capital Markets Board of Turkey (CMB)*

*19 February 2010, Ankara*

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### Legal Framework for Auditors and Public Auditor Oversight in Germany



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### Structure of Public Oversight in Germany (I)

#### Chamber of Public Accountants (WPK)

- established in 1961 as a corporation under public law
- governed by practitioners but staffed with non-practitioners
- organizes professional examination, approval, registration, withdrawal of approval and registration, disciplinary proceedings, quality assurance
- carries out quality assurance procedures (monitored peer review) and - since 9/2007 - inspections (with its own staff)
- all oversight activities under close supervision and subject to approval by the AOC which holds the *ultimate responsibility*

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**ABSCHLUSSPRÜFERAUFSICHTSKOMMISSION**  
**AUDITOROVERSIGHTCOMMISSION**

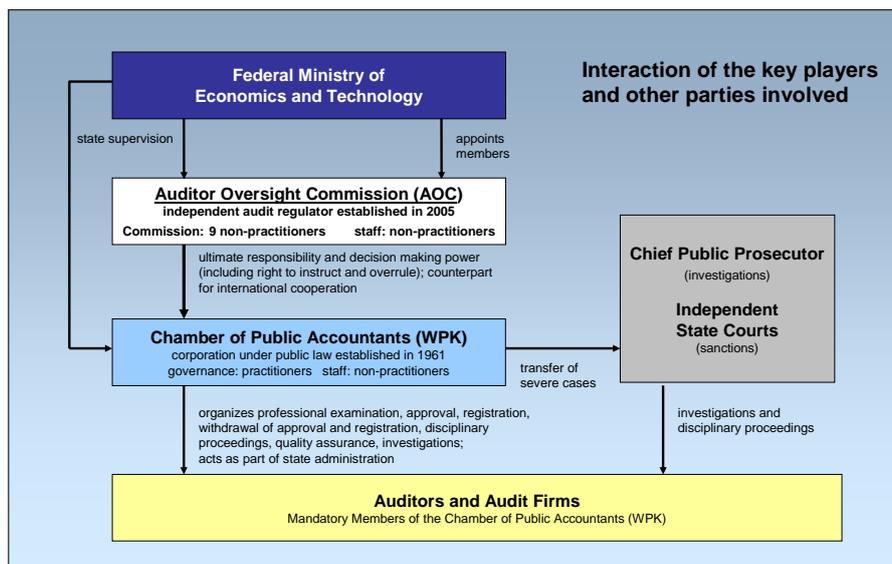
**Structure of Public Oversight in Germany (II)**

**Auditor Oversight Commission (AOC)**

- established in 2005 to practice independent public oversight over the WPK
- governed by independent non-practitioners
- ultimate responsibility and decision making power regarding all auditor oversight activities
- right to access any information on oversight matters and to participate in any oversight activity
- counterpart for international cooperation
- delegation of some tasks to the WPK, ultimate responsibility remains with the AOC
- right to initiate procedures, instruct and overrule the WPK

**ABSCHLUSSPRÜFERAUFSICHTSKOMMISSION**  
**AUDITOROVERSIGHTCOMMISSION**

**Structure of Public Oversight in Germany (III)**



## The Initial Phase of Auditor Oversight Commission (I)

### The initial phase was characterized by

- establishing internal rules and procedures (by-laws)  
=> e.g. voting procedures, confidentiality, committees, objectivity/bias
- familiarising with structures/procedures within WPK, both on a governance level and on a staff level  
=> *imminent under the German oversight system where administrative and operative responsibilities still rest with WPK but the ultimate responsibility for all decisions made rests with AOC*
- establishing committees  
=> *for quality assurance and disciplinary procedures*

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## The Initial Phase of Auditor Oversight Commission (II)

### The initial phase was characterized by

- establishing rules for flow, contents and form of information from WPK to AOC  
=> *AOC has access to all information in oversight matters and can request such information anytime from WPK; but the amount of information requires prioritisation to avoid an excess of information and distraction from relevant matters*
- establishing independent staff support  
=> *legal form prevents AOC from employing own staff; AOC can resort to staff of WPK; secretariat of AOC only accountable to the members of AOC*
- seeking and establishing contacts with foreign counterparts  
=> *e.g. CH FAOA, F H3C, NL AFM, US PCAOB, UK FRC*

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## Practical Implications (I)

### Practical implications result from

- the “clash of culture” moving from self-regulation to independent auditor oversight, i.e. the loss of ultimate responsibility for the profession  
*=> requires sensitivity with regard to the self-conception of the profession and may result in lots of discussions*
- discussions with WPK’s board and committees to coordinate their work  
*=> requires proactive role of AOC in monitoring WPK’s operations and bodies*
- the members of AOC being volunteers (vs. full-time)  
*=> requires independent staff support / back office including experts for auditing/accounting*

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## Practical Implications (II)

### Practical implications result from

- the need to (re)affirm own rights and authorities  
*=> as a result of disputes with the profession or ambiguities in the regulatory framework*
- flaws in the regulatory framework  
*=> constant need to consider improvements due to domestic flaws or changes in the global regulatory environment (e.g. EU Directives, European Commission Recommendations, expectations of foreign regulators with respect to recognition and “full” reliance)*
- the workload  
*=> the number and complexity of procedures (quality assurance, inspections, investigations etc.) requires prioritisation; international contacts require a lot of time but are invaluable for reassessing, shaping and improving the own system*

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## Conclusions

### Lessons learned:

- the effects on the profession moving from self-regulation to independent public oversight should not be underestimated
- the advantages of a cooperative approach with the professional body against confrontation should be considered
- the workload, both on a domestic level and on an international level should not be underestimated
- responsibilities should be prioritized; routine jobs (e.g. licensing) vs. main focus (e.g. quality assurance)
- the importance of an exchange with foreign counterparts, e.g. bilateral meetings, international conferences, EGAOB and IFIAR

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## **“Quality Assurance for Statutory Auditors in Germany”**

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## Overview on Quality Assurance in Germany (I)

### Quality Assurance System involves

#### Monitored Peer Reviews

- introduced in 2001
- for all statutory auditors and audit firms
- reviews performed by “peers” (i.e. practitioners)

#### Independent Inspections

- introduced in 2007
- for statutory auditors and audit firms of PEs only
- inspections performed by staff of WPK (non-practitioners)

**=> Both procedures are organised under the ultimate responsibility of the AOC and subject to close supervision**

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## Overview on Quality Assurance in Germany (II)

### Monitored Peer Review

- review report submitted to WPK for an assessment by WPK staff and the Quality Assurance Committee
- review report includes an opinion on the appropriateness and effectiveness of the internal quality control system, but does not refer to individual findings if not material with regard to the opinion
- reviewed audit firm receives a “certificate of participation”
- certificate required for appointment as auditor by companies
- certificate can be withdrawn in case of material shortcomings in the internal quality control system
- AOC has ultimate responsibility for all decision taken and has the right to participate in any review

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## Overview on Quality Assurance in Germany (III)

### Independent Inspections

- introduced in anticipation of the EC Recommendation on External Quality Assurance
- enhanced public interest and international acceptance of the German Oversight System required introduction of a more independent and more transparent quality assurance system for PIE auditors
- use of non-practitioners as inspectors (vs peers) is indispensable to safeguard the objectivity and credibility of the system
- PIE auditors subject to monitored peer review *and* independent inspections
- AOC has ultimate responsibility including the right to participate in any inspection
- plus: influence on methodology, policies, procedures and the appraisal/handling of findings

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### 3. The Inspection System (I)

#### Who is affected?

Auditors and audit firms of **listed companies (PIEs)**

- 128 audit firms in 2008 (148 in 2007)
- 800 engagements including about 1400 audits of financial statements (including group audits)
- about 70% of all relevant audit engagements are performed by “Big 5” (KPMG, PWC, Ernst & Young, Deloitte, BDO)
- applies also to auditors and audit firms who audit companies from third countries listed in Germany

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### The Inspection System (II)

#### When will an inspection be performed?

- anytime on a sample basis, no indications for misconduct needed
- AOC is responsible for inspections and is especially entitled to initiate them
- additional cycle considered for operational purpose depending on the number of audit engagements
  - 26 and more engagements: every year (approx. 10 firms)
  - 25 and less engagements: 3 years (approx. 120 firms)
- does not limit the AOC to just one inspection within such cycle

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### **The Inspection System (III)**

#### **What does an inspection involve?**

1. Inspection and evaluation of the internal quality control system (whole firm review)
  - focus on tone at the top, fees, partner remuneration, structure, policies, documentation, effectiveness etc.
2. Inspection and review of selected audit engagements (engagement review)
  - focus on compliance with professional rules (auditing standards, ethics including independence issues)

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### **The Inspection System (IV)**

#### **Process and Methodology**

- inspections performed by full-time staff of WPK (no involvement of practitioners)
- staffing: 16 inspectors by 31 December 2009 (including Director and Deputy Director)
- work plan is issued to determine which firms will be inspected during the forthcoming year
- firms will be informed at short notice („surprise effect“)
- inspection begins with a request for relevant documents to facilitate a risk analysis to determine which audit engagements are to be inspected („inspection plan“)

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## The Inspection System (V)

### Process and Methodology

- instruments used: interviews, review of working papers and other documents and on-site inspections
- auditors and firms are obliged to cooperate fully, i.e. to provide correct and complete oral information and any documents requested (fines in case of non-cooperation)
- confidentiality obligations waived by law; AOC and WPK including their staff subject to strict confidentiality
- auditor's right to remain silent applies only to oral information, does not affect the obligation to provide documents
- right to enter and inspect premises and offices „anytime“, to inspect documents and to transcript or copy documents

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## The Inspection System (VII)

### Outcome of an inspection

- AOC receives draft report from the inspectors for approval; AOC can demand additional inspection procedures be performed, if deemed necessary
- findings on non-compliance with professional rules are presented to the AOC to consider the need for further investigations and/or measures by the Disciplinary Department
- findings on deficiencies in the internal quality control system are presented to the AOC to consider the need for further measures by the Quality Assurance Department - ultimately leading to withdrawal of the certificate required to perform statutory audit
- private report on the findings is presented to the auditor or firm
- depending on the findings, actions may include call for remediation and/or sanctions
- annual report on overall findings (anonymous basis) is publicized

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## The Inspection System (VI)

### First Results of Inspections in Germany

- 80 inspections conducted until end of 2009, including all the “Big Five”
- some of the more frequent findings include:
  - need for improvement relating to internal policies and procedures (e.g. insufficient consideration of quality criteria in the partner remuneration / promotion system; lack of adequate professional education, particularly in the area of IFRS; insufficient internal consultation procedures; deficiencies re engagement quality control review procedures)
  - need for improvement relating to the audit engagement performance and its documentation, including areas of increased risks to be affected by the economic downturn (e.g. going concern, fair value accounting estimates, impairment of assets including goodwill and other intangibles, etc.)

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## Outlook

### Issues considered for future improvements

- direct operational responsibility of the AOC for disciplinary oversight and inspections of PIE auditors (at present: via WPK)
- exemption of PIE auditors from peer review (at present: PIE auditors subject to peer review and inspections)
- extending the scope of inspections to all statutory audit *engagements* (at present: only PIE audit engagements)
- conforming scope, methodology and reporting of peer review to inspections (at present: peer review focuses on internal quality control; no individual findings)

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