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**BRIGITTE STEINBAUER**

University Gdansk, Germany

## **DO HARD CASES MAKE BAD LAW? THE EFFECTIVENESS OF GERMAN'S APPROACH TO STRENGTHEN FINANCIAL MARKET INTEGRITY**

### **Abstract:**

Background: As a direct consequence of the Wirecard scandal from 2020, which brought the work and, above all, the cooperation of the executive board, supervisory board, and external auditors into the focus of the legal discussion, the German legislator adapted the Stock Corporation Act and also the German Corporate Governance Code has been adapted. Executive board members of Wirecard have been subjected to a criminal investigation after reporting fake revenues and air bookings worth billions. The German Stock Exchange, the Federal Institute for Financial Services Supervision, the Financial Reporting Enforcement Panel, the auditing firm, and the Wirecard supervisory board were all criticized for failing to detect the problem earlier. Former Wirecard stockholders lost money, and lawsuits were filed seeking compensation from the statutory auditor, Wirecard AG, and former board members.

Research purpose: Following the formal amendment of the law and the GCGC, the focus is now on the effectiveness of the law and the GCGC in practice. The purpose of this study is to assess whether the German solution to strengthening financial market integrity is effective. Research hypothesis: It is hypothesized that German corporate governance requires additional improvements and further reforms.

Methods: The analysis of academic literature, journal and magazine articles, reports, and other relevant literature has enabled the author to empirically build the hypothesis of this document and to identify and address major issues that require further amendments in law as well as and additional studies.

Conclusions: The reform of the German law has a substantial impact on the work of companies, its main bodies and statutory auditors. It is evident that certain provisions require modification, and further reforms are both expected and necessary to address the gaps. Aspects of trust, transparency, control and monitoring need to be in the focus of the legal discussion as well as the internationalization of stock corporations with the overarching goal to ensure financial market integrity and to regain trust in German companies.

### **Keywords:**

Corporate governance, reforms, financial markets integrity, Wirecard

**JEL Classification:** G34, K22, G30

1) 'Hard cases make bad law', is 'one of the most famous aphorisms in Anglo-American law', Shahshahani, S., 'Hard Cases Make Bad Law? A Theoretical Investigation', 51 J. Legal Stud., available at: [https://ir.lawnet.fordham.edu/faculty\\_scholarship/1153](https://ir.lawnet.fordham.edu/faculty_scholarship/1153), 2021. It is 'often used by judges, nowadays quite often by others... and dates back to at least 1837', du Plessis, Jean J., 'Directors' duty to act in best interests of the corporation: 'Hard cases make bad law'', 34 Australian Journal of Corporate Law, 2019

## 1. Introduction

The author presents a comprehensive analysis of the latest corporate governance reform in Germany, offering both a summary and a critical evaluation. The Wirecard case, which is summarized in 2.1, has been a prominent subject of academic and political discourse in Germany pertaining to corporate governance. It continues to attract public attention due to the ongoing court proceedings and the media's engagement in addressing the scandal. The Wirecard case is 'the largest accounting fraud in the country's postwar history'.<sup>1</sup> Prior to the occurrence of the Wirecard case, it was deemed inconceivable that a company listed on the DAX segment of the German stock exchange would engage in fraudulent activities, coupled with deficiencies and malfunctions in auditing and regulatory oversight.

Following the public disclosure of the Wirecard case, the German politicians acted quickly and with determination. Based on a governmental action plan, the German Act to Strengthen Financial Market Integrity (FISG)<sup>2</sup> is part of the latest corporate governance reform in Germany<sup>3</sup> and introduced significant changes to corporate governance, particularly in the areas of audit, risk management, internal control system, audit committee membership and competencies, and corporate body responsibility.

Since 01.07.2021, the FISG has been in effect. Most of the regulations have been in place since that date; some transitional provisions existed and new regulations about enforcement have been effective since 01.01.2022.

## 2. The Way from Wirecard to FISG

### 2.1 The Wirecard story

Wirecard was a German payment services company that was listed on DAX 30 until 21.08.2020, which was the last day, Wirecard was stock listed. The DAX index serves as both a barometer and a benchmark for various financial instruments in Germany. It covers the major companies listed on the Frankfurt Stock Exchange as a selection index.<sup>4</sup> The DAX's composition has been revised to DAX 40 since 01.09.2021, along with new DAX listing standards.

A financial journalist for the Financial Times ('FT'), investigated and uncovered the Wirecard case.<sup>5</sup> Wirecard was founded in 1999 in Germany, stock listing took place in 2006. A German shareholder organization, the Schutzgemeinschaft der Kapitalanleger, initially raised the issue of balance sheet discrepancies and intransparencies during the annual shareholder's meeting

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<sup>1</sup> Engelen, K.C., 'Germany's Wirecard Scandal', *The International Economy*, Washington, D.C., volume 35, issue 1, 2021, p. 9-12.

<sup>2</sup> in German, 'Gesetz zur Stärkung der Finanzmarktintegrität' and abbreviated 'FISG'; the abbreviation is used in this paper

<sup>3</sup> There are additional changes in the German Stock Corporation Act, which are not the subject of this paper: The most important one is the new Section 76 (3a) German Stock Corporation Law, in force since 12.08.2021, which contains a binding gender quota for certain executive board.

<sup>4</sup> Deutsche Börse Group, Annual Report 2020, <https://www.deutsche-boerse.com/resource/blob/2377196/f9d7ba7ef99b6a507a7a42656313bda4/data/DBG-annual-report-2020.pdf>; access: 27.08.2023.

<sup>5</sup> McCrum, D., *Wirecard: the timeline*, Financial Times, June 25, 2020, <https://www.ft.com/content/284fb1ad-ddc0-45df-a075-0709b36868db>; access: 27.08.2023.

in June 2008.<sup>6</sup> The auditing firm EY was hired to conduct a special audit, and because of that audit, EY became Wirecard's statutory auditor. A company in Singapore became Wirecard's Asian headquarters. In 2015, the FT initiated an investigation into the Wirecard issue, titled 'House of Wirecard', and raised concerns about financial irregularities within the company. The FT obtained some of its material from a whistleblower in Singapore. According to the FT, the balance sheet had a €250 million deficit. The group's legal department initiated internal investigations into three members of the financial staff in 2018. The stock reached an all-time high of over €190 per share from the end of August until early October 2018. Wirecard succeeded Commerzbank in the DAX 30 index in September 2018. The first story about the Singapore investigations was published in the FT in 2019. A dawn raid took place at the Singapore offices. Short selling was forbidden by BaFin for two months, citing Wirecard's 'importance for the economy' and the 'serious threat to market confidence'.<sup>7</sup>

EY approved the 2018 accounts in April 2019 with minor qualifications relating to Singapore. Because of the FT's ongoing investigations, Wirecard filed a lawsuit. The FT published records showing that Wirecard's revenues in Dubai and Dublin were fraudulently exaggerated. A special audit was carried out by KPMG. Cash held in escrow accounts was declared inside the cash balances in the financial statements, according to the FT<sup>8</sup>. Research commissioned by the European Parliament's Committee on Economic and Monetary Affairs (ECON) provides a comprehensive history of Wirecard and summarizes the reasons for the Wirecard case as well as the necessary action: 'all lines of defense against corporate fraud, including internal control systems, external audits, the oversight bodies for financial reporting and auditing and the market supervisor, contributed to the scandal and are in need of reform'.<sup>9</sup>

The difficulties Wirecard faced became obvious when the annual financial statements as of 31.12.2019, showed assets in escrow accounts amounting to €1.9 billion that did not exist. When this became public in June 2020, the auditor EY refused to issue an audit certificate. At the company's request, the local court in Munich / Germany opened insolvency proceedings on 25.08.2020.<sup>10</sup>

## 2.2 The reasons for the Wirecard scandal

At Wirecard, there were severe deficiencies in corporate governance. In a speech on 21.10.2020, in Munich, Hopt,<sup>11</sup> a German law professor, detailed the reasons behind the Wirecard scandal. For a significant time, the supervisory board consisted of only five members and only six members after 2019. Since 2019, there has been no audit committee. The chairman of the supervisory board was also the chairman of the audit committee for a while.

<sup>6</sup> Schutzgemeinschaft der Kapitalanleger, Press release from 26.06.2020, <https://sdk.org/veroeffentlichungen/pressemitteilungen/sdk-stellt-strafanzeige-gegen-abschlusspruefer-der-wirecard-ag/>; access: 27.08.2023.

<sup>7</sup> McCrum, D., *ibid.*

<sup>8</sup> McCrum, D., *ibid.*

<sup>9</sup> Langenbucher, K., Leuz, C., Krahen, J. P., Pelizzon, L. *Study Requested by the ECON committee, What are the wider supervisory implications of the Wirecard case?*, ISBN 978-92-864-7441-1, 2020.

<sup>10</sup> Naumann, K., *Zur Fortentwicklung der Unternehmens- Governance sowie der Abschlussprüfung nach dem Fall Wirecard*, Audit Committee Quarterly, IV/2020, p. 15-17.

<sup>11</sup> Hopt, K., Speech at the University of Munich, Script *Der Aufsichtsrat als Kontrollorgan auf dem Prüfstand*, 2020.

Numerous deviations from the German Corporate Governance Code's<sup>12</sup> recommendations were disclosed in the declaration of conformity under Section 161 of the German Stock Corporation Act. The market did not react to the first reports about Wirecard in the financial press and later when the grievances became more visible to the public. The GCGC's 90-day deadline for the publication of the consolidated financial statements and the group management report was not met. The supervisory board's financial expert was unidentified. The audit, governance, national, and European supervision systems failed. The insolvency administrator discovered a liquidity deficit of more than 99 percent at Wirecard throughout his inquiries. Cash was available in the amount of €26.8 million, while debt was more than €3.2 billion.<sup>13</sup>

### 2.3 Reaction to the Wirecard scandal

The German Bundestag decided to convene an investigative committee on 01.10.2020. The work of the committee was completed in June 2021.<sup>14</sup> It manifests that Wirecard had been cheating both the authorities and the investors over a long period. On 06.10.2020, the German Federal Ministry of Finance issued a federal government action plan to combat accounting fraud and strengthen capital and financial market control.<sup>15</sup>

The ECON committee of the European Union conducted a study about the Wirecard case's wider supervisory implications. The authors<sup>16</sup> discuss the political implications and the study finds that 'all lines of defense against corporate fraud, including internal control systems, external audits, the oversight bodies for financial reporting and auditing and the market supervisor, contributed to the scandal and are in need of reform.'<sup>17</sup> To ensure market integrity and investor protection in the future, the authors set eight suggestions for the market and institutional oversight architecture in Germany and Europe.

### 2.4 The legislative procedure for the FISG<sup>18</sup>

The draft bill of the FISG<sup>19</sup> was released on 26.10.2020, the government draft<sup>20</sup> was presented on 16.12.2020. On 28.05.2021, the FISG was approved by the German Bundesrat. The FISG is published in the German Federal Law Gazette,<sup>21</sup> the official gazette of Germany, on 06.06.2021, and in force since 01.07.2021. Some amendments have been effective since 01.07.2021, while the enforcement-related amendments have been effective since 01.01.2022. The FISG is an amending act (also known as an 'Artikelgesetz'), that comprises

<sup>12</sup> German Federal Ministry of Justice and Consumer Protection, German Federal Gazette, BAnz AT 20.03.3030 B3, p. 1-9; in this paper, the German Corporate Governance Code is abbreviated 'GCGC'

<sup>13</sup> Süddeutsche Zeitung, *Der Mann der Wirecard stürzte*, 20.05.2021, supplement p. 18, München 2021

<sup>14</sup> German Bundestag, Drucksache 19/30900, 22.06.2021.

<sup>15</sup> German Federal Ministry of Finance,

[https://www.bundesfinanzministerium.de/Content/DE/Downloads/Finanzmarktpolitik/2020-10-08-aktionsplan-bekaempfung-bilanzbetrug.pdf?\\_\\_blob=publicationFile&v=2](https://www.bundesfinanzministerium.de/Content/DE/Downloads/Finanzmarktpolitik/2020-10-08-aktionsplan-bekaempfung-bilanzbetrug.pdf?__blob=publicationFile&v=2); access: 04.07.2021

<sup>16</sup> Langenbucher, K., Leuz, C., Krahn, J. P., Pelizzon, L., *ibid.*

<sup>17</sup> Langenbucher, K., Leuz, C., Krahn, J. P., Pelizzon, L., *ibid.*

<sup>18</sup> Tidgemeyer provides information on the legislative procedure at: Tidgemeyer, M., *Entwurf eines Gesetzes zur Stärkung der Finanzmarktintegrität: Diskussion der Reformpläne in der Literatur*, BB 2021, vol. 8, p. 491–494.

<sup>19</sup> German Federal Ministry of Finance,

[https://www.bundesfinanzministerium.de/Content/DE/Gesetzestexte/Gesetze\\_Gesetzesvorhaben/Abteilungen/Abteilung\\_VII/19\\_Legislaturperiode/2021-06-10-FISG/0-Gesetz.html](https://www.bundesfinanzministerium.de/Content/DE/Gesetzestexte/Gesetze_Gesetzesvorhaben/Abteilungen/Abteilung_VII/19_Legislaturperiode/2021-06-10-FISG/0-Gesetz.html); access: 13.11.2021.

<sup>20</sup> German Bundestag, Drucksache 19/26966, 24.02.2021.

<sup>21</sup> German Federal Law Gazette, BGBl. I, p. 1534, 10.06.2021.

changes to numerous acts. More than 26 acts were changed, e.g. the German Securities Trading Act (Wertpapierhandelsgesetz), the German Stock Exchange Act (Börsengesetz), the German Financial Services Supervision Act (Finanzdienstleistungsaufsichtsgesetz), the German Commercial Code (Handelsgesetzbuch), the German Stock Corporation Act (Aktiengesetz), the German Public Accountant's Code (Wirtschaftsprüferordnung) and others.

The FISG only applies to publicly traded corporations,<sup>22</sup> that is, companies whose shares are admitted to a market that is regulated and controlled by governmental agencies, takes place regularly and is directly or indirectly accessible to the public.

According to the German Bundestag's government draft,<sup>23</sup> the FISG aims to implement 'urgent measures to restore and permanently strengthen confidence in the German financial market'.

### **3. Corporate Governance Reforms in Germany**

#### **3.1 Executive Board related reforms**

##### **3.1.1 Focus on internal control, risk management and financial statement certification**

Since the implementation of Section 91 (3) of the German Stock Corporation Act, publicly traded companies are required to implement and maintain appropriate internal control and risk management systems, effective for the scope of their business activities and risk position. The FISG follows the German Control and Transparency in Business Act (Gesetz zur Kontrolle und Transparenz im Unternehmensbereich, abbreviated 'KonTraG')<sup>24</sup> from 1998, which was implemented in response to the Holzmann<sup>25</sup> and FlowTex<sup>26</sup> fraud cases. According to Section 91 (2) of the German Stock Corporation Act, all joint-stock companies were required to establish a monitoring system to identify risks that might threaten the company's existence at an early stage (the so-called 'early risk detection system'). Since then, this has been required to be audited by the auditor in publicly listed companies (Section 317 (4) German Commercial Code). The FISG brings the board's responsibilities legally up to date with current practice, as many companies – not just those listed on a stock exchange – have corporate control systems in place and existence, albeit to varying degrees of maturity.

The importance of corporate control systems was also emphasized in the German Accounting Law Modernization Act<sup>27</sup> (Bilanzrechtsmodernisierungsgesetz, abbreviated 'BilMoG') in 2008, which required the supervisory board or its audit committee to monitor the 'effectiveness of the internal control system, risk management system, and internal audit system', but did not impose a similar obligation on executive boards or management. The BilMoG is based on the Audit Directive 2006,<sup>28</sup> which was only partially implemented. The FISG has now addressed

<sup>22</sup> Section 91 (3) and Section 3 (2) German Stock Corporation Act.

<sup>23</sup> German Bundestag, Drucksache 19/26966, *ibid.*, p.1.

<sup>24</sup> German Federal Law Gazette, BGBl. I p. 786 from April 27, 1989, in force since 01.05.1998.

<sup>25</sup> Philipp Holzmann AG was a German global construction company located in Frankfurt/Main. Due to mismanagement, Holzmann went bankrupt in 2002.

<sup>26</sup> FlowTex Technologie GmbH & Co. KG was a German company fraudulently dealing with special equipment for underground pipelines. The insolvency proceeding started in 2000.

<sup>27</sup> German Federal Law Gazette, BGBl. I p. 1102, 25.05.2009.

<sup>28</sup> Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC, Official Journal of the European Union, L 157/87, 09.06.2006.

this inaccuracy.

The financial statement certification ('Bilanzzeit') ensures that the (consolidated) financial statements and (group) management report give a true and fair picture of the group/company. The financial statement certification is signed by the legal representatives. False financial statement certification is a crime, and the maximum penalty has been increased from three to five years in prison or a fine. Negligent conduct is punishable by up to two years in prison or a fine (Section 331a German Commercial Code).<sup>29</sup>

### 3.1.2 Assessment

Executive boards must take steps to implement effective internal control and risk management systems, as well as keep track of relevant paperwork and evidence that the systems are appropriate and effective. It is also required to establish paperwork demonstrating that the financial statement certification was given thoroughly.

The fact that only the executive boards of publicly listed companies are required to implement internal control and risk management systems, while other organizations are not, is a challenge. There is a discrepancy with Section 107 (3) of the German Stock Corporation Act, which specifies the supervisory board's responsibilities. All stock corporations and co-determined limited liability companies are subject to this rule (as well as other forms of corporations). When requesting the executive board to implement these systems, such supervisory boards can't argue with the FISG. Supervisory boards haven't always been able to persuade the executive board to implement adequate and functional control systems in the past, therefore, mandatory rules to implement an effective risk management system are required for large and medium-sized companies, independent from stock-listing in the regulated market.

## 3.2 Supervisory board related reforms

### 3.2.1 Focus on the financial expert, the audit committee and information rights

Before the FISG became effective on 01.07.2021, only one financial expert with expertise in accounting or auditing was required. According to Section 100 (5) of the German Stock Corporation Act, the audit committee must have at least two financial experts, one with accounting expertise and the other with auditing expertise. The new requirements need to be implemented with the next reappointment of a supervisory board member, which is in most cases the next regular election. One committee member can't fulfill both competencies at the same time. The government draft's explanatory memorandum states that auditing expertise does not require a tax advisory or auditing profession but can be obtained through additional education.<sup>30</sup>

Before the FISG, supervisory boards had the authority to decide on the establishment, composition, and powers of audit committees at their discretion. For stock-listed companies,

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<sup>29</sup> German Federal Ministry of Finance, *Entschlossen gegen Bilanzmanipulation: Gesetz zur Stärkung der Finanzmarktintegrität*, BMF-Monatbericht, October 2020, <https://www.bundesfinanzministerium.de/Monatsberichte/2020/10/Kapitel/kapitel-2b-schlaglicht.html>; last access: 09.09.2023.

<sup>30</sup> Simons, C., *Die Änderungen der Aufsichtsrats-Governance durch das FISG*, NZG 2021, vol. 32, pp. 1429-1438

the recommendation of the GCGC applies, which may only be deviated from with justification in the declaration of conformity which is governed by Section 161 of the German Stock Corporation Act ('comply-or-explain'). The implementation of an audit committee is a recommendation of the GCGC and has thus been implemented in most of the publicly listed companies.<sup>31</sup>

According to Section 107 (4) sentence 1 of the German Stock Corporation Act, supervisory boards of public interest entities (so-called PIEs - Public Interest Entities) as specified in Section 316a (2) German Commercial Code must now establish an audit committee, as described in Section 107 (3) sentence 2 German Stock Corporation Act. The audit committees must meet the new requirements for financial experts. If a supervisory board of a PIE only consists of three members, the complete board is deemed to be the audit committee, a criticized<sup>32</sup> special regulation for small supervisory boards. If a supervisory board rejects the installation of an audit committee, a penalty of up to €5,000 may be directed by the commercial register (Section 407 (1) German Stock Corporation Act).

The German Stock Corporation Act now contains regulations regarding the right of the chairperson of the audit committee to ask the heads of central divisions directly for information, as well as the direct right of the heads of relevant central divisions to inform the audit committee chairperson, and the information right of the chairperson of the supervisory board towards the heads of internal control, risk management, internal audit, and compliance management system. The FISG has abandoned the previous rule that the supervisory board receives information from the executive board. This practice, however, is already established under the Banking Act (Kreditwesengesetz, abbreviated 'KWG') for financial service providers, and it is used by many other companies, and it now has a legal basis. The audit committee chairperson is encouraged to consciously use this instrument to protect the governance structure and the managers who are required to disclose information.

In addition, the supervisory board is now in charge of monitoring the audit quality (Section 107 (3) sentence 2 of the German Stock Corporation Act), which means dealing with the auditor's selection and independence, the quality of the audit, and the additional services supplied by the auditor, among other things.

To summarize, the supervisory board must establish an audit committee, examine its composition and competence profile, and fill any gaps that exist. The supervisory board should establish guidelines for carrying out its information rights and establish procedures how to monitor the quality of the audit.

### **3.2.2 Assessment of the supervisory board related new legal requirements**

The FISG addresses most of its changes to the work of the supervisory board. The fact of being a financial expert does not necessitate that the expert is a member of the tax advisory or auditing professions. Whereas, according to the recommendation in D.4. of the GCGC, the chairperson of the audit committee in listed companies should have experience in the

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<sup>31</sup> Roth, M., *Aufsichtsrat und interne Kontrolle nach dem Finanzmarktintegritätsstärkungsgesetz (FISG)*, NZG 2022, vol. 2, pp. 53-59.

<sup>32</sup> Troidl, W., *Aufsichtsrat, Prüfungsausschuss – oder beides? Stellung und Aufgaben des dreiköpfigen Aufsichtsrats in Unternehmen von öffentlichem Interesse*, NZG 2023, vol. 1, pp. 3-9.

application of accounting principles and be familiar with the audit of financial statements, in addition to knowledge.

The FISG does not include the financial expert's independence. Only the GCGC specifies that the audit committee chairperson, who regularly acts as a financial expert, needs to be independent. For the second financial expert, there is no regulation. The independence of the supervisory board is a key element of good corporate governance. The GCGC gives recommendations about independence in Sections C.6–C.12. However, the GCGC is not legally binding. Pott et al.<sup>33</sup> wonder why the legislature isn't considering adopting provisions of the GCGC, such as independence, into law. Additional steps could include requiring supervisory board members to rotate regularly.

In small companies with a three-member supervisory board, all supervisory board members form the audit committee. As two of the three supervisory board members need to have expertise in accounting and auditing, only the remaining supervisory board member may be an expert in e.g., strategy, digitalization, or sustainability. Koch<sup>34</sup> asks for exemptions for such small companies, otherwise, the capital market's attractiveness for those companies in question will decrease.

The independence of financial experts within supervisory boards is a *sine qua non* for effective governance. A legally binding solution that ensures that the audit committee chairperson and the financial experts are independent, is needed. The specification in the GCGC that the audit committee chairperson needs to be independent, is not sufficient, as the GCGC has no binding legal nature.

### 3.3 Audit reforms

#### 3.3.1 Rotation and liability

Statutory auditors are in the focus of the FISG as well. External rotation is now mandatory after 10 years without any exceptions. This is valid for all capital-market-oriented companies and other PIE (Section 316a sentence 2 German Commercial Code). The legislator has chosen to not use the granted exceptions in the German Audit Reform Act<sup>35</sup> (Abschlussprüfungsreformgesetz, abbreviated 'AReG') which were possible according to the Statutory Audit Directive 2014;<sup>36</sup> each EU Member State has the option to implement two exceptions. For fiscal years beginning after 31.12.2021, the maximum time before the internal rotation of the relevant audit partner for the statutory audit of PIEs is reduced to 5 years.

To strengthen the independence of statutory auditors, a stricter separation of audit and consulting services is required. The option according to the Statutory Audit Directive 2014<sup>37</sup> to

<sup>33</sup> Pott, C., Heilmann, M., Freches, F., *Auswirkungen des FISG auf die Corporate Governance von Unternehmen*, BB 2021, vol. 31, p. 1835–1837.

<sup>34</sup> Koch, C., *Stärkung des Prüfungsausschusses durch den FISG-RegE – Ausnahmen für kleine Unternehmen erforderlich*, BB 2021, vol. 7, p. 1.

<sup>35</sup> German Federal Law Gazette, BGBl. I p. 1142, 17.05.2016.

<sup>36</sup> Directive 2014/56/EU of the European Parliament and of the Council of 16 April 2014 amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts, Official Journal of the European Union, L 158/196, 27.05.2014.

<sup>37</sup> Directive 2014/56/EU, *ibid.*



permit certain blacklisted non-audit services was revoked.

The auditor's liability towards the company or its affiliates is significantly increased, depending on the audited company and on the degree of negligence (Section 323 (2) German Commercial Code). In the case of intent, the liability is always unlimited. For simple negligence, the range is between €1.5 million – and €16 million, for gross negligence, from €12 million to unlimited liability.<sup>38</sup>

### 3.3.2 Assessment of the audit reform

From a company's perspective, affected companies need to analyze the necessity of an external rotation of the audit company and – depending on the relevant date – initiate the tender process. If the current or a potential statutory auditor is involved in tax consulting, a transition to another tax advisor is necessary.

The appointment of the statutory auditor is (still) the responsibility of the company. The statutory auditor is nominated by the supervisory board and subsequently elected by the general meeting. In practice, the supervisory board's decision is influenced by the company and its management. Bormann and Böttger<sup>39</sup> propose a specific public oversight authority. This debate has been going on for a long time. The challenge of how to control controllers, according to Emmerich,<sup>40</sup> is 'as old as mankind itself'. The discussion led to the fact that mandatory audit was enacted into German legislation in 1931, and the profession of auditors was born at that time.<sup>41</sup> The German Chamber of Auditors and the supervisory board (Section 171 German Stock Corporation Act) have control over the auditors. In the end, the implementation of a special public supervising authority must be ultima ratio and other measures must be a priority. The new regulations are an excellent start; additionally, having mandated audits undertaken by more than one audit firm would result in mutual oversight and, as a result, a more rigid and objective audit.<sup>42</sup> The idea of such joint audits was already discussed during the legislative process, but not brought to law.<sup>43</sup> A joint audit promotes both the strengthening of the independence of auditors through the four-eyes principle and the audit quality through two quality assurance systems. This creates trust for stakeholders and the public and is therefore strongly recommended.

The liability of the auditor is towards the company and its affiliates. However, shareholders and creditors must have confidence in the auditor's opinion. Lenz<sup>44</sup> therefore, claims that if an auditor has breached his professional duties intentionally or (grossly) negligently and investors and creditors have been harmed as a result, they too - and not just the audited company -

<sup>38</sup> Huneke, M., Haberstroh R., Bacher, A., Schupeck H., *Das neue FISG: Was ändert sich für Abschlussprüfer?* 08.06.2021, <https://www.menoldbezler.de/blog/das-neue-fisg-was-aendert-sich-fuer-abschlusspruefer>.

<sup>39</sup> Bormann, M., Böttger, J., *Die Abschlussprüfung im Blick des FISG-RegE – Bilanzbetrug adé'*, NZG 2021, vol. 8, p. 330–334.

<sup>40</sup> Emmerich, V., *Die Kontrolle der Kontrolleure*, w: Busse v. Colbe, W., Lutter M., *Wirtschaftsprüfung heute: Entwicklung oder Reform?*, Wiesbaden 1977, p. 214-232.

<sup>41</sup> Weyershaus, H.A., *Wirtschaftsprüfung in Deutschland und erster europäischer Zusammenschluss in den Jahren 1931 bis 1961*, Düsseldorf 2007.

<sup>42</sup> Emmerich, *ibid.*

<sup>43</sup> Krolop, K., *Ergänzungen und Änderungen bei den Bausteinen einer Governance der Abschlussprüfung in der finalen Fassung des FISG*, NZG 2021, vol. 20, p. 853–859.

<sup>44</sup> Lenz H., *Haftung und Strafbarkeit des Abschlussprüfers im FISG-RegE*, Betriebsberater 2021, vol. 11, p. 683-687.

should be able to sue him for damages. That is not necessary, because the liability regime in Section 826 German Civil Code is a suitable legal basis, an opinion that is also agreed upon in literature.<sup>45</sup>

### 3.4 Enforcement reforms

#### 3.4.1 New enforcement mechanism

The new financial reporting enforcement mechanism has been in place since 01.01.2022. Before FISG, the two-stage system was reliant on the companies' voluntary cooperation. This two-stage approach was replaced by a single-stage approach for financial reporting enforcement. As of 31.12.2021, the FREP was closed, and all pending audits, files, and records were transferred to the BaFin. BaFin now has the right to audit all publicly traded companies according to Section 264d German Commercial Code and to enforce the audit by summoning and questioning corporate bodies, employees, and statutory auditors (Section 107 (2) German Securities Trading Act). The BaFin will inform the public about cases in the public interest; audit orders will be published in the German Federal Gazette and on the BaFin website.

#### 3.4.2 Assessment of the new enforcement mechanism

Organizations should ensure that they are prepared to face enforcement proceedings. This necessitates the implementation of internal procedures for such enforcement, including a suitable degree of documentation, identifying responsible parties, and ensuring that a protocol is in place for dawn-raids. Haegler<sup>46</sup> also advises companies to prepare for the enforcement. He recommends building an accounting documentation system. The efforts to ensure enforcement-readiness should also include the executive and supervisory board members.

In terms of legislation, the Arbeitskreis Bilanzrecht Hochschullehrer Rechtswissenschaft (AKBR), a working group of German accounting and auditing law professors, issued a statement on the FISG's legislative draft. They address other requirements to promote corporate governance; one of the recommendations to increase the effectiveness of enforcement is to establish a task force to investigate prominent and large cases quickly and effectively. This task force must be adequately staffed, trained, and resourced; bearing in mind that the specialists are well compensated and will therefore be difficult to attract.<sup>47</sup>

To further improve the enforcement proceedings, Krahn and Langenbucher<sup>48</sup> ask for a solution that covers all national financial markets in the EU member states.

Overall, the enforcement mechanism calls for refinement. Task forces, empowered to conduct investigations in prominent, high-profile cases, need to be established at all relevant authorities. On a wider scale, a harmonized European solution is indispensable, spanning

<sup>45</sup> Homborg, E., Landahl, P., *FISG – Ist die Verschärfung der Abschlussprüferhaftung die richtige Antwort auf den Wirecard Skandal?* NZG 2021, vol. 20, p. 859–865.

<sup>46</sup> Haegler, O., *Anforderungen an die Unternehmen beim neuen Enforcement-Verfahren nach dem FISG*, BB 2021, vol. 31, p. 1838–1840.

<sup>47</sup> Anzinger H. et. al., *Bekämpfung von Unregelmäßigkeiten bei der Rechnungslegung einschließlich Betrug - Denkbare weitere Schritte zur Reform von Abschlussprüfung, Bilanzkontrolle und Corporate Governance*, NZG 2020, vol. 24, p. 938–945.

<sup>48</sup> Krahn, J., Langenbucher, K., *The Wirecard Lessons: A reform proposal for the supervision of securities markets in Europe*, Sustainable Architecture for Finance in Europe (SAFE), Frankfurt, 2020, Policy Letter No. 88, p. 1–7.

across all national financial markets.

#### 4. Conclusions

'Hard cases make bad law?' No doubt that Wirecard was and still is a 'hard case', but the FISG is not a 'bad law'. However, it is evident that certain provisions of the German stock corporation law require modification, and further reforms are necessary to address the existing gaps. The changes in the law do not merely concern purely formal rights. The internal order of the supervisory board, the structure of the cooperation between the two most important top-level bodies of the (listed) stock corporation, and the associated aspects of trust, transparency, control, and monitoring are the focus of the legal discussion. In addition, there is the unstoppable internationalization of stock corporations, which is characterized by the international composition of corporate bodies. German stock corporation law is no longer genuinely German law and will not be able to negate international practices and developments or channel them purely through the GCGC. The developments of the FISG and the GCGC illustrate that German stock corporation law will and must change and a 'FISG II'<sup>49</sup> must be initiated. Further capital market law adjustments were originally expected even after the elections in Germany,<sup>50</sup> yet they are not the focus of German politicians. On the European Union level, the important question associated with the harmonization of laws and controls is addressed. The European Commission has also announced that it is working on reform proposals in response to the events surrounding the Wirecard scandal.<sup>51</sup>

Germany is experiencing an ongoing process of reform in its stock corporation law, which can be characterized as a continuous evolution rather than a radical revolution. The 'stock corporation law reform in perpetuity', this term that dates back to Zöllner,<sup>52</sup> and is more relevant than ever and will be accompanied by actions from the European Commission.

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<sup>49</sup> Mattheus, D., *Das FISG als Startschuss für neue Governance-Regeln? Eine Würdigung aus Aufsichtsratsperspektive*, Board 2021, p. 58–61.

<sup>50</sup> Liebscher, M., Rinker, C., *Das Finanzmarktintegritätsstabilisierungsgesetz Neuerungen für Abschlussprüfer, Vorstände und Aufsichtsräte kapitalmarktorientierter Gesellschaften*, BKR 2021, vol. 8, p. 466–47; Schmidt, J., Trouvain, T., *Bundestagswahl 2021 – Pläne der Parteien für das Gesellschaftsrecht*, NZG 2021, vol. 26, p. 1141–1144.

<sup>51</sup> McGuinness, M., EU Commissioner for Financial Stability, Financial Services, and the Capital Markets Union, Speech about 'Corporate Reporting in the EU's Capital Market Union After Wirecard' on 27.05.2021 to the European Policy Centre, available at [https://www.youtube.com/watch?v=WD-\\_\\_cO3FHQ](https://www.youtube.com/watch?v=WD-__cO3FHQ); access: 28.11.2021.

<sup>52</sup> Zöllner, W., *Aktienrechtsreform in Permanenz – Was wird aus den Rechten des Aktionärs?*, Die Aktiengesellschaft 1994, vol. 39, p. 336-341.

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