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Information for Supervisory Board and Audit Committee members

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The Supervisory Board and Sustainability

Integrated Reporting – A perspective for a holistic architecture of corporate disclosure

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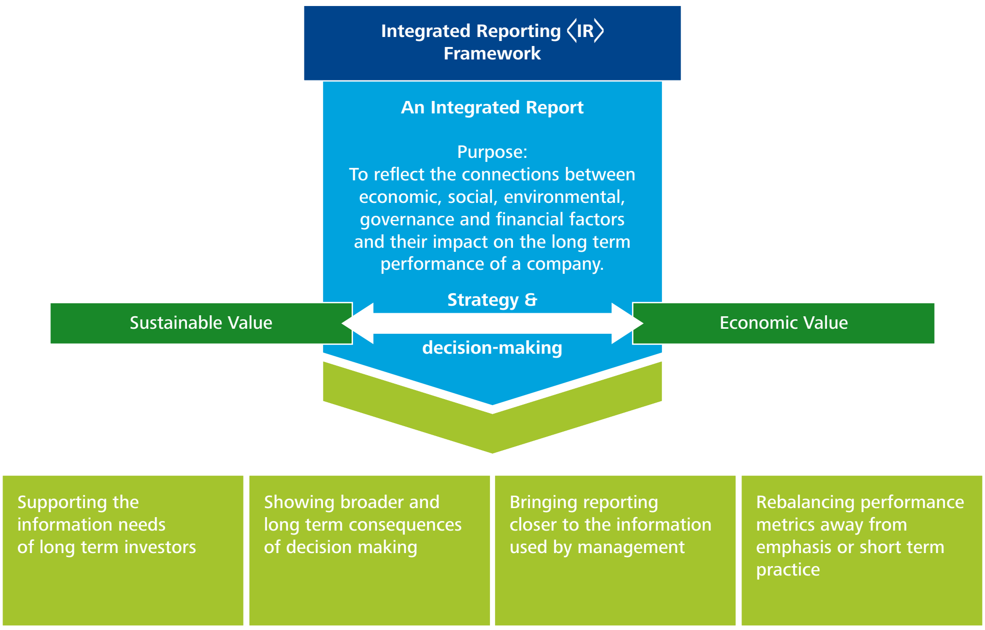
Evolving reporting requirements

In 2009, HRH The Prince of Wales called for a framework "to help ensure that we are not battling to meet 21st century challenges with, at best, 20th century decision making and reporting systems." As a well-known figure, highly respected by the Corporate Sustainability community, the Prince has been a strong advocate for a new approach to accounting and corporate disclosure; already in 2004 he had established the Accounting for Sustainability initiative that has been committed since then to link the sustainability agenda with the financial strategies and overall business policies of organizations. In 2010 Accounting for Sustainability issued the so-called Connected Reporting Framework to give practical guidance to organizations for embedding material sustainability parameters into information communicated to investors.

Soon afterwards, in August 2010, Accounting for Sustainability and the Global Reporting Initiative (GRI) announced the formation of the International Integrated Reporting Committee (IIRC)[1], a powerful, international cross section of leaders from the corporate, investment, accounting, securities, regulatory, academic and standard-setting sectors as well as civil society, committed to developing a framework for reporting financial, environmental, social and governance information in an integrated format: "The world has never faced greater challenges: over-consumption of finite natural resources, climate change, and the need to provide clean water, food and a better standard of living for a growing global population. Decisions taken in tackling these issues need to be based on clear and comprehensive information. The intention is to help with the development of more comprehensive and comprehensible information about an organization's total performance, prospective as well as retrospective, to meet the needs of the emerging, more sustainable, global economic model."[2, 3]

In parallel to this process, some nations have already established either mandatory or obligatory regulatory frameworks on Integrated Reporting. The largest companies in Denmark, for instance, are obliged to report on non-financial information in their annual reports. In Sweden the majority of listed companies publish sustainability information either in their annual reports or stand-alone reports while a tendency towards integration of sustainability information within the annual report, and in some cases as part of the audited Directors' Report section is recognized. To some extent this is due to the implementation of the Accounting Modernization Directive 2003/51/EC into Swedish account-



1 http://www.theiirc.org/wp-content/uploads/2011/03/Press-Release1.pdf

2 http://www.theiirc.org/

3 Integrated Reporting: A perspective from Net Balance; Terence L. Jeyaretnam and Kate Niblock-Siddle; The President and Fellows of Harvard College; Cambridge, Massachusetts; 2010

ing law, requiring disclosure of non-financial information in the Directors' Report. In Germany, too, the tendency towards Integrated Reporting is increasing on the one hand according to paragraph 289 and 315 of HGB (German Commercial Code), companies are requested to disclose non-financial information "as far as significant for the understanding of the state and development of business", on the other hand we observe that listed companies are beginning to pro-actively assess future scenarios and roadmaps towards Integrated Reporting. In South Africa, the King III-Code on Governance has required, since 2009, that JSE-listed companies issue an annual integrated report.

Why ONE-reporting?

The majority of listed German companies today publish their financial and governance information in their annual reports and their sustainability information (environment and society) separately in a Sustainability Report. In the introductory chapters of many of these Sustainability Reports the companies proclaim to being strongly committed to embedding sustainability into their overall business strategies and operations. However, in practice, when it comes to the disclosure of sustainability information, in many cases a hard-wired link to financial reporting and a substantial embedding into business information fails. Statements on the business relevance of sustainability objectives (value leverage and risks) in Sustainability Reports raises the expectation by stakeholders (including shareholders) to be able to access relevant and factual information on the financial and business impact of those objectives. Being responsive to those expectations can strengthen trust. In this respect, according to IIRC, an Integrated Reporting could help in four ways (see fig. above[4]) by:

- supporting the information needs of long-term investors,
- showing broader and long-term consequences of decision-making,
- bringing reporting closer to the information used by management,
- rebalancing performance metrics away from emphasis on short-term practice.

Hence an Integrated Report can reflect the connections between economic, social, environmental, governance and financial factors and their impact on the long-term performance of a company.

How ONE-reporting?

Integrated Reporting is more a "journey" than a "landmark". Indeed, the learning curve that most companies went through in the previous years by adopting the GRI guidelines showed that this is an ongoing, structured process, which should be supported by a mature coprorate reporting culture. Although trends in corporate sustainability are often more influenced by fashion and people's beliefs rather than facts, in the case of Integrated Reporting one can observe that many companies are currently systematically assessing the opportunities and risks of a reporting transition.

Indeed, a journey towards integrated reporting needs strategic planning scenarios, suitable teams and organization, rules and discipline, and leaders. In this respect, when it comes to the Integrated Reporting journey, companies face at least two major types of challenges:

- internal challenges: when a company aims at approaching Integrated Reporting it should not underestimate the challenges of organizational change that the transition will require;
- external challenges: the Integrated Reporting environment (i.e. regulations, guidelines, standards, etc.) may change; indeed the IIRC is in the early stages of developing a guiding framework and, at the same time, national regulations are still very diverse.

In order to tackle both types of challenges, companies would need to draw strategic roadmaps that (a) recognize solutions with respect to the required organizational change and (b) furthermore engage the organization proactively with multi-stakeholder collaboration platforms such as GRI and IIRC.

Perspectives

A strategic roadmap for Integrated Reporting at a company should address different scenarios. Design and evaluation of such scenarios would require, in an early phase, a diligent screening of both stakeholders' and shareholders' issues against common reporting criteria (i.e. materiality, transparency, consistency, etc.) as well as an assessment of the overall change impact on the organization and on the business in different time scales (short, mid, long).

[4] http://www.theiirc.org/

The Integrated Reporting journey may then open new perspectives for a holistic architecture of corporate disclosure:

- balancing economic value/risk against sustainable value/risk,
- rethinking and aligning corporate strategies from a sustainability perspective,
- increasing transparency to both stakeholders and shareholders while
- reducing complexity and aligning reporting of the organization.

Reflecting these four iconic changes to the business environment in Germany, the governance role of the supervisory board will be significant when it comes to assessing material sustainability impacts for the business. While the management board is responsible for ensuring sustainable business in terms of drawing up and executing company strategies, the supervisory board embodies the highest governing instance that has to monitor and supervise these strategies and their proper translation into sustainable business. A holistic and integrated reporting architecture can be an excellent information instrument at supervisory board level too. Lastly, the journey towards Integrated Reporting can strengthen Corporate Governance and hence contribute to the company´s credibility.

Verification of sustainability reporting

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Sustainability reporting

In recent years, stakeholders have focussed more and more on sustainability issues. As a result of this development, investors, for example, now regularly evaluate the sustainability information published by companies in order to assess whether the target companies are fulfilling their responsibilities regarding ecological and/or social issues and thus represent a suitable subject for investment.

However, virtually no regulations for the publication and/or presentation of sustainability information can be found in German law.[1] Nevertheless, the increased interest in sustainability has in the meantime led to almost every large, publicly traded company in Germany voluntarily providing information about sustainability – either as a part of the annual report or in a separate report.[2]

Criteria for sustainability reporting

Owing to the lack of statutory regulations, companies are free as to how and what they report on sustainability issues. However, in order to increase the value of sustainability information for the users of the information, it would make sense to avail oneself of criteria catalogues specifically developed for the purpose of sustainability reporting. The currently most widespread in this respect are probably the "Sustainability Reporting Guidelines" published by the Global Reporting Initiative.[3] These are now available in the 2011 G3.1 version (GRI G3.1) and represent a comprehensive framework for sustainability reporting. Fundamentally, the following disclosures are required: the company's strategy and profile, management approach and performance indicators. The latter serve the purpose of providing comparable data on the economic, ecological and social performance of the company. The GRI G3.1 further require the company to make a self-assessment regarding the quality of its sustainability report, by classifying the report to a pre-defined application level: a "C" represents the lowest and an "A" the highest level, "B" stands for a medium level.

[1] Non-financial performance indicators such as information on environmental and employee matters are required only in the management reports of large corporations or Groups, as part of the analysis of the business development and the company's position, insofar as they are important for an understanding of these reports; see ss. 289 (3), 315 (1.4) HGB.

[2] For example, BASF SE has for several years included sustainability information in its annual report; for an example of a separate sustainability report, HeidelbergCement AG may be named here as representative of many other companies; with regard to the latter, see the following article.

[3] The Sustainability Reporting Guidelines can be downloaded from http://www.globalreporting.org/ReportingFramework/.

In addition to the GRI Guidelines, the AA1000 AccountAbility Principles Standard 2008 is also available as a regulatory framework for sustainability reporting. Unlike GRI G3.1, AA1000 APS (2008) is purely principles-based; it may therefore be used in conjunction with other criteria catalogues. AA1000 APS (2008) is based on three basic principles: inclusivity, materiality and responsiveness and is based on the model of a responsible company. A process of the consistent integration of stakeholders in all sustainability issues is a core element thereof. Apart from the two mentioned, there are yet other, mainly industry-specific, criteria catalogues, which provide, for example, for the reporting of specific performance indicators.

Verification of sustainability reporting

A verification of sustainability reporting by comparing the information with the reporting criteria, and considering the business processes if necessary, can further increase the credibility of the reporting and thus the confidence of stakeholders in the business. For example, the GRI G3.1 permit, in this connection, a "+" to be added to the indication of the application level involved if the report has been verified by an independent third party.

Independent verifications may be conducted by auditors or other service providers. There are basically three different standards for verification by auditors available in Germany that can be partly combined with each other:

- ISAE 3000: Assurance Engagements other than Audits or Reviews of Historical Financial Information
- IDW PS 821: Generally accepted standards for the audit or limited review of reports in the area of sustainability
- AA1000 Assurance Standard 2008 (AA1000 AS (2008))

The main features of the standards are summarized in the table[4] below.

Conclusion

Stakeholders increasingly expect that sustainability issues will be embedded in the corporate strategy and that strategy implementation will then regularly be reported on. The task of the Supervisory Board, among other things, is to examine the company's corporate strategy and reputation critically. In this configuration, verification of sustainability reporting by an auditor can act in two directions: on the one hand verification strengthens the credibility of the company towards its stakeholders, and on the other the Supervisory Board can base its strategy monitoring on verified information and thus obtain support for its monitoring tasks. Due to the lack of regulations on sustainability reporting, the specific mandate agreement, in particular as to which audit standards should be applied, gains special significance.

	ISAE 3000	IDW PS 821	AA 1000AS (2008)
Published by	International Federation of Accountants (IFAC)	German Institute of Public Auditors (IDW)	AccountAbility
Subject of the engagement	(Selected) non-historical financial information (the standard is not designed for sustainability reports, but is regularly used for them)	Full-scope reports in the area of sustainability (reports on individual service areas or a comprehensive sustainability report)[5]	Sustainability reports in relation to the above AccountAbility Principles (Type 1 Assurance Engagements) and other methods of reporting such as performance indicators (Type 2 Assurance Engagements)
Definition of materiality	Materiality is based on whether the non-disclosure or misstatement of information may influence the decisions of users of the information.	Information is material if its non-disclosure or misrepresentation may influence the decision of an intelligent reader of the report.	Materiality relates not only to the non-disclosure or misrepresentation of information, but also relates to their relevance and significance to the company and its stakeholders.
Assurance levels	Reasonable Assurance or Limited Assurance or a combination	Audit (sufficient assurance) and limited review (limited assurance) or a combination	High Assurance (very low risk of error, but not zero) and Moderate Assurance (reduced risk of error, but not low or zero)

[4] Based on Höschen/Vu, WPg 2008, p. 382.
[5] The report must be verified in full, whereby parts may be subjected to an audit and other parts to an auditors' inspection, see IDW PS 821, marginal no. 13.

HeidelbergCement, a Global Company with Clear Sustainability Ambitions

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HeidelbergCement is the global market leader in aggregates and a prominent player in the fields of cement, concrete and other downstream activities, making it one of the world's largest manufacturers of building materials. The company employs some 53,400 people at 2,500 locations in more than 40 countries worldwide.

Sustainability is part of the Corporate Strategy of HeidelbergCement. The "HeidelbergCement Sustainability Ambitions 2020" (Ambitions) set ambitious sustainable development objectives, with clear deadlines and targets. The Ambitions are articulated around six main pillars: health and safety, biodiversity, sustainable construction, using waste as a resource, climate protection and reduction of other environmental impacts.

The Sustainability Steering Committee of HeidelbergCement – headed by the Chairman of the Managing Board – defines the basic framework for controlling and monitoring our sustainability strategy. The interdisciplinary committee's members are chosen from throughout the Group and consist of the heads of the Human Resources, Purchasing, Research and Technology and Communication departments, as well as the group-wide Global Environmental Sustainability department. The latter department is involved in the preparation of the Sustainability Report and is responsible for the assurance process of our sustainability indicators – under the supervision of Mr Daniel Gauthier, member of the Managing Board.

HeidelbergCement has been publishing a corporate sustainability development report since 2005. In this report, main sustainability related performance indicators are released for the different business lines of HeidelbergCement, at global level.

HeidelbergCement, a member of the Cement Sustainability Initiative

Most of these indicators are commonly defined on a global scale – by the international association of cement producers, the "Cement Sustainability Initiative" (CSI), a member of the World Business Council for Sustainable Development.

Over the past 10 years, CSI members developed a robust set of key performance indicators which track progress on major sustainability issues for the sector: CO_2 and other emissions, safety, alternative fuel use, quarry rehabilitation. Progress against these indicators is to be reported on an annual basis by all CSI member companies, including HeidelbergCement.

In particular, the CSI's CO_2 protocol is now the reference CO_2 emissions monitoring and reporting methodology in the global cement sector. It is now in the process of being officially adopted by standardization organizations (CEN and ISO). Reported CO_2 figures are feeding a global database – managed by an independent third party – which covers cement production from 1990 through 2009 (data is released with a year's delay to meet anti-trust regulations). 46 companies with over 900 production facilities worldwide submit data to this CSI's global, voluntary "Getting the Numbers Right" (GNR) database. Thus the GNR database represents about 26% of the global cement production. These figures show that energy efficiency has improved nearly 16% since 1990, while CO_2 emissions per unit of output have dropped more than 14% in the same period. 83% of the 2009 data is is validated or reviewed by independent 3rd parties. The data in the database yields accurate relevant reports useful to the industry and to policy makers.

HeidelbergCement – as a member of the Cement Sustainability Initiative – is committed to deliver qualitative sustainability information to all stakeholders complying with the CSI definitions and requirements. The external validation process is perceived by our company as a driver for continuous improvement of our monitoring and reporting practices. All CSI members have also made a voluntary commitment to ensure the external validation of CO_2 figures and safety figures before submitting them to the GNR database and communicating them externally.

First Comprehensive Assurance Process launched in 2009

HeidelbergCement initiated the first comprehensive external assurance process for a certain number of its sustainability indicators in 2009[1]. This had the following scope:

- health and safety figures for 2008 and 2009;
- CO_2 figures for 2007, 2008 and 2009;
- SO_2, dust and NOx data for 2008 and 2009;
- management system and reporting process.

From April to June 2010, several audits were performed in selected production facilities around the globe by a professional services firm. The auditors went to Ukraine (Kryvyi Rih), Germany (Hanover), Poland (Gorazdze), India (Damoh, Imlai, Amassandra), Canada (Edmonton),

[1] A first step was previously achieved with the external assurance of CO2 figures for the year 2006.

California (Cupertino), and Belgium (Antoing) and performed also assurance procedures at our headquarters in Heidelberg, as well as our Technical Center offices in Leimen (Germany).

Identified material exceptions and weaknesses could all be corrected. This improvement process required a significant amount of time and personal investment by HeidelbergCement employees. The assurance certification was finally issued by the auditor early in 2011.

The most valuable deliverable of this process was undoubtedly a clear list of recommendations aiming at improving our management system and monitoring processes. These recommendations were mainly focused on the development of a comprehensive set of reporting guidelines (harmonization of reporting formats and frequencies) to promote the responsibility of data providers and controllers.

Main Conclusions and Outlook

The first external assurance process represented a very clear eye-opener within our organization, indicating further opportunities for improvement in several areas. A comprehensive "sustainability reporting improvement project" has since then been initiated at global level within HeidelbergCement: reporting processes are being further harmonized, simplified where possible, better documented and useful integrated tools are being developed. This is today our main challenge: progressing further in the integration of the sustainability reporting processes into the existing management processes of our company.

The objective remains the delivery of continuously improving information to all external stakeholders – which is today a must for global companies:

- as a DAX-listed company, HeidelbergCement faces growing information requirements from investors and analysts focusing on "Environmental, Social and Governance" (ESG) issues;
- HeidelbergCement supports regulatory developments around sustainability reporting. The delivery of reliable information to (inter-)national public authorities is a clear prerequisite;
- our company is also committed to transparency towards its neighboring communities and towards NGO's, as recently demonstrated by the signature of a global partnership agreement with the world's largest nature conservation organization, BirdLife International.

In our view, effective strategies can only be based on accurate and reliable performance indicators. This has led our company to decide to progressively extend the scope of the external assurance process to all main sustainability indicators over the next few years.

Even if it requires a significant amount of time and energy from HeidelbergCement employees throughout the world, the external assurance process represents a very valuable management tool which our company wants to use to its whole extent – increasing transparency, reliability and efficiency.

Furthermore, our experience shows that a permanent organizational structure – with formalized responsibilities – has to be established at corporate level to coordinate the assurance process and to make sure that recommendations are actually being followed up by the business units. According to a decision of the HeidelbergCement Managing Board, this responsibility lies in the hands of the Global Environmental Sustainability Director, who coordinates between countries and various corporate departments. Dedicated project groups are being established to focus on main improvement areas. Within a global multicultural company, this represents a big challenge and calls for continuous internal communication with all involved line managers, including the Managing Board members.

Let's be clear: external assurance is a useful tool, but it is only one tool amongst many others to reach a full implementation of an efficient sustainability approach. An external control by a independent third party can only cover a limited number of production locations and offices and will of course never replace a continuous focus from the entire organization (from the Managing Board of HeidelbergCement all the way through to the work level). The alignment of the strategy, targets and action plans with the expectations and requirements of all stakeholders remains the task of the company itself!

Inherent Risks in Chairing an Annual General Meeting

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The key role at a stock corporation's annual general meeting (AGM) goes to the meeting's chairperson. His demeanour and his decisions will impact both the course of the AGM and, just as decisively, the legal effect of the adopted resolutions. Inappropriate reactions on the part of the meeting's chairperson are, in the best case, an annoyance devoid of legal repercussions. In the worst case, they may lead to a conflict-prone AGM or represent legally material procedural errors, culminating in legal challenges to, or the invalidity, of AGM resolutions, hence perhaps frustrating far-reaching entrepreneurial decisions.

Complex Legal Literature and Court Rulings

According to the articles of association, the role of chairperson of the AGM is ordinarily taken by the chairperson of the supervisory board and, if he is unavailable, usually by his deputy. The meeting's chairperson has the task of ensuring the AGM is properly conducted and executed. According to general opinion, he is equipped with all the necessary rights to properly manage the AGM. However, the actual scope of these rights can ultimately only be determined from the complex body of pertinent legal literature and numerous court rulings. Hence the meeting's chairperson is well-advised to consciously take time beforehand to prepare and discuss the AGM with highly specialised experts whom he can also turn to for support while the AGM is still in progress.

Admission of Shareholders and Opening of the AGM

As a first point, the meeting's chairperson must ensure participants have ready access to the AGM. Even at this stage, before the AGM actually begins, mistakes can creep in which may compromise the legal certainty of the entire AGM. Examples of this are exaggerated security measures, such as bag searches, improper registration of participants, or wrongful rejection of registered shareholders or their authorised proxies. Contrary to popular belief, an admission ticket is not a prerequisite for participating in the AGM. Anyone who has forgotten his or her admission ticket but can show proof of identity and is registered in compliance with the articles of association must be admitted.

To avoid the risk of legal challenges, the chairperson of the AGM should under no circumstances open the meeting before the time specified in the convening notice. Should the security check lead to delays, despite the punctual arrival of many of the AGM participants, it is recommended that, after duly informing those already there, the meeting be opened with a slight delay. On the other hand, if individual supervisory board members are absent or late, this is usually no reason for delaying the meeting.

Chairperson's Guidance Notes

Once the chairperson has opened the AGM and announced the rules and procedures, he should, from the very outset, make every effort to avoid possible provocations from what are, in some cases, seasoned participants. So to begin with, the chairperson must properly prepare speaking points (guidance notes) specifically addressing the agenda points of his particular AGM. Many guidance notes, though dealing with a manageable number of participants and a clear-cut agenda, contain the entirely superfluous and potentially volatile caveat that the meeting's chairperson reserves the right to limit speaking times and question times to ensure the agenda is completed within reasonable time.

From a legal viewpoint, the chairperson is strongly advised to use guidance notes that have been checked and approved by legal experts. Such notes give the AGM the necessary legal and factual structure. Over the past few years there has been a tendency towards increasingly brief guidance notes. Yet these then contain, in condensed form, the full range of statements the meeting's chairperson should make. To name just a few legally problematic examples from practical experience, there are cases where the chairperson forgets to ask whether there are any more floor requests or forgets to announce that there are no more floor requests and that all the questions put by the shareholders have been fully answered, sometimes incomplete or erroneous announcements are made about attendance details or voting results, and last but not least there are even cases where the chairperson omits to close the general debate or the entire AGM itself. Using guidance notes to ensure the meeting is handled in a structured manner that provides legal certainty enables the chairperson to chart a sure-handed and consistent course through the AGM. The chairperson can obtain the required degree of additional certainty by thoroughly preparing for the event together with his experienced advisers.

Structured Procedure for Answering Questions

One of the most frequent reasons given for raising a legal challenge is the infringement of the shareholders' right of access to information on the grounds that questions were answered inadequately or incorrectly. This makes it all the more important for the meeting's chairperson to ensure, and if necessary insist, that questions are answered in a structured and hence legally certain manner in the course of a general debate. This means that the speakers must first register a floor request, stating their respective voting card number, and are then called up in succession by the chairperson so as to pose their questions from a rostrum. After a certain number of speakers and questions have been heard, the chairperson makes a break, allowing the board of directors, assisted by the back office, to answer questions in the form of blocks, and in the same manner, in coordination with the board of directors, the chairperson answers questions concerning the supervisory board. The chairperson should hold fast to the procedure he or she has stipulated and generally not tolerate any deviations. A considerable risk is posed by spontaneous questions or interjections from the assembled shareholders or emotionally loaded one-on-one exchanges with the shareholders. This may not only cause the board of directors or the meeting's chairperson to get carried away to the point of giving spontaneous and legally problematic answers or assurances but may also allow the AGM to get out of hand entirely.

Risks Inherent in Handling Motions

The meeting's chairperson must be prepared for all manner of special situations which require a deviation from the main thread of his or her guidance notes. This particularly applies to the various motions which may be brought forward in the AGM. For example, these include motions for dismissing the meeting's chairperson, conducting an individual debate, changing the order of speakers, formally approving the actions of individual management board or supervisory board members, bringing in new agenda items, withdrawing announced agenda items, postponing the AGM, convening a new AGM, as well as counter motions to announced agenda items, motions for special audits, or motions for asserting damage claims against the management board and supervisory board. These motions must be subjected to detailed and meticulous legal scrutiny. In some cases the decision lies with the meeting's chairperson and in other cases it is for the AGM to vote on the motion. In the latter case, after a discussion on the motion has been allowed, the corresponding vote must sometimes be taken immediately, but often it is sufficient if the AGM does not vote on the motion until just before a vote is taken on the announced agenda items. In other cases, the vote must take place immediately after voting on the announced agenda items has been completed and in entirely different cases not until later in a separate vote. Mistakes made in handling such motions can lead to anything ranging from a legal challenge to an isolated agenda item all the way through to the invalidity of all AGM resolutions. To deal with such motions in a legally certain manner, the meeting's chairperson requires comprehensive briefing by competent advisers, backed up by extensive special guidance notes that cover all these special situations. Unfortunately most guidance notes covering special situations still only deal with individual votes on each individual shareholder's motion requiring a vote. However, this runs contrary to practical experience in cases where several shareholders' motions are put to the vote in a single vote.

Dealing with Hecklers in the Right Manner

Tact is required when dealing with hecklers. Even when faced with insults, the meeting's chairperson must not allow himself or herself to be provoked and needs to act calmly and collectedly in all situations. The chairperson may only use disciplinary measures to an appropriate and reasonable extent. An almost classic error is the case where an annoyed chairperson bans a first-time heckler from the entire AGM. Instead, as a first measure, if the heckler has been previously, albeit unsuccessfully, forewarned and cautioned, he or she may only be sent out of the assembly hall into the foyer for a "cooling down" period of around 15 to 30 minutes. Moreover, the chairperson is then well-advised to inform the heckler of his right to issue a power of proxy, beforehand also giving him or her an opportunity to have any objections placed on record by the notary. The ultimate exclusion of the heckler from the AGM is only ever an option if, following the cooling down period, he or she returns to the assembly hall and continues to heckle.

Restrictions on the Right to Pose Questions and Speak

The meeting's chairperson may only use the general restriction on the right to pose questions and speak on a graduated scale and to an appropriate and reasonable extent (limiting the question and speaking time, giving prior notice of closure and closing the list of speakers, additionally limiting the question and speaking time, and closing the debate). The proper chronological planning and use of these measures requires many years' experience. Under no circumstances may the question and speaking time be limited too early on. Neither may an AGM scheduled to last for a day be allowed to extend past midnight, so as not to risk the invalidity of all resolutions passed by the AGM. Allowance must also be made for any delays which might occur through shareholders raising objections with the notary that many questions have remained unanswered and by their demanding that these be recorded in the notarised minutes of the meeting, so regularly causing the management board to open up a new round of answers. Another case in point comes in the form of technical problems encountered in conducting the voting procedure or establishing the voting results. On the other hand, the AGM may not be allowed to finish too early either. Otherwise there is the risk of legal challenges being raised on account of the meeting's chairperson being too heavy-handed in imposing restrictions on the right to pose questions and speak.

Summary

In the final analysis, the demands made on the chairperson of an AGM are quite considerable. Regardless of the situation, he or she must conduct the meeting in a calm and sure-handed manner, acting resolutely when required. In addition, the chairperson must ensure that the process of handling and adopting the resolutions passed by the AGM is free of legal errors. Hence a successful AGM crucially depends not only on the chairperson's personality but particularly on the chairperson's comprehensive preparation and expert support, especially with respect to special situations.

Virtues of an Honourable Supervisory Board Member

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In the aftermath of the financial crisis and given the new legal regulations, the qualifications, duties, and rights of supervisory board members are being discussed anew and the corresponding requirements are increasing. In this connection it seems a helpful idea to correlate the virtues of an "honourable businessman" with the tasks of a supervisory board member and reflect upon these.[1]

Let us first look at the question of what is understood by the term honourable businessman. Based on a definition provided by Klink, one could describe this as follows: the "honourable businessman" does not view morality and profitability as a contradiction, but as a prerequisite. Profitability means creating sustainable values. The actions of entrepreneurs are in step with society at large and require, in addition to economic expertise and a personality which embraces responsibility, an all-round humanist education. In more concrete terms, the required factors are: honesty, caution, creating trust, maintaining confidentiality of trade secrets, audacity at the right moment, love of peace, seriousness, politeness, intelligence, orderliness, positive outward appearance, and last but not least a good education.

Now these character traits and skills cannot be acquired from one day to the next. We are talking more in terms of a general change of awareness. Let us therefore pose the question of what objectives might be pursued with the abilities of an "honourable businessman". For one thing, they are the hallmarks of good corporate governance. The German Corporate Governance Code (DCGK) provides a crucial basis in this respect. To quote Cromme, good corporate governance can be briefly summed up as follows: an attempt to "transpose the model of the honourable businessman into ethically responsible rules in an ever-changing world".

The debate surrounding the way in which supervisory boards perform their functions and tasks also raises questions about the conceptual components, the very aspects that enable the supervisory body to actively improve how it goes about its duties. Especially the introduction of Germany's Accounting Law Modernisation Act (BilMoG), which stipulates that at least one of the supervisory board members must have verifiable expertise of accounting or financial statements auditing, has refocused the debate on the issue of quality. This means that the intrinsic function of the supervisory board, that of monitoring and advising the management board, is becoming a greater focus of interest. As a result supervisory board members must also have the requisite technical knowledge. A prudent and conscientious supervisory official must possess the required minimum expertise to

[1] For more extensive details on this topic, with further supporting notes, cf. Ruter/Rosken: Was ist ein ehrbarer Aufsichtsrat/Beirat? Welche Bedeutung nimmt er im Rahmen einer nachhaltigen Unternehmensführung ein?, Der Betrieb, 2011, S. 1123–1126. This article appears below in abridged form.

be able to perform the duties of his or her office. According to the court rulings of the German Federal Court of Justice (Bundesgerichtshof) this means the minimum general, economic, organisational, and legal knowledge required to understand and professionally assess all commonly occurring business transactions, without any outside help. In this connection an appreciation of business ethics by an honourable supervisory board member would be desirable and something for each supervisory board member to exemplify in his personal behaviour.

Against this background, an honourable supervisory board member can be taken to mean the following:

- acting within the meaning of good corporate governance: the honourable supervisory/advisory board member takes the aspects and described understanding of what is good corporate governance seriously and is guided by it in his or her decisions and actions.
- assuming responsibility for the balance of legitimate demands of all stakeholders: the honourable supervisory board member sees himself or herself responsible for striking a balance between the diverse interests of all corporate stakeholders as far as possible (stakeholder governance, loyalty).
- focus on legal mandate: the honourable supervisory board member is well aware of his or her legal mandate. This is understood to include: controlling, monitoring, and advising the management board over the long-term.
- optimising the flow of information between supervisory board and management board: in many cases it can be observed that the supervisory board is not adequately informed by the management board about decisive topics so that it is obliged to make decisions knowing only "half the story". In this respect and in keeping with good corporate governance, supervisory board members are duty-bound to procure information that is crucial for making their decisions. In this connection, particularly accounting and controlling expertise becomes considerably more important.
- showing the independence of the supervisory board members or at least making dependencies transparent: the independence aspect is given considerable weight throughout the entire good corporate governance system. In other words, supervisory board members can only perform their official duties if they are independent of the management board's interests and objectives. For example, it can be an obstacle if a supervisory board member of a bank is simultaneously a customer of that same bank and wants to ask for a loan. In this case there is a conflict of interests and one could presume that his or her independence is impaired. It also means accepting liability and observing an appropriate "cooling off" period when appointing former management board members to the supervisory board.
- professionalism: supervisory board functions are not honorary positions. In additional to personal skills, professional skills are decisive.
- compliance: each individual member must strive to meet compliance rules and regulations. Particular emphasis is placed on the early recognition of risks including a whistleblowing system.
- time budget: each member must be given sufficient time to perform his or her tasks and duties in a due and proper manner. This means putting a limit on the number of supervisory board and advisory board mandates held by each individual.
- liability: each member accepts personal liability for any breaches of his or her bounden duties. He or she understands that they have a responsibility to bear and shows a willingness to be evaluated and assessed by others.

If the aspects described above are adhered to, the supervisory board can become a hallmark of quality for its company.

The introduction of Germany's Accounting Law Modernisation Act (BilMoG) has increased the demands made on supervisory and advisory boards. Today's qualification measures already include many legal and economic aspects. What is missing is a focus on the aspects of business ethics. In trying to learn from mistakes made in the financial market crisis, considering the above-mentioned aspects of an honourable supervisory board member may prove of practical use to supervisory board members in performing their work and seeking to mitigate the effects of the recent past.

The Auditor of the Annual Financial Statements in the context of Corporate Governance Reporting by the Supervisory Board

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Starting Position

The written reporting submitted by the supervisory board to the annual general meeting and the close co-operation between the supervisory board and the auditor of the annual financial statements are two key elements of Germany's corporate governance system. Their significance was reaffirmed by Germany's Accounting Law Modernisation Act (BilMoG): Examples of this are

- the mandatory publication of a Corporate Governance Statement pursuant to Section 289a of the German Commercial Code (HGB), primarily in the case of listed stock corporations,
- the legally concretised outline of the supervisory board's activity profile pursuant to Section 107 (3) 2 of the German Stock Corporation Act (AktG) (including monitoring the auditor's independence and the additional services rendered by the auditor) and
- appointment of at least one independent financial expert to the supervisory board of listed corporations as set out in Section 264d of the German Commercial Code (HGB) (pursuant to Section 107 [4] in conjunction with Section 100 [5] of the German Stock Corporation Act [AktG], Section 324 of the HGB).

This underlines the fact that the legislator seeks to sensitise the supervisory board as regards its intrinsic duty to monitor the audit of the annual financial statements. A similar approach is evident in the current plans of the EU Commission in their controversially discussed Green Papers.

Empirical Analysis of the Quality of Corporate Governance Reporting

We analysed the annual reports – primarily the reports issued by the supervisory board to the annual general meeting pursuant to Section 171 (2) of the German Stock Corporation Act (AktG), the corporate governance reports pursuant to Section 3.10 of the German Corporate Governance Code (DCGK), and the Corporate Governance Statement pursuant to Section 289a of the German Commercial Code (HGB) – for fiscal year 2007 (prior to the Accounting Law Modernisation Act [BilMoG]) and fiscal year 2009 (after BilMoG) of 150 stock corporations listed on the DAX (28), TecDAX (25), MDAX (48), and SDAX (49). An evaluation was made of the following information provided by the supervisory board:

- assessment of the auditor's independence including the auditor's statement of independence,
- submission of the nomination proposal to the annual general meeting,
- engagement of the auditor,
- determination of the focal points of the audit,
- fee agreement and
- examination of the audit report by the supervisory board.

In addition to evaluating index-related reporting levels, the possible impact of the Accounting Law Modernisation Act (BilMoG) was also examined.

The survey led to the following overview of analysis results, the first figures in each case relating to the reported quotas for fiscal year 2007 (prior to BilMoG) and the second figures to the corresponding quotas for fiscal year 2009 (after BilMoG).

Summary of Analysis Results

Auditor´s Independence including Obtaining and Evaluating the Auditor's Statement of Independence

Monitoring the auditor's independence pursuant to Section 107 (3) 3 of the German Stock Corporation Act (AktG) is connected directly with the recommendation set out in Section 7.2.1 of the German Corporate Governance Code (DCGK) regarding the supervisory board obtaining a statement of independence from the auditor as well as on the subsequent statement of independence issued by the auditor pursuant to Section 321 (4a) of the German Commercial Code (HGB) in the audit report. And yet the empirical analysis of both fiscal years produces sobering results. Only the majority of the supervisory boards of corporations listed on the DAX report on the independence of the auditor (67.9% and 82.1% respectively). The other indices show considerably lower reporting quotas [28.0% and 40.0% respectively (TecDAX); 18.8% and 41.6% respectively (MDAX); 28.6% and 40.8% respectively (SDAX)]. Nevertheless, in fiscal year 2009, the supervisory board's monitoring of the auditor's independence is more frequently addressed by the supervisory board across all indices.

The supervisory board's obtaining and evaluating of the auditor's statement of independence is in some cases mentioned only very briefly in the reports. Surprisingly the lowest quotas are to be found among corporations listed on the DAX (7.1% and 21.4% respectively), although the majority mention the assessment of the auditor by the supervisory board (67.9% and 82.1% respectively). The quotas in the other indices also show deficits [32.0% and 40.0% respectively (TecDAX); 18.8% and 41.6% respectively (MDAX); 28.6% in 2007 and 2009 (SDAX)]. Even if the report quotas show an increase in course of time – with the exception of the

SDAX – nowhere is a majority of supervisory board reporting to be found for fiscal year 2009.

Submission of the Nomination Proposal to the Annual General Meeting

Pursuant to Section 124 (3) 1 of the German Stock Corporation Act (AktG), the supervisory board is obliged to submit a nomination proposal for the auditor to the annual general meeting. This formal act and additional details on the nomination process are again given comparatively brief mention. Whereas 35.7% of DAX corporations (2007 and 2009) and 18.8% and 29.2% respectively of MDAX corporations report on this, only 2.0% and 10.2% respectively of SDAX corporations and 0.0% and 8.0% respectively of TecDAX corporations give it a mention. With the exception of the DAX, an increase in report quotas in the course of time was again determined, although big reporting deficits still exist.

Engagement of the Auditor including Determination of the Focal Points of the Audit and the Auditor's Fee

After the auditor's election by the annual general meeting, the supervisory board is obliged to engage the auditor pursuant to Section 111 (2) 3 of the German Stock Corporation Act (AktG). The overwhelming majority of MDAX corporations (83.3% and 87.5% respectively) correctly mention this in their corporate governance reporting. The other stock exchange segments, however, only show low report quotas of 64.3% and 67.9% respectively in the DAX, 44.9% and 49.0% respectively in the SDAX, and 32.0% (2007 and 2009) in the TecDAX. The increase in the reporting rates determined in the course of time is insignificant.

In addition, the engagement of the auditor is directly linked to determination of the focal points of the audit – as is recommended in Section 5.3.2 of the German Corporate Governance Code (DCGK). With the exception of SDAX corporations (34.7% in 2007 and 2009), the majority of corporations was found to mention this set of issues in their publications at a predominantly constant quota in the course of time [67.9% (DAX), 58.3% (MDAX), and 56.0% and 43.0% respectively (TecDAX)].

Apart from determining the focal points of the audit, Section 5.3.2 of the German Corporate Governance Code (DCGK) stipulates that the auditor's fee also needs to be set. With the exception of the DAX (67.9% and 71.4 % respectively), supervisory boards only address this topic briefly. In the MDAX the report quota is merely 35.4% and 41.6% respectively, in the TecDAX 28.0% and 32.0% respectively, and in the SDAX only 18.4% and 30.6% respectively.

Evaluation of the Audit Report Submitted by the Auditor

The audit report is the key information instrument the supervisory board has at its disposal for its own accounting audit pursuant to Section 171 (1) of the German Stock Corporation Act (AktG). Given the supervisory board's reporting obligations under Section 171 (2) 3 of the German Stock Corporation Act (AktG) (statement on the results of the audit submitted by the auditor), it is hardly surprising that the majority of corporations throughout all indices mention the audit report in their supervisory board accounting. The index-related analysis shows a quota of 80.0% in the TecDAX (2007 and 2009), 77.6% and 79.6% respectively in the SDAX,

Reporting of the supervisory board [fiscal year 2007 / fiscal year 2009 in brackets]	DAX	TecDAX	MDAX	SDAX
Monitoring the auditor's independence	67.9% (82.1%)	28.0% (40.0%)	18.8% (41.6%)	28.6% (40.8%)
Obtaining and evaluating the auditor's statement of independence	7.1% (21.4%)	32.0% (40.0%)	18.8% (41.6%)	28.6% (28.6%)
Submission of the nomination proposal to the annual general meeting	35.7% (35.7%)	0.0% (8.0%)	18.8% (29.2%)	2.0% (10.2%)
Determination of the focal points of the audit	64.3% (67.9%)	32.0% (32.0%)	83.3% (87.5%)	44.9% (49.0%)
Commissioning of the audit	67.9% (67.9%)	56.0% (64.0%)	58.3% (58.3%)	34.7% (34.7%)
Determination of the auditor's fee	67.9% (71.4%)	28.0% (32.0%)	35.4% (41.6%)	18.4% (30.6%)
Evaluation of the audit report	71.4% (75.0%)	80.0% (80.0%)	77.1% (77.1%)	77.6% (79.6%)

77.1% in the MDAX (2007 and 2009), and 71.4% and 75.0% respectively in the DAX. It is not only surprising that the lowest reporting quota is to be found in the DAX but that a not insubstantial share of these corporations leave out any mention of the audit report in their supervisory board reporting.

Conclusion

The analysis of annual reports for the fiscal years 2007 and 2009 of corporations listed on the DAX, TecDAX, MDAX, and SDAX reveals deficits in supervisory board reporting relating to the auditor of the annual financial statements, even if these gaps are shrinking in the course of time. This could be attributable to Germany's Accounting Law Modernisation Act (BilMoG). With the exception of the DAX, improvement potentials for supervisory board reporting seem to primarily lie in the assessment of the auditor's independence and the fee agreement. The same applies, with the exception of the DAX and MDAX, to the engagement of the auditor and, throughout all indices, to the nomination proposal. The Corporate Governance Statement set out under Section 289a of the German Commercial Code (HGB) stipulates, among other things, a "description of the working method" of the supervisory board and a description of the composition and working methods of its committees. The aforementioned examined variables are included therein, so that the partially only marginal increases in reporting rates for fiscal year 2009 are disappointing.

Over the next few fiscal years a continuing trend towards a more rigorous style of supervisory board reporting on the board's relationship with the auditor of its annual financial statements is expected. An appropriate capital market information policy regarding the cooperation between supervisory board and auditor is likely to generate positive reactions among investors and these should be exploited.

Increased Demands on the Supervisory Boards of Credit Institutions, Financial Service Providers, and Insurance Companies

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In the public eye, the financial crisis was triggered not only by financial institutions' excessive bonus payment arrangements, leading to entirely inappropriate risk-taking, but was also attributable to an insufficient degree of supervision and control. This view is shared by the European Central Bank (ECB) and the political world.

The legislator has responded by introducing a great many new regulations, particularly in the financial services sector. For example, regulations for monitoring members of supervisory bodies were introduced through Germany's Act to Strengthen Financial Market and Insurance Supervision (FMVAStärkG) of 29 July 2009, in the German Banking Act (KWG), and in the German Insurance Supervision Act (VAG). This expanded the competences of Germany's Federal Financial Services Supervisory Authority (BaFin); the dismissal procedure implemented in Section 36 (3) of the German Banking Act (KWG) provides a significant boost to its supervisory powers.

In an information sheet dated 22 February 2010, BaFin concretised the legal requirements for appointing members of the supervisory board.

Personal Requirements

Expertise

In assessing the expertise of supervisory board members, BaFin takes into account the size and complexity of institutions and service providers as well as their systemic significance for the financial markets. Relevant expertise is assumed if experience has already been gathered by being a member of the management team of a comparable company. This also applies if someone has had previous experience as a member of a supervisory body of a comparable company. In all other cases, business expertise must be proven. In as far as the required expertise has not been obtained on being appointed to the supervisory board, this can be acquired subsequently.

Reliability

Apart from the required degree of expertise, the supervisory authority attaches great importance to the reliability of the supervisory body member; the individual in question may not have anything about him or her that compromises the due and proper execution of their supervisory mandate.

First Steps in Practical Experience

Since the new regulations have entered into force, ten cases have already become known in which BaFin demanded the dismissal of the supervisory boards of credit institutions. Although no details are published by BaFin, apart from its criticism (in three cases) that there were too many supervisory mandates, BaFin also (in one case) noted a lack of basic understanding of the banking business, and (in six cases) found fault with a lack of reliability. What is more, there are critical cases in which conflicts of interest exist between supervisory board members' own economic activities and their supervision of the institute in question. If members of the supervisory board are also borrowers of the said institute, a loan that is at risk of default is generally deemed to represent a conflict of interests and hence signify a lack of reliability. However, extensive business activities – whether as a borrower or investor in the investment sector – do not necessarily represent a conflict of interests. This even applies to major borrowers within the meaning of the German Banking Act (KWG).

Reporting Obligation regarding First-Time Nomination

Companies are now obliged to report to BaFin – and the German Federal Bank – in the case of a first-time appointment to the supervisory board to say that the appointment has been made (Section 24 [1] 15 of the German Banking Act [KWG]). This report is to be accompanied by documents which allow an assessment of the expertise and reliability of the new supervisory board member. This relates to

- a police clearance certificate,
- a declaration that the individual has no previous convictions, and
- an in-depth curriculum vitae (CV).

The CV must substantially meet the customary requirements applying to business managers of financial services institutes. In individual cases, BaFin can demand additional documents if it feels this is necessary after having evaluated the aforementioned papers. In as far as supervisory board members were appointed prior to 1 August 2010, even if they are reappointed, no report to BaFin is required. However, the requirements regarding reliability and expertise also apply to such individuals; in this respect, BaFin is entitled to conduct a material review of such individuals as regards their reliability and expertise, and in extreme cases it may demand the dismissal of those it would reject on the basis of the new regulations (Section 36 [3] of the German Banking Act [KWG]).

Ongoing Duties

The duties of supervisory board members are to be seen in terms of the size and complexity of business operations in which the enterprise to be supervised is engaged. Under Section 36 (3) 4 of the German Banking Act (KWG), the legislator demands that those with supervision responsibilities exercise their supervisory and control mandate in a due and proper manner. They must support and monitor the company – even outside of regular meetings – and possibly make use of their right of access to information (cf. Section 111 of the German Stock Corporation Act [AktG]). Thus far BaFin's approach is in line with current general opinion.

The statement that a considerable change (deterioration) in the risk situation of a company requires the increased involvement of its supervisory board, i.e. (even) closer monitoring, also reconfirms the existing opinion.

Conclusion

The core duties of supervisory board members are in short: (i) relevant expertise, (ii) reliability, (iii) no conflicts of interest, and (iv) active monitoring and control of the management team. In the event of any breach of these duties, BaFin may caution the supervisory board and, if the behaviour that caused the breach persists, it may demand that the company dismiss the member in question from the board. Prior to this, BaFin will grant a hearing to the person in question, so giving the individual an opportunity to draw the consequences and resign of his or her own accord in order to protect the reputation of the company and their own reputation.

Even if the new regulations do not provide BaFin with its own power of dismissal, it has nevertheless been given the power to materially intervene in a company's own organisational matters. The first ongoing dismissal procedures show that it is not timid about using this power. On the other hand, in view of the more stringent requirements and consequences, it is to be expected that the selection of supervisory board members will now be conducted with increased scrupulousness and also lead to an increase in further training measures in existing bodies, ultimately as a means of avoiding rejection or even dismissal from the outset. If this interplay should not function (any longer), then it is difficult to rule out the additional possibility that BaFin might even be granted its own powers of dismissal.

The composition of the supervisory board should hence be reviewed on a case-by-case basis and possibly even be agreed with BaFin in advance.

Bespoke Service replaces Off-The-Peg Offers: The Next Generation of Supervisory Board Professionalisation

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"The demands made of the topmost supervisors of companies are increasing. For the German Corporate Governance Code (DCGK) requires that supervisory board members train continuously and advance their professionalisation."

This is more or less the way most advertising leaflets for training offers start, which nowadays clutter the letter boxes of supervisory board members on an almost weekly basis. The offers claim to be "excellent", "exclusive", or even "certified". However, so far there is a lack of individualised measures and offers, the very things that that are crucial for ensuring sustainable and appropriate further training within the meaning of the Code; sector-related or even company-specific aspects are not covered by the current range of offers.

Against this background, four strong partners have come together in an attempt to fill the gap. They have jointly founded the Arbeitskreis deutscher Aufsichtsrat e.V. (AdAR) (German Supervisory Board Working Group), so establishing an independent platform for supervisory board members.

The AdAR founders are the Deutsche Schutzvereinigung für Wertpapierbesitz e.V. (DSW) (German Society for the Protection of Securities Holders), the Institut für Gesellschaftsrecht der Universität zu Köln (Company Law Institute of the University of Cologne) under the auspices of Professor Barbara Dauner-Lieb, the Cologne-based company law expert and lawyer Dr. Stefan Siepelt from the law firm LLR, and the Bundesanzeiger Verlag (publisher of the German Federal Gazette). They are further supported by a close-knit network of renowned experts covering all aspects of the work performed by those with supervisory mandates. The AdAR is hence able to serve the practical requirements of supervisory board work in a professional manner by combining academic excellence with practical experience.

In keeping with the requirements of the Code, the AdAR seeks to promote professional, effective, and conscientious supervisory board work. This is intended to strengthen a corporate culture that is crisis-resistant, oriented to sustainable growth, and conscious of its overall responsibility to society at large – doing so not only, as previously, on the basis of sporadic training offers but by providing a permanent platform, continuously serving the needs of individual supervisory board members or the board as a whole.

But how can this work in day-to-day business and how can this noble objective be sustainably achieved? AdAR has developed a number of services for this very purpose, all of them oriented to the needs of individuals with a supervisory mandate.

Existing or upcoming holders of supervisory mandates can visit the new website www.adar.info and find comprehensive case-oriented and solution-oriented guidance with a specially developed dictionary for supervisory board members, an online library, and a full-text repository of all relevant court rulings and essays.

In addition, members receive the new, high-quality specialist journal for supervisory board members, entitled BOARD. It is published every two months and provides information on all current topics, such as liability issues concerning supervisory board members, remuneration issues (concerning supervisory board members and management board members), accounting issues, and the information rights and obligations of the governing body.

As an independent and competent platform for companies and mandate holders, AdAR hence offers a continuous service of understandable information and practice-oriented first aid as well as a continuous exchange with specialists and other supervisory board members.

Apart from all else, AdAR offers training courses which, in keeping with the AdAR concept, strongly emphasise the uniqueness of individual requirements. The AdAR network enables training courses for supervisory board members to be held in the form of individually coordinated, modular in-house training courses that can be arranged before, during, or after supervisory board meetings. In other words, the coach comes to the supervisory board member and not the other way around. The supervisory body is free to pick out the topics it particularly wishes to focus on from a modular toolbox concept. There is an additional advantage: since the coaching only involves the supervisory board members of a single company, confidentiality is preserved and the very basis for fruitful debate is hence given. This simultaneously improves the efficiency of the supervisory body.

In order to enjoy these benefits, only the interested company needs to become a member of the AdAR, not the individual supervisory board member. This meets two Code requirements at once: supervisory board members have the opportunity to improve their skills using AdAR training offers and companies can support the education and further training of their supervisory boards by dint of their AdAR membership.

Current developments in the EU on the Auditing Green Paper

On 13 September 2011, the European Parliament adopted a Resolution[1] on the EU Commission's Green Paper on Auditing.[2] The main points of this Resolution are summarized below.

With reference to corporate governance, attention is drawn to the need for debate about the role of the audit to be accompanied both by a strengthening of the Audit Committee and also by an improvement in financial and risk reporting by companies. Thus, among other things, where an Audit Committee is compulsory, the auditor should be engaged by it and not by the Executive Board of the company to be audited. At the same time, the Audit Committee members should have relevant experience, and at least half of them should have experience of accounting and auditing. The audit committee should then take measures to ensure the independence of the auditor, in particular with regard to the consulting services the auditor provides, or offers to provide.

Regarding invitations to tender for the audit of public interest entities, the Commission should provide regulations under which, in addition to the Big Four accounting firms, fair access to the tendering procedure is afforded to at least two others. Audit Committees should play a key role in the selection procedure, which should also involve the shareholders. The final decision of the shareholders on the appointment of the auditor should be based on a proposal by the Audit Committee, in which the tendering procedure and also selection criteria used are described and the reasons for the recommendation are given.

While the Parliament does see, in the mandatory rotation of auditors, a possibility for strengthening the independence of the auditor, it nevertheless continues to consider the regular internal rotation of the partner responsible for the audit, rather than external rotation, to be the best regulatory solution. Likewise, the Parliament acknowledges that joint audits could have positive effects on diversification in the auditing market, but at the same time points to varying experience in the individual Member States. Any proposals for the introduction of external rotation or joint audits require, in the Parliament's opinion, a careful assessment of their impact.

With regard to the compatibility of audit and non-audit services, the Parliament takes the view that a clear dividing line should be drawn between audit and non-audit services, in order to avoid conflicts of interest and comply with the profession's codes of conduct. The Commission is asked to create a list of conditions under which certain services are considered to be incompatible with auditing. Approval of and agreement to services which are in principle permissible should moreover be the prerogative of the Audit Committee. Any introduction of revenue-dependent limitations on non-audit services presupposes in the first instance an impact assessment as regards the consequences and feasibility of such a scheme.

In connection with the audit of consolidated financial statements, the Parliament follows the proposals in the Green Paper and stresses the necessity of the Group auditor having a clear overview of the group. When auditing financial institutions whose Groups are subject to supervision, the Group auditor should be in dialogue with the competent supervisory authority.

Finally, the Commission is prompted, with regard to the auditing market, to ensure a level playing field among auditing firms and to simplify the rules in the auditing area at the European level. Easier market access and the removal of barriers to market entry are seen as key elements, whereby companies' Audit Committees are more likely than their Executive Boards to be in a position to determine the type of audit best suited to the needs of the audited companies and to monitor the audit's effectiveness and quality. Furthermore, a prohibition of contractual clauses that limit the selection of auditors to the Big Four auditing firms is considered essential.

A legislative proposal could be presented by the EU Commission in November 2011.

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1 See European Parliament Resolution, available at http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P7-TA-2011-0359+0+DOC+XML+V0//EN

2 For the EU Green Paper on auditing see also "Corporate Governance Forum Special Issue: EU Green Paper Auditing", available at http://www.corpgov.deloitte.com/site/uk/ or http://www.corpgov.deloitte.com/site/us/

Local Authority Supervisory Board Members: Their Duty of Confidentiality and their Obligation to follow instructions

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The public sector is increasingly utilising corporate entities under private law (AGs [stock corporations], GmbHs [limited companies]) to fulfil its tasks. Local authorities seek to secure their influence by seconding representatives to the supervisory boards of such companies. It is not unusual for people to expect that the same degree of influence and control can be exercised there as is typically possible in an owner-operated municipal enterprise. However, the seconded supervisory board members are in actual fact caught in a conflict between satisfying the requirements of communal law and fulfilling the obligations of company law. This conflict takes on particular practical relevance when weighing up company law non-disclosure obligations against local authority and civil servant reporting and disclosure duties and when weighing up the independence of the supervisory board mandate against local authority representatives' obligation to follow their instructions.

General Autonomy of the Supervisory Board Mandate

Contrary to the corresponding rules set out in many local authority ordinances, supervisory board members of owner-operated municipal enterprises are not duty-bound to follow instructions since in their particular case company (*private*) law takes precedence over federal state (*public*) law. This is wholly true for supervisory board members serving in German stock corporations (AGs). They are tasked with autonomously monitoring the board of directors (Section 111 [1] of the German Stock Corporation Act [AktG]) and hold an office demanding a high degree of personal responsibility (Section 111 [5] of the AktG), concerning which, by the same token, they are personally liable for their actions (Section 116 [93 ff.] of the AktG). This does not mean that the interests of the public sector can be ignored in decisions taken by the supervisory board member. However, each individual member is free to decide how to reconcile both duties. In cases of doubt, precedence must be given to the interests of the company.

A distinction is made in the case of a German limited company (GmbH). If establishing a supervisory board is mandatory, for example due to the requirements of the German Act on Workers' Codetermination Rights (MitbestG), compliance with the pertinent stock corporation law regulations is also mandatory in this case. If the supervisory board is optional, though the German Limited Liability Companies Act (GmbHG) also refers to the pertinent regulations under stock corporation law, the latter only apply if nothing to the contrary is stipulated in the shareholders' agreement (Section 52 [1] of the GmbHG). Hence, if the shareholders' agreement incorporates no particular provisions in this respect, the stock corporation law principle of an autonomous mandate correspondingly applies. However, if the local authority wishes to be able to exercise a right to instruct the supervisory board members, it can establish such a right by explicitly including it in the shareholders' agreement or by making reference to the local authority ordinance in the shareholders' agreement.

Ability to Limit the Confidentiality Obligation

The supervisory board members of a German stock corporation (AG) are bound to confidentiality regarding confidential reports and talks (pursuant to Section 116 [2] of the German Stock Corporation Act [AktG]). In the case of regional authority representatives this obligation is limited to the extent that the latter are subject to a legally embedded, public sector reporting obligation (pursuant to Section 394 of the [AktG]). However, this does not establish a general duty to provide information or reporting obligation/authorisation with regard to local councils, parliaments, or parliamentary groups. Instead the report is to be rendered to the regional authority's representative (e.g. mayor) or to such individuals as manage the local authority holdings or monitor the activities of local authority supervisory board members and are hence bound to confidentiality themselves (pursuant to Section 395 of the [AktG]).

In the case of a mandatory GmbH supervisory board, the above-mentioned comments concerning an AG apply. But the member of an optional supervisory board also has a reporting obligation even without this being expressly stipulated in the shareholders' agreement since the GmbH, which is based on personal relationships, provides no scope for maintaining confidentiality between the supervisory board and a (sole) shareholder (Section 51 a (1) of the German Limited Liability Companies Act [GmbHG]). However, here again, provided nothing to the contrary is stipulated in the shareholders' agreement, it is to be assumed that confidential information is only to be provided to the aforesaid special local authority representatives.

Practical Implications

Prior to deciding in favour of a private law company structure, local authorities should consider the mandatory legal restrictions while also actively exploiting the existing legal structuring possibilities.

In addition to meeting requirements stipulated under public law, supervisory board members should not ignore their obligations under the shareholders' agreement and – last but not least to avoid personal liability – they should call for a clear structuring of their rights and obligations. When disclosing sensitive information the necessity for disclosure and the appropriate recipients should be considered, and the underlying reasons for decisions should also be documented.

"There can be only one …" – Earnings Reporting under IFRS

What is performance? What is understood under profit (for the period)? What are the earnings achieved in the said period? These are questions that have occupied the International Accounting Standards Board (IASB) since its establishment all of ten years ago. And an answer is still not in sight.

This much we know at least: the International Financial Reporting Standards (IFRS) include, apart from the familiar P&L (income statement) and its items "net income" or "net loss", a second statement known as "Other Comprehensive Income" (OCI). And although valuation results were reported outside the traditional P&L as far back as the start of the 80s, in those days they were not yet recorded as a measure of earnings but as a component of equity.

We also know valuation results from German accounting: there they are called "Abschreibungen" (write-downs) and "Zuschreibungen" (write-ups) or "Wertaufholungen" (reversal of impairment losses). The reason for recording write-downs and write-ups is the circumstance that an item's fair value no longer corresponds to its current book value (carrying amount) but is either lower or higher. The self-understood practice of recording a write-up or write-down in the P&L under German commercial law is, in terms of international accounting, only one of the possible ways of documenting them: under certain circumstances the change in value is not recorded in the P&L but in OCI. This has given birth to the German word pair "erfolgswirksam" (recognised in earnings [literally: with an impact on earnings], for value changes reported in the P&L) and "erfolgsneutral" (not affecting net income [literally: with a neutral impact on earnings], for value changes recorded in OCI).

Even today the term OCI is still often associated with a company's valuation reserves. That is not entirely wrong, but not entirely correct either. For since 2007, the IASB has determined that a company's OCI is part of its value added: together net income/loss and other comprehensive income (OCI) make up what is called comprehensive income. Hence OCI is not a valuation reserve but the valuation result. This subtle distinction lies in the period under review: the valuation result is the net balance of value changes in a period that are not recorded in the P&L (income statement), the valuation reserve is a collective item for recording the accumulated valuation results (gains and losses) from all previous periods.

The change that was introduced in autumn 2007, and reconfirmed only recently in June 2011, is much more than a mere semantic clarification: the IASB was concerned that companies were giving too much weight to the result for the period and only mentioning the valuation results in passing. Hence the board decided to put the result for the period together with other comprehensive income to form comprehensive income and make it obligatory to report the item; the board felt this was a way of putting things right again. Somehow one cannot help thinking of the film "Highlander": "There can be only one...".

The fact that this change has passed many analysts by with little or no effect is ultimately down to the fact that the IASB permitted companies to

- use other terms for the earnings statement and
- record earnings either in a single overall statement or in two successive statements – an Income Statement and Other Comprehensive Income (OCI).

As good as all companies have used the two-statements option – hence implicitly letting the IASB know what they think of its rule!

The question therefore remains, what is to be recorded inside the income statement and what is to be recorded outside. But this is exactly where there has so far been neither a conceptual basis nor consensus. A fair number of people see Other Comprehensive Income as covering everything one wants to leave out of the income statement, regarding OCI as little more than a refuse dump. Others say OCI should include those valuation gains which actually occurred from a reporting date point of view but which would largely be cancelled out in the course of time. They believe these should only be reported in the income statement once they have been realised, resulting in a transfer from OCI to the result for the period – vividly conveyed by the term "recycling". However, in the meantime, (accumulated) other operating income also includes items that are never recycled, so this statement alone is insufficient. At least, in its latest amendment, the IASB demands that items that are recycled must be denoted as such within OCI – a cold comfort!

In conclusion, it can be said that some rethinking is needed to fully take in the new and unfamiliar composition of IFRS earnings.

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Events

- **Deloitte Executive Dinner with David McAllister, Prime Minister of Lower Saxony. Topic: "Challenges for a sustainable recovery"** Hannover, 24.10.2011
- **Deloitte Executive Dinner with Volker Bouffier, Prime Minister of Hessen.** Frankfurt, 22.03.2012

Publications and further information

- Plendl/Kompenhans/Buhleier: The Audit Committee of the stock corporation – Practical Guideline for Supervisory Board Members (book available in German only)
- Deloitte Global Center for Corporate Governance: Women in the boardroom – A global perspective
- Director`s Alert: 11 for 2011
- Audit Committee self-evaluation: Aid to efficiency checks, 2nd edition
- Supervisory Board self-evaluation: Aid to efficiency checks, 2nd edition
- Supervisory Board self-evaluation: Aid to efficiency checks for municipal enterprises (available in German only)
- Global Economic Outlook Q3 2011
- On an adventure?: an inspection by the Financial Reporting Enforcement Panel (Deutsche Prüfstelle für Rechnungslegung, DPR). Information on the enforcement process of the DPR (available in German only)
- Finance & Accounting Forum – An update for the finance organisation (available in German only)
- RA Dr. Klaus Cannivè/WP StB Andreas Suerbaum: The Fairness Opinion on Non-Cash Capital Increases in German Stock Corporations: Legal and formal requirements according to IDW S 8, in: Die Aktiengesellschaft, Heft 09/2011, S. 317–326

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