STUDY

Requested by the ECON committee

What are the wider supervisory implications of the Wirecard case?

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PE 651.385 - November 2020

EN

What are the wider supervisory implications of the Wirecard case?

Abstract

The paper discusses the policy implications of the Wirecard scandal. 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. To ensure market integrity and investor protection in the future, the authors make eight suggestions for the market and institutional oversight architecture in Germany and in Europe.

This document was provided by the Economic Governance Support Unit at the request of the ECON Committee.

This document was requested by the European Parliament's Committee on Economic and Monetary Affairs.

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Original: EN

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Manuscript completed in May 2020
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[1] Katja Langenbucher is Member of BaFin's Supervisory Board. The opinions expressed in this paper are entirely her own and do not reflect a position taken by BaFin.

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LIST OF ABBREVIATIONS

ACP	Autorité de Contrôle Prudentiel
AktG	Aktiengesetz (Stock Corporation Act)
AMF	Autorité des Marchés Financiers
AOB	Auditor Oversight Body (Abschlussprüferaufsichtsstelle, APAS)
BaFin	Bundesanstalt für Finanzdienstleistungsaufsicht
CONSOB	Commissione Nazionale per le Società e la Borsa
DAX	Deutscher Aktienindex (German stock index)
ESCMS	European Single Capital Market Supervisor
ESMA	European Securities and Markets Authority
EU COM	European Commission
FCA	Financial Conduct Authority
FRC	Financial Reporting Council
FREP	Financial Reporting Enforcement Panel (Deutsche Prüfstelle für Rechnungslegung,
FRRP	Financial Reporting Review Panel
FT	Financial Times
HGB	Handelsgesetzbuch (Commercial Code)
H3C	Haut Conseil du Commissariat aux Comptes
IFRS	International Financial Reporting Standards
MAR	Market Abuse Regulation
NCA	National Competent Authority
PCAOB	Public Company Accounting Oversight Board
PIE	Public interest entity
PRA	Prudential Regulation Authority
SEC	Securities and Exchange Commission
SSM	Single Supervisory Mechanism
SSR	Short Selling Regulation
TD	Transparency Directive
WpHG	Wertpapierhandelsgesetz (Securities Trading Act)

EXECUTIVE SUMMARY

This policy briefing explores possible policy lessons from the downfall of Wirecard, the German fintech payment provider, then listed in the country's top stock market segment DAX. In our view, all five lines of defence against corporate fraud and deception have failed in one way or another: the company's internal control system, its supervisory board, its external audit, the oversight bodies for financial reporting and auditing and, last but not least, the market supervisor BaFin. The slow unravelling of Wirecard is surprising as there were a number of signals suggesting fraudulent behaviour years before its eventual revelation. Our analysis finds a root cause to be a flawed market and institutional oversight architecture, implicating all five lines of defence. In its current form, it is not sufficiently fit to preserve market integrity and investor protection. To improve the system, we suggest changes at the national as well as the European level. In fact, we understand the Wirecard scandal in Germany as a potentially pivotal event for Europe's capital market, triggering a regulatory reform of financial market oversight that ultimately improves its competitiveness among global capital markets.

Our policy conclusions aim to ensure the integrity of the capital market by strengthening accountability. Towards this end, we propose to improve the information flow to markets and supervision, respecting whistleblowing and short selling as important information sources. The accountability of external auditors has to be strengthened so that they have stronger incentives to detect accounting manipulations and fraud, which enhances the information value of audits for capital markets and ultimately the accuracy and credibility of firms' financial reporting. To strengthen internal control mechanisms, listed firms should be legally required to have an appropriate and effective internal control system. We recommend that its head reports to the supervisory board, not to the management board. Internal control audits should be considered. BaFin needs considerably stronger supervisory and enforcement powers in order to live up to its overarching mandate as to market integrity and investor protection. We recommend entrusting the agency with broad enforcement powers, including forensic and investigative tools. These changes also entail relegating self-regulatory enforcement bodies such as FREP in Germany to a purely ancillary, optional function. Along with strengthening its powers, we propose to clearly establish the supervisory agency's accountability for fulfilling its overarching mandate. This accountability requires an appropriate level of institutional independence as well as sufficient resources to fulfil its tasks. Finally, we submit that Wirecard holds lessons that go well beyond the German market and oversight system. Considering the negative spillovers of fraud cases in a European market and anticipating that national interests may play a role in market supervision, which also creates unhelpful externalities, we suggest establishing a European Single Capital Market Supervisory body (ESCMS). Given that national supervisors are highly knowledgeable of the local situation, we recommend integrating them into a European supervisory network. A hub-and-spoke architecture with clear reporting lines to the hub will also introduce an element of institutional independence into national agencies and make regulatory capture harder.

PREFACE

Wirecard was initially founded as a German fintech in Munich in 1999. After an interlude of insolvency in 2001, Wirecard was listed in 2005 in the Deutsche Börse's Prime Standard market segment. It became a leading fintech company in Germany, focusing on payment and risk management services in the debit and credit card business in Europe, Asia and America. It moved up to the Tec Dax in 2006 and, in 2018, to the DAX, the top index segment of the German market. Starting in 2015, there were allegations about accounting inconsistencies, esp. in the Financial Times (FT) which wrote about a "House of Wirecards", partly based on whistleblower information about the Singapore operations of the firm. In 2016, an analyst report, known as the Zatarra Report, accused Wirecard of money laundering and fraud. Following this report, there was significant short selling of the Wirecard stock, some of which BaFin referred to the German prosecutor for market abuse, leading to indictments and settlements.

After another detailed report in the FT, in January 2019, BaFin requested an investigation of Wirecard's financial statements by the Financial Reporting Enforcement Panel (FREP). FREP is a private agency, entrusted with a public mandate. It has been set up as the "first step" in the German "two-step procedure" of financial reporting enforcement. When short selling peaked again, BaFin intervened and prohibited increases in net short sale positions for a period of two months, in accordance with the European Securities and Markets Authority (ESMA). It also filed a criminal complaint against a number of short sellers as well as the journalist who had authored the January FT article. The FT continued to report on allegedly inflated sales and profit numbers at Wirecard, backed up with internal documents. In October 2019, KPMG was hired by Wirecard to conduct a forensic investigation. The report was published with several delays in April 2020, stating that KPMG was unable to verify the existence of 1 billion Euros in foreign bank accounts. BaFin filed a criminal complaint against Wirecard in June 2020 and, a few days later, the company filed for bankruptcy acknowledging that financial assets of 1.9 billion Euros were missing.[2]

This policy briefing has been commissioned by the European Parliament. The paper was written in the months of September and October 2020 by the four authors Jan Krahnen, Katja Langenbucher, Christian Leuz and Loriana Pelizzon. We are grateful for discussions with, and valuable comments from a number of colleagues who spoke to us or read a draft of the paper: Ray Ball, Jannis Bischof, Joachim Böcking, Joachim Hennrichs, Tom Huertas, Maximilian Muhn, Christian Laux, Christophe Moussu, Eugene Soltes, and Michael Troege. We also thank Elisabeth Roegele and her team at BaFin for discussing several questions relating to short selling, audits and supervisory governance in a telephone call on September 30. Last but certainly not least, we are deeply thankful for the intensive support given to us by Johannes Kasinger, Head of SAFE Policy Center, and excellent research and editorial assistance by Patrick Blank and Patricia Breuer.

[2] A detailed timeline for the Wirecard history from 2019 onwards is in Appendix A, in the Annex to this briefing.

1. MARKETS, OVERSIGHT AND THE WIRECARD CASE

Capital markets are a powerful instrument to allocate resources from investors to issuers, i.e. firms and states. A well-functioning capital market is a key determinant of economic growth as well as of private and public wealth. The term "capital market" refers to a complex institutional structure, comprising various contractual arrangements, regulatory or legal rules, and enforcement mechanisms, physical and virtual trading venues, and a variety of financial instruments, like stocks, bonds, derivatives, and currencies, owned by a variety of investors. Together with the banking system, the capital market provides the financial infrastructure of the economy. As in banking, trust in the proper functioning of the capital market is a prerequisite for it to play its beneficial role. It is, for instance, critical for broad investor participation (Guiso et al. 2008).

Scandals such as Wirecard can destroy investor trust in capital markets working fairly and with integrity, which in turn creates negative spillover effects. Scandals can make it harder for other, non-fraudulent firms to raise capital as investors raise the risk premium or choose to no longer participate in the market (e.g. Aggarwal and Wu 2006; Kyle and Viswanathan 2008; Giannetti and Wang 2016; Gurun et al. 2018). It is for this reason that fraud deserves attention. In essence, trust in the capital market is a (valuable) public good. Among other things, it requires assurance that corporate insiders do not embezzle investors' money (e.g. Shleifer and Wolfenzon 2002).

For this reason, countries' legal frameworks and capital market regulation aim to facilitate capital formation and market transactions and, at the same time, to protect market integrity and investors. This typically encompasses financial reporting and disclosure requirements, anti-fraud provisions, restrictions on insider trading and market manipulation, limits on self-dealing by corporate insiders, and corporate governance stipulations. However, rules alone are not sufficient. Investors need to trust that compliance with these rules is monitored and, if necessary, enforced. Therefore, well-functioning capital markets also require effective public and private enforcement mechanisms. Effective capital market regulation *and* enforcement contribute to the development of the capital market (e.g. La Porta et al. 2006) and lower firms' cost of capital (Hail and Leuz 2006; 2009). These arguments form the economic basis for supervisory mandates in many countries. To illustrate: the US Securities and Exchange Commission (SEC) describes its mission as one "to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation" (SEC 2013). In a similar spirit, BaFin's website states: "The objective of securities supervision is to ensure the transparency and integrity of the financial market and the protection of investors."

Consistent with these objectives and the above economic arguments, we use market integrity and investor protection as the guiding principles for the analysis in this policy briefing. The goal is to draw a number of wider lessons from the Wirecard case. At the start, it is natural to ask: Why did the scandal – fraud and deception at Wirecard – remain undetected for so long? Who or what is to blame? Was it due to deficiencies in institutional and legal design, supervisory failures, professional negligence or (moral) failures of the perpetrators?[3] Common sense dictates that, in the end, the scandal is due to a mix of reasons. In this briefing we will try to identify major reasons for the occurrence and slow detection of the scandal, emphasising the role of institutional deficiencies. These deficiencies can, in principle, be mitigated by reforming market and oversight institutions as well as supervisory agencies.[4]

[3] See Soltes (2016) on the complex reasons why executives engage in white-collar crime.

[4] The German government has recently issued an action plan to fight accounting fraud and to strengthen control in capital markets. This plan contains several proposals consistent with our suggestions. Given its recent issuance, and the fact that it outlines possible steps still to be taken, we will not discuss this action plan in our paper. More details can be found here.

We realise that, even with much more stringent market and institutional oversight, fraud will probably never be completely prevented. But this cannot and should not be the overall objective of regulatory effort anyway, as it would be excessively costly to businesses, and stifle capital formation and market transactions. That said, well-functioning capital markets needs equally well-functioning market and regulatory oversight. Without it, capital markets cannot deliver their positive contributions to the formation and allocation of capital in an economy. The Wirecard scandal has revealed major weaknesses in this oversight in Germany, especially with respect to investor protection and market integrity. Moreover, we believe the Wirecard scandal holds broader lessons for European capital market oversight.

In this policy briefing, we discuss four shortcomings of market and institutional oversight that the Wirecard case has brought to light: Shortcomings with respect to whistleblowers and information flows into prices (section 2.1); Weaknesses of external audits, internal controls but also market forces when it comes to Wirecard's accounting information (section 2.2); Limitations in the supervisor's investigation and enforcement powers, limiting its ability to take the appropriate action when needed (sections 2.3 and 2.4); The potential for negative externalities and the risk of supervisory capture in a fragmented European capital market (section 2.4). All four limitations give rise to far-reaching reform proposals of the oversight system in Germany and Europe. Those proposals are summarised in section 3.

2. WEAKNESSES OF MARKET AND INSTITUTIONAL OVERSIGHT

The criticism of the market and institutional oversight in Germany, discussed in this chapter, is not expressed lightly. We are well aware of the risk of judging with hindsight bias, and thus do not intend to point fingers based on information that was probably not available at the time. The main purpose of this briefing is to discuss what we learn from the scandal so that we can improve the market and institutional oversight system.

2.1. Information flows blocked

Securities prices need to be as accurate as possible at any moment in time, relying on a free flow of information into prices. An institutional architecture allowing for availability of and equal access to information makes for a high level of confidence in fair treatment in markets by investors. This is a prerequisite for securities markets to play an important role in capital formation of an economy. Market supervisors are seen as guarantors of this feature of capital markets. In Germany, the capital market supervisor is integrated in BaFin, the supervisory agency for banks, markets and insurance companies.

In this section, we focus on two elementary channels of information flow that can contribute to the discovery of fraud and the accuracy of market prices. The first channel is whistleblowers who directly point out fraudulent behaviour to management, auditors, supervisors, and/or the general public. The second channel is short sellers who build up speculative positions in single securities, based on negative information they have received and which is not yet reflected in market prices. Both channels, whistleblowing (when acted upon) and short selling contribute to price accuracy, reflecting the fundamental value of the firm in question (Duffie et al. 2002). The Wirecard case sheds light on the importance of the accuracy of the stock price since an early and significant decline of Wirecard's market price might have raised the level of scepticism and scrutiny by investors, banks, rating agencies and supervisors, which would have been needed to avoid a scandal of the Wirecard dimension.[5]

Whistleblowers

When fraud is uncovered, we often realise that early warnings were missed or ignored. Making sure that early providers of information will be heard by the relevant parties and be taken seriously is crucial (see, e.g. Call et al. 2018; Dyck et al. 2010). Such information can take various forms, e.g. critical reports by analysts and short sellers, negative press reports, and whistleblowing from within the firm as well as outside business partners, or in some cases from the auditor. At Wirecard, several of these information sources were active at one time or another, but did not receive the attention that (at least ex post) they should have deserved. In several cases, these critical voices were silenced, or at least not sufficiently heard, by the addressees, the auditor and the supervisor (see Appendix A).

Having said that, we must not fall victim to hindsight bias: there may have been – and probably always will be – many whistleblowers at the same time, some with true information, others just disgruntled employees, and still others with market manipulation in mind. It will be difficult to tell one from the other. Supervisory attention, therefore, needs an analytical process of *escalating* attention and scrutiny in order to identify what is likely relevant information, and what is likely not. Not surprisingly, the single most relevant whistle is often not known until much later and the fraud has been revealed.

Since whistleblowing is a way for insiders to warn about ongoing fraud at an early stage, we recommend effective policies to encourage insiders to reveal their knowledge to the responsible

[5] We do not discuss the trading activities by BaFin staff in the months before the Wirecard collapse, which have received wide attention in the public debate, and led to a trading ban for BaFin staff (Reuters 2020a). Nevertheless, we have too few details about the case and therefore feel unable to assess the facts and potential implications properly.

agencies. At a minimum, whistleblowers should be credibly protected from job-related or other repercussions and prosecution as provided for in the EU Whistleblowing Directive 2019. Going beyond that, we recommend considering financial incentives to overcome the threat of personal penalties. SEC practice of handing out significant monetary rewards to provide positive incentives for whistleblowers could be a model for that (Dyck et al. 2010).[6] Additionally, a duty to follow up on anonymous whistleblowing should be considered.

Short sellers

Another information channel that has played a role in the Wirecard case is short selling.[7] It contributes to information processing in stock market prices by allowing investors who have negative information about a company to trade on that information.

Conversely, prohibiting short sales introduces an element of asymmetry into the pricing process, as downward pressure on prices is reduced one-sidedly. If short sales are banned, information is less likely, and slower, to be reflected in stock market prices (e.g. Beber and Pagano 2013; Fang et al. 2016).[8] That is why a short sale ban as instituted for Wirecard stock between February and April 2019, has likely harmed investors, who subsequently bought stocks at excessive prices. The short sale ban's effect on prices and investors is exacerbated because some investors may have inferred mistakenly from the intervention that BaFin possessed private information that the short sellers were actually wrong.

When deciding on a short sale ban, the EU Short Selling Regulation requires an assessment of the negative effects on financial market stability that may arise if extensive downward price pressure endangers market stability through contagion effects. More concretely, EU 236/2012 on "Short selling and certain aspects of credit default swaps" requires the regulator to show that financial stability and market confidence is endangered, and the proposed measure –the ban– is subjected to a proportionality test. Note that the two criteria just mentioned, i.e. market stability and market confidence, both refer to the market as a whole and not merely to the single stock that is subjected to the ban.[9]

BaFin banned opening or increasing net short positions on Wirecard shares (as defined in article 3(4) of the Short Selling Regulation) after the approval of ESMA on 18 February 2019. According to the public notification (ESMA 2019), the ban was justified by a substantial increase in the volatility of Wirecard shares, observed after the first FT report on January 30. The increase in volatility was interpreted as reduced market confidence in the reliable formation of prices that might extend to other DAX issuers. We find this argument to be unconvincing, or at least incomplete. If excessive volatility is the concern, there are other instruments to calm down the market, like a trading suspension. With these interventions all orders are held back for a short interval, and a new market clearing price can be determined.[10] These interventions might at first glance be perceived as "stronger" than a ban of

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[6] A recent EU Directive on Whistleblower Protection (Directive (EU) 2019/1937 of 23 October 2019) which includes financial services and markets is a first step; a positive incentive scheme for anonymous whistleblowing is not included.

[7] A short sale happens when a security is sold today for delivery at a later date, and the sale is covered only at that second date, i.e. the would-be seller does not hold the stock initially, be it owned or borrowed, the transaction is called a naked short sale, otherwise it is a covered short sale. The former is illegal in most jurisdictions. See Duffie et al. (2002) for details.

[8] Another example is Kaplan et al. (2013). See also the pertinent blog post by Christian Schlag in March 2020.

[9] From ESMA (2019), point 24 on p. 4: *"ESMA believes that the price drop, the sharp increase in the net short positions and the high volatility observed in the prices of Wirecard shares constitute a threat to the orderly markets and to market confidence if those circumstances have not been caused by the release of fundamental information related to Wirecard."*

[10] Lehmann and Zetzsche (2020) come to a similar conclusion, noting that the proportionality test by BaFin seems insufficient and the notification of the short sale ban did not include verifiable facts that substantiate a detrimental effect on other companies.

increasing net short positions. However, the key is that they are *symmetric* and therefore do not have the consequences that we discussed above.

For this reason, the conditions under which supervisors may enact short sale prohibitions should be significantly more restrictive, effectively limiting it to situations of market-wide (systemic) risk.

To sum up, the prompt reflection of new information in market prices is a key element of market integrity. Without it, security prices cannot be accurate, and liquidity may be negatively affected. We therefore recommend that supervisors respect whistleblowing and short selling as important potential gateways of information flow and treat them accordingly.

2.2. Weaknesses in external audits, internal oversight, and market forces

In this section, we discuss the role of key *private* oversight institutions in the Wirecard case, i.e. the external auditors, companies' internal controls, the supervisory board and outside investors. The scandal has exposed weaknesses in all these elements, leading to several suggestions.

External Auditors

In the case of Wirecard, much of the debate revolves around its audited financial statements. The 1.9 billion Euro in bank trust accounts that are apparently "missing" put a big question mark behind the clean (i.e. unqualified) audit opinion that one of the leading audit firms in the world, Ernst & Young (EY), provided for Wirecard's financials from 2009-2018. External auditors and their audit opinions certifying the financial statements play a critical role in the oversight system, not least because of their privileged access to corporate information. Auditors get to see their clients' books and can obtain detailed information about the underlying transactions as part of the audit. Therefore, aside from a firm's own internal auditors and controls, external auditors are the first line of defence against accounting manipulation and fraud.[11]

Fundamentally, external audits are a response to the agency problem between outside investors and corporate insiders, in particular, management. Outside investors rely heavily on audited financials to get information on what insiders do with their money. For this reason, credible financial reporting is viewed as a cornerstone of well-functioning capital markets (Summers 1999) and audits play an important role in facilitating the trust needed for broad investor participation. The credibility of audit opinions depends crucially on auditor independence. When independence or audit quality are in question, investors respond by not trusting the numbers and raising the required risk premium (e.g. Watts and Zimmerman 1983). Therefore, credible audits can generate significant cost of capital benefits for firms.[12] It is likely for this reason that listed firms have provided audited financial statements long before external audits became mandated (e.g. Watts and Zimmerman 1983; Bourveau et al. 2020).

However, as many high-profile accounting scandals in Europe and the US illustrate, auditing is not a perfect solution. A key reason are agency problems in auditing. For instance, auditors are chosen and paid by the firm they audit, which can create incentives to please their clients.[13] Moreover, auditors could cut corners to save costs or become captured by their clients over time. These and other problems with auditing are well documented (e.g. DeFond and Zhang 2014).

[11] Internal auditors are part of a firm's internal control system and employed by the firm. External audits are performed by (private) audit firms and mandatory for publicly listed issuers. For the latter reason, they are also called statutory audits.

[12] For evidence on the market pricing of reporting credibility see Gipper et al. (2020).

[13] In Germany, the Stock Corporation Act (AktG) requires that auditors are chosen at the shareholders' annual meeting, based on a proposal by the supervisory board. So, auditors are not appointed by management, highlighting the important role that supervisory boards play in independent oversight. We come back to this role below.

In principle, reputation effects, competition in the audit market and private litigation can mitigate these problems and provide incentives for auditors to be tough (DeFond and Zhang 2014). But there are various institutional and market hurdles that question the strength of these mechanisms. First of all, in many countries, auditor liability is capped by law; in Germany the maximum is currently 4 million Euro. Next, the audit market, at least for large companies, is highly concentrated. The Big Four (Deloitte, EY, KPMG, PwC) form an oligopoly and their joint market share for large publicly listed firms is close to 100%. It is important to see that high concentration likely arises from the complexity of modern audits; few firms beyond the Big Four have the network and expertise to deliver audits for large clients.[14] But regardless of the reasons for the oligopoly, it raises concerns about the competitive forces in the audit market. A case in point, audit firm rotation is mandatory in Germany and the EU, but the choice at rotation is limited, for the same reasons the market is concentrated in first place, and it can be further limited by conflicts of interest (e.g. auditing a competitor). Finally, reputation effects can only work if audit firms face penalties and, in the extreme, can fail as evidenced by the demise of Arthur Andersen in 2002 after the Enron scandal (Ball 2009).[15] But is this still realistic with only four large players remaining? We are sceptical. All Big Four auditors have had major accounting failures among their clients since Arthur Andersen went out of business.[16]

Another factor that hinders market forces is that the audit process is largely unobservable to outsiders. This is true for good reason: auditors review proprietary information, and hence there is no simple transparency solution. But it means capital markets find it hard to price differences in audit quality. Moreover, judging audit work requires a lot of technical expertise that few outsiders would have. Auditing is therefore largely a “credence good”. But this “credence good” nature is also the reason why accounting scandals have negative spillovers on the credibility of other firms’ audited financials. When investors cannot distinguish between good and bad audits, they carry over their misgivings from one to the next (Leuz and Schrand, 2009, for evidence from Enron). As noted earlier, this is a public good problem: firms with weak audits do not internalise the negative effects that their choices have on other firms and the capital market as a whole.

Audit Oversight

Public oversight of auditing, essentially monitoring the monitor, is one way to address this problem. Inspecting audit firms and reviewing the audit papers of individual engagements could, in principle, ensure a certain level of audit quality, while protecting the privacy of corporate information. This process could maintain the credibility of financial reporting and auditing.[17] Consistent with this argument, Gipper et al. (2020) study the introduction of the Public Company Accounting Oversight Board (PCAOB) after Enron and show that strict audit oversight can play an important role in ensuring audit quality and firms’ reporting credibility. Following this logic, most countries have public audit oversight bodies, although with varying powers.

[14] Audit market concentration is also related to auditors’ credibility role in public markets. Credibility comes from reputation and reputation derives from putting capital “on the line” that can be lost when performance is poor. The issue is that the build-up of reputation capital is facilitated by market concentration and limited market entry, leading to high quasi-rents for incumbents.

[15] Similar client reactions were seen in Germany after the ComROAD scandal (Weber et al. 2008).

[16] To list a few: Deloitte (Royal Ahold and Steinhoff), EY (Anglo Irish), KPMG (ComROAD and Flowtex), PwC (BT Italia and Tesco). Of course, there are also examples for non-Big Four auditors: BDO (Pescanova), Grant Thornton (Parmalat and Patisserie Valerie).

[17] But public audit oversight is not a panacea. We know from regulatory economics that public sector supervisors face significant problems, such as resource constraints, lack of sufficient expertise, regulatory capture, and political pressure (e.g. Demsetz 1968; Stigler 1971; La Porta et al. 2006). These issues can also arise with public oversight of the audit profession and, at a minimum, require careful design of and sufficient funding for the oversight body.

In Germany, the public "Auditor Oversight Body" (AOB) is part of the Federal Office for Economic Affairs and Export Control. Its role is to uphold professional standards and the quality of external audits for publicly listed firms. The AOB carries out regular audit firm inspections on a risk-oriented basis, taking into account the type and scope of an audit firm's engagements.[18] Importantly, however, the AOB does not disclose its inspection results for individual audit firms to the public. There is only an annual report describing the AOB's activities in the aggregate. In contrast, the US PCAOB discloses its inspection findings at the audit firm level (not for individual engagements), which provides useful information to clients and investors.[19]

Auditors and Audit Oversight in the Wirecard case

How did auditors and audit oversight perform in the case of Wirecard? Answering this question is very difficult because there is relatively little public information about audits and audit oversight. Much of what we know is from press reports and KPMG's forensic report, commissioned by Wirecard at the end of October 2019. EY provided no qualifications to or comments in its audit opinions for the 2015-2017 financials, which is surprising in light of serious allegations in the FT in April 2015 and the Zatarra Report in February 2016. EY still issued an unqualified opinion for 2018 but provided comments on the allegations in Singapore. It was not until 2020 that EY withheld its clean audit opinion for the 2019 financials.

Press reports allege that EY was content with balance confirmations for large escrow accounts at Singapore's second largest bank issued in the name of a trustee (Storbeck 2020a). KPMG's forensic report (2020) not only states that it was unable to verify the existence of these accounts but also questions whether it was appropriate to classify these escrow accounts as cash or cash equivalents under IFRS (p. 34). The KPMG probe also found that EY had an internal whistleblower in May 2016 who raised fraud allegations against Wirecard and reported an attempt to bribe an auditor in India. This incident triggered an investigation by EY, which supposedly shared information with its group audit team, but was eventually shut down at the behest of Wirecard management, which oversaw this investigation, rather than the supervisory board (Storbeck 2020b).

In June 2020, EY issued a statement that there are "clear indications for a […] sophisticated fraud", which could not have been detected even with the best audit methods (Reuters 2020b). It also highlighted that EY ultimately discovered that the underlying documentation for the escrow accounts were false and informed the relevant authorities, management and the supervisory board in 2020 (Reuters 2020b). In a letter to clients, EY's CEO Di Sibio also points to the responsibilities of the supervisory board (Spiegel 2020b).

In terms of audit oversight, EY is inspected annually by the AOB given its size and number of public interest entities (PIE) audits. However, we do not know whether the AOB specifically inspected EY's Wirecard engagement prior to October 2019. In September 2020, the AOB published a statement (see APAS 2020), reacting to a newspaper report that AOB had a telephone conversation with EY about Wirecard back in February 2019 (Berliner Zeitung 2020). The AOB statement in September 2020 explains that the call in February did not provide concrete indications for violations of professional standards by EY and that the agency obtained no information that it deemed relevant for other agencies like BaFin. The AOB initiated a preliminary investigation in October 2019, which was

[18] For auditors that conduct Public Interest Entities audits, the inspections should be carried out at least every 3 years. For auditors that perform more than 25 PIEs in a calendar year prior to inspection, the inspections should be carried out annually. This requirement implies that the Big Four auditors are inspected annually.

[19] See, e.g. Nagy (2014), Christensen et al. (2016), and Aobdia and Shroff (2017).

converted into a formal professional supervision procedure in May 2020 after KPMG's forensic report was published. These AOB proceedings are still ongoing.

Based on the sequence of events and public information, it seems that EY and AOB did not detect the Wirecard fraud until very late. To be clear, detecting sophisticated fraud is difficult. Moreover, professional audit standards point out that the primary responsibility for preventing and detecting fraud rests with management and the supervisory board (ISA 240, IDW PS 210). Auditors are also not specifically tasked to detect fraud, which requires a more forensic approach. However, an auditor "is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error." (ISA 240).[20] Moreover, auditors cannot "look the other way" if they come across indications for fraud. In material cases, they have to modify their audit opinions appropriately (ISA 700, IDW PS 210) and may have to inform the authorities. Thus, a proper audit goes beyond checking for mere compliance with the accounting standards. Yet, auditors rarely assume responsibility when major accounting manipulations or fraud come to light. There is a well-known "expectation gap" between the legal responsibilities of auditors in providing assurance and the level of assurance that the public and outside investors expect auditors to provide. While in fraud cases this expectation gap often has elements of hindsight bias, we believe it is also a manifestation of a deeper problem with external audits.

Reform Suggestions for External Audits and Audit Oversight

In our view, it is high time to consider a major reform of external audits, not only in Germany.[21] It is not that Wirecard exposes a new or particular weakness, but that it is symptomatic for and very similar to other high-profile accounting scandals that went undetected by the respective auditors, providing clean audit opinions certifying that the financials, loosely speaking, provide a true and fair view. A reform of external audits should therefore start by clarifying the task that auditors are asked to perform under the law. In Germany, auditors already have to consider whether the financial statements provide a "true and fair view" of the financial position.[22] But, in practice, the focus often seems to be on compliance with the accounting and auditing standards. Thus, what is necessary is a change in "focus" and stronger accountability.

We recommend an explicit clarification in the law, and not just the professional auditing standards, that professional scepticism and reasonable checks to uncover accounting manipulations and fraud are an integral part of an external audit.[23] It may also require more explicit statements in the prescribed audit opinion as to the level of assurance that the auditor provide with respect to accounting manipulations and fraud.[24] In addition, the market supervisor and public oversight body need to spell out their expectations for auditors that certify financial statements as providing a true and fair view.

[20] It also notes that the "risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error. This is because fraud may involve sophisticated and carefully organized schemes designed to conceal it, such as forgery, deliberate failure to record transactions, or intentional misrepresentations being made to the auditor."

[21] The experience in the financial crisis further reinforces this argument, as it also exposed major weaknesses in the quality of bank audits (Bischof et al. 2020).

[22] § 321 HGB: „Es ist auch darauf einzugehen, ob der Abschluss insgesamt unter Beachtung der Grundsätze ordnungsmäßiger Buchführung oder sonstiger maßgeblicher Rechnungslegungsgrundsätze ein den tatsächlichen Verhältnissen entsprechendes Bild der Vermögens-, Finanz- und Ertragslage der Kapitalgesellschaft oder des Konzerns vermittelt."

[23] For a similar recommendation see AKBR (2020).

[24] Historically, stronger audit certifications have existed. In the US, audit opinions testified financial positions and then shifted to certifying compliance with the accounting standards. This shift occurred when US courts clarified and expanded the responsibilities of auditors in the 1920s around the time auditing became mandatory (Bourveau et al. 2020). One interpretation of this shift is that it was intended to lower expectations and liabilities as to the level of assurance.

Next, existing monetary limits on auditor liability should be raised considerably to increase the penalties for weak audits, which in turn would also strengthen auditors' ex ante incentives to perform sceptical and independent audits. Although auditors carry liability insurance, the resulting insurance premia still provide incentives. Higher auditor liability would also make private enforcement via litigation more likely, which in turn would lead to more court cases and precedent on the true and fair view principle.[25]

The final element of audit reform involves strengthening public audit oversight. Market supervisors need to have the power to question the auditor and obtain critical information, including access to audit papers, when major concerns about misconduct arise. We discuss such powers in Sections 2.3 and 2.4 in more detail. Next, we recommend reviewing the effectiveness of public audit oversight bodies, as they play an important role in the oversight system. In the Wirecard case, much of the debate has focused on BaFin and FREP, but if there were weaknesses in the EY audit, the relevant oversight body is the AOB. At a minimum, the public audit oversight body should disclose summary metrics about its inspection findings for individual audit firms (not at the engagement level) on its website. Doing so would provide information about audit quality at the audit firm level to clients and investors, and allow markets to better "price" audit quality differences. This recommendation follows the US model; the PCAOB discloses inspection reports for individual audit firms.

One could also consider a more drastic change in the oversight of external audits and require *non-Big Four* auditors to provide a "second opinion" as a check on the primary auditor (not just concurring opinions by partners within the same firm). Dual-audit models exist in other countries (e.g. France). As a full dual audit would be expensive, second opinions should be limited in scope and focus on the audit process and papers. Still, this idea requires careful cost-benefit considerations. A potential benefit of requiring second opinions by *non-Big Four* auditors would be that it "builds up" the next tier of auditors, which over time could mitigate the concentration and resulting lack of choice in the audit market.

Internal Controls

Apart from external audits, a company's internal controls are the other major line of defence against accounting manipulations and fraud. Consistent with this thinking, the Sarbanes-Oxley Act in the US primarily strengthened firms' internal controls and mandated their audits after a series of accounting scandals.[26] In Germany, internal controls do not have to be audited, but management has to install an "early warning system" that is part of the risk management system and the internal controls and has to be audited (§ 317 HGB). A broader audit mandate for the internal controls would likely not only strengthen the internal control system, but also clarify expectations about the auditor's role in detecting accounting manipulations and fraud. The empirical evidence on internal control audits in the US is mixed (e.g. Coates and Srinivasan 2014; Leuz and Wysocki 2016), but this evidence has to be seen in the context of the very litigious US environment, which is likely the primary reason why internal control audits turned out to be quite costly for smaller firms (Coates 2007). It is not clear that this experience applies in the same way to Europe. We therefore believe that the pros and cons of mandating internal controls audits should be discussed. An alternative to internal control audits could be (random) internal control inspections by the market supervisor. At a minimum, the law should require that publicly listed firms have an appropriate and effective internal control system and that supervisory boards review this system.

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[25] Unlike the U.S., true and fair view and the resulting responsibilities and assurances are rarely litigated in German courts and therefore its private enforcement is largely missing. See Ball (2009) for a discussion of the role of courts in enforcing "fair representation" beyond compliance with the accounting standards.

[26] It also introduced public oversight of the audit profession, creating the PCAOB. Auditors' professional standards also emphasize the role of internal controls and the supervisory board in preventing and detecting fraud.

Supervisory Board Oversight

Another internal oversight element is the supervisory board. Given the agency problem between outside investors and management, the supervisory board plays a very important role in providing oversight of management. In Germany, supervisory boards already have extensive responsibilities, as well as corresponding liabilities, and we do not believe these responsibilities per se need to be extended. The key question is whether supervisory boards truly exercise independent oversight. For this, board composition and the information flow to the board are key. To provide appropriate oversight, the supervisory board needs access to relevant information (documents, data and employees), independent from management, but also dedicated support staff to process the information. We suggest considering that the head of compliance or the internal control function reports to the supervisory board. Such a recommendation is in line with the "Best Practices for Corporate Governance" in Switzerland, which suggests that internal controls report to the Swiss *Verwaltungsrat* or its Audit Committee.[27]

Our next recommendation for supervisory board oversight pertains to the board's role in overseeing the external audit. Under German law (§ 171 AktG), external auditors already report to the supervisory board on their audit of the financial statements as well as on significant weaknesses in the company's internal control and risk management systems. But, at present, not all publicly listed firms have dedicated audit committees, despite the German Corporate Governance Code recommending this practice. We suggest requiring that supervisory boards of publicly listed firms have dedicated audit committees comprised of people with a specific qualification, following the role model of regulated industries. The chair of the audit committee and the majority of the members of this committee should be independent. The chair of the audit committee should be a financial expert and, additionally, should not be the chairman of the supervisory board.[28] Following our recommendations, the supervisory board receives critical information from the external and internal auditors.

Market and Investor Oversight

A final element of external oversight and monitoring comes from the capital providers (shareholders and debtholders), information intermediaries (analysts and rating agencies) as well as other market participants such as stock exchanges. For brevity, we focus on capital providers, but note that Moody's maintained its investment grade rating for Wirecard throughout 2019 and that analysts' buy recommendations for Wirecard substantially outnumbered sell recommendations in 2018 and 2019 (BMF 2020a).

Large outside shareholders and institutional investors as well as creditors can demand access to information and can play an important monitoring role. Surprisingly, however, there is little evidence that these large stakeholders have played a significant role in disciplining Wirecard management or in uncovering the fraud. Two consortia of banks provided significant new debt finance to Wirecard in 2018 and 2019. The former consortium apparently did not insist in the debt contract on having access to the more detailed, non-public audit report, but instead relied on the public audit opinion and the credit rating (Börsen-Zeitung 2020).

At this point we can only speculate as to the potential reasons but in our mind the evident lack of more forceful market and investor oversight underscores our suggestions in this briefing. Ironically, the only

[27] We of course realize that the Swiss *Verwaltungsrat* differs in important ways from the German *Aufsichtsrat*.

[28] This implies tightening regulation on independence and on financial competence on supervisory boards (see Art. 39 Auditors Directive 2014/56/EU on audit committees for PIE). EU Law suggests independence only in a recommendation (2005/162/EC). For financial experts, EU Law provides discretion for Member States (Art. 39 para. 2 Auditors Directive 2014/56/EU), which allowed Germany to roll back regulation requiring (some) board members to be independent and financial experts.

market players that seem to have demonstrably exerted public pressure on Wirecard were the short sellers, but they were eventually constrained by the short sale ban issued by BaFin, as we discussed in Section 2.1.

2.3. Impaired enforcement of financial information disclosure

A robust legal regime has to combine appropriate rules with adequate enforcement mechanisms and an appropriate enforcement culture. Wirecard suggests failures of both, private and public, enforcement mechanisms. Private enforcement, such as shareholder litigation, is not the focus of this briefing. Public enforcement refers to state entities in the broadest sense. From an economic standpoint, stricter enforcement of rules has been shown, using European data, to be beneficial in terms of market liquidity (Christensen et al. 2013; 2016). Moreover, there is evidence that investors respond to stricter enforcement by lowering their required return, i.e. the cost of capital (Hail and Leuz 2006).

The framework for enforcement of financial markets and securities laws is to a large extent preformatted by EU law, yet includes some German specificities. In accordance with Art. 22 Market Abuse Regulation (MAR), general market oversight is entrusted to BaFin as the competent authority. Its investigative powers follow Art. 23 MAR, transposed in §§ 6 et seq. *Wertpapierhandelsgesetz* (WpHG). They include, for instance, investigation of documents, issuing a subpoena, hearing witnesses and certain rights of search and seizure. By contrast, as far as financial reporting oversight is concerned, the institutional architecture follows Art. 24 Transparency Directive, transposed in §§ 106 et seq. WpHG and in light of the ESMA guidelines on enforcement of financial information of 4 February 2020, which aim at ensuring consistent enforcement across the Union. Again, BaFin is the designated central authority. Additionally, certain tasks are delegated as suggested by Art. 24 para. 2 Transparency Directive to the private, yet publicly mandated body FREP (see above). The investigative powers as to financial reporting are considerably narrower than those involving general market oversight. Additionally, a Germany-specific two-step enforcement structure has made the system prone to latency and unclear responsibilities. This is especially evident as far as accounting fraud/management involvement is concerned, given that FREP depends on information provided by management on a voluntary, cooperative basis.

The German institutional structure for enforcing audited financial reporting according to the accounting and auditing standards rests on three bodies: (1) the professional quality and integrity of the auditing process in Germany as such is monitored by the AOB, as described in Section 2.2, (2) the accuracy of accounting information and the compliance of the financial statements with the accepted accounting standards is monitored by a second institution, the German Financial Reporting Enforcement Panel (FREP). (3) BaFin fulfils a double role in supervision, namely as (a) a bank regulator and (b) a securities markets regulator. Its role is further complicated by the fact that Germany has the two-step enforcement procedure in place (see above). FREP mandatorily takes the first step before some of BaFin's tasks come into play, thus relegating BaFin to a wait-and-see role.

If (a) the relevant firm is a regulated institution, e.g. a bank, BaFin has the monitoring duties and direct rights to access and information a bank supervisor enjoys. While the Wirecard group included a bank subsidiary, the parent company was not a bank and also not considered a financial holding company under the EU Capital Requirements Regulation. Hence, BaFin did not supervise the parent company in its role as *bank supervisor*. This has an effect on investigative rights, too: The very extensive monitoring rights BaFin would have enjoyed, had Wirecard parent company been considered a financial holding company, were not available. However, a more limited range of investigative rights might have been available, considering that the Wirecard group included the bank subsidiary. § 44b *Kreditwesengesetz*

allows for an investigation of entities holding a significant stake in a financial institution. The suitability, soundness and reliability of entities holding a significant stake is checked when they first acquire a stake in a financial institution ("*Inhaberkontrollverfahren*", § 2c *Kreditwesengesetz*). § 44b *Kreditwesengesetz* extends these rights to gain access to information after the stake has been acquired, in order to make sure current developments affecting the suitability of the stakeholder will be taken into account. We recommend spelling out this duty to supervise, not only when acquiring the stake, but also on an ongoing basis more clearly.

In what follows, we focus not on banking supervision, but on (b), the relevant firm not being a regulated institution. We discuss BaFin's rights and duties as a securities market, not a bank supervisor. As outlined above, these focus on institutional market stability and integrity. German law (§ 107 para. 1 s. 1 *Wertpapierhandelsgesetz*, WpHG) requires BaFin to check breaches of laws on financial reporting if there is concrete evidence for such breach. However, if this is the case, it is not BaFin, but FREP that is the first entity competent to run an investigation. Such investigation might be triggered by BaFin, directing FREP to do so, § 108 para. 2 WpHG ("*Verlangensprüfung*"). Alternatively, FREP can start an investigation on its own initiative under §§ 108 para. 1, 107 para. S. 1 WpHG ("*Anlassprüfung*"). In both cases, German law's two-step enforcement procedure will have to be followed.

Germany is –together with Austria– the only EU Member State following a two-step enforcement procedure as to financial reporting. Before 2004, enforcing financial reporting standards was largely in the hands of the corporation's supervisory board and its auditors. Reacting to corporate scandals such as Enron (US) or Flowtex (Germany), the two-step enforcement procedure was established. It aimed at combining a private body's expertise (FREP) with a public body's enforcement tools (BaFin, plus if necessary, the public prosecutor's office), see BT-Drucksache 15/3421 (p. 11). While a delegation of tasks is acceptable under Art. 24 para. 2 Transparency Directive (see also ESMA 2020, p. 13), the particular institutional architecture chosen in Germany seems to have slowed down efficient enforcement, giving priority to the private body's examination.[29]

FREP could be called a hybrid institution: it is a private entity, appointed by the government under Section 342b *Handelsgesetzbuch* (HGB) (see ESMA 2017a, p. 21). This HGB rule outlines the procedure for the Federal Ministry of Justice, in consensus with the Ministry of Finance, to accredit FREP. The body is widely seen as a comparatively weak institution, being dependent on the consent and cooperation of the corporation it investigates (ESMA 2017a, b), and working on a very limited budget of around 6 million Euro (in 2019). However, since FREP was accredited, BaFin's enforcement competencies under § 107 WpHG can only be claimed in two situations, as outlined in § 108 WpHG:

- If FREP reports to BaFin that the issuer does not cooperate or disputes the result of FREP's investigation (§ 108 para. 1 s. 2 Nr. 1 WpHG) or
- If BaFin has "serious doubts" as to the accuracy of the result of the investigation by FREP or claims "improper execution" of the investigation by FREP (§ 108 para. 1 s. 2 Nr. 2 WpHG).

As to Wirecard, FREP ran random checks of the 2011 and 2014 accounts, without discovering reporting errors (BMF 2020b, Question 34). As far as we can tell, press articles in 2016 and 2017 were not considered concrete evidence to start an investigation by FREP or by BaFin. Reacting to the FT articles in January and February 2019, BaFin requested on 15 February 2019 an investigation by FREP ("*Verlangensprüfung*", § 108 para. 2 WpHG) of the interim group accounts as of 30 June 2018. On 30 April 2020, BaFin requested an investigation of the annual group accounts as of 31 December 2018. On

[29] Empirical evidence both around the introduction of IFRS reporting and the creation of FREP as well as market reactions to FREP/BaFin enforcement actions suggest that this new structure was an improvement over the prior enforcement situation in Germany (e.g. Hitz et al. 2011; Christensen et al. 2013).

24 June 2020, FREP on its own account started an investigation under § 107 para. 1 s. 1 WpHG ("*Anlassprüfung*") for the interim group account as of 30 June 2019. On the same day, BaFin requested that same investigation ("*Verlangensprüfung*"). On 25 June 2020, BaFin also requested an investigation of older accounts as of 31 December 2017.

There has been a growing discussion on whether BaFin could or should have claimed "improper execution of control" by FREP in order to take over the investigation under § 108 para. 1 s. 2 Nr. 2 WpHG. The *Wissenschaftliche Dienste* at the *Bundestag* in Berlin has put forward arguments why BaFin would have been able to claim the legal power to do so. A report by Böcking and Gros (2020), commissioned by BaFin, is of the opposite opinion. Another report by a group of university professors (see AKBR 2020) supports the conclusion reached by the *Wissenschaftliche Dienste* (2020) for cases in which accounting fraud/management involvement is suspected, arguing that an interpretation of the words of the law only would lead to untenable results. Having said that, there was no legal precedent available at the time. Legal scholarship had emphasised that gross deficiencies are needed to justify taking the mandate away from FREP (see Hennrichs 2020, #7: gross deficiencies necessary) and the legislator insisted on good cooperation between these two bodies (as emphasised by Böcking and Gros, 2020). Against this background – and being careful not to fall prey to hindsight bias – it would have been an unprecedented and "courageous" step for BaFin to claim "improper execution of control".

The question whether agency competencies can be claimed on the basis of a broad and "courageous" reading of a statutory rule, as intriguing as it may be for legal scholars, is not the focus of this report. The same is true for a deep dive into German regulatory culture, which seems rather hesitant when it comes to monitoring financial reporting. This hesitant approach is facilitated, among other things, by the two-step enforcement structure, which creates latency. Additionally, we recommend considering the incompatibility between serving on the board of FREP and on the supervisory board of one of the corporations being supervised. Taking these arguments together, we would like to highlight that the existing German institutional architecture has not succeeded in establishing clearly defined competencies. Instead, it created an unhelpful mix of first- and second-mover tasks. Especially with an eye on latency, considering the long time it took to uncover the fraud, this clearly hurts markets. Additionally, it could shield corporations from quick reactions by a public supervisor (and eventually, a public prosecutor). Lastly, ESMA's 2017 peer review had already expressed doubts as to the conformity of the two-step-enforcement procedure with EU law, given that BaFin was not able to "request some enforcement actions" (ESMA 2017a, p. 127). Hence, we suggest considering reforming the two-step enforcement procedure with an eye towards a more streamlined and clearly focused institutional architecture. ESMA's 2020 guidelines rightly stress that "the final responsibility for supervising compliance with provisions of the Transparency Directive (…) remains (…) with the designated competent authorities" (p. 13). Against this background, we recommend making BaFin the only competent authority and understanding FREP as an entity to which BaFin can delegate tasks. We recommend to not have an institutional architecture that gives a private entity an institutionalised role in enforcement. Instead, BaFin should be fully accountable for how it organises the enforcement process (including random and incidence-driven checks). As to the European framework, we suggest strengthening the competencies for supervisory authorities under the Transparency Directive. We recommend investigative and enforcement powers modelled on the strictest standards available under the Market Abuse Regulation.

2.4. Overarching mandate and accountability of the market supervisor

As far as the market supervisor is concerned, we discussed BaFin's role in investigating market manipulation of and imposing a short sale ban for Wirecard stock (Section 2.1) as well as its oversight role as to financial reporting (Section 2.3). Its duties and powers in these two areas are quite different.

For the former, BaFin is entrusted with general securities market oversight under the Market Abuse Regulation. For the latter, its role and powers are more limited and follow the framework under the Transparency Directive. However, as the Wirecard case illustrates these areas are closely connected, revealing a supervisory structure that is not well equipped to deliver strong supervision and swift enforcement in the case of corporate fraud. Instead, the impression of regulatory fragmentation emerges, both in the system of financial reporting enforcement and at the level of capital market supervision more broadly. While we appreciate that there is a division of tasks and powers in supervisory work, regulatory fragmentation is dangerous as it muddles responsibilities, dilutes accountability and facilitates regulatory capture. This message is relevant for the German supervisory architecture, but also for the broader European structure.

Overarching Mandate, Supervisory Powers, and Institutional Accountability

To counter such fragmentation at the national level, an effective capital market supervisor needs a clear and overarching mandate and responsibility. In our view, the goal of capital market supervision is to preserve market integrity and investor protection, while facilitating capital raising and market transactions. In order to deliver on this mandate, the supervisor needs forceful investigative powers and institutional accountability as well as the necessary funding to effectively carry out its mandate.

Whenever credible sources raise serious allegations of misconduct and fraud, an effective capital market supervisor must both be willing and capable to "act", which entails investigating in all directions and weighing all the available evidence. In such circumstances, the supervisor's regulatory philosophy must entail taking on a more forensic approach. Only then can it fulfil its role of an independent arbiter, having in sight the capital market oversight with which it is entrusted.

Of course, when looking at scandals in hindsight, one quickly misses the typical ambiguity and uncertainty surrounding the early phases of cases like Wirecard and Enron, when a stellar business success seems to be in reach. No supervisor will lightly stand in the way of a "rising star", risking the reproach of destroying a corporate success story. But it is precisely for this reason that the supervisor not only needs powers but also institutional accountability.

Therefore, we propose, along with strengthening its powers, to clearly establish the supervisory agency's accountability for fulfilling this overarching oversight mandate in substance, and not just in form. Aside from sufficient resources, accountability of this type requires an appropriate level of institutional independence, so that the supervisor is, as much as possible, shielded from pressures that come from specific national, political, or business interests.

We have seen further above that the legal options for BaFin to react to allegations of fraud in Wirecard went beyond the (somewhat narrow) financial reporting regime, encompassing market abuse regulation and banking regulation. We do not venture into the reasons why legal tools under these other regulations were not used more extensively or considered inappropriate. However, against the background of concerns that have been voiced in the public debate[30] as to regulatory capture of elements of the oversight system as well as incentives to protect a presumed national champion, installing some version of overarching accountability would send a clear counter-signal.

The reason is (again) the presence of externalities. They are twofold. As noted earlier, a scandal of the size of Wirecard can send ripple effects to other countries within the same European capital market. Moreover, weaknesses or inappropriate interventions by a national supervisor can also create negative externalities at the European level. Externalities of both types just described can be internalised by

[30] For example, Spiegel (2020a) on Germany's finance minister Olaf Scholz and Wirecard.

taking supervisory accountability out of the national realm and locating it at the European, common market level. Therefore, we propose to create a single, responsible market oversight institution at the European level to address these externalities.

A Transnational Network of Supervisors with a Single Market Supervisor in Europe

Our externality arguments reinforce arguments for the Capital Market Union (CMU). To this point, the arguments supporting the CMU revolved primarily around the notion that harmonisation leads to a more unified and efficient European capital market.[31] Wirecard illustrates that the case for the CMU is even stronger. National idiosyncrasies in the legal and institutional systems may result in weaknesses in the capital market oversight regimes in other European countries as well.

In this sense, institutional heterogeneity and regulatory fragmentation at the European level is not only a weak spot in the competition for funds in global capital markets, but it also opens the European market up to externalities of the type we described. Thus, the Wirecard example makes a case for a unified, Europe-wide supranational oversight regime. An EU authority, if it had existed, would have introduced not only a more impartial outsider's view, and disrupted national traditions, but also would have been less subject to national pressures.

Borrowing from the development in the banking sector post 2008, where the Single Supervisory Mechanism (SSM) has helped, through its constant push for cross-sectional harmonisation of monitoring and enforcement practices to better align supervision across larger European banks, we suggest establishing a European Single Capital Market Supervisor (ESCMS). Such a European agency coordinating supervisory actions across national markets and carrying out independent enforcement actions would aim for a common level of market integrity and investor protection. For pragmatic reasons, as for smaller companies externalities are deemed smaller, and compliance costs are relatively bigger, the responsibility of a European single supervisor could be limited to larger listed companies, e.g. the top 1000 in Europe.

In such a pan-European supervisory model, national securities market agencies would not lose their role. To the contrary, today's national supervisory and enforcement institutions could be integrated into a European supervisory network in which national branches report to a common European (apex) agency. As to governance, the ESCMS would be independent from the member states, but also from the European Commission. A core issue is to provide the apex institution with the necessary staff to carry out its role as supervisor.

Under this approach, ESCMS would have a clear mandate to preserve the integrity of all markets, protect investors and to facilitate capital raising and market transactions. The competences of the new agency would comprise all features covered by today's general market authorities (e.g. prospectus audit, market abuse, insider trading, as well as the oversight as to price formation, disclosure, and market infrastructure). Wirecard teaches us that financial reporting will have to figure prominently on that list, too. Endowed with strong enforcement powers, and assisted by the existing national agencies, the ESCMS would be entrusted with an overarching mandate and accountability to protect investors, ensure market integrity and facilitate the development of the Single Capital Market in Europe.

While we acknowledge the existence of significant political, legal, and institutional obstacles, those have to be weighed against the potential gains of a credible market and institutional oversight system for the effectiveness of capital markets in Europe.

[31] However, as Christensen et al. (2016) show for past EU directives (MAD and TPD), a common directive is not sufficient. Uneven implementation and also uneven enforcement structures across Member States lead to measurable differences in market liquidity.

3. CONCLUSIONS

The Wirecard case has revealed major weaknesses in market and institutional oversight, especially with respect to investor protection and market integrity. It shows that when serious allegations and concerns arise, especially when they come from credible sources (e.g. a reputable newspaper), an effective capital market supervisor must both be willing and capable to act. Moreover, the first lines of defence against fraud and manipulation are companies' internal controls, their supervisory boards and external audits along with transparency vis-à-vis the public and market participants to facilitate market discipline. All these elements of market and institutional oversight have failed in one way or another in the Wirecard case. Thus, the lessons of the Wirecard case go beyond reforms to current supervisory system. The scandal uncovered weaknesses in the oversight system more generally, demonstrating the need for broader reforms in Germany and in Europe at large.

Towards this end, we make eight suggestions on how to improve the current market and institutional oversight for publicly listed firms. These suggestions represent in our opinion the wider implications of the Wirecard case. Taken together, these suggestions are meant to strengthen the oversight architecture in Europe, without unduly burdening markets and firms. The goal should be to increase the attractiveness of Europe's capital market for domestic and international investors and issuers.

Suggestion 1 (Information flow: whistleblowing): To start investigations in a timely manner, early providers of information (whistleblowers) must be heard by the relevant parties and be taken seriously. We recommend developing a supervisory strategy allowing for an effective screening of the many voices raised and encouraging whistleblowing from within or outside publicly listed firm. Such a strategy may include substantial financial incentives for whistleblowers.

Suggestion 2 (Information flow: short selling): A short sale ban is an asymmetric intervention that prevents critical information to be reflected in price. As prices are also important signals to market participants, management, and supervisors, having such information in price is important. Therefore, we recommend making the conditions under which supervisors may enact short sale prohibitions significantly more restrictive.

Suggestion 3 (External audits): We suggest a reform of external audits to strengthen auditor accountability. It is not that Wirecard is different, or a special case, but that there is a common refrain to accounting scandals. Therefore, the law, not just professional standards, should unmistakably state that auditors' professional scepticism and reasonable checks to uncover accounting manipulations and accounting fraud are an integral part of an external audit. The market supervisor and the audit oversight body also need to spell out their expectations for auditors that certify financial statements as providing a true and fair view. To strengthen auditor incentives as well as penalties for weak audits, auditor liability should be raised considerably. Finally, we recommend reviewing the effectiveness of existing public audit oversight bodies. At a minimum, these bodies should publicly disclose summary metrics about their inspection findings for individual audit firms, as this would provide valuable information about auditor quality to clients and investors.

Suggestion 4 (Internal controls and supervisory board oversight): The Wirecard experience suggests strengthening companies' internal controls and the oversight role of supervisory boards. At a minimum, the law should require that publicly listed firms have an appropriate and effective internal control system. External auditing of this control system should be considered. A mandate would reinforce our Suggestion 3 as it would clarify the role of auditors in detecting accounting fraud. Supervisory boards need access to critical information independent from management. Therefore, the head of the internal control function should report to the supervisory board (as external auditors already do). To strengthen supervisory board oversight of external audits, publicly listed companies

should be required to have a dedicated audit committee. The chair of this committee needs to be independent and a financial expert. In addition, the majority of the audit committee members need to be independent.

Suggestion 5 (Enforcement of financial reporting): The legal framework for enforcement is shaped by EU law but includes German specificities. While general market oversight is entrusted to BaFin, the Wirecard case shows that its investigative powers are too limited as far as financial reporting oversight is concerned. Additionally, a Germany-specific two-step enforcement structure has made the system prone to latency and created unclear responsibilities and accountability in cases of accounting fraud. We suggest reforming the two-step enforcement procedure, making BaFin the only competent authority. BaFin can enlist the help of bodies like FREP for the enforcement of financial reporting, if they wish so, but the powers and accountability remain entirely with BaFin. As to the European framework, we suggest strengthening the mandatory competencies granted to supervisory authorities under the Transparency Directive. They should have investigative and enforcement powers modelled on the strictest standards available under Market Abuse Regulation

Suggestion 6 (Overarching market oversight mandate): More generally, the Wirecard case shows that BaFin, as the responsible agency, did not or could not live up to its overarching mandate to protect investors and market integrity. Along with strengthening its powers, we propose to clearly establish the supervisory agency's accountability for fulfilling this overarching oversight mandate in substance. This accountability requires an appropriate level of institutional independence as well as sufficient resources to fulfil its tasks.

Suggestion 7 (Market oversight agency): The Wirecard experience offers lessons beyond the failure of internal controls, auditors and the market supervisor. We read it also as an illustration of a mismatch between national Member State's historically grown institutions (and cultures) and the introduction of a European regime. Reaping the benefits of a truly unified European CMU will require addressing such mismatches. We propose to create a single, responsible market oversight institution at the European level, which may be called the European Single Capital Market Supervisor (ESCMS). Such an institution would address ripple effects to other countries within the same European capital market that scandals like Wirecard create. In addition, it would help to overcome regulatory fragmentation, conflicts of interest due to national competition in the markets for goods and services as well as regulatory arbitrage and capture.

Suggestion 8 (European market oversight): A Europe-wide market oversight system will require the expertise of national markets, with their idiosyncrasies in corporate law, insolvency law and more. We propose to build the European oversight architecture with the existing national agencies as branches of an integrated European supervisory network. The ESCMS serves as the apex layer in the network, to which all national agencies are reporting. A hub-and-spoke architecture of this type will also introduce an element of institutional independence into national agencies.

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ANNEX

Appendix A on the facts and timeline

The overview is based on public information only and is not meant to be comprehensive.

Who blew the whistle?

There have been repeated allegations about Wirecard's accounting practices since 2008, for example:

- **2008**: The *small shareholder association SdK* accused Wirecard of reporting margins that are too high and that Wirecard accounted customer deposits as their own cash (Fairless et al. 2020). EY was hired to conduct a special audit of the 2007 accounts and has since taken over as group auditor (McCrum 2015);
- **2016**: The *Zatarra Report* prepared by anonymous investors accused Wirecard of corruption, fraud, and money laundering. Matthew Earl and Fraser Perring co-authored the report (Fairless and Kowsmann 2020; Murphy 2019);
- **Since 2015**: The FT issued its series "House of Wirecard" (e.g. McCrum 2015), pointing at balance sheet inconsistencies. According to Wirecard, the reason for these discrepancies was that accounting standards and the day of consolidation vary from one country to another. In October 2018, Wirecard employees from Singapore sent internal documents to FT journalists because they were concerned that an internal investigation had been suppressed. The whistleblowers have never gone public with their identity (McCrum and Palma 2019a, b).

It is worth pointing out that Wirecard has been a target of increased short seller activities for a while; some trading activities were in fact linked to market abuse: In 2012, two former executives of the shareholders association SdK, Tobias Bosler and Markus Straub, were convicted of market manipulation. As far as the 2016 Zatarra Report is concerned, the Munich public prosecutor's office investigated the authors Earl and Perring. The proceedings were, on payment of a five-digit euro amount, discontinued in May 2020; it was considered a minor case of market manipulation (McCrum 2015; Poltz 2020).

It was against this backdrop that the BaFin justified an intervention in February 2019: "*The recent events once again prompted the public prosecutor of Munich to launch an investigation regarding possible market manipulation. The public prosecution office also confirmed that currently no investigation has been opened against Wirecard.*" (ESMA 2019, p. 3)

2019

January 30: The Financial Times publishes its first article on the Singapore investigation. Wirecard is said to use forged and backdated contracts in order to boost revenues (McCrum and Palma 2019a).

February 15: BaFin directs FREP to examine Wirecard's accounts as of June 30, 2018, as part of the two-step procedure (BMF 2020).

- FREP is responsible for checking that the balance sheets were in accordance with the accounting principles. Tracking down accounting fraud and investigations are usually not part of the task catalogue (FREP 2018);
- FREP assigns a single auditor to the case of Wirecard (Fairless et al. 2020).

February 18: BaFin issues a General Administrative Act prohibiting with immediate effect the establishment of net short positions and increases in existing net short positions in Wirecard shares until April 18, 2019 (BaFin 2019).

- ESMA (2019, p. 4) approves the short selling ban: "*The possibility that the large short positions and the severe declines in price observed over the last weeks might correspond to manipulative practices constitutes in ESMA's view a clearly adverse scenario for market confidence, as it risks undermining investors' trust in the price formation mechanism.*"

April 10: BaFin files a criminal complaint against the FT journalists Dan McCrum and Stefania Palma (Giesen et al. 2019; Storbeck 2019), and ten short sellers (Storbeck 2019) with the public prosecutor's office in Munich on suspicion of market manipulation (BMF 2020).

April 15: BaFin imposes a fine of €1.52 million upon Wirecard for the delay in the publication of the 2018 interim financial statements (BMF 2020).

October 15: The Financial Times claims that Wirecard had sought to inflate reported sales and profits at Wirecard units in Dublin and Dubai and publishes internal documents to support the allegations (McCrum 2019b).

October 31: Wirecard hires KPMG to conduct an independent, forensic investigation to refute accusations published in the press and on the internet (KPMG 2020).

2020

March 12: Wirecard announces that the investigation is largely completed but still ongoing. So far, KPMG is said to have found no evidence of balance sheet manipulation (Wirecard 2020a).

April 22: Wirecard issues another ad-hoc announcement saying that the KPMG special audit is not yet complete, but no evidence of balance sheet manipulation has been found so far (Wirecard 2020b).

April 28: KPMG publishes its special report with delay: the auditor was unable to locate around €1 billion in trust accounts, which corresponds to a quarter of the balance sheet, due to insufficient documentation by Wirecard and its third-party acquirers (TPAs). KPMG could not refute nor confirm the allegations and urged further investigations (see KPMG, 2020, for more details):

- Accounting-related allegations in Asia: Wirecard inflated sales and revenues by cooking the book (round tripping). Money from Wirecard Bank in Germany seems to have been sent to a network of subsidiaries and "external" customers to look like legitimate profits (McCrum and Palma 2019b; KPMG (2020), p. 57);
- Third-party acquiring: TPAs were used to inflate reports by creating fictional revenue streams (Davies 2020; BKA 2020; McCrum 2019a, b). Most of these revenues are on escrow accounts,

which Wirecard claimed to be kept in two Philippine banks. However, Philippine authorities claim that there never has been a transaction of the money to the Philippines and the banks deny that Wirecard has ever been a client (Taylor and Morales 2020);

- The TPAs did not cooperate with the special investigation auditor KPMG. There was no official confirmation from banks nor official statements of accounts (pp. 15-16);

  "With regard to the amount and existence of sales revenues from the TPA business relationships between Cardsystems Middle East, Wirecard UK & Ireland as well as Wirecard Technologies and the respective relevant TPA partners, KPMG cannot make any statement as a result of the forensic investigation activities carried out with regard to the investigation period 2016 to 2018 that the sales revenues exist and are correct in terms of their amount, nor can it make any statement that the sales revenues do not exist and are incorrect in terms of their amount." (KPMG 2020)

April 30: BaFin directs FREP to examine Wirecard's accounts as of December 31, 2018, as part of the two-step procedure (BMF 2020).

June 2: BaFin files a criminal complaint for Wirecard's deceptive ad-hoc announcements on the interim status of the KPMG special audit (BMF 2020).

June 18: BaFin files a criminal complaint against Wirecard for accounting fraud (§ 331 HGB, „*Bilanzbetrug*") and thus of market manipulation through incorrect disclosures in the 2016 to 2018 annual financial statements (BMF 2020).

June 22: Wirecard's board of directors assumes that the bank balances in trust accounts in the amount of €1.9 billion previously reported in favour of Wirecard do not exist with a high degree of probability, and possibly the third-party business is incorrect in the manner described so far (Wirecard 2020c).

June 24: BaFin directs FREP to examine Wirecard's accounts as of June 30, 2019 (BMF 2020).

June 25: Wirecard files for bankruptcy proceedings, due to impending insolvency and over-indebtedness (Wirecard 2020d).

- EY states that there are *"clear indications for a […] sophisticated fraud involving multiple parties around the world in different institutions with a deliberate aim of deception"*. EY ascertains that bank confirmations about the existence of certain credit balances in escrow accounts are forged and, therefore, EY refuses to sign off Wirecard's accounts for 2019 (Kowsmann et al. 2020);
- BaFin directs FREP to examine Wirecard's accounts as of December 31, 2017 (BMF 2020).

June 26: The Financial Times claims that EY did not check directly with OCBC Bank (Singapore) to confirm that the lender held €1 billion of cash on behalf of Wirecard. Instead, the auditor relied on documents and screenshots provided by a trustee (Storbeck et al. 2020).

June 28: The Federal Ministry of Justice and the Federal Ministry of Finance (BMF) announce that the contract with FREP, an institution organized under private law, will be duly terminated. The remaining term is 18 months.

July 20: FREP reported in a letter to BaFin that Wirecard either refused to cooperate in the examination (regarding the accounts as of December 31, 2017, and June 30, 2019) or did not agree with the examination results (June 30, 2018, and December 31, 2018) (BaFin 2020).

July 24: As part of the two-step procedure, BaFin initiates its own examinations by formally ordering an examination of the above-mentioned accounts on July 24, which is announced on August 4 in the Federal Gazette (BaFin 2020).

What happened to whistleblowers?

- Wirecard accused Matthew Earl of defamation and malicious falsehood and market manipulation. According to him, Wirecard used private detectives to monitor his activities. Wirecard's lawyer confirmed that they undertook "limited and lawful surveillance". During the period of the lawsuit, Earl and some colleagues suffered cyberattacks (Paul and Chung 2020).
- Both the FT and the journalist McCrum were sued by Wirecard in March 2019. He claims that private detectives hired by Wirecard followed him (FT 2020).
- BaFin investigated the short sellers' accusations and claimed that their research is market manipulation to destabilize the German financial market. Several short sellers and investigative journalists, including Matthew Earl and the FT journalist Dan McCrum, were sued (Storbeck 2019; BMF 2020; Paul and Chung 2020).

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Appendix B on an overview of supervisory architectures across Europe

Table 1: Comparison of market supervision models

General Information	Germany	France	Italy	United Kingdom
Central competent administrative authority for securities markets	**BaFin**	**AMF**	**CONSOB**	**FCA**
Integrated regulator	Yes	No, ACP (attached to Banque de France) is responsible for banks and insurance companies	No, Banca d'Italia is in charge of prudential regulation	No, PRA is responsible for prudential regulation of banks and insurance companies
Legal status	Independent public authority with its own legal personality	Independent public authority	Independent public authority with its own legal personality	Not relevant because FCA is not involved in the enforcement of financial information under TD
Independence	Subject to legal and technical oversight of the Ministry of Finance (MoF). However, BaFin does not need approval for its operational decisions.	Since AMF has far-reaching rule-setting competences, there are decisions that need to be stamped by the MoF. AMF is accountable to the Parliament.	In specific cases, CONSOB must submit secondary regulation to the MEF. CONSOB is accountable to the Parliament and reports annually through the MEF.	Not relevant
Financial autonomy	Fully self-funded. Revenues derived from fees, reimbursements, and contributions for regulated entities.	Fully self-funded. Revenues derived from fees imposed on market participants. For legal reasons, the range of fees is fixed by the MoF. Cap on hiring.	Partially self-funded. Revenues derived from fees and budget allocation by the State. CONSOB manages its budget autonomously. Cap on hiring.	Not relevant

Enforcement of Financial Information Function				
Competent authority for examination	**FREP**	**AMF** (Direction des affaires comptables)	**CONSOB**	**FRC** (FRRP)
Competent authority for taking actions	BaFin	AMF	CONSOB	FRC (Conduct Committee authorised by the Secretary of the State)
Legal status (if applicable)	FREP is a private sector organisation	-	-	FRC is a private company limited by guarantee and independent from the FCA
Number of issuers in 2015	686	535	245	2354
Number of issuers per full-time employee (Ø[32]: 50)	below average	below average	below average	[203] above average
Number of examinations completed per full-time employee in 2014 (Ø: 6)	below average	below average	below average	above average
Number of examinations completed per full-time employee in 2015 (Ø: 6)	below average	above average	below average	above average
Proportion of staff holding qualifications as an accountant or auditor (in %; Ø: 36)	100	85-90	<85	85-90

[32] Adjusted average across Europe

Selection Method[33]	Germany	France	Italy	United Kingdom
Documentation of the selection model available to the market?	Yes	No	Yes	Selection method is not formalised in a written document
Share of IFRS issuers selected for examination each year (in %)	19	17	20	11
Number of issuers selected per full-time employee each year (in %)	4,6	5	3,8	12,2
Selection model	Risk-based and random sampling with rotation	Risk-based and random sampling with rotation	Risk-based and random sampling	Risk-based and random sampling with rotation
Time it takes until all issuers will be covered (self-reported by NCA!)	4 to 5 years for indexed companies, 8 to 10 years for other issuers	Never	Never	Never
Remarks on the selection of issuers	In the 2017 ESMA Peer Review the model applied by FREP is mentioned as a good example of a balanced selection method.	Issuers from the CAC40 index reviewed every two years; selection based on market cap: from compartment A reviewed every three years; and compartment B and C issuers are reviewed every five years		Focus on equity and on market capitalisation: FTSE 350 companies are reviewed more frequently on a rotational basis
Criteria used by NCAs (non-exhaustive list)	Review of media (e.g. newspapers) is used to identify most of the issuers under the abstract risk assessment.	Significant changes in market cap or in shareholders' equity, major acquisitions or disposals of entities; ratios such as indebtedness/equity; intangible assets/total of assets, market capitalization/equity; Type of	Financial ratios, Type of industry/sector	Type of industry/sector

[33] Enforcers use different criteria to select issuers for review.

		industry/sector; Type of securities issued		
Proportion of issuers selected for examination because of random sampling or rotation (in %) [by inspection]	84	31	9	63
Examinations	**Germany**	**France**	**Italy**	**United Kingdom**
Total number of examinations planned for period (2014-15)	174	207	110	284
Proportion of planned examinations completed (in %)	70	95	100	100
Are desk-top examinations counted separately?	No	No	Yes, they make up for 2/3 of examinations	No
Prioritisation of examinations	Yes, priority to issuers selected based on risk	Yes, priority to issuers selected based on risk and with higher market cap	Yes, unknown criterion	Yes, priority to issuers where complaints have been raised
Examination process	Unlimited scope examinations are default approach. FREP concentrates on material errors and a few core issues; these priorities are a form of checklist. Two-step procedure: Almost all error identification examinations are carried out by FREP. Before FREP initiates an examination, it will communicate the selection to BaFin. (…)	Corporate Accounting and Auditing Directorate ("Direction des affaires comptables") carries out unlimited scope examinations by default. Checklist containing instructions for the examination and considerations for the review of financial statements is used. (…)	Unlimited scope examinations are considered as the default approach. CONSOB does not use any checklists nor work instructions. Most of the examinations involve discussions with both companies and their auditors. (…)	Two-step unlimited scope approach: First, the FRRP requests clarifications on the reporting adopted. The review involves several rounds of correspondence, informal phone calls and meetings. Information is usually sought on a voluntary basis. (…) **[Continued on next page]**

Examination process (cont.)	(…) FREP requests clarifications on the reporting adopted. The review may involve several rounds of correspondence and informal meetings. If a company refuses to cooperate with FREP or does not agree with the results of the examination, BaFin takes over. It can also intervene if there are substantial doubts about the accuracy of FREP's conclusions, however, BaFin must not intervene in ongoing examinations. Follow-up examinations are done automatically.	(…) It conducts focused examinations when studying specific accounting issues and upon request of the Corporate Finance Division ("Direction des émetteurs"). Follow-up examinations are done automatically.	(…) CONSOB makes on-site inspections occasionally. Follow-up examinations are performed frequently.	(…) Second, given that an agreement has not been reached, a Review Group (at least five members, including the FRRP Chair and Deputy) enters into a confidential discussion on the reporting issues. It aims to reach an agreement by persuasion. Checklist containing instructions for the examination and considerations for the review of financial statements is used. Follow-up examinations are done automatically.
Reviews refer to industry-relevant accounting issues	Frequently	Always	Sometimes	Always
Information gathering	Although FREP is recognized in German law, it has no statutory powers. As a result, FREP relies on the voluntary cooperation of the companies it examines. This is why the case is transferred to BaFin when an issuer refuses to cooperate.	Investigators may request to receive all documents, hear all persons who may be of interest to the investigation, access professional premises and carry out home visits and seize documents by a substantiated order by the custodial judge of the competent court.	CONSOB has extensive powers to carry out inspections and request the production of documents.	Information is usually sought on a voluntary basis. If they refuse to do so, the Conduct Committee can apply to the court to require information and documents to be produced by a company, or any of a company's officers, employee, or auditor. In each examination, audit committee reports are reviewed.

Information gathering from auditors	Once a year, FREP holds discussions with representatives of medium-sized audit firms via the platform of the Institute of Public Auditors in Germany, and during the first quarter of each year, FREP holds individual discussions with the chairs of the management boards or managing directors of the five largest German audit firms.	When AMF requests clarifications, the letter is sometimes copied to the auditors of the company. A Memorandum of Understanding between the H3C (auditor oversight body) and the AMF allows for coordination on inspection plans. The AMF can impose administrative sanctions on auditors if it finds material problems in the context of an error identification procedure.	Auditors file information on the issuer's financial statements, audit opinion and corporate governance in a structured format. In addition, auditors are frequently requested to provide additional information.	Formal power to request information from auditors. However, the examination process typically involves correspondences between the FRRP and the company. Companies are expressly encouraged to consult their auditors and invite them to meetings.
Whistleblower program?	Contact point for whistleblowers on BaFin website	Not applicable	Special Office has been set up. It conducts a preliminary inquiry into each complaint. The office then forwards its initial findings to the operational units of CONSOB which can decide whether to open an examination.	Contact point for whistleblowers on FRC website. FRC is not required to investigate every complaint.

Enforcement Actions	Germany	France	Italy	United Kingdom
Enforcement powers	If an error is identified either by FRED or BaFin, BaFin is the enforcer in charge. Even if the company accepts FREP's conclusions, FREP cannot order the publication of a corrective note. This is why it usually takes about six weeks until the market is informed.	Three tools: (1) recommendations when problems are not material, companies are requested to make corrections in the next report. (2) Orders to disclose information immediately to the public when material information is missing. According to the AMF staff, this is rarely used after financial statements have been approved by external auditors and the board, for practical reasons. (3) In serious cases, a formal investigation is requested that may result in administrative sanctions.	CONSOB may require the disclosure of additional information and require issuers to restate their financial statements. If the company does not comply, CONSOB may sue the issuer in civil court.	Given agreement has been reached, the Conduct Committee decides on some form of publicity and does not comment nor discuss the conclusions further. It may suffice to publish a corrective statement separately or in the next report with a correction of the comparative figures. Otherwise, the Committee may apply to court for (1) a declaration that the annual accounts do not comply and (2) an order requiring the company to prepare revised accounts or a revised report. FRC does not have the power to directly order a corrective note. As a result, the correction of future statements seems to be the preferred action.
Enforcement actions taken in 2014-15 (see 2017 ESMA Peer Review)				
Reissuance	-	15	1	0
Corrective note	6	2	11	1
Correction in future reports	-	80	0	82
Letter about immaterial departures	29	40	20	11

Visibility of corrections	Corrective notes are published in the Federal Gazette as well as in either a national newspaper for statutory stock exchange announcements or by means of an electronic information system used by credit institutions.		After having ordered a corrective note, CONSOB also requests a price-sensitive press release. If the company does not comply, CONSOB has the right to communicate to the market itself.	Significant corrective or clarificatory changes may be announced via a press notice. Announcements are usually circulated to those who have signed up for FRC press announcements on the website.

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The paper discusses the policy implications of the Wirecard scandal. 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. To ensure market integrity and investor protection in the future the authors make eight suggestions for the market and institutional oversight architecture in Germany and in Europe.

This document was provided by the Economic Governance Support Unit at the request of the ECON Committee).

PE 651.385
IP/A/ECON-BU/IC/2020-118

Print ISBN 978-92-846-7441-1 | doi: 10.2861/92641 | QA-03-20-741-EN-C
PDF ISBN 978-92-846-7442-8 | doi: 10.2861/936827 | QA-03-20-741-EN-N