

Information Relating to the Examination Process of the Financial Reporting Enforcement Panel

This information is intended to explain the basic principles and the process of the examination to those companies and persons involved with enforcement. Published information from the Panel is also available on its website. In addition, the Code of Procedure and the Principles of the Sample Selection are also found there.

1. Legal Basis

In order to enforce the required accounting practices, the **Balance Sheet Control Law** established a two-tier enforcement regime on December 15, 2004.

The first tier involves the **Financial Reporting Enforcement Panel (the Panel)**, an institution organized under private law and recognized by the German Ministry of Justice together with the German Ministry of Finance (§§ 342b to 342e HGB (German Commercial Code)). In the second tier, the **Federal Financial Supervisory Authority (BaFin)** joins in (§§ 37n to 37s WpHG (Securities Trading Act) to determine whether an error has occurred when the Panel's opinion differs from that of the company, to order the publication of identified errors, or to perform an examination with sovereign means when a company is not willing to cooperate with the Panel.

The addressees of the enforcement process are capital market oriented companies; i.e. those, whose financial instruments are authorized to trade within regulated markets on domestic stock exchanges.

The Panel and BaFin, as appropriate, have to examine whether the most recently adopted individual financial statement and the related management report or **the most recently adopted consolidated financial statements and the related management report** comply with the applicable principles and regulations, including the accounting standards permitted by law.

If through the examination it is determined that the financial statements are erroneous, the related company must publish the error and the reasoning in the electronic Federal Gazette and a multi-regional financial newspaper, when ordered to do so by BaFin.

2. Initiation of an Examination

The Panel will initiate an examination

1. if there are concrete indications of an infringement of financial reporting requirements (**examination with cause**)
2. at the request of BaFin, when certain indications exist, or
3. without any concrete indications based on random sampling (**random sampling examination**)

No examination with cause shall be conducted if it is evidently not in the public interest to conduct such an examination.

An enforcement examination will generally not occur if an action has been filed under § 256 of the German Stock Corporation Act to declare the adopted financial statements void or if a special auditor has been appointed in accordance with § 142 or § 258 of the German Stock Corporation Act (= **Hindrance Reasons**).

The Panel only examines financial statements if the company under examination is willing to cooperate with the Panel. If the company declares its **willingness to cooperate**, the legal representatives of the company and the other persons assisting the legal representatives in their cooperation with the Panel's examination shall be obliged to provide accurate and complete information and to submit accurate and complete documents.

The Panel shall notify BaFin if the company refuses to declare its willingness to cooperate or does not declare its willingness to cooperate within a reasonable period. Subject to its discretionary authority, BaFin will order an examination at the second tier level.

3. The Company's Cooperation with the Examination

The Panel contacts the **legal representatives** of the company under examination, usually the Management Board. They must declare whether they are willing to cooperate with the examination by the Panel or not, evidenced through a sufficient number of signatures so that it is legally enforceable. In addition, they are requested to name other people who are able to provide information about the company, to whom the Panel can address its questions.

The **financial statement auditor** may also be considered as another person who is able to provide information about the company. Including him in the examination process is preferable to facilitate an efficient and appropriate examination process. This should generally be in the interest of both the company and its financial statement auditor. If the financial statement auditor is named as a person who will provide information to the Panel, the company shall release him from his confidentiality obligation. It is also appropriate to involve the financial statement auditor because he is required to provide information to BaFin at the second enforcement tier without any additional conditions. The examination at the first tier should have access to the same sources of information as that on the second tier.

4. First Documents

When initiating its examination, the Panel requests the **audit reports** in addition to the individual or consolidated financial statements and the related management reports. These documents provide the Panel with an immediate overview of the material, company-specific accounting topics and facilitate in the selection of critical examination areas.

The Panel also requests the **list of unadjusted audit differences** as well as a statement from the legal representative that he believes that the effect of the unadjusted audit differences does not have a material effect, individually or in total, on the individual or consolidated financial statements or uncorrected disclosures in the management reports.

5. Examination Process

Once the company has declared its willingness to cooperate in the Panel's examination, the appropriate Panel **chamber**, determined based on the allocation plan and consisting of the President, Vice President and one additional Panel member, will name a Responsible Panel Member and the Quality Control Panel Member. The Responsible Panel Member and the

Quality Control Panel Member, who assists the Responsible Panel Member, are also both full-time Panel Members.

It is ensured that the Panel personnel involved in a specific case are independent from the company and its financial statement auditor in order to perform the examination in an impartial and unbiased manner. All persons are committed to a strict confidentiality requirement.

The **Responsible Panel Member** contacts the company. He will set the areas for examination based on the documents received when the company declared its cooperation. Additional correspondence, discussions and examination procedures will also take place with or relating to the company.

The Panel corresponds with the company in writing, either via mail or fax. The company may communicate with the Panel also using electronic means; however, it alone bears the dangers involved with sending emails. However, the company must make binding statements in writing.

It can be appropriate in certain cases to evaluate difficult accounting issues directly in a **discussion**, to which the financial statement auditors are also included, or to review detailed documents at the company's location. The Responsible Auditor will coordinate this with the company.

6. Scope of the Examination

The scope of an **examination with cause** is limited to each issue for which indications of an erroneous accounting treatment were identified. The Panel is not prevented, however, from extending the scope of the examination if other deviations from accounting standards are observed.

Regarding a **random-sample examination**, the Panel determines critical examination areas usually based on its review of the requested financial statements and audit reports. These areas focus on critical accounting issues or financial statement positions for which questions could exist concerning the appropriateness of the financial statements. Hence, also in this case the Panel examines based on a limited scope.

7. Examination Result

At the end of his examination, the Responsible Panel Member and the Quality Control Panel Member report to the responsible **chamber** which then determines whether the company's accounting complies with the required standards or whether erroneous accounting exists.

If the chamber determines that **the accounting is not erroneous**, the Panel reports this to the company and BaFin.

If the Panel decides that **the accounting is erroneous**, it asks the company whether it concurs with the presentation of the facts, the error and its reasoning. If it agrees, BaFin is informed and orders the publication of the error; unless no public interest for such a publication exists or, in rare cases, overwhelming company interests conflict with a publication.

If the company completely or partially does not concur with the error assertion, BaFin will initiate an enforcement examination at the second tier and subsequently confirm or refute the Panel results. Afterwards, BaFin will order a publication of the error, if appropriate.

8. Time and Costs of an Examination

The Panel is interested in an efficient enforcement examination; this must also apply to the companies and persons involved. Thus, the Panel requests adequate but short deadlines to respond to its questions or submit requested documentation.

Unnecessary delays to questions or submission of requested documents will be viewed by the Panel as a discontinuation of the company's corporation and the enforcement case will be referred to BaFin.

Since the examination concentrates on key issues or accounting questions, these should have already been reviewed in connection with the preparation and the audit of the financial statements. Therefore, if everything was properly documented, the information and explanations requested by the Panel should be available with minimal time and costs.

The Panel expenses are allocated to all capital market oriented companies, so that no additional costs arise for the company. In contrast, the costs incurred at the second enforcement tier by BaFin will be assessed if erroneous accounting has been determined.

For additional information, the Panel Members, in particular the Responsible Panel Member, are available.

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