

FREP Presidential Board

Berlin, 20 January 2020

Activity Report 2019

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1 Overview

- The error rate for 2019 of 20% exceeded that of the prior year. The higher error rate is mainly due to the fact that more indication-based examinations were completed than in the prior year and that the financial statements were found to be erroneous in all of these examinations. 79% of companies accepted the FREP's finding of an error, an acceptance rate similar to that of the prior year.
- In 2019, the FREP completed a total of 86 examinations (prior year: 84), including 79 unlimited scope examinations, six indication-based examinations, and one examination performed at the request of the BaFin.
- The number of publicly listed companies has stabilized at around 550 in the last three years.
- The enforcement of new financial reporting standards IFRS 15 and IFRS 9 has not yet resulted in any findings that financial statements are erroneous; however, the FREP has made recommendations to companies for future financial reporting purposes.
- The follow-up on 2018 shows that, to the extent determinable, the errors identified were once again corrected in the subsequent financial statements. As in prior years, companies implemented the recommendations made by the FREP.
- The focus was once more on error prevention activities. The considerable increase in the number of case-related ex-ante queries (2019: 5, 2018: 1) and of recommendations made (2019: 66, 2018: 49) deserves particular notice.
- FREP representatives continued to be highly committed to contributing to the steadily expanding European cooperation in 2019.
- The FREP's expenses of EUR 5.49 million were slightly higher than in the prior year (EUR 5.37 million).

2 Examinations in 2019

2.1 Key results of examinations

The FREP completed a total of 86 examinations in 2019 (prior year: 84). 17 out of these 86 examinations identified errors. The error rate of 20% exceeded that of prior years. The number of companies subject to the German enforcement regime has remained almost unchanged since 2017 (see Figure 1).

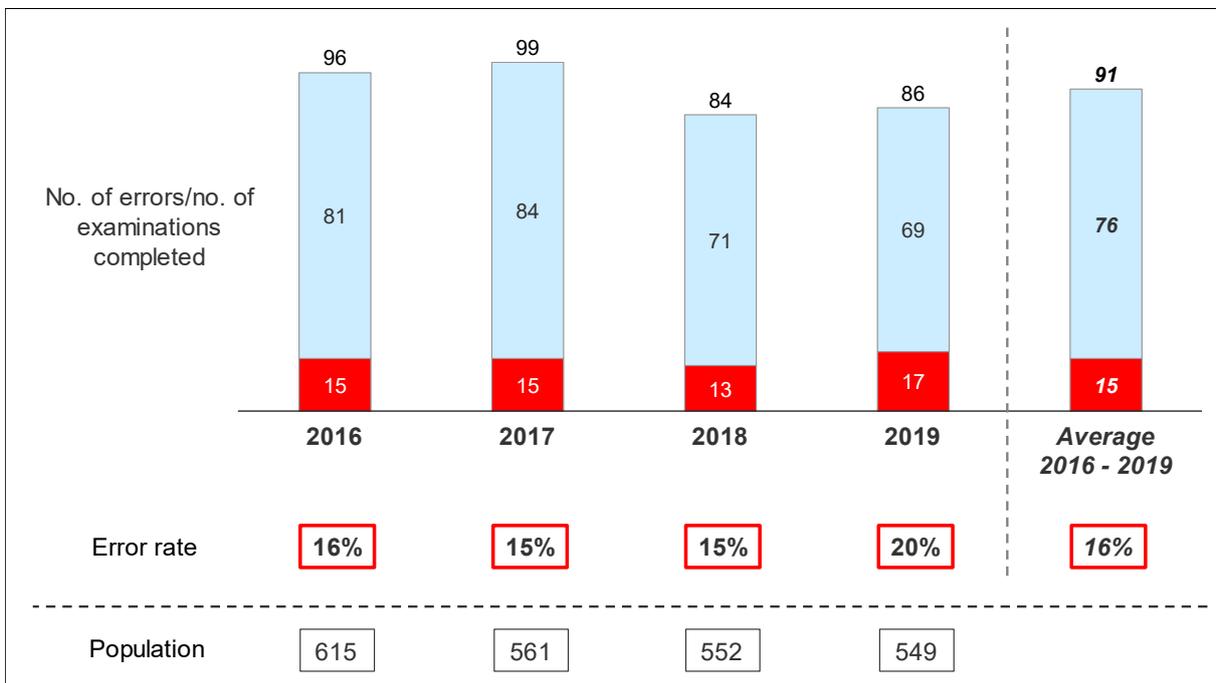


Figure 1: FREP examinations completed, error rate trend, and population

Error rate trend

The error rate for examinations completed in 2019 exceeds both the prior year error rate and the average error rate for the years 2016 to 2019. The higher error rate is mainly due to the fact that twice as many indication-based examinations were completed in 2019 as in 2018, all of them identifying errors (2019: six indication-based examinations, 2018: three indication-based examinations).

Number of examinations

Having steadily decreased over time since the FREP was founded, the population¹ has remained almost unchanged since 2017 (see Figure 1); 23 companies were eliminated from the prior year population, while 20 companies were added. In prior years, the decrease largely related to smaller companies not included in an index.

In order to adhere to the examination cycle specified in the FREP's selection principles for unlimited scope examinations (index companies are examined every four to five years, non-index companies every eight to ten years), the FREP has to complete approximately 70 to 90 examinations per year based on the current population. The number of examinations completed in 2019 falls within this interval (see Figure 1).

Analysis of examinations completed by type of examination

The examinations completed in 2019 consisted of the following: 79 out of 86 examinations completed were unlimited scope examinations. In addition, the FREP completed six indication-based examinations and one examination conducted at the request of the BaFin (see Figure 2).

The 13% error rate for unlimited scope examinations was slightly higher than in the prior year. During the period from 2016 to 2019, the average error rate for unlimited scope examinations completed was 12%. Just as in 2018, all financial statements subject to an indication- or request-based examination were found to be erroneous. This resulted in an average error rate for the period 2016 to 2019 for indication-based examinations of 79%; 56% of request-based examinations completed during the same period identified errors.

The increase in the absolute number of indication-based examinations completed during the year compared to the prior year was primarily attributable to two unlimited scope examinations in which issues became apparent that represented sufficiently concrete indications of infringements of financial reporting requirements by these companies' parent companies, which were publicly listed as well. The indication-based examinations of the parent companies initiated as a result and completed during the year found the financial statements to be erroneous, as had the unlimited scope examinations of the subsidiaries. In two other examinations, the FREP

¹ The population is determined annually by the BaFin as at 1 July of each year.

identified indications of a possible error as a result of the audit opinion issued by the auditors. These examinations also found that the financial statements were erroneous.

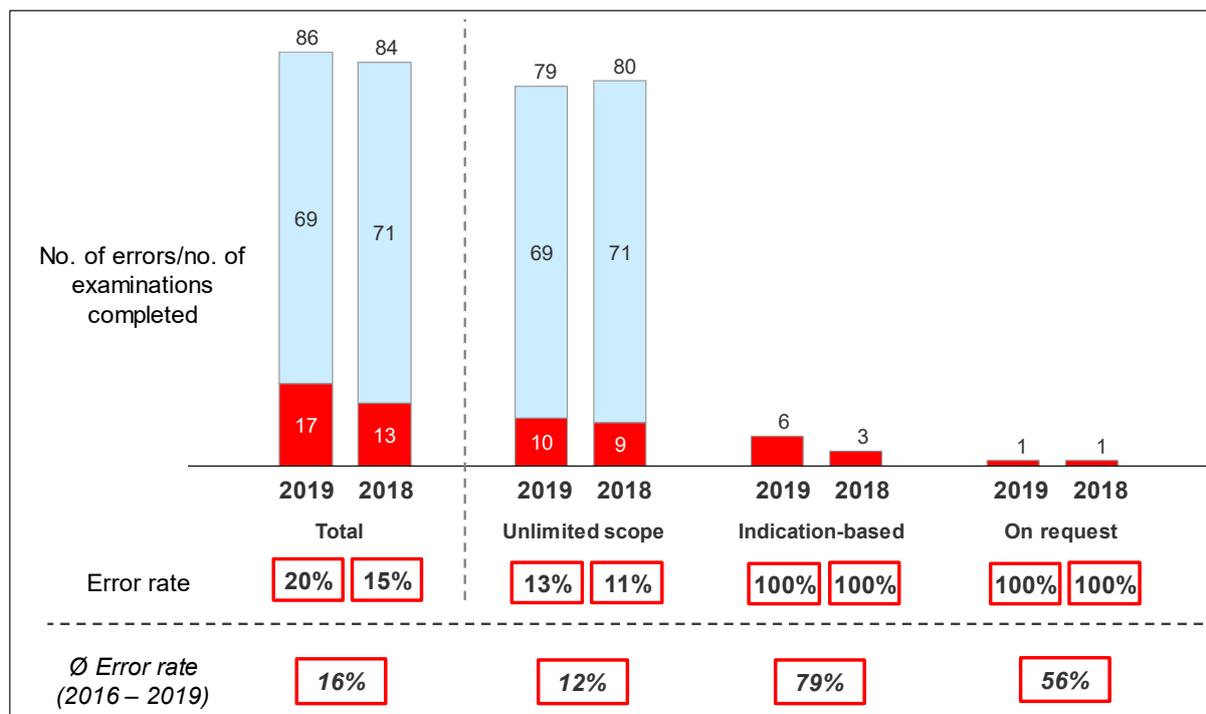


Figure 2: FREP examinations completed by type of examination (incl. error rates)

Analysis of indication- and request-based examinations initiated during the year

In 2019, the FREP’s Pre-Review Committee initiated seven indication-based examinations of annual financial reports. Apart from the causes described above, in most other cases the initiative for an examination came from the FREP’s Media Analysis Committee. In one instance, the examination was initiated based on information provided by an external third party.

In addition to the examinations discussed above, the BaFin identified concrete indications of an error in a semi-annual financial report in one case in 2019 and requested the FREP to initiate an examination (request-based examination).

Analysis of examinations completed by company size

An analysis of examinations completed by company size (i.e. inclusion in a stock index) shows that the error rate for index companies of 13% (prior year: 16%) for 2019 continued to exceed the average of the years 2016 to 2019 (8%) by a wide margin. For companies not included in a stock index, the error rate of 24% (prior year: 15%) was in line with the average of the past

four years (see Figure 3). The index companies whose financial statements were found to be erroneous in examinations completed during the year consisted of one MDAX, one TecDAX², and two SDAX companies.

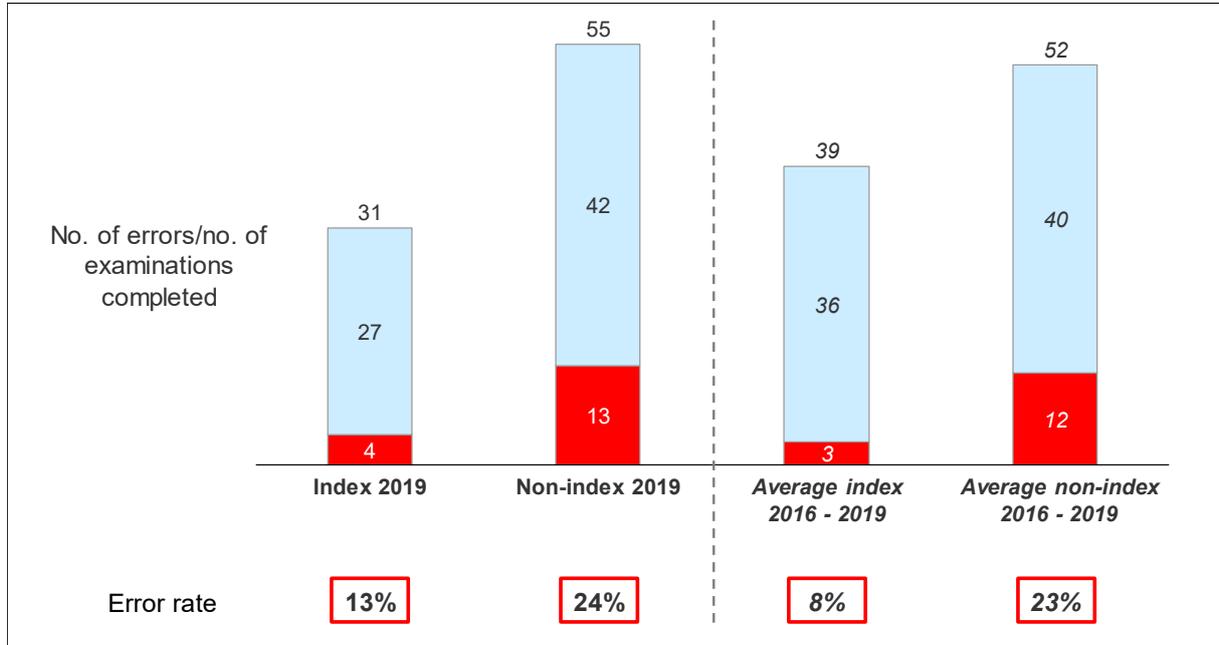


Figure 3: FREP examinations completed by index/non-index (incl. error rate)

² Inclusion in index before the reform of the stock indexes of Deutsche Börse AG effective 24 September 2018.

2.2 Types of errors and related analysis

The errors found in 2019 were once more attributable to the following factors:

- Comprehensiveness and application challenges of IFRS with respect to accounting for complex transactions
- Insufficient reporting in the notes and in the management report

First, it should be noted that the number of infringements identified has nearly doubled compared to the prior year (2019: 51 infringements, 2018: 26 infringements). Along with the increase in the number of completed examinations in which the financial statements were found to be erroneous, the main contributors to this change were two examinations completed in 2019 that identified nine infringements each, an unusually high number of infringements.

Figure 4 shows the errors most frequently identified:

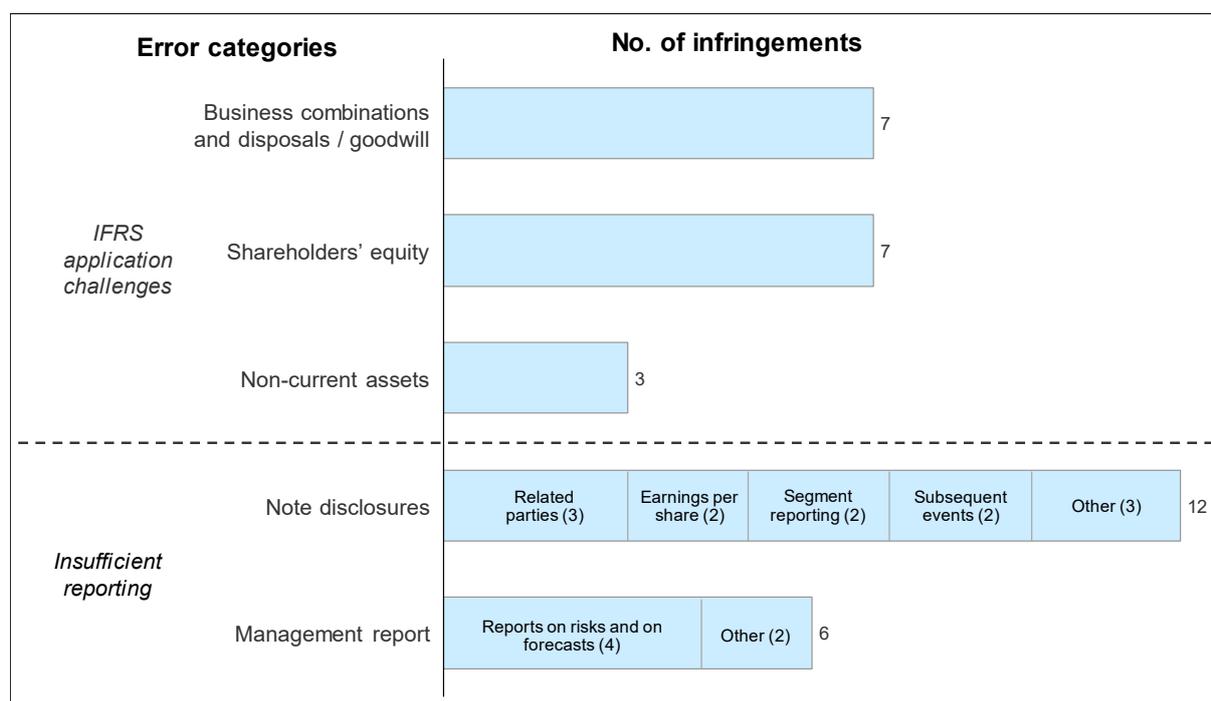


Figure 4: Most common types of errors

In 2019, application challenges of certain IFRS with respect to accounting for complex transactions related specifically to the issues of business combinations and disposals/goodwill, shareholders' equity, and non-current assets. Findings of an error in the business combinations and disposals/goodwill category related primarily to goodwill impairment tests performed inappropriately and to an erroneous purchase price allocation. The five findings of an error

relating to the impairment test were mainly due to the use of assumptions about future trends that fell outside a range of reasonably acceptable amounts. The seven infringements related to shareholders' equity were mainly attributable to an inappropriate accounting treatment of non-controlling interests, inappropriate recognition of transaction costs incurred in connection with an initial public offering, inappropriate recognition of a shareholder contribution as income, and recognition of a payment to offset losses under a profit and loss transfer agreement as income as well. Reasons for findings of errors in the non-current assets category included not sufficiently taking into account existing risks when determining the lower attributable value of non-current financial assets under HGB.

Insufficient disclosures in the notes and in the management report once again represented a significant source of errors in 2019. Figure 4 sets out the issues giving rise to the findings of an error in these categories. Seven of the 12 infringements in the note disclosures category were identified in the financial statements of two companies that were part of the same group.

2.3 Acceptance rate

When the FREP finds a financial report to be erroneous, it asks the company involved whether it accepts this finding. The finding of an error is normally preceded by a discussion with the company. This discussion is designed to give companies and their auditors the opportunity to present their perspective and arguments and to enter into open discussions. The FREP's representatives in turn explain their rationale for considering the accounting treatment or presentation in the notes/management report to be inappropriate.

The acceptance rate was 79% in 2019 (see Figure 5), approximately in line with the average for the years 2016 to 2019.

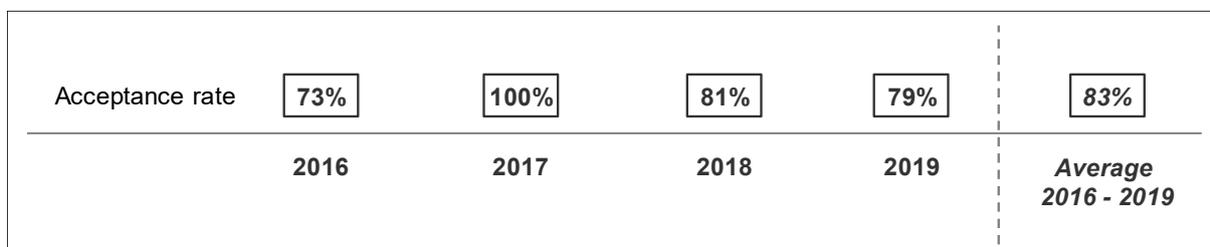


Figure 5: Trend in error acceptance rate

All examinations in which errors are found are referred to the BaFin, regardless of whether the company has accepted the finding. The BaFin normally initiates its own examination whenever

the company has not accepted the finding of an error or the company has refused to cooperate with the FREP in the examination. If the company accepts the finding, the BaFin makes the finding of an error public (2019: 12 examinations, including three examinations where the FREP had completed its examination in the prior year) or decides not to make the finding of an error public (2019: no examinations).

The BaFin initiated two examinations in 2019 because the companies had not accepted the FREP's finding of an error (prior year: three examinations). One examination in this category that the FREP had completed in 2017 was completed by the BaFin with the finding that the financial statements were erroneous and with publication of the error (prior year: three examinations from prior years).

In 2019, the FREP transferred four examinations to the BaFin because the companies refused to cooperate; three of these examinations related to the financial reports of the same company as at various reporting dates.³

³ At the time of writing of this activity report (early January 2020), two of these examinations had not yet been initiated by the BaFin since evaluations of the pre-requisites for opening a second-tier enforcement examination had not been completed yet.

2.4 Length of examinations

During the period from 2016 to 2019 examinations were completed in 8.1 months on average (see Figure 6). 83% of examinations were completed within one year, 40% within six months. About 17% of examinations lasted longer than one year. These cases frequently resulted in a finding of an error (45%).

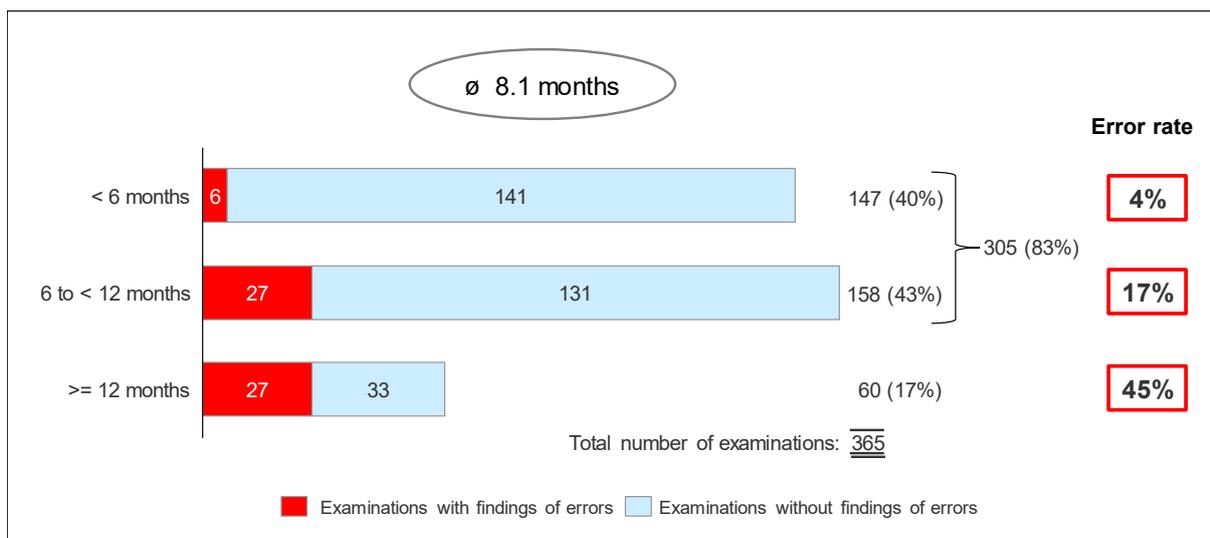


Figure 6: Length of examinations 2016 to 2019 (incl. error rate)

In 2019, examinations lasted an average of 8.4 months (prior year: 8.0 months).

After reviewing the documents submitted by the company at the beginning of the examination (specifically the financial report and related long-form audit reports issued by the auditors), the responsible panel member prepares an initial letter containing detailed inquiries on the areas being examined, which are specifically selected for each examination. Additional sets of questions may follow once the initial response has been critically reviewed. This normally occurs if the responsible panel member believes that issues have been identified that could potentially result in a finding that the financial statements are erroneous.

Therefore, the number of sets of questions in an examination is correlated to the error rate, as demonstrated by the following diagram of the number of sets of questions per examination completed in the period from 2016 to 2019:

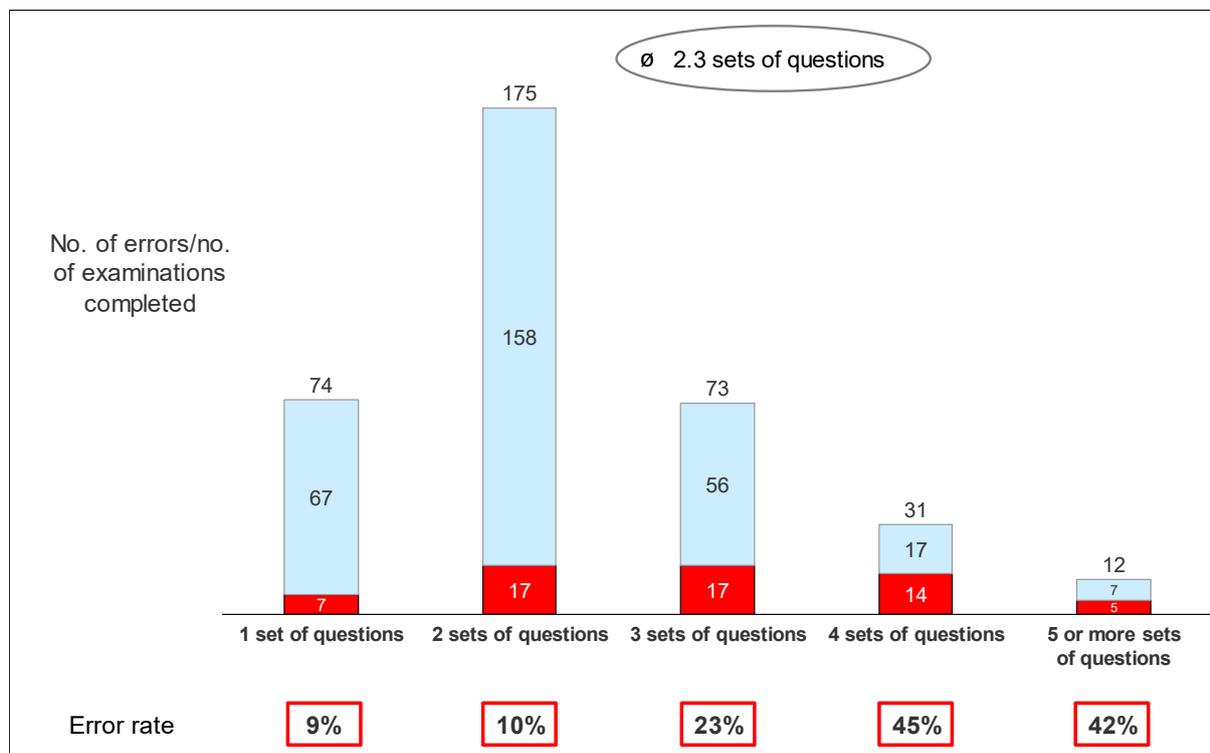


Figure 7: Number of sets of questions 2016 to 2019 (incl. error rate)

The average number of sets of questions in 2019 was 2.1 (prior year: 2.4).

2.5 Types of recommendations and related analysis

As part of its error prevention function, the FREP frequently makes recommendations to companies during the examination in order to help rectify weaknesses in future financial statements and thus improve the quality of future financial reporting (see chapter 3.1).

Figure 8 shows the most common categories of recommendations:

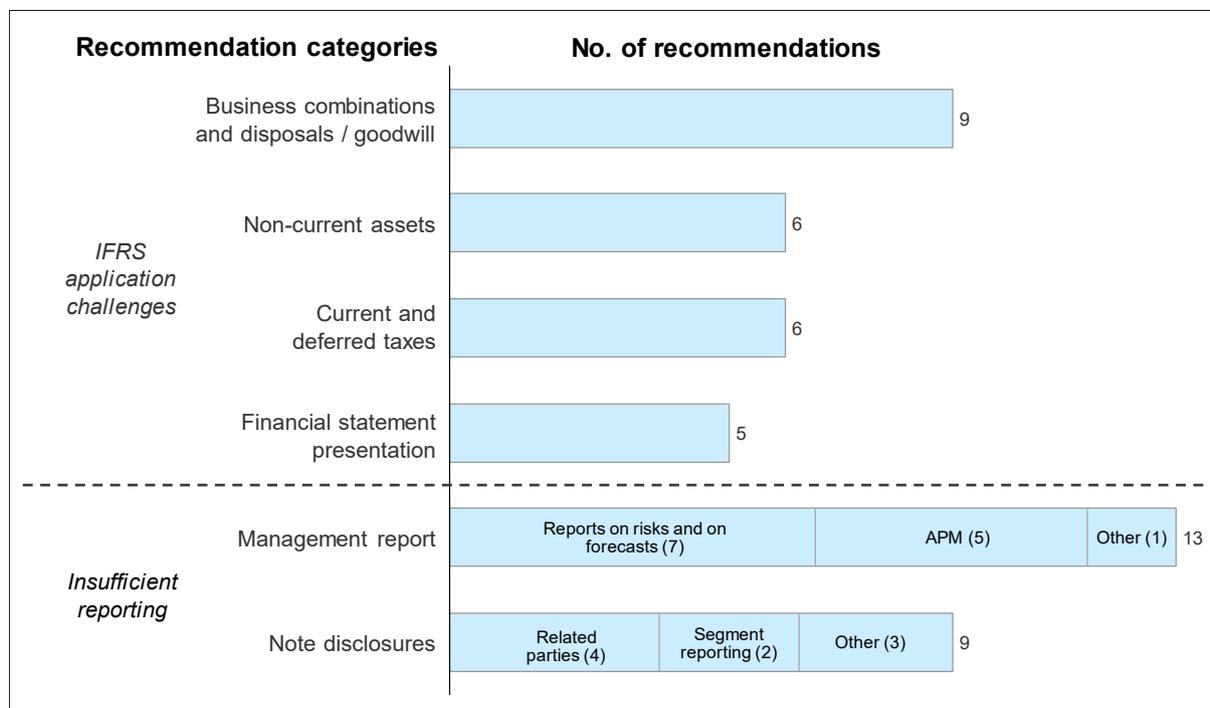


Figure 8: Most common types of recommendations

In 2019, recommendations were once more attributable especially to insufficient reporting in the notes and management reports. Figure 8 sets out the issues giving rise to the recommendations in these categories. Five recommendations made during the year demonstrate the significant importance of reviewing company-specific performance indicators referred to in section 315 (1) sentence 3 HGB to enforcement in Germany. The FREP also reflects the “ESMA Guidelines on Alternative Performance Measures (APM)” in these examination activities since their requirements are largely identical with the current version of GAS 20 issued in December 2017 (see chapter 4.2 for a discussion of a recent ESMA study on APMs). The recommendations included in “Other” in the note disclosures category were made to improve note disclosures on joint ventures, sale and leaseback transactions, and the IAS 36 impairment test. Further, application challenges of IFRS were noted with respect to accounting for complex transactions especially in the business combinations and disposals/goodwill, non-current assets, current and deferred taxes, and financial statement presentation categories.

Attachment II [*in German only*] to this report sets out selected anonymized recommendations for future financial reporting purposes made by the FREP in these and other categories in 2019.

2.6 Enforcement of new financial reporting standards IFRS 15 and IFRS 9

Examinations focused on the (initial) application of IFRS 15 and IFRS 9 in 2019, since these were selected as enforcement priorities. The two new financial reporting standards have significantly increased the workload of companies, auditors, and the FREP.

Where examinations gave rise to IFRS 15-specific questions, the FREP established internal working groups aimed at evaluating these questions as consistently as possible. Issues these working groups discussed with the relevant companies included various questions related to revenue recognition over time, distinguishing between principal and agent, combination of contracts, alliances and cooperations, as well as on disaggregation and presentation of revenue.

Especially in examinations of credit institutions, IFRS 9 was selected as an individual enforcement priority. Examinations dealt with issues including methods implemented to determine significant deterioration in credit quality and the new disclosure requirements in IFRS 7 that were introduced along with IFRS 9.

The examinations completed during the year did not identify any infringements of the requirements of IFRS 15 or IFRS 9 that would have resulted in a finding that the financial statements were erroneous. However, the FREP made a few recommendations to companies for future financial reporting purposes as part of its preventative function (see Attachment II [*in German only*]).

2.7 Follow-up

The FREP follows up on the correction of errors found in the prior year as well as on the implementation of recommendations made in the prior year based on publicly available information. If, at the time of the follow-up, a company is no longer subject to the enforcement regime, financial statements are not available, or an examination is still pending at the second tier, i.e. with the BaFin, the follow-up is omitted. As in prior year, where the FREP was able to determine whether errors found in the prior year were corrected and recommendations made were implemented, it found that the correction or implementation had indeed been made.

The FREP will continue to follow up timely on whether errors are corrected and recommendations are implemented.

2.8 Decision of the Oberlandesgericht (*Higher Regional Court*) Frankfurt/Main regarding enforcement

In February 2019, the Oberlandesgericht (OLG) Frankfurt/Main issued a decision on a finding of an error in an enforcement procedure - Wertpapiererwerbs- und Übernahmegesetz [*Securities Acquisition and Takeover Act (WpÜG)*] 3/16, WpÜG 4/16. The decision was based on the following facts: As part of its examination of the company's 2012 consolidated financial statements, the FREP had sent a preliminary finding of an error to the company, which ceased to cooperate in the FREP examination in response. The BaFin then opened the examination at the second tier, which was completed with a finding that the financial statements were erroneous, containing four separate infringements. Following unsuccessful objection proceedings, the company then filed a judicial complaint against the finding of an error and the order to publicize the error with the OLG. At the same time, the company sought temporary judicial relief by applying to have publication of the finding of an error waived; however, the application was denied - WpÜG 1/15, WpÜG 2/15. As a result, the company had to publish the finding of an error in the Bundesanzeiger (*Federal Gazette*).

The OLG issued a decision in the case in February 2019, partly upholding the company's judicial complaint against the rejection of its objections to the finding of an error and the publication order. The company then published a corrected finding of an error in June 2019.

One of the pivotal issues in the proceedings was the question of whether the evaluation of an infringement of financial reporting requirements should be based on an objective or subjective concept of an error. The OLG's decision rejects the subjective concept of an error.⁴

The OLG further stated that in order to conclude – in an enforcement procedure – that the financial statements are erroneous, the infringement has to be material not only quantitatively, but from a qualitative perspective as well. The reason is that both of these aspects are essential to assessing materiality, i.e. to evaluating whether “infringements are relevant to the investor and other institutions active in the capital markets, meaning, in particular, whether they can affect the presentation of the performance of the business and the resulting assessments of the future performance of the group or company”.⁵

The decision and its practical implications are currently the subject of extensive discussion in the technical literature.⁶

⁴ See OLG Frankfurt a.M., 4.2.2019 - WpÜG 3/16, WpÜG 4/16, pg. 26.

⁵ See OLG Frankfurt a.M., 4.2.2019 - WpÜG 3/16, WpÜG 4/16, pg. 46.

⁶ Regarding the decision of the OLG, see, for instance: Böcking/Gros/Wirth, *Der Konzern*, issue 6 2019; Böcking/Gros/Wirth, *Der Betrieb*, issue 48 2019; Lüdenbach/Freiberg, *Der Betrieb*, issue 42 2019; NJW-Spezial, issue 10 2019; Lüdenbach/Freiberg, *Der Betrieb*, issue 48 2019; Pöschke, *Die Wirtschaftsprüfung*, issue 16 2019.

3 Error prevention

3.1 Overview

As in prior years, the FREP once again undertook several activities in 2019 to help avoid future errors in financial statements (see Figure 9).



Figure 9: Error prevention activities of the FREP

In 2019, the FREP made 66 individual recommendations with respect to future financial statements to companies subject to examinations (see chapter 2.5 for categories of recommendations). Selected anonymized recommendations for future financial reporting purposes made by the FREP in 2019 are set out in Attachment II to this report *[in German only]* to facilitate a more general preventative effect of these recommendations beyond the relevant company subject to examination.

In addition, the FREP announced its enforcement priorities for 2020 in November 2019 in order to give companies and auditors an opportunity to critically review the corresponding accounting issues in depth during the preparation and audit of financial reports (see chapter 3.2 for further detail).

Another of the FREP's error prevention instruments is the case-related ex-ante query, which helps avoid errors and provide guidance to companies during financial statement preparation. Companies utilized this instrument somewhat more extensively again in 2019 (see chapter 3.4 for further detail).

Furthermore, the FREP's prevention activities once more included its annual discussions with audit firms in 2019 (see chapter 3.3 for further detail). The FREP also continued to share experiences with audit committee members regarding enforcement-related issues using a variety of platforms in 2019.

To improve the quality of financial reporting standards, the FREP's preventative instruments include a regular dialog with standard setters as well. Thus, the FREP continued monitoring the issue of goodwill impairment testing and the IASB primary financial statements project – both already addressed in the prior year – and commented on these issues at a variety of events.

Furthermore, the FREP's preventative measures also focused on public relations activities in the form of speeches, seminars, as well as articles and commentaries in 2019 (see chapter 3.5 for further detail).

3.2 Enforcement priorities for 2020

As in prior years, the FREP published its enforcement priorities for the following calendar year in the fourth quarter of 2019. These are addressed by the FREP in unlimited scope examinations to the extent they are material.

The following enforcement priorities were set for 2020:

1. Specific issues related to the application of IFRS 16 Leases
2. Follow-up of specific issues related to the application of
 - IFRS 9 Financial Instruments for credit institutions
 - IFRS 15 Revenue from Contracts with Customers for corporate issuers
3. Specific issues related to application of IAS 12 Income Taxes (including application of IFRIC 23 Uncertainty over Income Tax Treatments)
4. Impairment testing of goodwill and intangible assets with indefinite lives, particularly brands – IAS 36
5. Group management report

The first three enforcement priorities represent the “European Common Enforcement Priorities” identified by national enforcers in cooperation with ESMA.⁷ The “European Common Enforcement Priorities” include the new standard IFRS 16, that became effective during the calendar year 2019, and a follow-up to new standards IFRS 15 (for corporate issuers) and IFRS 9 (for credit institutions), that became effective during the previous calendar year. A further priority is the standard IAS 12, partly due to the interpretation IFRIC 23 becoming effective in 2019.

The two enforcement priorities “impairment testing of goodwill and intangible assets with indefinite lives, particularly brands – IAS 36” and “group management report” represent the FREP’s national enforcement priorities.

The FREP has decided to address the issue of goodwill impairment testing more extensively again because the high carrying amount of goodwill renders it a high risk in numerous

⁷ Further issues potentially relevant to the FREP are the note disclosures on the impact of a new benchmark interest rate on the financial statements (Amendments to IFRS 9 (and IAS 39): Financial Instruments - Interest Rate Benchmark Reform) and the potential consequences of various Brexit scenarios. The common European enforcement priorities along with detailed explanations can be downloaded from the ESMA website.

consolidated financial statement of publicly listed companies and, in addition, initial indications are emerging of an economic slowdown in Germany. Further, numerous examinations identified errors in impairment tests of goodwill and intangible assets with indefinite lives as well as in group management reports.

The national priorities also expand on the enforcement priority related to IFRS 16. The impact of IFRS 16 on impairment testing of goodwill, the presentation of net assets, financial position, and earnings, and the calculation of key performance indicators in the group management report is especially significant from that perspective.

The details of the FREP's national enforcement priorities are as follows:

Impairment testing of goodwill and intangible assets with indefinite lives, particularly brands – IAS 36

- Identifying the appropriate level for impairment testing (segment limits IAS 36.80 (b), cash generating unit (CGU) instead of individual asset IAS 36.22; IAS 36.66)
- Estimating value in use using reasonable assumptions and taking into account the risks specific to the asset or CGU (IAS 36.30 et seq.; IAS 36.A17 (a))
- Estimating fair value less costs of disposal from the perspective of independent market participants (IFRS 13.22) and taking into account the fair value hierarchy (IFRS 13.72 et seq.); if applicable, requirement to calibrate inputs upon initial recognition using the transaction price (IFRS 13.64)
- Determining the impact of IFRS 16 on the goodwill impairment test

Group management report

- Presentation of impact of IFRS 16 on the net assets, financial position, and earnings (section 315 (1) sentence 1 HGB)
- Presentation and calculation of key performance indicators taking into account the initial application of IFRS 16, particularly adjusting for certain items to arrive at alternative performance measures, preparation of a reconciliation to the consolidated income statement (section 315 (1) sentences 2 and 3 HGB)

3.3 Discussions with audit firms

Each year, the FREP holds discussions with the management boards or managing directors of the five largest German audit firms. Discussions are also held with the managing directors of two medium-sized audit firms each year; these discussions were started in 2018 and different firms are selected each year. The aim of these talks is twofold: to provide insight on the FREP's activities using specific cases as well as to give the audit firms an opportunity to report on observations and results of past examinations from their point of view. This year discussion topics included errors identified in the most recent round of examinations, issues noted in the financial reports of companies audited by the relevant audit firm, regulatory issues, as well as current developments in the operational and organizational structure of the relevant audit firm.

Once a year, the FREP also shares experiences with representatives of medium-sized audit firms auditing publicly listed companies via the platform of the IDW. This event is intended to make the FREP's approach transparent to auditors in order to raise the auditors' awareness of potential problem areas. In January 2019, the FREP took the opportunity provided by this event to discuss the enforcement priorities for 2019 in detail in order to make auditors aware of the associated sources of errors.

3.4 Case-related ex-ante queries

The case-related ex-ante query, an instrument introduced just over ten years ago, was utilized five times in 2019 (prior year: once). Four of the five case-related ex-ante queries received in 2019 met the requirements to be accepted for review by the FREP. Three of the four case-related ex-ante queries accepted were completed by year-end; the FREP considered the proposed accounting treatment unacceptable in all cases. The case-related ex-ante queries completed during the year dealt with issues related to revenue recognition, initial preparation of

consolidated financial statements, and distinguishing between principal and agent under IFRS 15.

From their introduction to the end of 2019, the FREP has completed a total of 23 case-related ex-ante queries, considering the proposed accounting treatment acceptable in 11 cases and not acceptable in 12 cases.

Ex-ante queries are dealt with as timely as possible to provide guidance to the enquiring companies when preparing their financial statements, thus fulfilling the instrument's preventative function.

3.5 Public relations activities

In 2019, the FREP once more fulfilled the general public relations aspect of its error prevention function by giving speeches and seminars. The Presidential Board, the managing director, and the FREP's members utilized various platforms and technical conferences to provide insight into the FREP's work and approach as well as into technical topics specific to financial reporting. Representatives of the FREP gave presentations and participated in discussions at more than 20 technical conferences, primarily to financial statement preparers, auditors, and supervisory board members.

The speeches dealt mainly with national and European developments in enforcement. Topics of speeches and discussions also included initial experiences with enforcing new financial reporting standards IFRS 15 and IFRS 9 as well as financial reporting issues prone to error, such as accounting for goodwill. In addition, as in prior years, the panel's Presidential Board delivered a speech on the enforcement priorities issued for the following year at the annual "Financial Statement Oversight" conference of Deutsches Aktieninstitut in November 2019.

4 Developments in Europe

4.1 ESMA Corporate Reporting Working Groups

In order to further harmonize enforcement in Europe, ESMA has various working groups on Corporate Reporting in which FREP representatives were members in 2019 (see Figure 10).

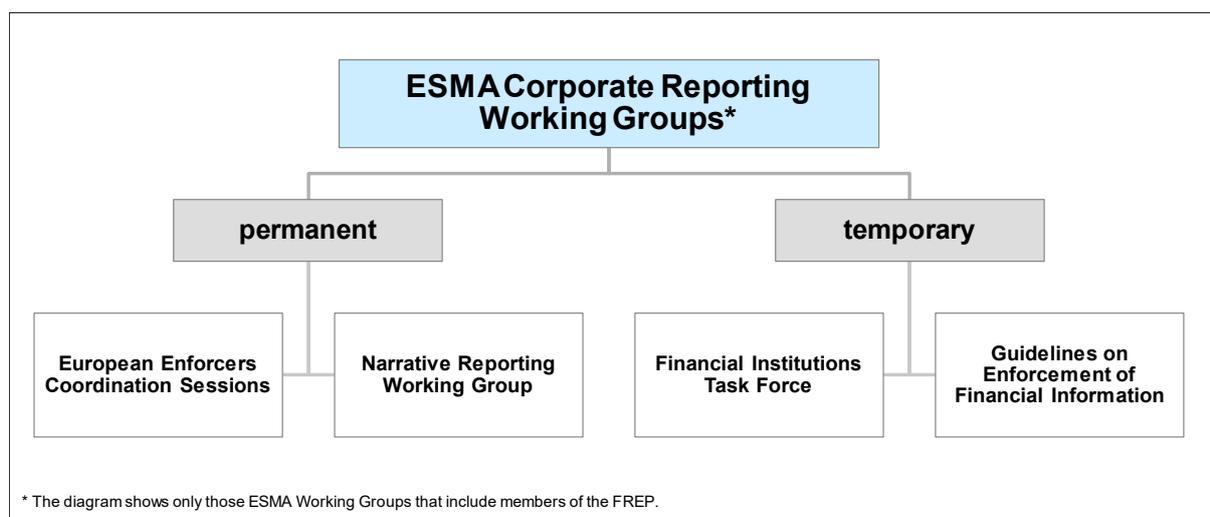


Figure 10: Overview of ESMA Working Groups

These memberships include the FREP’s active participation in the “European Enforcers Coordination Sessions” (EECS), which remained a key component of European cooperation in 2019. The EECS represents a permanent forum for national enforcers and ESMA to discuss IFRS application issues of transnational interest that meets approximately nine times per year. In 2019, the FREP presented, on an anonymous basis, issues in the EECS meetings arising either from ongoing examinations as emerging issues (i.e. before a decision was taken in the national enforcement procedure) or from decisions taken in actual examinations. ESMA publishes extracts containing selected decisions of national enforcers discussed at the EECS meetings. A total of 253 decisions by national enforcers have been published in the 23 extracts published to date; for legal reasons, cases from Germany are not included.

In addition to attending EECS meetings, representatives of the FREP participate or participated in sub-groups of the EECS. Particularly worthy of mention is “Sub-group of EECS on IAS 12 Income Taxes”, which was coordinated by a representative of the FREP; publication of

ESMA Public Statement on IAS 12 Income Taxes⁸ in July 2019 brought this sub-group to a successful close. This Public Statement addresses recognition, measurement, and disclosure requirements for deferred tax assets arising from unused tax losses.

A member of the FREP also participates in the permanent “Narrative Reporting Working Group” implemented last year. This working group was established in order to help create consistent, efficient, and effective enforcement practices for nonfinancial information and alternative performance measures. In 2019, the working group dealt mainly with a study on the ESMA Guidelines on Alternative Performance Measures (see chapter 4.2). The members of the working group also discussed the various frameworks for preparation and disclosure of nonfinancial reports, since nonfinancial information continues to become increasingly significant.

The two temporary working groups established in the prior year continued their activities in 2019. The “Guidelines on Enforcement of Financial Information Task Force” is working on partially revising the ESMA Guidelines on Enforcement issued in 2014 in light of the results of the 2016 and 2017 ESMA Peer Reviews; the revised version is expected to be published in early 2020. Application issues relating to IFRS 9 Financial Instruments and to IFRS 17 Insurance Contracts, which is currently still in the endorsement process, are the subject of the “Financial Institutions Task Force”. Representatives of the FREP contribute their knowledge and experience to these two task forces as well.

⁸ See ESMA32-63-743 “Considerations on recognition of deferred tax assets arising from the carryforward of unused tax losses”.

4.2 ESMA Guidelines on Alternative Performance Measures

ESMA study on the implementation of the Guidelines

The ESMA published “ESMA Guidelines on Alternative Performance Measures (APM)” in 2015 in order to help improve the comparability, reliability and comprehensibility of published financial information in Europe.⁹ The Guidelines are applicable to measures that are presented outside of the financial statements (e.g. in the management report) and that are not defined in a financial reporting standard (e.g. EBIT, adjusted EBITDA, ROCE).

In 2019, three years after the Guidelines became effective, the ESMA, together with the national enforcers, conducted a study in order to investigate the implementation and application of the Guidelines. The study focused on the use of APMs in reports as well as on compliance with the Guidelines. The study included a review of the group management reports of 123 companies from 27 countries. The ESMA concluded that only 16 companies fully complied with the Guidelines (i.e. each APM published complies with all of the Guidelines); all other companies were only partially in compliance with the Guidelines. The full report titled “On the use of Alternative Performance Measures and on the compliance with ESMA’s APM Guidelines” was made available to the public in December 2019.¹⁰

FREP enforcement of the Guidelines in Germany

As part of the ESMA study on the implementation of the Guidelines, the FREP analyzed the group management reports of a number of selected German companies. From an enforcement perspective, this desktop review showed largely positive results regarding compliance with the Guidelines for this non-representative sample. About one third of the 241 APMs identified were adjusted. The most commonly used APMs included gross profit and EBIT, followed by free cash flow, adjusted EBIT, and net capital employed.

⁹ The Guidelines can be downloaded from the ESMA website.

¹⁰ The report can be downloaded from the ESMA website.

The review showed that APMs were most frequently adjusted for items related to consolidation, currency translation, and restructuring (see Figure 11).

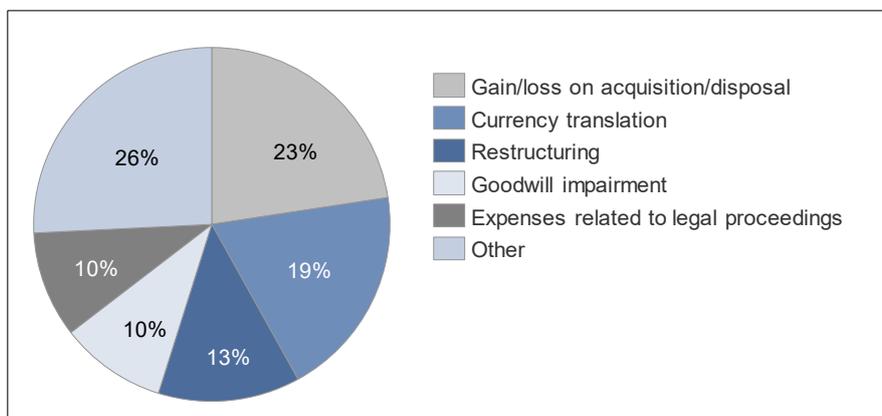


Figure 11: Most common types of adjustments

The positive results regarding compliance with the Guidelines are not entirely surprising, since Germany has had extensive requirements on the use and presentation of APMs in management reports in place in the form of German Accounting Standard - GAS 20 for several years.

In 2019, in addition to participating in the ESMA study, the FREP also continued to apply the Guidelines in actual examinations when examining management reports related to consolidated IFRS financial statements or stand-alone HGB financial statements as well as during examinations of interim management reports. Where it identifies discrepancies or departures from GAS 20 or the Guidelines, the FREP brings the requirements of GAS 20 and the Guidelines to the companies' attention as part of its error prevention function. Five of a total of 13 recommendations made on the group management report during the examinations completed in 2019 concerned the use and presentation of APMs, such as the labeling and explanation of APMs as well as the unbiased elimination of nonrecurring items (see chapter 2.5).

In 2020, the FREP will continue to focus on the presentation of APMs – especially in connection with the initial application of IFRS 16 – in line with the European focus on the issue of APMs and the German enforcement priority “Group management report” (see chapter 3.2).

4.3 European Single Electronic Format

The amendment to the “EU Transparency Directive”¹¹ in 2013 required companies with securities listed on a regulated market within the EU to prepare their annual financial reports for fiscal years beginning on or after 1 January 2020 in the uniform “European Single Electronic Format” (ESEF). This requirement is further elaborated in the regulatory technical standard (RTS) developed by the ESMA and the ESEF regulation¹² issued by the European Commission.

As part of the process of implementing these European requirements in national law, the BMJV and the BMF issued a Ministerial Draft [*Referentenentwurf*] of the planned amendment in late September 2019.¹³ This draft is currently being discussed and commented on in the technical literature and by several organizations. Especially the plan to locate the new reporting requirements within the requirements regarding the preparation of financial statements is meeting with criticism from several stakeholders.¹⁴

The FREP currently anticipates that future enforcement examinations will have to cover annual financial reports prepared in the ESEF format, regardless of where in German law the ESEF reporting requirements are implemented – in the requirements for the preparation of financial statements or those for their publication.

¹¹ Directive 2013/50/EU of 22 October 2013.

¹² Delegated Regulation (EU) 2018/815 of 17 December 2018.

¹³ Ministerial Draft: Gesetz zur weiteren Umsetzung der Transparenzrichtlinie-Änderungsrichtlinie im Hinblick auf ein einheitliches elektronisches Format für Jahresfinanzberichte [*Act on the Further Implementation of the Directive Amending the Transparency Directive Regarding a Single Electronic Format for Annual Financial Reports*]; available from the BMJV and BMF websites.

¹⁴ Various comment letters on the above draft are available from the BMJV website.

5 Acknowledgements and outlook

The FREP was able to continue its work successfully in 2019 and would like to thank the companies examined and their auditors for their willingness to cooperate and for the extensive technical discussions. The FREP would also like to extend its particular gratitude to those who have generously supported it: The members of the FREP association, its Governing Board and Nomination Committee, as well as our advisory group, the responsible bodies at the BMJV, at the BMF, and in particular the BaFin, the APAS, the ASCG, the audit firms, the IDW, and the WPK. Special thanks go to the vice president, managing director, panel members, and office staff for their consistently excellent work.

In 2020, extensive regulatory changes – both at the national and at the international level – will pose challenges, not just for the FREP:

- In 2020, the public and politicians, particularly the European Commission, will continue to focus on enforcing the CSR Directive. The ESMA's recommendations to the European Commission, such as mandatory inclusion of the nonfinancial statement in the management report and requiring assurance on its contents as part of the financial statement audit, were made in this context.¹⁵ In Germany, this would likely subject CSR reports, as well, to the German enforcement regime.
- In 2020, the FREP will need to prepare for the enforcement of ESEF, which is expected to become one of the FREP's responsibilities starting in 2021. However, the specific implementation of the European requirements in national law and, therefore, the exact definition of the FREP's responsibilities are still outstanding.
- The FREP is also looking forward to the IASB discussion paper on goodwill impairment testing expected to be published in early 2020, as the continually increasing carrying amounts of goodwill in the statements of financial position of companies listed on the regulated market represent a significant risk to the capital markets. The IASB's narrow decision against reintroducing amortization of goodwill as well as the FASB's amortization option provided to certain groups of companies demonstrate that the standard setters have at least critically reviewed the financial reporting risk resulting from the impairment-only approach.

¹⁵ The ESMA report "Undue short-term pressure on corporations" published on 18 December 2019 can be downloaded from the ESMA website.

In the European context, the FREP, together with the BaFin, will continue to work closely with the European enforcers in 2020 as well. As part of these activities, representatives of the FREP will regularly attend the meetings of the various ESMA Working Groups.

Finally, the FREP will continue its extensive prevention activities in order to help improve the quality of financial reporting for the long term in the 15th year of its existence as well.

Professor Dr. Edgar Ernst
(President of the Enforcement Panel)

List of abbreviations

APAS	German Audit Oversight Body (<i>Abschlussprüferaufsichtsstelle</i>)
APM	Alternative Performance Measure
ASCG	Accounting Standards Committee of Germany (<i>Deutsches Rechnungslegungs Standards Committee e. V.</i>)
BaFin	Federal Financial Supervisory Authority (<i>Bundesanstalt für Finanzdienstleistungsaufsicht</i>)
BMF	Federal Ministry of Finance (<i>Bundesministerium der Finanzen</i>)
BMJV	Federal Ministry for Justice and Consumer Protection (<i>Bundesministerium der Justiz und für Verbraucherschutz</i>)
CSR	Corporate Social Responsibility
EBIT	Earnings before interest and taxes
EBITDA	Earnings before interest, taxes, depreciation, and amortization
EECS	European Enforcers Coordination Sessions
ESEF	European Single Electronic Format
ESMA	European Securities and Markets Authority
EU	European Union
FREP	Financial Reporting Enforcement Panel (<i>Deutsche Prüfstelle für Rechnungslegung DPR e. V.</i>)
GAS	German Accounting Standard
HGB	German Commercial Code (<i>Handelsgesetzbuch</i>)
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IDW	Institute of Public Auditors in Germany (<i>Institut der Wirtschaftsprüfer e. V.</i>)
IFRS	International Financial Reporting Standards
ROCE	Return on capital employed
RTS	Regulatory technical standard
WPK	German Chamber of Public Accountants (<i>Wirtschaftsprüferkammer KöR</i>)

Attachment

Attachment I: How to access previously published findings of an error



Findings of an error published to date [*in German only*] can be accessed via the website of the Federal Gazette as follows:

1. Open the German-language website of the Federal Gazette: www.bundesanzeiger.de
2. Switch language to English by clicking on the British flag
3. Click on the “Search” tab
4. Under the heading “Accounting/financial reports”, select “Error notices”
5. Click the “Search” button

Attachment II: Selected anonymized recommendations for future financial reporting purposes made by the FREP in 2019 [in German only]

Recommendations 2019	
Management reports	<ul style="list-style-type: none"> • Im Konzernlagebericht sind zukünftig die Risiken entsprechend der internen Risikoberichterstattung zu quantifizieren (DRS 20.152), so dass im Rahmen der Beurteilung der Risiken (§ 315 Abs. 1 Satz 4 HGB) deren Bedeutung besser erkennbar wird (DRS 20.150). • Die Risikoberichterstattung ist zukünftig an den spezifischen Gegebenheiten des Konzerns und den mit seiner Geschäftstätigkeit verbundenen Risiken auszurichten (§ 315 Abs. 1 Satz 4 HGB i.V.m. DRS 20.146 f.). • In der Risikoberichterstattung des Konzernlageberichtes sind, entsprechend der internen Risikoberichterstattung, zukünftig gemäß DRS 20.152 die finanziellen Auswirkungen der berichteten Risiken in Bandbreiten zu quantifizieren. • Auf die Verwendung des Begriffes „operationelles EBIT“ sollte künftig verzichtet werden, da der Großteil der in dieser Größe berücksichtigten Bereinigungsposten einen operativen Charakter hat. Dies gilt insbesondere auch für die Bereinigung von Reorganisations- und Restrukturierungsaufwendungen, da solche Aufwendungen regelmäßig anfallen und von ihrer Art her weder einmalig noch nicht operativ sind. • Soweit Sie auch zukünftig im Konzernlagebericht bei der Darstellung der Ertragslage Einmaleffekte aus dem Konzernergebnis bereinigen, sollten im Sinne einer verständlichen und konsistenten Lageberichterstattung neben Einmalaufwendungen auch wesentliche Einmalserträge (wie Gewinne aus dem Verkauf von Tochtergesellschaften) eliminiert werden (§ 315 Abs. 1 HGB, vgl. auch ESMA Leitlinien zu alternativen Leistungskennzahlen, Tz. 41). • Der Begriff „Auftragsbestand“ umfasst nach allgemeinem Verständnis den erwarteten künftigen Umsatz aus vorliegenden verbindlichen Kundenverträgen. Künftig ist dieser Begriff im Rahmen der Lageberichterstattung nur in dieser Bedeutung zu nutzen. • In der Vorperiode berichtete Prognosen sind zukünftig im Konzernlagebericht mit der tatsächlichen Geschäftsentwicklung zu vergleichen (§ 315 Abs. 1 HGB i.V.m. DRS 20.57).

Recommendations 2019

Management reports	<ul style="list-style-type: none"> • Im Hinblick auf eine konsistente, ausgewogene und umfassende Berichterstattung (§ 315 Abs. 1 HGB) sowie dem Einklangerfordernis der Konzernlageberichterstattung mit dem Konzernabschluss sind zukünftig Sonderaufwendungen in die Prognose einzubeziehen. Dem steht nicht entgegen, dass diesbezüglich besondere Unsicherheiten zum Ausdruck kommen. Im Hinblick darauf, dass Risiken definiert werden als mögliche Ereignisse oder Entwicklungen, welche zu einer negativen Prognose- bzw. Zielabweichung führen können (DRS 20.11), ist zudem unabhängig vom Wirkungszeitraum langfristiger Risiken (DRS 20.156) auch deren Bedeutung für den Prognosezeitraum zum Ausdruck zu bringen.
Note disclosures	<ul style="list-style-type: none"> • In der Segmentberichterstattung sind zukünftig intersegmentäre Umsatzerlöse, die im internen Reporting bei der Ermittlung der Ergebnisgrößen einbezogen werden, gesondert auszuweisen (IFRS 8.23 (b)) und die diesbezüglich angewendeten Rechnungslegungsmethoden zu erläutern (IFRS 8.27 (a)). • Zudem sind Informationen über Geschäftsaktivitäten, die nicht den berichtspflichtigen Segmenten zugeordnet sind, nicht mit sonstigen Abstimmungsposten, wie beispielsweise der Eliminierung intersegmentärer Erträge und Aufwendungen zu saldieren, sondern separat darzustellen (IFRS 8.16 und IFRS 8.28 (b)). • Zukünftig sind zu Geschäftsvorfällen mit nahestehenden Unternehmen die Bedingungen und Konditionen gemäß IAS 24.18(b)(i) anzugeben. • Unterschiedliche Geschäftsvorfälle mit nahestehenden Unternehmen sind zukünftig getrennt anzugeben, damit Abschlussadressaten die Auswirkungen auf den Konzernabschluss, wie etwa bei dem Verkauf von Vermögenswerten des Anlagevermögens, beurteilen können (IAS 24.24 i.V.m. IAS 24.21). • Komplexe Sachverhalte und deren bilanzielle Beurteilung einschließlich damit ggf. verbundener Erläuterungen von Ermessensausübungen sind umfassend zu dokumentieren (§ 238 Abs. 1 HGB); soweit die Frage der Umsatzrealisierung bei einer Sale-and-Leaseback-Transaktion ermessensbehaftet ist, ist hierüber zukünftig im Konzernanhang zu berichten (IAS 1.122).

Recommendations 2019

Business combinations and disposals / goodwill	<ul style="list-style-type: none"> • Bei der Ermittlung des erzielbaren Betrags zum Zweck der Werthaltigkeitsüberprüfung ist künftig bei dem Übergang in die sogenannte ewige Rente die mehrjährige Zyklizität der Geschäftsentwicklung zu berücksichtigen, insbesondere wenn der Detailplanungszeitraum in eine Aufschwungsphase fällt und die geplante Profitabilität signifikant über den Ist-Werten der Vergangenheit liegt. Zudem sind künftig im Anhang die zugrundeliegenden Annahmen zur Cashflow-Entwicklung anzugeben, so dass die Ausgangsbasis für die Sensitivitätsberechnung besser erkennbar wird. • Im Rahmen künftiger Unternehmenserwerbe mit Minderheiten im mehrstufigen Konzern ist gemäß IFRS 3.19 bei der Konsolidierung die additive Methode anzuwenden, indem die Beteiligungsquote des direkten Mutterunternehmens zugrunde gelegt wird. • Angesichts der in der Planung für den Bereich XX unterstellten Markterholung, der regulatorischen und Integrationsrisiken sowie der Größenordnung der zu testenden Vermögenswerte sind künftig die wesentlichen Annahmen der Planung (Umsatz- und Ergebniswachstum, IAS 36.134 (e) (i)) und Sensitivitätsangaben (IAS 36.134 (f)) in den Konzernanhang aufzunehmen. Soweit die Annahmen, welche im Einklang mit der Perspektive eines unabhängigen Marktteilnehmers zu wählen sind (IFRS 13.22), auf externen Informationsquellen beruhen, sollte dies künftig deutlicher im Konzernanhang zum Ausdruck kommen (IAS 36.134 (e) (ii)). • Künftig sind die Vermögenswerte des Anlagevermögens von akquirierten Unternehmen gem. IFRS 3.18 zum Zeitpunkt des Zuganges im Anlagegitter mit ihren Zeitwerten netto anzusetzen
Financial statement presentation	<ul style="list-style-type: none"> • Künftig sind Gewinne und Verluste aus der Währungsumrechnung als Bestandteil des separat ausgewiesenen Betriebsergebnisses auszuweisen, soweit sich diese Währungseffekte aus der Umrechnung von Forderungen und Verbindlichkeiten aus Lieferungen und Leistungen ergeben, die nicht in der Funktionalwährung fakturiert sind, oder aus derivativen Finanzinstrumenten resultieren, deren Zweck es ist, Währungseffekte innerhalb des Betriebsergebnisses zu kompensieren (IAS 1.BC56).

Recommendations 2019	
Financial statement presentation	<ul style="list-style-type: none"> • Negative Zinsen sind im Konzernabschluss zukünftig zu quantifizieren, sofern sie nicht unwesentlich sind (IAS 1.112 (c) und/oder IAS 1.85).
Revenue recognition	<ul style="list-style-type: none"> • Im Hinblick auf die Erfassung der Erlöse aus dem Verkauf von kundenspezifisch angefertigten Vermögensgegenständen auf Basis des Zeitpunkts der Lieferung anstatt über einen bestimmten Zeitraum (IFRS 15.31 f.) ist die Unwesentlichkeit des hieraus resultierenden Effekts jährlich zu überprüfen und zu dokumentieren. • Zukünftig sind Verträge mit Kunden auf eine separate Leistungsverpflichtung aufgrund der über die gesetzliche Garantiedauer hinausgehenden zusätzlichen dreijährigen Garantie zu überprüfen (IFRS 15.B28).
Financial instruments	<ul style="list-style-type: none"> • Bitte überprüfen Sie die Sachgerechtigkeit der ergebnisneutralen Erfassung der Dividendenzahlungen einer Tochtergesellschaft dahingehend, dass der Erwerb der nicht beherrschenden Anteile an dieser Tochtergesellschaft bereits unterstellt wurde („Anticipated-Acquisition-Method“) und somit das Ergebnis dieser Tochtergesellschaft bereits zu 100% dem Konzern zugeordnet wird. • Zukünftig sind im Konzernanhang die Inputfaktoren, Annahmen und Schätzverfahren, die verwendet werden, um zu bestimmen, ob sich das Ausfallrisiko bei Finanzinstrumenten signifikant erhöht hat, vollständig anzugeben (IFRS 7.35G (a) (ii)), und es ist zu spezifizieren, wie zukunftsorientierte Informationen in die Bestimmung der erwarteten Kreditverluste einfließen (IFRS 7.35G (b)). Bitte überprüfen Sie zudem für die erfolgswirksam zum beizulegenden Zeitwert bilanzierten finanziellen Vermögenswerte im Level 3, ob die Klassen sachgerecht gebildet wurden (IFRS 13.94) und welche weiteren quantitativen Angaben zu wesentlichen nicht beobachtbaren Parametern für diese Vermögenswerte im Konzernanhang offenzulegen sind, weil Informationen darüber mit vertretbarem Aufwand verfügbar sind (IFRS 13.93 (d)).

Recommendations 2019	
Statement of cash flows	Bitte beachten Sie zukünftig, dass Verbindlichkeiten gegenüber Banken in der Kapitalflussrechnung grds. den Finanzierungstätigkeiten zuzuordnen sind. Die in IAS 7.8 geregelte Ausnahme gilt nur dann, wenn die Kredite einen integralen Bestandteil der Zahlungsmitteldisposition darstellen. Davon ist dann auszugehen, wenn deren Kontosaldo häufigen Schwankungen zwischen Soll- und Haben-Beständen unterliegt.
Consolidation	Bei der Entscheidung, welche Tochterunternehmen aufgrund von Unwesentlichkeit nicht im Wege der Vollkonsolidierung gemäß IFRS 10.20 in den Konzernabschluss einbezogen werden (IAS 1.7 in Verbindung mit IAS 8.8), sind zukünftig auch die erzielten Ergebnisse der Tochterunternehmen zu berücksichtigen. Zudem ist ein angemessenes Verfahren zur Entscheidung, ob Unwesentlichkeit auch für die Gesamtheit der nicht im Wege der Vollkonsolidierung einbezogenen Tochterunternehmen vorliegt, anzuwenden und zu dokumentieren.
Provisions	Zukünftig sind alle wesentlichen Gruppen von Rückstellungen gemäß IAS 37.85(a) und (b) zu erläutern. Zudem sind Ertragssteuerschulden gesondert darzustellen (IAS 12.12 i.V.m. IAS 1.54(n)).
Foreign currency translation	Wir bitten Sie, die Bilanzierung von Darlehen als Nettoinvestition in ausländische Tochterunternehmen zukünftig zu überprüfen, da eine vereinbarte Rückzahlung innerhalb absehbarer Zeit der derzeitigen bilanziellen Behandlung grundsätzlich entgegensteht (IAS 21.15).