My *wish list*

Edgar Ernst currently heads three audit committees and is President of the Berlin-based Financial Reporting Enforcement Panel. He believes that companies in other countries could learn some valuable lessons from the German system of corporate governance.

GIVE YOUR EMPLOYEES A VOICE

Germany's two-tier system, with separate management and supervisory boards, is often underestimated. Non-Germans think it's complicated and time-consuming, but I'm a big supporter of it.

One of the main advantages is that, classically, German supervisory boards have employee representatives. This means that, even in difficult situations like restructurings, employee representatives are part of the decision-making process from the start. They have a chance to influence companies' decisions and make sure they are organized in a socially responsible manner.

That's one of the reasons that hostile, mutinous strikes rarely occur in Germany. Giving employee representatives the chance to shape the company's strategy means they are held accountable and incentivized to think about its future as a business. I think that's a good way to get outcomes that both sides feel comfortable with.

WORK CLOSELY WITH YOUR AUDITORS

In Germany, the head of the audit committee of the supervisory board hires the external auditors. I'm in this position at three listed companies and I've always made sure that auditors understand that I work with them in a close, trusting relationship. They are an invaluable resource if you want to know what's going on in the different departments of your company.

I expect auditors to get in touch with me if they feel the accounting is too aggressive – if goodwill tests are too loose, the business plan has too many positive assumptions baked in, or write-offs aren't properly accounted for. If management and auditors disagree on issues like these, they can talk to the audit committee. I don't want any secret meetings – that would damage the relationship with management – but I think the audit committee should be involved if there are doubts. In the long run, it's in the best interests of the company and its stakeholders.

FOCUS ON STRATEGY

Bad supervisory boards consist of "yes men" who agree with whatever management says. Ideally, both sides have a critical, open and trusting relationship and use meetings as opportunities to bounce ideas off one another – whether about new markets to enter or new businesses to acquire.

Strategy talks are an essential part of the supervisory board's work and, in my experience, separate meetings to discuss strategy

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are a good way to focus on these issues without short-term distractions such as quarterly reports.

I'm aware that this trusting relationship between management and supervisory boards doesn't always exist. In Germany, the supervisory board appoints the management board, which can lead to power struggles. A trusting relationship is something both sides have to work at.

ENFORCEMENT IS IMPORTANT

Every year, the Financial Reporting Enforcement Panel (FREP), which I'm the President of, checks the annual reports of around 100 listed German companies on a sample basis.

I like to think our work has made a positive impact on financial reporting in Germany. Our institution was founded in 2005 and has an unusual structure. In most European countries, it's up to the authorities to control the companies' reports, but in Germany we have a two-tier system. There's the FREP and then there's the Federal Financial Advisory Authority (BaFin), which is a government agency. If we find a fundamental mistake in a report, we get in touch with the company and ask it to publish a correction. But if the company disagrees, we hand the case over to the BaFin, which looks at the books again and makes its own assessment.

For me, the advantage of this procedure is that it gives a window into the company from two different angles. Whereas the BaFin deals with a company's books from a legal, administrative perspective, we try to read them like an economist would. Accounting isn't an exact science and there are a wide range of interpretations. That's why it's important to have that second approach, and that's what we provide.

Statistics show that we have made a positive impact. When we started, we found significant mistakes in 25% of the reports we checked; today it's only 13%. Ultimately, our work increases the trust in Germany's capital markets.

BEING A BOARD MEMBER TAKES COMMITMENT

In recent years, independent directors and supervisory board members have had to deal with a stream of regulatory changes. Some colleagues complain about that, and it's true that it means more work for everyone. But I also think it's an inevitable part of the professionalization of our job. The days are long gone when it was enough for supervisory board members to show up at a few meetings every year and get paid handsomely just for doing that.

Today, being a board member requires constantly keeping up to date with the company's news and the regulatory environment, preparing for the next meeting or working on new reports. And that's a good thing, because it helps us to do our job. ■

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Profile

Since 2011, Edgar Ernst has been President of the Financial Reporting Enforcement Panel (FREP), a government-appointed but privately organized institution in Berlin that controls the accounting practices of listed companies in Germany. Prior to that, he worked for 15 years as CFO on the management board of Deutsche Post DHL and its state-run predecessor, Deutsche Bundespost Postdienst. He currently serves on the supervisory boards of DMG Mori, TUI, Vonovia and Deutsche Postbank and heads the audit committees of the first three companies. Since 2006, he has also been an honorary professor at the Otto Beisheim School of Management in Vallendar, near Koblenz.

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