

The role of the auditor and the audit committee in the dualistic system

Summary

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1. The crucial feature of the two-tier board system is a strict organizational separation of the managerial and the control functions in a dualistic organized company. The management is carried out by the management board and the control is assumed by the supervisory board.
2. A logic consequence of this power division within the company's administration is the fact, that the external auditor is connected with the supervisory board, rather than with the management board. Along with its function as a guarantor of the public accounting of the company, the auditor is an "assistant" of the supervisory board of the company.
3. In the dualistic system the function of management supervision and audit are primarily within the scope of competence of the *supervisory board*. The auditor assists the board in carrying out this function due to his special skills and expertise.
4. While the auditor has to check mainly whether the accounting of the company is in line with legal provisions, the supervisory board has also to scrutinize the material correctness of the managerial decisions: Whether the managements acted according to the interests of the company's stakeholders. The general responsibility for the accuracy of corporate control remains with the supervisory board.
5. Additionally to auditing the legality of accounting the German law is imposing two specific tasks on the auditor, which underline his role as assistant of the supervisory board: the auditor has to provide his opinion on the management report, where the management is describing the current and the anticipated state of the enterprise; and he has to check whether the controlling system of a public listed company is operational. Insofar the auditor is performing the function of a material audit of the management with the aim of supporting the supervisory board.
6. In a two-tier board system there is a high level of independence of the auditor from the *management board*. The contract with the auditor, defining inter alia the scope of audit is concluded on behalf of the company not by the management but by the supervisory board. The auditor is reporting on the documents and information provided by the management directly to

the supervisory board. This, however, doesn't exclude the right of the auditor to report to the management where he finds it appropriate and as far as there is not conflict with the auditor's controlling function. It may happen by means of the so called "management letter". Insofar the auditor may (but is not obliged to) act as a consultant of the management.

7. The only function of the *Shareholder's meeting* in respect to the auditor is the appointment of the auditor. This does not include the definition of the scope of audit and the remuneration of the auditor, which is subject of the auditor agreement made by the supervising board. The auditor has to be present in the Shareholder's meeting if the latter is adopting the annual financial statement. In other aspects the auditor is independent from the Shareholder's meeting.

8. The *audit committee* in the two-tier board system is a committee within the Supervisory board which carries out auxiliary functions for the board. The audit committee – which should mainly comprise financial literate members of the supervisory board – elaborates and prepares decisions of the board connected with the accounting audits and the auditor. The decisions of the Supervisory board may however not be substituted by the decisions of the audit committee.

9. Despite the formal differences and different approaches the dualistic and the monistic systems are approximating each other as far as corporate control is concerned driven by the demands of the capital market and corporate governance.