

praxis-forum *Alert!*

Current Amendments to Accounting Legislation: German Draft Bill on Modernisation of Accounting Regulations (Draft Bill of Bilanzrechtsmodernisierungsgesetz, the German Act on Modernisation of Accounting Regulations (BilMoG)

After the Draft Statute was presented on 8 November 2007, the federal cabinet initiated the German Draft Bill on Modernisation of Accounting Regulations (BilMoG-E) on 21 May 2008.

This Act has two purposes: Within the scope of a deregulation, exemptions and reduced requirements with respect to bookkeeping or accounting duties are provided especially for small and medium-sized sole traders carrying on only a small business, but also for firms organised in a corporate form (including KapCo companies, i.e. general and limited partnerships with a general partner other than an individual). In addition, the accounting regulations under the German Commercial Code (HGB) are intended to be modernised, as an equivalent, though simpler and more cost-efficient answer to the International Financial Accounting Standards (IFRS), and the information function related to the accounts under German commercial law is to be improved for non-capital-market-orientated companies. With respect to the financial statements, it is, however, intended to maintain, as a general rule, the function of the balance sheet under the German Commercial Code (HGB) as a means of measuring distributions and maintaining the capital. By abandoning reverse authoritativeness, the exercise of options under German tax law is, however, no longer to impact the annual financial statements under German commercial law.

Based on the Draft Bill, the following statements give an overview of the major amendments to German accounting law through the German Act on Modernisation of Accounting Regulations (BilMoG), with the central deviations from the Draft Statute being shown and outlined in a synopsis after the respective sections addressing the recognition and valuation rules applicable to individual financial statements.

For further details on the German Draft Bill on Modernisation of Accounting Regulations (BilMoG-E), we refer to our presentations, to which we cordially invite you.



To provide a better overview, the proposed application of the individual regulations under German commercial law is shown in the text.

First-time application of the regulations in the version of the German Act on Modernisation of Accounting Regulations (BilMoG) to annual and consolidated financial statements for the financial year beginning after	<ul style="list-style-type: none"> ① 31 December 2007 ② 29 June 2008 ③ 5 September 2008 ④ 31 December 2008
Last-time application of previously applicable regulations under the German Commercial Code (HGB) to annual and consolidated financial statements for financial years beginning before	<ul style="list-style-type: none"> ⑤ 30 June 2008 ⑥ 6 September 2008 ⑦ 1 January 2009
Effective date is the date of promulgation	⑧

1 Financial Statements

1.1 Recognition Rules

1.1.1 Principle of Economic Allocation

By including the principle of economic allocation in § 246 (1) Sentence 2 German Commercial Code Draft Version (HGB-E)^④, the economic approach will be attached major importance within the scope of the entire accounting regulations under the German Commercial Code (HGB) in the future, beyond the specific cases previously referred to. Although, according to the grounds cited in support of the Act, the crucial aspect of the principle of completeness under German commercial law is primarily legal ownership, the corresponding assets must be allocable to the trader – under aspects of creditor protection alone. If beneficial and legal ownership fall apart, the beneficial owner is deemed to be the party “to which the major risks and opportunities are attributable by way of an evaluating assessment”. For liabilities, this principle is limited insofar as these are still required to be disclosed at the level of the party that has the legal obligation.

1.1.2 Consistency of Recognition

Analogous to the principle of consistent valuation codified in § 252 (1) No. 6 German Commercial Code Draft Version (HGB-E)^④, the principle of consistent recognition is now also codified in § 246 (3) German Commercial Code Draft Version (HGB-E)^④. Deviations from the concept of consistent recognition are admissible with reference to § 252 (2) German Commercial Code (HGB) only in justified exceptional cases.

1.1.3 Duty to Recognise Goodwill Acquired at a Consideration

In accordance with § 246 (1) Sentence 4 German Commercial Code Draft Version (HGB-E)^④, goodwill acquired at a consideration will be deemed to be an asset of limited useful life in the future. Abolishing the previous option (§ 255 (4) German Commercial Code Previous Version (HGB-alt)^⑦, according to which (full or partial) capitalisation of goodwill was at the discretion of the trader, derivative goodwill is required to be capitalised and regularly to be amortised on a scheduled basis over the estimated useful life according to the general valuation rules under German commercial law (§ 253 (3) German Commercial Code Draft Version (HGB-E)^④). According to § 253 (5) Sentence 2 German Commercial Code Draft Version (HGB-E)^④, write-downs of goodwill are required to be maintained because, according to the grounds cited in support of the Act, a reversal is normally not due to the fact that the reasons that led to the write-down ceased to exist but is rather due to an (inadmissible) capitalisation of internally generated goodwill.

1.1.4 Duty to Offset Corresponding Assets and Liabilities Related to Retirement Benefit Obligations

Assets to which all other creditors are denied access, and the sole purpose of which is the settlement of liabilities due to retirement benefit obligations or comparable long-term obligations towards employees will be required to be offset against related liabilities in the future (§ 246 (2) Sentence 2 German Commercial Code Draft Version (HGB-E)^④. Deviating from the Draft Statute, which provided for a scope of application beyond retirement benefit obligations, the proposed requirement to offset is limited to pension obligations, retirement benefit obligations, obligations under working life models and other comparable long-term obligations. This means that all other obligations towards employees as well as other secured items will still be required to be disclosed in gross terms. In comparison with the Draft Statute, there are two further amendments. On the one hand, § 253 (1) Sentence 4 German Commercial Code Draft Version (HGB-E)^④ stipulates that the assets that serve for collateralisation purposes will possibly have to be measured at fair value beyond acquisition cost; the upper limit will, however, be the settlement value of the liabilities. On the other hand, the netting refers also to the related income and expenses in the income statement.

1.1.5 Duty to Recognise Intangible Fixed Assets

Instead of the previous prohibition from accounting for internally generated intangible fixed assets (§ 248 (2) German Commercial Code Previous Version (HGB-alt)^⑦, the acquisition costs incurred in developing an internally generated intangible fixed asset will be required to be capitalised in the future (§ 255 (2a) German Commercial Code Draft Version (HGB-E)^④. Development is deemed to be “the application of research results or other knowledge in newly developing goods or techniques by means of major changes”. Research expenses are, however, still intended to be prohibited from being capitalised. Capitalisation will also still be excluded if it is impossible to separate research from development reliably. According to the grounds cited in support of the Act, capitalisation will require in any case that the asset to be capitalised can be classified as an asset within the meaning of German commercial law, i.e. that it is usable according to generally accepted standards. To avoid the capitalisation of brands, printing rights, rights of publication, customer lists or comparable intangible fixed assets which were not acquired at a consideration, an explicit prohibition of recognition was formulated in § 248 No. 4 German Commercial Code Draft Version (HGB-E)^④, deviating from the Draft Statute. Creditor protection is to be taken into account through a corresponding limitation on profit distribution and transfer (§ 268 (8) German Commercial Code Draft Version (HGB-E)^④, § 301 Sentence 1 German Stock Corporation Act Draft Version (AktG-E) as well as supplementary disclosures in the notes to the financial statements regarding research and development expenses (§ 285 No. 22 German Commercial Code Draft Version (HGB-E)^④). In accordance with Art. 66 (3) Introductory Act to the German Commercial Code Draft Version (EGHGB-E), the duty to capitalise will, however, be applicable only to developments starting after 31 December 2008.

On account of § 5 (2) German Income Tax Act (EStG), research and development expenses will still be required to be recognised as an expense in the tax accounts.

1.1.6 Cancellation of Expenditure Provisions

The previous option under § 249 (1) Sentence 3 German Commercial Code Previous Version (HGB-alt)^⑦ to recognise an expenditure provision for deferred maintenance that is completed after a three months' period after the balance sheet date, though

within the following financial year, is intended to be revoked. Accordingly, § 249 (2) German Commercial Code Previous Version (HGB-alt)^⑦ is intended to be cancelled on the grounds that the related disclosure of expenditure provisions, for example for regular general overhauls or large-scale repair work carried out at long-term intervals, is in economic terms of the nature of reserves. Related existing provisions may be maintained under Art. 66 (1) Introductory Act to the German Commercial Code Draft Version (EGHGB-E); alternatively, the amounts resulting from a release will be required to be allocated to the revenue reserves directly.

1.1.7 Cancellation of Accounting Convenience for Business Start-up and Expansion Expenses

The previous option to capitalise in full or in part business start-up and expansion expenses is revoked (§ 269 German Commercial Code Previous Version (HGB-alt)^⑦). Accordingly, the regulation governing their amortisation will also be revoked (§ 282 German Commercial Code Previous Version (HGB-alt)^⑦). Under Art. 66 (4) Introductory Act to the German Commercial Code Draft Version (EGHGB-E), expenses already capitalised will be permitted to be amortised and be required to be amortised at least by one fourth in the each following financial year.

1.1.8 Change to Prepaid Expenses

The previous option to capitalise customs duties and excise taxes as well as valued added tax on payments on account disclosed at the balance sheet date or openly deducted from inventories which has been recognised as an expense, is to be cancelled (§ 250 (1) Sentence 2 German Commercial Code Previous Version (HGB-alt)^⑦). The regulation under § 5 (5) Sentence 2 German Income Tax Act (EStG) will, however, remain unchanged.

1.1.9 Duty to Recognise Deferred Tax Assets

According to the Draft Bill, deferred tax assets will be required to be recognised in the balance sheet in the future and, like deferred tax liabilities, for which the Draft Statute provided for disclosure under provisions, to be disclosed in a separate item ("deferred tax assets" or "deferred tax liabilities"; §§ 274, 266 (2 D.) and 266 (3 E.) German Commercial Code Draft Version (HGB-E)^④). Since deferred tax liabilities can also include elements of provisions, a new clause was included in the Draft Bill which explicitly prohibits discounting on deferred taxes. Also deviating from the Draft Statute, it will no longer be admissible in the future to offset the items against each other. Related income and expenses will be required to be disclosed separately under the item "taxes on income" in the income statement. Save as provided in the regulations governing the requirements to be met for recognising provisions in accordance with § 249 (1) Sentence 1 German Commercial Code Draft Version (HGB-E)^④ (cp. the grounds cited in support of the Act with respect to § 274a No. 5 German Commercial Code Draft Version (HGB-E)^④), "small" firms organised in a corporate form within the meaning of § 267 German Commercial Code Draft Version (HGB-E)^① will be exempt from the duty to determine and disclose deferred tax (§ 274a No. 5 German Commercial Code Draft Version (HGB-E)^④).

Synopsis of Major Amendments – Recognition Rules					
Ref.	Regulation	German Commercial Code (HGB)	German Act on Modernisation of Accounting Regulations (BilMoG – Draft Statute)	German Act on Modernisation of Accounting Regulations (BilMoG – Draft Bill)	StB
1.1.1	Economic allocation	Regulations with respect to specific cases	General regulation	General regulation	General regulation
1.1.2	Consistency of Recognition	No regulation	Duty	Duty	No regulation
1.1.3	Goodwill acquired at a consideration	Option	Duty	Duty	Duty
1.1.4	Duty to offset retirement benefit obligations	Prohibition	Duty	Duty	Prohibition
1.1.5	Internally generated intangible fixed assets	Prohibition	Duty (without exceptions)	Duty (with defined exceptions)	Prohibition
1.1.6	Expenditure provisions	Option	Prohibition	Prohibition	Prohibition
1.1.7	Capitalisation of business start-up and expansion expenses	Option	Prohibition	Prohibition	Prohibition
1.1.8	Prepaid expenses (customs duties and excise taxes)	Option	Prohibition	Prohibition	Duty
1.1.9	Deferred tax assets	Option	Duty (exception: small firms organised in a corporate form)	Duty (exception: small firms organised in a corporate form)	-

1.2 Valuation Rules

1.2.1 Measurement at Fair Value of Financial Instruments Acquired for Trading

§ 253 (1) Sentence 3 German Commercial Code Draft Version (HGB-E)⁴ will provide in the future for binding measurement at fair value of financial instruments acquired for trading. Accordingly, the realisation rule will be extended for these financial instruments in the future also to realisable profits, which will then have to be recognised through profit and loss. For derivatives acquired for trading, the rule of non-accounting for pending transactions will be overridden. According to the grounds cited in support of the Act, a contractual relationship is deemed to be a pending contractual relationship if its value reacts to changes in the value of a basic object (for example, interest rate, exchange rate, raw materials price, price or interest index, credit standing, credit index or another variable), if no or only a minor amount of acquisition cost is incurred, and if it will be performed only in the future. The trading intent, i.e. the intention to realise profits from short-term price fluctuations, must reasonably exist at the time of acquisition and requires the existence of an active market within the meaning of § 255 (4) Sentence 1 German Commercial Code Draft Version (HGB-E)⁴. The measurement at fair value of financial instruments previously valued at cost or the valuation at cost of financial instruments previously measured at fair value is intended to be inadmissible.

The measurement at fair value has to be based on the market price determined on the basis of an active market (for example, the price easily and regularly available at a stock exchange, from a dealer or an industry group). If such a market price can not/no longer

be determined, the fair value has to be derived by means of generally accepted valuation methods (for example, comparison with other transactions). If the fair value can not be determined reliably, the instruments are required to be valued at cost (§ 255 (4) Sentences 2 and 3 German Commercial Code Draft Version (HGB-E)④).

Since unrealised profits will also be realised as income in the future on account of the measurement at fair value, the realisation principle is, deviating from the Draft Statute, intended to be taken into account by means of a limitation on profit distribution and transfer (§ 268 (8) German Commercial Code Draft Version (HGB-E)④; § 301 Sentence 1 German Stock Corporation Act Draft Version (AktG-E). In addition, the Draft Bill provides for disclosure of an “of which” note for each balance sheet item which includes financial instruments measured at fair value (§ 253 (1)) Sentence 5 German Commercial Code Draft Version (HGB-E)④).

Except for banks and financial service providers that come under the regulations of §§ 340 et seq. German Commercial Code (HGB), the measurement at fair value has no impact on the tax balance sheet (§ 6 (1)) No. 2b German Income Tax Act Draft Version (EStG-E).

1.2.2 Recognition of Separate Valuation Units

The purpose of the revision of § 254 German Commercial Code Draft Version (HGB-E)④ is to embody in the law the recognition of separate valuation units (“hedging”), which is already regarded as being in compliance with generally accepted accounting principles in literature. According to the grounds cited in support of the Act, this codification is to involve no change in the previous accounting practice. By recognising separate valuation units, hedging risks from an underlying transaction through a hedging instrument is addressed by not taking into account unrealised losses to the extent that these are matched by equivalent unrealised profits and it is, hence, excluded that the risks hedged materialise. Accordingly, §§ 249 (1), 252 (1) Nos. 3 and 4, 253 (1) Sentence 1 and 256a German Commercial Code Draft Version (HGB-E)④ are not applicable. Eligible items for hedging are, as a general rule, all assets, liabilities, pending transactions or transactions planned with high probability (anticipatory hedging). Planned transactions will be deemed to be legal transactions in the future that have to be more or less certain as to their conclusion, which will be prevented at most only by extraordinary circumstances outside the sphere of influence of the entity concerned. Deviating from the Draft Statute, which defined a broad category of potential hedging instruments, the only hedging instruments now provided for are financial instruments. In view of current practice, the instruments have deliberately not been restricted to derivatives in the grounds cited in support of the Act, with the different possibilities of recognising separate valuation units (micro, macro and portfolio hedging) being regarded as admissible and equal. Besides the original intention of hedging and comprehensive documentation, the recognition of separate valuation units also requires objective substantiation with respect to risk hedging. The range of the hedging effect within the scope of appropriate risk management that is specified in the grounds cited in support of the Act is an efficiency range from 80% to 120%. If separate valuation units are recognised, these are required to be disclosed in the notes to the financial statements, alternatively in the management report (newly provided for by the Draft Bill; § 285 No. 23 German Commercial Code Draft Version (HGB-E)④).

1.2.3 Valuation of Provisions and Liabilities at Settlement Value

Liabilities and provisions are intended to be recognised generally at “settlement value” (based on sound business judgement) in the future. In addition to its clarifying nature, the introduction of the term “settlement value” in § 253 (1) Sentence 2 German Commercial Code Draft Version (HGB-E)④ illustrates that future price and cost increases, i.e. the price and cost situation at the time the expenses are actually incurred, will also

have to be taken into account in valuing provisions in the future, restricting the concept of measurement at the balance sheet date.

In addition, § 253 (2) German Commercial Code Draft Version (HGB-E)^m provides for future discounting of provisions at the average market interest rate that corresponds to their term. As opposed to the Draft Statute, this will though apply only to provisions with a term of more than one year. The average market interest rate is required to be derived from the respective past seven financial years (Draft Statute: five financial years). For reasons of simplification, it is possible to measure provisions for pensions and accrued benefits also on a lump-sum basis, by discounting at the average market interest rate based on an assumed term of 15 years, rather than at the average market interest rate for matching maturities.

The applicable discounting rates are to be determined through ordinance of the German Central Bank and be published at monthly intervals.

With respect to potential effects under German commercial law on the revaluation of pension provisions, Art. 65 (1) Introductory Act to the German Commercial Code Draft Version (EGHGB-E) provides for a transition period until 31 December 2023, during which it will be possible to fully accumulate the corresponding amount of the provision immediately, to accrue it at equal annual rates or, taking into account the net income/loss for the financial year, to accrue it at different annual rates. An amount recognised that possibly exceeds the necessary pension provisions can be maintained if additions are necessary during the following financial years; optionally, it can, however, also be released and directly be allocated to the revenue reserves. The regulations under German tax law governing pension provisions (§ 6a German Income Tax Act (EStG)) are, however, to remain unchanged.

The cancellation of optional accrual of indirect pension obligations (Art. 28 (1) Sentence 2 Introductory Law to the German Commercial Code (EGHGB)), which was included in the Draft Statute, is no longer provided for in the Draft Bill.

With respect to the adjustments of the other provisions, it is assumed in the grounds cited in support of the Act that in practice future price and cost increases have already been taken into account or that the resulting charges will largely be compensated for through reliefs due to the discounting.

1.2.4 Cancellation of Optional Write-downs

The optional write-downs which permit write-downs of current assets in order to avoid that the value recognised will have to be changed in the near future on account of fluctuations in value (§ 253 (3) Sentence 3 German Commercial Code Previous Version (HGB-alt)^o), and write-downs based on sound business judgement (§ 253 (4) German Commercial Code Previous Version (HGB-alt)^o) are intended to be cancelled. Under Art. 66 (2) Introductory Act to the German Commercial Code Draft Version (EGHGB-E), previous write-downs can be maintained or reversed. Amounts resulting from write-ups are required to be allocated directly to the revenue reserves.

1.2.5 Restriction of Write-downs

The optional write-down of assets for only temporary impairment is now intended to be restricted for all entities to long-term financial assets (§ 253 (3) Sentence 4 German Commercial Code Draft Version (HGB-E)^o). § 279 (1) German Commercial Code Previous Version (HGB-alt)^o is repealed accordingly.

1.2.6 Reversal Requirement

Except for goodwill acquired at a consideration, a reversal is intended to be mandatory for all entities if the reasons for a write-down cease to exist (§ 253 (5) German Commercial Code Draft Version (HGB-E)④. § 280 German Commercial Code Previous Version (HGB-alt)p is repealed accordingly.

1.2.7 Redefinition of Minimum Production Costs under German Commercial Law

Besides the previous elements (cost of materials, production cost and special production costs), minimum production costs under German commercial law will require to include in the future, rather than optionally include, also appropriate portions of indirect material, production overhead and production-related deductions for depreciation on fixed assets (§ 255 (2) Sentence 2 German Commercial Code Draft Version (HGB-E)④, thus further adjusting minimum production costs under German commercial law to minimum production costs under German tax law. Also, it will still be admissible according to the Draft Bill, to recognise optionally general and administrative expenses, expenses for voluntary social facilities of the business as well as expenses for voluntary social benefits and retirement benefits. These must, however, relate to the period of production. The prohibition with respect to research and development expenses remains unchanged.

1.2.8 Cancellation of Previously Recognised Valuation Simplification Methods

The only methods for simplifying valuation that are intended to be recognised in the future (§ 256 Sentence 1 German Commercial Code Draft Version (HGB-E)⑦ are LIFO (“last in – first out”) and FIFO (“first in – first out”). Other methods for simplifying valuation concerning the order of consumption or prices (for example, HIFO (“highest in – first out”) or LOIFO (“lowest in – first out”) would, hence, become inadmissible.

1.2.9 Duty to Translate Foreign Currencies in Financial Statements at Spot Exchange Rate

Previously, the law has been silent on foreign currency translation. Under the newly introduced § 256a German Commercial Code Draft Version (HGB-E)④, assets and liabilities with a term of more than one year that are denominated in foreign currencies will be required to be translated at the spot exchange rate in effect at the balance sheet date when being valued subsequent to initial recognition. The realisation principle, the imparity principle (§ 252 (1) No. 4 German Commercial Code (HGB)) and the historical cost concept (§ 253 (1) German Commercial Code (HGB)) apply.

Assets and liabilities with a term of up to one year are, however, permitted to be translated at the spot exchange rate in effect at the balance sheet date. This applies also to financial instruments acquired for trading.

According to the grounds cited in support of the Act, the transactions denominated in foreign currency will be required to be translated at spot exchange rate also at the time of recognition, with the selling or buying rates being applied as a general rule; unless this has major effects, it is also possible to apply average and middle rates.

1.2.10 Balance Sheet Method of Determining Deferred Tax

Abandoning the previous income statement method (“timing concept”) of determining deferred tax, deferred tax is intended to be determined according to the internationally recognised balance sheet method (“temporary concept”) in the future (§ 274 German Commercial Code Draft Version (HGB-E)④. This conceptual change has practical effects insofar as accounting and valuation differences between commercial and tax balance sheets will have to be taken into account in the future. In addition, it is made clear in the grounds cited in support of the Act that quasi permanent differences (for example, resulting from recognition of different values for a long-term equity in-

vestment in the commercial and tax balance sheets) will also have to be taken into account in computing deferred tax. The new regulations governing the duty to capitalise deferred tax assets covers explicitly also tax reliefs anticipated on account of unrealised tax loss carryforwards as well as tax credits and interest carryforwards. These are, however, only permitted to be taken into account if they are expected to be used for netting losses within the five financial years following the balance sheet date.

Deferred tax has to be calculated on the basis of the individual, taxable-entity-related tax rates that are likely to be applicable at the time the temporary differences are reversed. If these are not known, the individual tax rates applicable at the balance sheet date have to be applied. Changes have to be taken into account only if the responsible body, i.e. the upper house of the German parliament, has approved the corresponding tax legislation on or before the balance sheet date.

Synopsis of Major Amendments – Valuation Rules					
Ref.	Regulation	German Commercial Code (HGB)	German Act on Modernisation of Accounting Regulations (BilMoG – Draft Statute)	German Act on Modernisation of Accounting Regulations (BilMoG – Draft Bill)	Tax balance sheet
1.2.1	Measurement at fair value financial instruments (held for trading)	Prohibition	Duty (no limitation on distribution)	Duty (limitation on distribution)	Prohibition (exception: entities as defined under § 340 German Commercial Code (HGB))
1.2.2	Recognition of separate valuation units	No regulation	Duty	Duty	In accordance with German Commercial Code (HGB); authoritative-ness
1.2.3	Liabilities and provisions				
	• Liabilities	Repayment value	Settlement value	Settlement value	Settlement value (authoritativeness)
	• Provisions	Sound business judgement	Settlement value	Settlement value	Settlement value (exception: see below)
	• Price and cost increase	No regulation	Duty	Duty	Prohibition
	• Discounting	Prohibition (exception: interest portion included)	Duty	Duty	Duty (5.5%)
1.2.4	Optional write-downs				
	• Future value fluctuations	Option	Prohibition	Prohibition	Prohibition
	• Business judgement	Option for firms other than firms organised in a corporate form; prohibition for firms organised in a corporate form	Prohibition	Prohibition	Prohibition

Synopsis of Major Amendments – Valuation Rules					
Ref.	Regulation	German Commercial Code (HGB)	German Act on Modernisation of Accounting Regulations (BilMoG – Draft Statute)	German Act on Modernisation of Accounting Regulations (BilMoG – Draft Bill)	Tax balance sheet
1.2.5	Write-downs for non-permanent impairment of fixed assets	Option for firms other than firms organised in a corporate form; option for firms organised in a corporate form only for long-term financial assets	Prohibition; option only for long-term financial assets	Prohibition; option only for long-term financial assets	Prohibition
1.2.6	Reversal requirement	Option for firms other than firms organised in a corporate form; duty for firms organised in a corporate form	Duty (prohibition goodwill)	Duty (prohibition goodwill)	Duty
1.2.7	Minimum production costs – capitalisation of appropriate portions of overheads	Option	Duty	Duty	Duty
1.2.8	Valuation simplification methods – deviating from LIFO, FIFO	Option	Prohibition	Prohibition	LIFO only
1.2.9	Foreign currency translation	No regulation	Explicit regulation	Explicit regulation	No regulation (authoritativeness)
1.2.10	Deferred tax				
	• Tax rate	No regulation	Explicit regulation	Explicit regulation	-
	• Inclusion loss carryforwards, tax credits & interest carryforwards	Prohibition	Duty	Duty (five years)	-

1.3 Disclosure Rules

1.3.1 Balance Sheet Classification

As a result of the duty to capitalise internally generated intangible fixed assets, the balance sheet classification is extended to the item "internally generated industrial and similar rights and assets" (§ 266 (2 A. I. 1.) German Commercial Code Draft Version (HGB-E)^④, whereas the assets to be disclosed in the item under § 266 (2 A. I. 2.) German Commercial Code Draft Version (HGB-E)^④ are restricted to intangible fixed assets acquired at a consideration. With "deferred tax assets" (§ 266 (2 D.) German Commercial Code Draft Version (HGB-E)^④ and "deferred tax liabilities" (§ 266 (3 E.) German Commercial Code Draft Version (HGB-E)^④ new items are included, which take account of the changes in the treatment of deferred tax (§ 274 German Commercial Code Draft Version (HGB-E)^④. Furthermore, treasury shares will no longer be disclosed on the asset side in favour of open deduction on the liability side (§ 266 (2 B. III. 2.) German Commercial Code Previous Version (HGB-alt)^⑦.

1.3.2 Cancellation of Optional Disclosure of Unclaimed Outstanding Contributions

On account of the amendment of § 272 (1) German Commercial Code Draft Version (HGB-E)^④, the previous option to disclose outstanding contributions by way of gross or net disclosure in the commercial balance sheet is eliminated and net disclosure becomes mandatory. Unless the subscribed capital has already been fully called, the item "Unclaimed Outstanding Contributions" is required to be deducted from the item "subscribed Capital" in a pre-column and the remainder is required to be disclosed under the item "Called-in Capital". The amount called-in, but not yet paid in is required to be separately disclosed under receivables.

1.3.3 Disclosure of Treasury Shares

Depending on the different circumstances at acquisition, treasury shares have previously either been deducted on the liability side, for example, acquisition for the purpose of redemption (§ 71 (1) No. 6 German Stock Corporation Act (AktG)), or, in the event of another reason for acquisition under § 71 (1) German Stock Corporation Act (AktG), disclosed separately on the asset side (§ 265 (3) Sentence 2 German Commercial Code Previous Version (HGB-alt)^⑦. For reasons of harmonisation, treasury shares are intended to be openly deducted from the item "subscribed capital" as a repayment of share capital at their nominal value (or computational value) in the future, with the difference between nominal value (computational value) and acquisition cost being required to be offset against freely available reserves, i.e. against freely available revenue and capital reserves; incidental acquisition costs are required to be taken into account as an expense of the financial year (§ 272 (1a) German Commercial Code Draft Version (HGB-E)^④. If treasury shares are sold, which is deemed to be a capital increase in economic terms according to the grounds cited in support of the Act, the corresponding netting has to be reversed (§ 272 (1b) German Commercial Code Draft Version (HGB-E)^④. Amounts exceeding original acquisition cost are required to be allocated to the capital reserves.

1.4 Disclosures in the Notes to the Financial Statements

As a result of the proposed amendments or as complementary disclosures, the Draft Bill provides for a number of supplementary disclosures in the notes to the financial statements. The major mandatory disclosures cover the following items:

§§ German Commercial Code Draft Version (HGB-E) ^④	Regulation
285 No. 3	Nature and purpose as well as risks and benefits of off-balance-sheet transactions to the extent necessary for assessing the financial position
285 No. 13	Reasons that justify the assumption of an estimated useful life of more than five years for goodwill acquired at a consideration
285 No. 17, 288 (1) and (2)	The total fee charged by the auditors for the financial year, classified by auditing services, other certification services, tax services and other services (unless included in the consolidated financial statements); small and medium-sized firms organised in a corporate form are not required to include these disclosures in the notes to the financial statements; medium-sized firms organised in a corporate form are required to transmit this information at request to the Chamber of Auditors
285 No. 19	Disclosure of nature and scope, fair value, book value and balance sheet item as well as justification why the fair value can possibly not be calculated, for each category of derivative financial instruments that are not accounted for at fair value
285 No. 20	Fundamental assumptions on the determination of fair value by means of generally accepted valuation methods for financial instruments measured at fair value as well as nature and scope of every category including major conditions
285 No. 21, 288 (1) and (2)	Disclosures regarding (material) transactions not conducted at market conditions (legal transactions or measures for transferring assets and liabilities) of the Company with related parties, including nature of relationship, value of transactions as well as further disclosures for assessment purposes; summary by types of transactions is possible; excepted are transactions between entities (in)directly wholly-owned which are included in consolidated financial statements; for the time being, the term "related parties" is to be interpreted in accordance with IAS 24; small firms organised in a corporate form are not required to include these disclosures, medium-sized firms organised in a corporate form only to a limited extent and only if these are stock corporations
285 No. 22	Total amount of research and development expenses of the financial year as well as proportion relating to internally generated intangible fixed assets, with respective classification by research and development expenses
285 No. 23	Disclosure as to which types of separate valuation units have been recognised for hedging against what risks, and how far the occurrence of the risks is excluded (optional disclosure in management report)
285 No. 24	Actuarial calculation methods applied to pension provisions and similar obligations as well as fundamental assumptions with respect to interest rate, anticipated wage and salary rises and mortality tables
285 No. 25	Acquisition cost and fair value of netted assets, settlement amount of netted liabilities as well as netted income and expenses
285 No. 26	With respect to shares or equity investments in domestic investment funds (within the meaning of § 1 German Investment Act (InvG)) or comparable foreign investment funds (within the meaning of § 2 (9) German Investment Act (InvG)), among other things, investment objectives, value, difference to book value including justification of deferred amortisation and distribution for the financial year
285 No. 27	With respect to liabilities and contingent liabilities disclosed below the balance sheet in accordance with § 251 German Commercial Code (HGB), reasons for assessment of risk of related settlements
285 No. 28	Total amount as well as classification of income that is subject to limitation on distribution under § 268 (8) German Commercial Code Draft Version (HGB-E) ^④

2. Consolidated Financial Statements

Beyond the amendments of the general regulations governing the financial statements that relate to the consolidated financial statements in accordance with § 298 (1) German Commercial Code Draft Version (HGB-E)^④, the group accounting regulations are to be amended through the German Act on Modernisation of Accounting Regulations (BilMoG) especially in the following areas:

2.1 Group of Entities to Be Consolidated and Consolidation Methods

2.1.1 Definition of Group of Entities to Be Consolidated

On account of the cancellation of the equity investment criterion under § 290 (1) Sentence 1 German Commercial Code Draft Version (HGB-E)^④, entities will be required to be included in the group of consolidated entities in accordance with § 290 (1) German Commercial Code Draft Version (HGB-E)^④ even if only the criterion of uniform control is met. According to the grounds cited in support of the Act, uniform control is deemed to include the performance of original control tasks for the group as a whole by the parent company and, hence, scheduled coordination of business policies and other aspects of group management. The existence of uniform control depends on the overall conditions. Even though the amendment is intended to be an approximation to International Accounting Standards, it is stated in the grounds cited in support of the Act that the elements of § 290 German Commercial Code Draft Version (HGB-E)^④ cannot be interpreted according to these. On account of the proposed amendment, all entities that have to be classified as a subsidiary at the first balance sheet date of the consolidated financial statements after the effective date of the regulation and that come, hence, under the scope of application of § 294 (1) German Commercial Code (HGB; exception: § 296 German Commercial Code (HGB)) will, as a general rule, be required to be included in the group of consolidated entities.

The amendment targets, among other things, so-called “special purpose entities” and has to be seen in connection with the duties of disclosure under § 285 No. 26 and § 314 (1) No. 19 German Commercial Code Draft Version (HGB-E)^④ with respect to shares or equity investments in investment funds.

2.1.2 Preparation of Subgroup Accounts

Entities have previously been required to prepare subgroup accounts even if the requirements under § 291 (2) German Commercial Code (HGB) were met if, among other things, shareholders within the meaning of § 291 (3) No. 2 Sentence 2 German Commercial Code Previous Version (HGB-alt)^⑦ did not agree to the exemption. This regulation, which is quite difficult to implement in practice, is to be cancelled.

2.1.3 Requirement of Initial Consolidation According to the Revaluation Method as at the Time of Acquisition

The previous option granted within the scope of capital consolidation to choose between the book value method and the revaluation method will be revoked in view of better international comparability in favour of the revaluation method as the sole method admissible in the future (§ 301 (1) Sentence 2 German Commercial Code Draft Version (HGB-E)^④). This means that the hidden reserves and latent losses that relate to minority shareholders will also mandatorily have to be disclosed in the future. The determination of the related values is linked to the term of “fair value” in connection with § 255 (4) German Commercial Code Draft Version (HGB-E)^④.

Deviating from the previous option, the fair value will be required in the future to be determined, as a general rule, as at the time the entity concerned became a subsidiary (§ 301 (2) German Commercial Code Draft Version (HGB-E)^④), irrespective of a poten-

tial acquisition of an equity investment. If it is impossible to determine the final values to be recognised on time, it will now be possible, complementing the Draft Statute, to adjust the values without profit and loss impact within the following year (§ 301 (2) Sentence 2 German Commercial Code Draft Version (HGB-E)④. If the parent company is required for the first time to prepare consolidated financial statements or did not take advantage of the option under § 296 German Commercial Code (HGB), the valuation has to be based on the values as at the time the subsidiary was included in the consolidated financial statements. This requires, however, that the entity concerned has not become a subsidiary only in the financial year for which the consolidated financial statements have to be prepared.

2.1.4 Cancellation of Pooling of Interest Method

The previous option to consolidate the capital according to the pooling of interest method is intended to be revoked (§ 302 German Commercial Code Previous Version (HGB-alt)⑦).

2.2 Valuation and Disclosure Rules

2.2.1 Duty to Disclose Gross Amounts and to Amortise Goodwill

Positive and negative differences arising on capital consolidation will no longer be permitted to be eliminated against each other and will be required to be separately disclosed as goodwill or “negative consolidation difference” (after equity) in the consolidated balance sheet (§ 301 (3) German Commercial Code Draft Version (HGB-E)④. Cancelling the previous option to amortise goodwill by at least one fourth annually, to amortise it on a scheduled basis or to offset it without profit and loss impact against the reserves, goodwill will be required to be amortised on a scheduled basis in the future (§ 309 (1) German Commercial Code Draft Version (HGB-E)④.

2.2.2 Disclosure of Treasury Shares

Analogous to the disclosure of treasury shares under § 272 (1a) German Commercial Code Draft Version (HGB-E)④, shares of the parent company which are held by a subsidiary included in the consolidated financial statements will be required to be openly deducted from the item “subscribed capital” on the liability side of the group balance sheet (§ 301 (4) German Commercial Code Draft Version (HGB-E)④.

2.2.3 Balance Sheet Method of Determining Deferred Tax

By appropriate application of the amended § 274 German Commercial Code Draft Version (HGB-E)④, the balance sheet concept (temporary concept) is intended to be authoritative also for the consolidated financial statements (§ 306 German Commercial Code Draft Version (HGB-E)④, with a difference arising on initially recognising goodwill or a negative consolidation difference not being taken into account (§ 306 Sentence 2 German Commercial Code Draft Version (HGB-E)④. The calculation of deferred tax is to be based on the respective tax rates of the subsidiaries included in the consolidated financial statements in effect at the time the difference is reversed. Under materiality aspects, the application of a uniform average tax rate at group level is in exceptional cases admissible according to the grounds cited in support of the Act.

2.2.4 Duty to Translate Financial Statements in Foreign Currencies Included in the Consolidated Financial Statements According to the Modified Reporting Date Method

According to the new § 308a German Commercial Code Draft Version (HGB-E)④, the modified reporting date method is required to be applied in translating sets of financial statements denominated in foreign currencies for the purpose of uniform translation. The internationally applied functional currency concept is not followed. According to the foreign currency translation method chosen by the legislator,

- equity is required to be translated into euro at the historical rate;
- other assets and liabilities are required to be translated into euro at the spot exchange rate in effect at the group balance sheet date; and
- income statement items are required to be translated into euro at average rates.

The purpose of translating the income statement items at average rates, rather than at historical rates, which deviates from the Draft Statute, is intended to simplify translation. The net income/loss for the financial year is computed as a net amount. Potential translation differences are required to be disclosed under consolidated equity after the reserves under the item "equity difference arising on foreign currency translation". If a subsidiary is disposed of in full or in part, this item is released accordingly with profit and loss impact. According to the grounds cited in support of the Act, § 308a German Commercial Code Draft Version (HGB-E)⁴ is not intended to be applicable to financial statements denominated in foreign currencies of hyperinflationary economies.

2.2.5 Duty to Measure Shares in Associated Companies According to the Book Value Method

The option granted under § 312 (1) German Commercial Code Previous Version (HGB-alt)⁷ to recognise shares in associated companies at book value (book value method) or at the amount of proportionate equity (equity method) is cancelled in favour of book value recognition. The difference between book value and proportionate equity as well as positive or negative goodwill included are required to be disclosed in the notes to the consolidated financial statements.

2.3 Disclosures in the Notes to the Consolidated Financial Statements

As a result of the proposed amendments or complementing the existing legal regulations, the Draft Bill provides for a number of supplementary disclosures in the notes to the consolidated financial statements. Thus, the disclosures required to be made under § 285 Nos. 3, 3a and Nos. 16–27 German Commercial Code Draft Version (HGB-E) will become mandatory from the point of view of the consolidated financial statements also for the consolidated financial statements in accordance with § 314 (1) Nos. 2, 2a and Nos. 8–19 German Commercial Code Draft Version (HGB-E). (Cp. Section 1.4.)

3. Capital Market Orientation

3.1 Definition of "Capital Market Orientation"

§ 264d German Commercial Code Draft Version (HGB-E)^m is to include for the first time a definition of a capital-market-orientated firm organised in a corporate form. "A firm organised in a corporate form is deemed to be orientated towards the capital market if it operates in an organised market within the meaning of § 2 (5) German Securities Trading Act (WpHG) through its issued securities within the meaning of § 2 (1) Sentence 1 German Securities Trading Act (WpHG) or has applied for admission to trading in an organised market". On account of references in further legal regulations, this definition is applicable also to entities of other legal forms, for example, to cooperatives (cp. § 36 (4) German Cooperatives Act Draft Version (GenG-E)).

3.2 Extension of Annual Financial Statements

Entities that are orientated towards the capital market and are not required to prepare consolidated accounts are required to extend their financial statements and to include a statement of cash flows and a statement of changes in equity. In addition, the financial statements can be extended to include segment reporting (§ 264 (1) Sentence 2 German Commercial Code Draft Version (HGB-E)⁴).

3.3 Extended Disclosures in the Management Report

Entities that are orientated towards the capital market as defined under § 264d German Commercial Code Draft Version (HGB-E)^④ will be required to describe the material features of the internal control system and of the internal risk management system in relation to the accounting process in the management report (§ 289 (5) German Commercial Code Draft Version (HGB-E)^③). According to the grounds cited in support of the Act, it will neither be mandatory to establish nor to shape in terms of contents an accounting-related internal control system or risk management system, notwithstanding § 91 (2) German Stock Corporation Act (AktG), which provides for mandatory establishment of a risk early-warning and monitoring system by stock corporations. Such establishment will, as a general rule, be at the discretion of the management bodies. In the legislator's opinion, a description in the management report will force the management bodies, however, to analyse the contents of the internal control system and the risk management system because insufficient establishment may involve a risk of a failure to comply with the duty of due care and diligence. The accounting-related internal control system covers the principles, methods and measures for ensuring the effectiveness and efficiency of the accounting, for ensuring their compliance with generally accepted accounting principles and compliance with the relevant legal regulations. Internal accounting-related risk management is of special import if internal risk hedging is reflected in the commercial balance sheet (for example, within the scope of a separate valuation unit).

A corresponding duty with respect to the group management report ensues from § 315 (2) No. 5 German Commercial Code Draft Version (HGB-E)^③ if the parent company or one of the subsidiaries included in the consolidated financial statements is capital-market-orientated within the meaning of § 264d German Commercial Code Draft Version (HGB-E)^④.

3.4 Establishment of an Audit Committee

Capital-market-orientated firms organised in a corporate form within the meaning of § 264d German Commercial Code Draft Version (HGB-E)^④ will be required to establish a so-called "audit committee" in the future (§ 324 German Commercial Code Draft Version (HGB-E)^② unless they have already established a supervisory or administrative board which meets the requirements under § 100 (5) German Stock Corporation Act Draft Version (AktG-E). Under the corresponding conditions, the supervisory or administrative board can, hence, perform the tasks of the audit committee itself. In accordance with § 100 (5) German Stock Corporation Act Draft Version (AktG-E), companies within the meaning of § 264d German Commercial Code Draft Version (HGB-E)^④ should have at least one independent member of the supervisory board with expertise in the fields of accounting or auditing of financial statements. The criterion of independence goes beyond the segregation of board of directors and supervisory board, which is already guaranteed through § 105 (1) German Stock Corporation Act (AktG). Thus, especially direct or indirect business, financial or personal relationships with management can, according to the grounds cited in support of the Act, give rise to suspected partiality (see also German Corporate Governance Code, Item 5.4.2). The criterion of expertise requires that the supervisory board member is or was professionally concerned with accounting and/or auditing of financial statements. Besides the members of the tax consulting or auditing professions, this is deemed to be the case, for example, for financial managers, professionals in the areas of accounting and controlling as well as persons who have been members of auditing committees or works councils for many years. The members of the audit committee have to be appointed by the shareholders. The committee must not solely constitute members of management; the chairperson must not be a member of the management board.

In accordance with § 107 (3) Sentence 2 German Stock Corporation Act Draft Version (AktG-E), the major tasks of the audit committee will be monitoring

- the accounting process;
- the effectiveness of the internal control system, of the internal risk management system and of the internal audit system; as well as
- the audit of the financial statements, in particular the independence of the auditors.

According to the grounds cited in support of the Act, monitoring the effectiveness of an existing internal control system (or of a risk management system or of an internal audit) always involves the task to examine whether supplements, extensions or improvements are necessary or, if there is no risk management system, it is necessary to establish such a system. With respect to auditors, the monitoring activity is intended to cover all activities from selection to termination of the audit. Monitoring the auditors' independence is closely connected with the amendment under § 171 (1) German Stock Corporation Act Draft Version (AktG-E), according to which the auditors are required to provide information on circumstances that could give rise to suspected partiality.

The regulations concerning the establishment of an audit committee apply in particular to capital-market-orientated limited liability companies without codetermination, unless a supervisory board was established or if the regulations under § 100 (5) and § 107 (4) German Stock Corporation Act Draft Version (AktG-E) are not applicable to an appointed supervisory board on account of deviating provisions under the articles of association. General commercial partnerships or limited commercial partnerships within the meaning of § 264a German Commercial Code (HGB) can, however, also come under these regulations.

3.5 Corporate Governance Representation

Under the newly introduced § 289a German Commercial Code Draft Version (HGB-E)®,

- listed stock corporations (§ 3 (2) German Stock Corporation Act (AktG)); and
- stock corporations which have issued exclusively securities other than shares (for example, debentures) for trading in an organised market within the meaning of § 2 (5) German Securities Trading Act (WpHG) and whose issued shares are traded at own request via a multilateral trading system (§ 2 (3) Sentence 1 No. 8 German Securities Trading Act (WpHG))

will be required in the future to make a corporate governance representation. According to the grounds cited in support of the Act, the purpose of restricting the duty to make the representation to entities whose shares are traded "at own request" via a multilateral trading system is to handle the regulation in a practicable manner because the operators in the capital market are not required to provide information to the entity.

The proposed scope of the corporate governance representation is as follows (§ 289a (2) German Commercial Code Draft Version (HGB-E)®):

- A representation regarding the Corporate Governance Code in accordance with § 161 German Stock Corporation Act Draft Version (AktG-E);
- Disclosures relevant to corporate governance practices that are applied beyond the legal requirements (including reference as to where these are accessible in the public domain); and
- A description of the working practices of the board of directors and supervisory board as well as the composition and working practices of their committees.

With respect to the representation under § 161 (2) German Stock Corporation Act Draft Version (AktG-E), it has to be taken into account that explicit justification will have to be provided in the future as to why specific recommendations of the Corporate Governance Code are not applied and that the representation will have to be permanently accessible in the public domain on the website of the entity (§ 161 German Stock Corporation Act Draft Version (AktG-E)). According to the grounds cited in support of the Act, the corporate governance practices required to be disclosed, which relate to the respective corporate governance code applied, can refer, for example, to ethical standards or working and social standards applicable to the entity as a whole. The element of relevance restricts the duty of disclosure so that it is not necessary to report on all organisational regulations or rules existing at corporate level. The disclosures concerning the members of company bodies, which are already required to be made under § 285 Sentence 1 No. 10 German Commercial Code (HGB), are complemented by the description of the composition of the committees established by the board of directors and the supervisory board. The required disclosures can optionally be made in a separate section of the management report or, with corresponding reference, on the website of the company. In accordance with § 317 (2) Sentence 3 German Commercial Code Draft Version (HGB-E)®, the disclosures made within the scope of the representation are not subject to the audit by the auditors. Without prejudice to this, the disclosures are required to be made in the notes to the (consolidated) financial statements in accordance with § 285 No. 16 or § 314 (1) No. 8 German Commercial Code Draft Version (HGB-E)④.

4. Other Amendments and New Legislation under German Commercial Code (HGB)

4.1 Raising of Thresholds

The thresholds that are relevant for taking advantage of various exemption and reduced disclosure requirements with respect to accounting, statutory audit requirement and disclosure under §§ 325 et seq. German Commercial Code Draft Version (HGB-E)④ are raised as stated in the table below (§ 267 German Commercial Code Draft Version (HGB-E)①. The size criterion “employees” is not adjusted.

Size category	Balance sheet total (EUR)		Sales revenues (EUR)	
	Previously	Under German Act on Modernisation of Accounting Regulations (BilMoG)	Previously	Under German Act on Modernisation of Accounting Regulations (BilMoG)
“Small”	4,015,000	4,840,000	8,030,000	9,680,000
“Medium-sized”	16,060,000	19,250,000	32,120,000	38,500,000

Irrespective of these thresholds, capital-market-orientated firms organised in a corporate form within the meaning of § 264d German Commercial Code Draft Version (HGB-E)④ are always deemed to be large-sized firms organised in a corporate form.

The thresholds for the duty to prepare consolidated financial statements have also been raised (§ 293 German Commercial Code Draft Version (HGB-E)①:

Determination	Balance sheet total (EUR)		Sales revenues (EUR)	
	Previously	Under German Act on Modernisation of Accounting Regulations (BilMoG)	Previously	Under German Act on Modernisation of Accounting Regulations (BilMoG)
Added	19,272,000	21,000,000	38,544,000	42,000,000
Consolidated	16,060,000	19,250,000	32,120,000	38,500,000

In order to assess whether these thresholds were exceeded or failed to be reached at two consecutive balance sheet dates, the new thresholds have to be compared to the balance sheet and income statement values of the last two financial years.

4.2 Revocation of Accounting Duties under German Commercial Code (HGB) for Sole Traders

The Draft Bill provides for size-dependent exemption of non-capital-market-orientated sole traders from the accounting duties (“Doppik”) and inventory taking duties under German commercial law if they do not exceed the thresholds for sales revenues and the net income for the financial year (up to € 500,000 and up to € 50,000, respectively) in two consecutive financial years (§§ 241a, 242 (4) German Commercial Code Draft Version (HGB-E)^①). For newly established entities, the legal consequences will ensue already if the requirements are met at the first balance sheet date. For the time being, the Draft Bill does not provide for an additional exemption of partnerships and cooperatives, which had still be provided for in the Draft Statute.

4.3 Optional Preparation of Financial Statements According to German Commercial Code (HGB) or IFRS

The option to prepare exempting financial statements under IFRS as applicable in the EU, which was provided for in the Draft Statute, is not provided for in the Draft Bill (§ 264e German Commercial Code Draft Statute (HGB-RefE)).

5. Regulations Applicable to Specific Industries

5.1 Banks and Financial Service Providers in Accordance with § 340 German Commercial Code (HGB)

5.1.1 Measurement at Fair Value of Financial Instruments Held for Trading

§ 340e (3) German Commercial Code Draft Version (HGB-E)^④ includes a special regulation applicable to banks and financial service providers governing the measurement of financial instruments held for trading. According to this regulation, banks are required to measure at fair value financial instruments that are allocable to the trading portfolio, i.e. financial instruments that are neither part of the liquidity reserve nor of the investment portfolio (cp. §§ 340c (1) and 340f (1) German Commercial Code (HGB)). In this context, the grounds cited in support of the Act refer to the definition within the meaning of the German Banking Act (KWG) and is likely to be generally in line with the definition of the trading book under supervisory law (cp. § 1a German Banking Act (KWG)). Instead of the limitation on distribution newly laid down in § 268 (8) German Commercial Code Draft Version (HGB-E)^④, which is not applicable to banks and financial service providers in accordance with § 340a (2) Sentence 1 German Commercial Code Draft Version (HGB-E)^④, a negative risk allowance will be required to be taken into account – as a surrogate – in measuring financial instruments held for trading at fair value in the future (risk adjusted fair value). According to the grounds cited in support of the Act, the purpose of this negative risk allowance is to address the probabilities of loss of realisable gains. According to the grounds cited in support of the Act with respect to § 253 (1) Sentence 3 German Commercial Code Draft Version (HGB-E)^④, a reclassification to and from the trading portfolio has been explicitly excluded in accordance with § 340e (3) Sentence 2 German Commercial Code Draft Version (HGB-E)^④.

Deviating from fair value measurement under § 253 (1) Sentence 3 German Commercial Code Draft Version (HGB-E)^④, the measurement of financial instruments held for trading by banks at risk adjusted fair value is codified accordingly for tax purposes by including § 6 (1) No. 2b German Income Tax Act Draft Version (EStG-E).

5.1.2 Foreign Currency Translation

By including the general regulations concerning foreign currency translation (§ 256a German Commercial Code Draft Version (HGB-E)^④ and recognition of separate valuation units (§ 254 German Commercial Code Draft Version (HGB-E)^④, the industry-related regulation concerning foreign currency translation (§ 340h German Commercial Code Previous Version (HGB-alt)^⑦ is intended to be cancelled. The regulations governing the treatment of income and expenses that relate to assets, liabilities or foreign exchange dealings for specific and general hedging purposes, which are included in § 340h (2) German Commercial Code Previous Version (HGB-alt)^⑦, are, hence, superseded by the regulations governing recognition of separate valuation units (§ 254 German Commercial Code Draft Version (HGB-E)^④, thus revoking the previous possibility of recognising unrealised gains through profit and loss also beyond the effectiveness of a separate valuation unit. This is compensated for by the fact that financial instruments denominated in foreign currency with terms of up to one year will have to be translated at spot exchange rates, and financial instruments held for trading will be subject to risk adjusted fair value measurement (§ 340e (3) German Commercial Code Draft Version (HGB-E)^④. Other foreign currency transactions within the scope of separate valuation units recognised under § 254 German Commercial Code Draft Version (HGB-E) will be subject to treatment according to the imparity principle. According to the grounds cited in support of the Act, it will be at the discretion of the banks and financial service providers as to whether the transactions are “transmitted in the books of account” or the accounting is “frozen” with respect to the part of the separate valuation unit.

5.1.3 Establishment of an Audit Committee

According to § 340k (5) German Commercial Code Draft Version (HGB-E)^②, capital-market-orientated banks within the meaning of § 264d German Commercial Code Draft Version (HGB-E)^④ will be required to establish an audit committee even if they are not operated in the legal form of a firm organised in a corporate form and have no supervisory or administrative board that meet the requirements under § 100 (5) German Stock Corporation Act Draft Version (AktG-E).

5.2 Insurance in Accordance with § 341 German Commercial Code (HGB)

5.2.1 Fair Value Measurement of Contracts for Covering Obligations to Persons Entitled to Benefits

By appropriate application of the amendment to § 341b German Commercial Code Draft Version (HGB-E)^④, contracts that are concluded by pension funds with life insurance companies for covering obligations to persons entitled to benefits will be required to be measured at fair value in the future (§ 341b (4) German Commercial Code Draft Version (HGB-E)^④. According to the grounds cited in support of the Act, the codification of this practice already existing is to address the fact that, in economic terms, these are transitory items without impact on the net assets, financial position and results of operations.

5.2.2 Measurement of Insurance Reserves

Notwithstanding the amendments to § 253 (1) Sentence 2 and (2) German Commercial Code Draft Version (HGB-E)^④, the previous measurement concept concerning insurance reserves is intended to remain unchanged. An amendment makes it clear that neither future cost and price increases are permitted to be taken into account, nor are insurance reserves required to be discounted in measuring insurance reserves (§ 341e (1) Sentence 3 German Commercial Code Draft Version (HGB-E)^④.

5.2.3 Establishment of an Audit Committee

Analogous to banks, capital-market-orientated insurance companies within the meaning of § 264d German Commercial Code Draft Version (HGB-E)^④ will be required to establish an audit committee even if they are not operated in the legal form of a firm organised in a corporate form and have no supervisory or administrative board that meet the requirements under § 100 (5) German Stock Corporation Act Draft Version (AktG-E) (§ 341k (4) German Commercial Code Draft Version (HGB-E)^②). This relates in particular to capital-market-orientated insurance companies in the legal form of a mutual insurance society.

5.3 Adjustment of Accounting Ordinances and Forms

Especially in view of the proposed legal amendments, the accounting ordinance applicable to banks and the accounting ordinance applicable to insurance companies including the related forms will be adjusted.

6. Tax Law Amendments

6.1 Authoritativeness

The Draft Bill maintains the authoritativeness of the commercial balance sheet for determining taxable income (§ 5 (1) Sentence 1 German Income Tax Act (EStG)). The new legislation partly leads to changes in the differences between commercial and tax balance sheets. Thus, there will be no longer any differences of recognition between commercial and tax balance sheets in the future, for example, with respect to the duty to capitalise derivative goodwill (§ 246 (1) Sentence 4 German Commercial Code Draft Version (HGB-E)^④ and the prohibition from capitalising accounting conveniences (revocation of § 269 German Commercial Code Previous Version (HGB-alt)^⑦). Deviations will arise in the future, for example, with respect to the prohibition from accruing customs duties and excise taxes accounted for as an expense (§ 250 (1) Sentence 2 German Commercial Code Previous Version (HGB-alt)^⑦, the duty to capitalise development expenses for internally generated intangible fixed assets (revocation of § 248 (2) German Commercial Code Previous Version (HGB-alt)^⑦, the fair value measurement of financial instruments held for trading (§ 253 (1) Sentence 3 German Commercial Code Draft Version (HGB-E)^④ as well as the valuation of pension provisions (§ 253 (1) Sentence 2 and (2) German Commercial Code Draft Version (HGB-E)^④.

6.2 Cancellation of Reverse Authoritativeness

The concept of reverse authoritativeness, which had previously been laid down in § 5 (1) Sentence 2 German Income Tax Act Previous Version (EStG-alt), is intended to be cancelled. The related regulations under the German Commercial Code (HGB; §§ 247 (3), 254, 273, 279 (2), 280, 281, 285 Sentence 1 No. 5 German Commercial Code Previous Version (HGB-alt)^⑦ will be revoked or adjusted. Options under German tax law will be permitted to be exercised in the future also without corresponding disclosure in the commercial balance sheet. This will require, however, that the assets concerned are recorded in current listings, which will have to substantiate the option exercised, the date of acquisition or production and amortisation, depreciation and write-downs.

6.3 Prohibition of Netting

§ 246 (2) German Commercial Code Draft Version (HGB-E)^④ provides for certain assets and liabilities to be offset against each other. This is, however, not intended to be applicable to the determination of taxable income (§ 5 (1a) Sentence 1 German Income Tax Act Draft Version (EStG-E)). Taxable income will continue to have to be disclosed as a gross amount, i.e. balance sheet items are not permitted to be offset against each other for tax purposes.

6.4 Financial Instruments

The Draft Bill provides for financial instruments held for trading by taxpayers that come under the scope of application of § 340e German Commercial Code (HGB) (banks and financial service providers) to be measured at fair value less risk markup. As a result, profits and losses that have not yet been realised will impact also the determination of taxable income (§ 6 (1) No. 2b German Income Tax Act Draft Version (EStG-E)). This regulation will be applicable to financial years beginning after 31 December 2008. For half of the profit that results from first-time application of the new regulation, a profit-reducing reserve, which is required to be released in the following financial year, is permitted to be recognised in the tax balance sheet. According to the grounds cited in support of the Act with respect to § 253 (1) Sentence 3 German Commercial Code Draft Version (HGB-E)®, fair value measurement of financial instruments acquired for trading has, however, no tax impact.

6.5 Recognition of Provisions

Whereas provisions will have to be recognised at the settlement amount, and price and cost increases will have to be taken into account, in the commercial balance sheet in the future, the values as at the balance sheet date will remain relevant for tax purposes (§ 6 (1) No. 3a Subpara. f German Income Tax Act Draft Version (EStG-E)). This regulation will be applicable to financial years beginning after 31 December 2008.

7. Effective Date

Most of the major amendments to the German legislation governing financial statements on account of the German Act on Modernisation of Accounting Regulations (BilMoG) are intended to be applicable for the first-time to financial years beginning after 31 December 2008, i.e., if the financial year corresponds to the calendar year, to financial statements or consolidated financial statements for financial years ending on or after 31 December 2009.

The increase in the thresholds (see Section 4.1) and the exemption from the duty to keep books of account applicable to non-capital-market-orientated sole traders (see Section 4.2) are, however, intended to be applicable for the first time to financial years beginning after 31 December 2007.

The effective date of application was stated in the corresponding references to the legal regulations.

8. Outlook

The German Draft Bill on Modernisation of Accounting Regulations (BilMoG-E) provides for significant amendments to German accounting regulations, with the effects not being limited to German commercial law, but covering also German tax law and the entities' corporate governance. A variety of changes in comparison with the Draft Statute reflect the intensive discussion and the outstanding issues with respect to the future detailed contents. If the regulations are to take effect for the financial year 2009, as is largely intended, it will be necessary not only to address the issues in terms of contents, but also to generate the not insignificant conditions for technical implementation, by the end of 2008.

Contacts: Susanne Kolb, Barbara Weimert, Wilhelm Wolfgarten

Deloitte refers to one or more of Deloitte Touche Tohmatsu, a Swiss Verein, its member firms, and their respective subsidiaries and affiliates. As a Swiss Verein (association), neither Deloitte Touche Tohmatsu nor any of its member firms have any liability for each other's acts or omissions. Each of the member firms is a separate and independent legal entity operating under the names "Deloitte", "Deloitte & Touche", "Deloitte Touche Tohmatsu", or other related names. Services are provided by the member firms or their subsidiaries or affiliates and not by the Deloitte Touche Tohmatsu Verein.

Disclaimer

This client information exclusively contains general information not suitable for addressing the particular circumstances of any individual case. Its purpose is not to be used as a basis for commercial decisions or decisions of any other kind. This client information does neither constitute any advice nor any legally binding information or offer and shall not be deemed suitable for substituting personal advice under any circumstances. Should you base decisions of any kind on the contents of this client information or extracts therefrom, you act solely at your own risk. Deloitte & Touche GmbH Wirtschaftsprüfungsgesellschaft will not assume any guarantee nor warranty and will not be liable in any other form for the content of this client information. Therefore, we always recommend to obtain personal advice.

About Deloitte

Deloitte provides audit, tax, consulting, and financial advisory services to public and private clients spanning multiple industries. With a globally connected network of member firms in 140 countries, Deloitte brings world-class capabilities and deep local expertise to help clients succeed wherever they operate. Deloitte's 165,000 professionals are committed to becoming the standard of excellence.

Deloitte's professionals are unified by a collaborative culture that fosters integrity, outstanding value to markets and clients, commitment to each other, and strength from cultural diversity. They enjoy an environment of continuous learning, challenging experiences, and enriching career opportunities. Deloitte's professionals are dedicated to strengthening corporate responsibility, building public trust, and making a positive impact in their communities.

© 2008 Deloitte & Touche GmbH Wirtschaftsprüfungsgesellschaft.