

EUROPEAN COMPARISON: **UK & GERMANY**

The main differences between UK and German accounting practice



by Adrian Crampton, Sasha Dorofeyev, Susanne Kolb and Wolfram Meyer-Hollatz



Contents

	Page
ABBREVIATIONS	5
INTRODUCTION	8
SCOPE OF BOOKLET	9
STANDARD-SETTING IN THE UK	10
STANDARD-SETTING IN GERMANY	13
COMPARISON OF FINANCIAL STATEMENT FORMAT	18
MAJOR DIFFERENCES IN ACCOUNTING POLICIES	27
1. CLASSIFICATION OF CURRENT ASSETS AND LIABILITIES	27
2. GOODWILL	29
■ TREATMENT	29
■ NEGATIVE GOODWILL	31
■ IMPAIRMENT REVIEWS	32
3. OTHER INTANGIBLE ASSETS	34
■ AMORTISATION	34
■ IMPAIRMENT REVIEWS	34
■ RESEARCH AND DEVELOPMENT	35
■ START-UP COSTS	35
4. TANGIBLE FIXED ASSETS	37
■ INITIAL MEASUREMENT	37
■ REVALUATION	37

	Page
■ CAPITALISATION OF BORROWING COSTS	40
■ DEPRECIATION	40
■ IMPAIRMENT REVIEWS	42
5. ACCOUNTING FOR INVESTMENTS	4
■ INVESTMENT PROPERTIES	45
■ ACCOUNTING FOR ASSOCIATED UNDERTAKINGS	46
■ JOINT VENTURES	50
6. STOCKS/INVENTORIES AND LONG-TERM CONTRACTS	52
■ STOCK VALUATION	52
■ LONG-TERM CONTRACTS	54
7. DEBTORS: IMPUTED INTEREST	56
8. DEBT AND CAPITAL INSTRUMENTS	57
■ CAPITAL INSTRUMENTS	57
■ PROFIT-PARTICIPATION RIGHTS	57
■ NON-EQUITY SHARES IN SUBSIDIARIES	58
■ DISCOUNTS AND PREMIUMS ON ISSUE OF DEBT	59
■ DEBT ISSUE COSTS	60
9. EMPLOYEE BENEFITS	61
■ PENSION COSTS	61
■ PENSIONS	61
■ POST RETIREMENT BENEFITS OTHER THAN PENSIONS	66
■ ACCOUNTING FOR SHARE OPTIONS	66
10. ACCOUNTING FOR INCOME TAXES	67
11. OTHER PROVISIONS	71
■ GENERAL REQUIREMENTS	71
■ RESTRUCTURING COSTS	72
■ SPECIAL ACCOUNT WITH CHARACTERISTICS OF RESERVE	73
12. SHARE CAPITAL AND RESERVES	75
■ CAPITAL RESERVES AND LEGAL RESERVES	76
■ REVALUATION RESERVE	77
■ PURCHASE OF OWN SHARES	77
■ REVENUE RESERVES AND REVENUE RECOGNITION	78

	Page
13. DIVIDENDS AND FINANCE COSTS OF SHARES	79
■ FINANCE CHARGE IN RESPECT OF NON-EQUITY SHARES	80
■ DIVIDENDS RECEIVABLE FROM EQUITY INVESTMENTS	81
14. EXTRAORDINARY AND EXCEPTIONAL ITEMS	82
■ EXTRAORDINARY ITEMS	82
■ EXCEPTIONAL ITEMS	83
15. DISCONTINUED OPERATIONS	84
16. CHANGES IN ACCOUNTING POLICIES/PRINCIPLES	86
17. EARNINGS PER SHARE	87
18. FOREIGN CURRENCY TRANSLATION	88
■ IN INDIVIDUAL COMPANY'S FINANCIAL STATEMENTS	88
■ IN CONSOLIDATED FINANCIAL STATEMENTS	89
19. LEASES	92
■ FULL AMORTISATION CONTRACTS	93
■ PARTIAL AMORTISATION CONTRACTS	95
■ SALE AND LEASEBACK	98
20. BUSINESS COMBINATIONS	99
■ MERGER (POOLING-OF-INTERESTS) ACCOUNTING	99
■ ACQUISITION (PURCHASE) ACCOUNTING	101
21. CONSOLIDATION	106
APPENDICES	110
APPENDIX I	111
■ CONSOLIDATED BALANCE SHEET – BRITISH HOLDINGS PLC	111
■ BALANCE SHEET – GERMAN COMPANY	112
APPENDIX II	115
■ CONSOLIDATED PROFIT AND LOSS ACCOUNT – BRITISH HOLDINGS PLC	115
■ PROFIT AND LOSS ACCOUNT – GERMAN COMPANY	116
Format 1 – Expenses classified by their nature (Gesamtkostenverfahren)	116
Format 2 – Expenses classified by function (Umsatzkostenverfahren)	118

	Page
APPENDIX III	119
■ CONSOLIDATED CASH FLOW STATEMENT – BRITISH HOLDINGS PLC	119
■ RECONCILIATION OF NET CASH FLOW TO MOVEMENT IN NET DEBT – BRITISH HOLDINGS PLC	120
■ CASH FLOW STATEMENT – GERMAN COMPANY (INDIRECT METHOD)	121
LIAISON RESOURCES	122
OFFICES IN THE UNITED KINGDOM, CHANNEL ISLANDS AND THE ISLE OF MAN	123
OFFICES IN GERMANY	126
INTERNATIONAL OFFICES	128



Abbreviations

UNITED KINGDOM

ASB	Accounting Standards Board
ASC	Accounting Standards Committee
1985 CA Sch 4	Schedule 4 of the 1985 Companies Act
FRED	Financial Reporting Exposure Draft issued by the ASB
FRS	Financial Reporting Standard issued by the ASB
SOP	Statement of Principles for Financial Reporting
ICAEW	Institute of Chartered Accountants in England and Wales
SORP	Statement of Recommended Practice
SSAP	Statement of Standard Accounting Practice issued by the UK accountancy bodies
STRGL	Statement of total recognised gains and losses.
UITF	Urgent Issues Task Force

INTERNATIONAL

G 4 + 1	Representatives of national standard setting bodies from Australia, Canada, New Zealand, United Kingdom and the United States of America together with representatives of the IASC
IAS	International Accounting Standards
IASC	International Accounting Standards Committee

ISA	International Standards on Auditing
IFAC	International Federation of Accountants
US GAAP	US Generally Accepted Accounting Principles

GERMANY

AG	Aktiengesellschaft (Stock Corporation)
AktG	Aktiengesetz (Stock Corporation Law)
BGB	Bürgerliches Gesetzbuch (Civil Law)
DRSC	Deutsches Rechnungslegungs Standards Committee (German Accounting Standards Committee or GASC)
DRS	Deutscher Rechnungslegungs Standard (German Accounting Standard)
DVFA	Deutsche Vereinigung für Finanzanalyse und Anlageberatung e.V. (German Association of Financial Analysis and Investment Consulting)
EStG	Einkommensteuergesetz (Income Tax Law)
EStR	Einkommensteuerrichtlinien (Directives to Income Tax Law)
GmbH	Gesellschaft mit beschränkter Haftung (Limited Liability Company)
GmbHG	GmbH-Gesetz (Limited Liability Companies Law)
GmbH & Co KG	Partnership with a limited liability company as general partner
GoB	Grundsätze ordnungsmäßiger Buchführung (Generally Accepted Accounting Principles)
HFA	Hauptfachausschuß des IDW (Main Technical Committee of the IDW)
HGB	Handelsgesetzbuch (Commercial Code)
EGHGB	Einführungsgesetz zum Handelsgesetzbuch (Introductory Law to the Commercial Code)
IDW	Institut der Wirtschaftsprüfer (Institute of Professionally Qualified Auditors)
KGaA	Kommanditgesellschaft auf Aktien (Partnership Limited by Shares)

KonTraG	Gesetz zur Kontrolle und Transparenz im Unternehmensbereich (Law on Control and Transparency within Enterprises)
PublG	Publizitätsgesetz (Publicity Law)
SABI	Sonderausschuss Bilanzrichtlinien-Gesetz des IDW (Special Committee of the IDW for the Accounting Directives Law)



Introduction

Due to European Union harmonisation, many believe that financial statements prepared in the UK are similar to those prepared in Germany. Those familiar with practice in both countries know this is not the case. Significant differences remain particularly in the detailed methods of computing profits.

These differences are partly attributable to the differing business traditions within the two countries and the different historical development of the legal systems. The heavily codified law in Germany with its comprehensive legal provisions contrasts sharply with the common law and case law prevalent in the United Kingdom. As a result accounting in Germany has been basically governed by detailed legal regulations.

The UK has a long history of wide share ownership, with not only multinationals but also medium-sized domestic companies obtaining listings on the London market. The requirements of shareholders and the desire of companies to demonstrate continuously upward profit trends have, as a result, influenced significantly, the development of UK accounting practice.

In the past German industry was dominated by the “Mittelstand” – private companies (many of which are effectively family businesses), whose capital has traditionally been provided by the banking sector. Consequently, the major developments in German accounting have been driven by the needs of the creditors (the so called “Gläubigerschutzprinzip”) rather than those of the shareholders. Indeed, it is possible to argue that whilst profitability (the profit and loss account) is most important to the general user of UK financial statements, financial security (the balance sheet) has traditionally been of greatest significance to the German user. There is, however, a clear trend in Germany towards wider share ownership and the attractiveness of the legal form of public company is coming to bear.

UK accounting practices have developed separately from tax law and reconciliations between tax accounts and statutory accounts are often complex, whereas German accounting has been significantly affected by tax rules. The important German principles of “Massgeblichkeit” (§ 5 (1) 2 EStG) and “umgekehrte Massgeblichkeit”, which have no precise UK equivalents, result in many tax incentives being claimable only if the same treatment is adopted in the commercial (statutory) financial statements. The effect of this is that differences in Germany between tax and financial accounts are generally minimised although, as a result of recent legislation, both commercial and taxation, there is now a distinctive trend away from these principles.

In Germany, profit distributions are assessed and taxed on the basis of the companies’ individual accounts. In the past, individual accounts were, hence, the focus of interest whereas consolidated financial statements were traditionally of minor importance. As a result of increased cross-border capital flows and the orientation of many enterprises towards the requirements of international capital markets, consolidated financial statements are gradually becoming the focus of public interest.

The German legislation supports this development by allowing enterprises whose securities are publicly traded to prepare their consolidated financial statements according to International Accounting Standards (IAS) or US Generally Accepted Accounting Principles (US GAAP) rather than according to German Generally Accepted Accounting Principles (§ 292a of the Commercial Code (HGB)). This provision came into existence in 1998 and it is envisaged that it will be applicable until the year 2004. At the time this book was printed, it was not clear whether consolidated financial statements which are prepared according to UK GAAP also come under this provision.

SCOPE OF BOOKLET

This booklet is intended to assist companies which trade in both the UK and Germany to obtain a general understanding of the differences between UK and German GAAP. The differences outlined are a high level overview only.

The differences between UK and German GAAP discussed in this booklet are a summary of those most likely to arise for companies trading in non-specialised industries. It is not possible to identify all differences that could exist as a result of particular circumstances. Consequently, where differences at a detailed level are important, for example in complex areas such as leasing and pension accounting, the reader is advised to consult his financial advisor at one of the offices listed in the back of this booklet.

The analysis does not attempt to cover differing accounting practice in specialised industries such as banking, insurance, oil and gas or utilities.

Differences in disclosure requirements in both countries are not the primary focus of this booklet. Discussion of disclosure requirements included below is limited to assisting the reader in understanding the primary differences in accounting policies only. Significant differences do, however, exist in required financial statement disclosure. Furthermore, companies which are listed on a stock exchange in the UK or in Germany must comply with disclosure rules published by these institutions. Such rules may cause additional financial reporting differences not discussed in this publication.

This booklet reflects accounting practices followed and standards that were issued prior to 30 November 2000.

STANDARD-SETTING IN THE UK

Standard-setting outside company law began in 1970, with the establishment of the Accounting Standards Steering Committee by the Institute of Chartered Accountants in England and Wales (ICAEW). In 1976, this committee was reconstituted as a joint committee of the six accountancy bodies who comprise the Consultative Committee of Accountancy Bodies, and was known as the Accounting Standards Committee (ASC).

By 31 July 1990, the ASC had still in issue 22 Statements of Standard Accounting Practice (SSAPs), two Statements of Recommended Practices (SORPs), and numerous exposure drafts of proposed SSAPs.

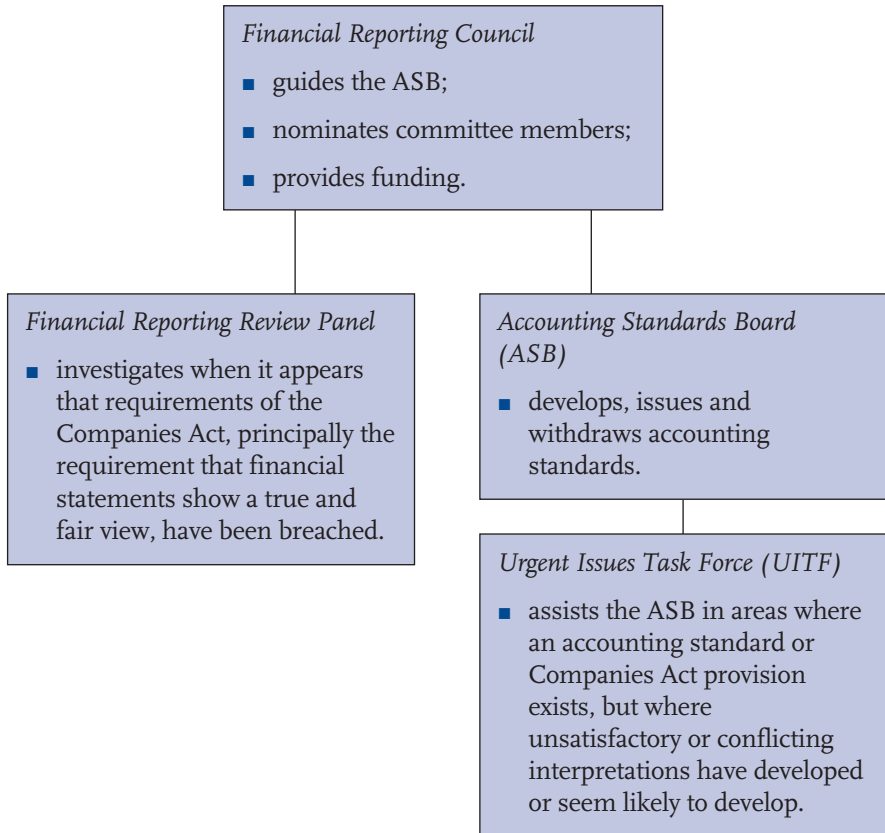
SSAPs generally deal with broad principles on areas of accounting that are applicable to almost all UK companies. There remain significant issues for which no statements have been produced and issues, although covered by SSAPs, where a variety of treatments are acceptable. The existence of such variety results from two features of SSAPs:

- SSAPs may recognise more than one basis of accounting (e.g. revaluation of fixed assets); and
- SSAPs may specify acceptable practice, however the emphasis on broad principle permits a number of different interpretations which lead to alternative treatments.

The ASC was very slow to respond to changes in the financial reporting environment, because it needed to secure the agreement of six accounting

institutes and because it lacked necessary resources. Many observers also felt that the ASC was too willing to compromise. These factors coupled with increasing complexity of accounting issues and a growing demand for more sophisticated financial reporting led to implementation of a new standard-setting and regulatory framework.

The new framework is as follows:



In August 1990, the Accounting Standards Board (ASB) replaced the ASC, with statutory authority to issue accounting standards without the need to seek approval from the six accountancy bodies that make up the Consultative Committee of Accountancy Bodies. The ASB has adopted and still retains 13 SSAPs issued by the ASC and, prior to 30 November 2000, issued 16 Financial Reporting Standards (FRS). Work on a conceptual framework has resulted in the issue of the Statement of Principles for Financial Reporting

(SOP) in December 1999. As of the date of publication, the ASB has additionally issued three more standards:

Standards	Topic
FRS 17 (issued 30/11/00)	Retirement Benefits (superseding SSAP 24)
FRS 18 (issued 07/12/00)	Accounting Policies (superseding SSAP 2)
FRS 19 (issued 07/12/00)	Deferred Tax (superseding SSAP 15)

The new standards on pension costs and deferred tax represent a significant change from the current requirements and have extended implementation period. These changes are referred to in the relevant parts of the comparison: Section 9 “Employee Benefits” and Section 10 “Accounting for Income Taxes”.

The Urgent Issues Task Force (UITF) was established by the ASB in 1991. It assists the ASB in areas where an accounting standard or Companies Act provision exists, but where unsatisfactory or conflicting interpretations have developed or seem likely to develop. The results of the UITF’s deliberations on a subject are promulgated by means of published Abstracts.

Statements of Recommended Practice (SORP)

The ASC developed and issued two SORPs related to pension schemes and charities, together with an Explanatory Foreword to SORPs. In addition the ASC ‘franked’ SORPs developed by bodies representative of the industry/sector to which the SORP would apply. The ASB has announced that it will not issue its own SORPs. However, SORPs will be developed by bodies recognised by the ASB to provide guidance on the application of accounting standards to specific industries. The ASB will not ‘frank’ such SORPs. Instead, where it is satisfied about certain particulars it will require to be appended to the SORP a ‘negative assurance statement’.

The Companies Act

The Companies Act 1985 regulates the constitution and conduct of practically all British corporations. Its provisions cover:

- company formation;
- company administration and procedure;
- allotment of shares and debentures;
- increases, maintenance and reduction of share capital;
- annual financial statements;

- audit of financial statements; and
- distribution of profits and assets.

The requirement for all companies, both private and public, to prepare annual financial statements giving a true and fair view, to appoint auditors (the very smallest companies are exempt from audit) and to file such financial statements with the Registrar of Companies, comes from the Companies Act. Holding companies of a certain size must file consolidated financial statements in addition to the individual company financial statements.

The Companies Act 1989 amended the Companies Act 1985 introducing into it a definition of “accounting standards” along with a requirement for companies over a certain size to disclose in financial statements whether or not they have been prepared in accordance with applicable accounting standards, and if not, particulars and reasons for any departure. Auditors are required by regulation and professional standards to have regard to all applicable accounting standards in reaching a ‘true and fair’ opinion.

In 1998 UK government commenced wide-scale review of the companies legislation which is expected to result in fundamental changes in several years time.

STANDARD-SETTING IN GERMANY

Financial statements of all business entities in Germany are required to be drawn up in accordance with generally accepted accounting principles (Grundsätze ordnungsmäßiger Buchführung or GoB, § 243 (1) Handelsgesetzbuch or HGB).

Traditionally, German accounting practice is a result of detailed codification. The main accounting rules are governed by the Commercial Code (HGB):

- Regulations applicable to all business entities including keeping of books and records, accounting and valuation rules, retention periods (§§ 238 – 263 HGB);
- Supplementary regulations for companies¹ including requirements on classification of balance sheet and profit and loss account items, special valuation rules, notes to the accounts, management report, group accounting, audit and disclosure (§§ 264 – 335 HGB);

¹ Here and elsewhere in this book references to ‘companies’ in the German side of the comparison comprise the following legal forms of entities: Stock Corporation (Aktiengesellschaft or AG), Limited Liability Company (Gesellschaft mit beschränkter Haftung or GmbH), Partnership with a limited liability company as general partner (e.g. GmbH & Co KG) and Partnership limited by shares (Kommanditgesellschaften auf Aktien or KGaA).

- §§ 290 to 315 of the HGB includes specific provisions governing preparation of consolidated financial statements. Generally, the rules applicable to statutory (individual company's) financial statements also apply to consolidated financial statements (§ 298 (1) HGB). However, under the provisions of §§ 300 (2) and 308 (1) HGB, all elements and the valuation of assets, liabilities, prepaid expenses and deferred income in the consolidated financial statements can, however, deviate from the underlying individual company's financial statements;
- Supplementary regulations for co-operatives and enterprises operating in certain industries such as banking and insurance (§§ 336 – 341o HGB);
- Regulations specifying remit of a private accounting body serving as advisory board for accounting matters (§§ 342, 342a HGB).

Furthermore, special regulations applicable to specific legal forms are included in the Stock Corporation Law (Aktengesetz or AktG) dealing with public companies and in the Law on Limited Liability Companies (GmbH-Gesetz or GmbHG). Additionally, all other large business entities must comply with the regulations under the Publicity Law (Publizitätsgesetz or PublG). Under this law, all enterprises meeting particular size criteria defined under § 1 PublG are required to publish their accounts.

Since 1998 four new laws have come into force which have significantly changed the HGB and contributed towards convergence of German accounting principles with international accounting practice:

- Law on Control and Transparency within Enterprises (Gesetz zur Kontrolle und Transparenz im Unternehmensbereich or KonTraG);
- Law on the Facilitation of Raising of Capital (Kapitalaufnahmeerleichterungsgesetz or KapAEG);
- Law on Individual Share Certificates (Stückaktiengesetz or StückAG); and
- Law on Partnerships with a Limited Company as General Partner (Kapitalgesellschaften-und-Co-Richtlinie Gesetz or KapCoRiLiG), with the introduction of which, for example, the “GmbH & Co. KG’s” lose their exemption from the stringent auditing and disclosure requirements.

Written legal regulations have been complemented by the “GoB” which apply to all matters not otherwise covered in the law or in all cases where specific legal regulations require an interpretation. The GoB are the generally accepted rules of maintaining commercial books of account (documentation) as well as preparing the annual financial statements (accounting) of entities.

A large number of the GoB, which were originally not fixed in writing have, over the years, been included in the law, for example:

Principles of preparation of the financial statements	§§ HGB
Clearness and understandability	243 (2)
Completeness	246 (1)
Prohibition of offsetting	246 (2)
Balance sheet continuity	252 (1) 1
Going concern concept	252 (1) 2
Separate determination of the value of items	252 (1) 3
Prudence concept	252 (1) 4
Accruals concept / matching principle	252 (1) 5
Consistency concept	252 (1) 6
Historical cost principle	253 (1)

Another source of interpretation and guidance is the pronouncements issued by the Institut der Wirtschaftsprüfer (IDW) which are to some extent similar in nature to standards and interpretations issued by the ASB and the UITF in the UK. Interpretation guidance is developed by the IDW and its Main Technical Committee, HFA. It is issued in the form of statements of the IDW.

As part of the ongoing efforts to move German accounting and auditing principles closer to the internationally accepted practice, the IDW has started to revise its statements on accounting and auditing renaming them “IDW Prüfungs-standards” or “IDW PS” (Auditing Standards), “IDW Stellungnahmen zur Rechnungslegung” or “IDW RS” (Accounting Standards), “IDW Prüfungshinweis” or “IDW PH” (Auditing Practice Statements), and “IDW Rechnungslegungshinweis” or “IDW RH” (Accounting Practice Statements). The classification of the Auditing Standards is based on the scheme used by IFAC in developing the International Statements on Auditing (ISA).

Traditionally, in Germany great importance is also attached to the detailed views set out in numerous commentaries on accounting issues (referred to further in the text of this book as ‘accounting literature’ or ‘literature’).

German Accounting Standards Committee (GASC)

In 1998 the German Accounting Standards Committee (Deutsches Rechnungslegungs Standards Committee or DRSC) was set up by the

government. According to § 342 HGB, this body, which itself is a non governmental organisation, was given the following tasks:

- the development of accounting standards for listed companies' consolidated financial statements;
- advising the German Ministry of Justice on new legislation concerning accounting standards and
- liaison with international standard setters and representation of the Federal Republic of Germany on international accounting committees.

Since its formation, GASC has issued the following accounting standards and exposure drafts:

Standards	Topic
DRS 1 (published 22/7/00)	Exempting Consolidated Financial Statements in Accordance with § 292a HGB
DRS 2 (all published 31/5/00) <ul style="list-style-type: none"> ■ DRS 2-10 ■ DRS 2-20 	Cash Flow Statements <ul style="list-style-type: none"> ■ Cash Flow Statements of Financial Institutions ■ Cash Flow Statements of Insurance Enterprises
DRS 3 (all published 31/5/00) <ul style="list-style-type: none"> ■ DRS 3-10 ■ DRS 3-20 	Segment Reporting <ul style="list-style-type: none"> ■ Segment Reporting by Financial Institutions ■ Segment Reporting by Insurance Enterprises
E DRS 4 (adopted 29/8/00)	Purchase Accounting
E DRS 5 (issued 24/11/00) <ul style="list-style-type: none"> ■ DRS 5-10 (adopted 29/8/00) 	Risk Reporting <ul style="list-style-type: none"> ■ Risk Reporting by Financial Institutions
E DRS 6 (issued 8/9/00)	Interim Financial Reporting
E DRS 7 (issued 2/10/00)	Presenting Equity in Consolidated Financial Statements
E DRS 8 (issued 8/11/00)	Accounting for Investments in Associates

The final standards on purchase of shares (DRS 4) and reporting of risk by banks (DRS 5) are expected shortly, and other proposals are in the pipeline. One of these other proposals is a discussion paper on accounting for share options.

Comparison of Financial Statement Format

UNITED KINGDOM

Requirements for preparation, audit and publication of financial statements as well as those in respect of the form and content of the financial statements vary depending on the size of the company concerned (§ 267 HGB in Germany and Companies Act in the UK respectively). The following comparison is based on the requirements in respect of large companies only.

Schedule 4 of the Companies Act contains permitted financial statement formats for the balance sheet and profit and loss account. Formats for other primary statements are contained in the relevant accounting standards. FRS 1 (revised 1996) discusses the Cash flow statement and FRS 3 discusses the Statement of total recognised gains and losses.

All financial statements are required by the Companies Act to be accompanied by a directors' report which must include certain specified disclosures.
(1985 CA s234 and Sch 7)

GERMANY

All companies (see Standard Setting in Germany) are required to prepare a balance sheet, profit and loss account and notes to the accounts, which together must comply with GoB and present a true and fair view. (§§ 266, 275, 284-288, 264 (1), 264 (2) HGB)

As a means of explaining the balance sheet and profit and loss account, the notes to the financial statements are equivalent to UK disclosure practice.

Additionally, companies are required to prepare a management report ("Lagebericht"). As in the case of directors' report in the UK, the management report must be consistent with the information in the annual financial statements.
(§ 289 HGB)

Many large companies also accompany their accounts with a general review of performance in the year.

Some additional disclosures may be required by the London Stock Exchange.

Balance sheet

The Companies Act 1985 permits two formats:

- a “vertical” format with current liabilities deducted from current assets to show net current assets or liabilities. This is the most commonly used format. See Appendix I for example;
- a “two-sided” balance sheet showing total assets to the left or top of the page and total capital, reserves and liabilities to the right or bottom of the page.

Assets and liabilities are presented in reverse order of liquidity.

Balance sheets are required to be presented with comparative figures.

FRS 4 requires additional information to be disclosed. The face of the balance sheet should show Shareholders’ funds and minority interests in subsidiaries analysed between equity and non-equity interests. Similarly, liabilities must be analysed between convertible and non-convertible obligations.

Some additional disclosures may be required by the Deutsche Börse AG.

Balance sheets are required to be presented in a “two-sided” format with assets segregated into fixed and current categories (§ 266 HGB). However, in Germany liabilities do not have to be segregated between current and long-term (this disclosure is required to be made in the notes to the accounts). See Appendix I for example of the balance sheet format used in statutory accounts. The HGB has no special regulations in respect of the format of consolidated financial statements.

As in the UK, assets and liabilities are presented in reverse order of liquidity.

Comparative figures are required for companies (§ 265 (2) HGB) and large business entities (§ 5 (1) PublG).

In contrast to UK GAAP, shareholders’ funds and minority interests are not analysed between equity and non-equity. However, similar to UK GAAP, loans must be analysed between convertible and non-convertible on the face of the balance sheet.
(§ 266 (3) HGB)

Profit and loss account

Four formats are permitted by the Companies Act 1985:

- two “vertical” formats, one categorising expenditure as cost of sales, distribution costs and administrative expenses and showing gross profit; and the other showing more detail, for example change in stocks, own work capitalised, raw materials, other external charges, staff costs. The former is the most commonly used; and
- two “horizontal” formats showing expenses on one side and income on the other; these formats are rarely used by commercial entities.

See Appendix II for example of most commonly used format.

FRS 3 requires additional information to be disclosed on the face of the profit and loss account. Specifically, turnover and operating profit must be analysed between continuing operations, acquisitions and discontinued operations.

Profit and loss accounts are required to be presented with comparative figures.

Only the “vertical” formats are permitted. As under UK GAAP, expenditure may be categorised either by function, showing gross profit (§ 275 (3) HGB), or by type of expenditure (§ 275 (2) HGB), the latter being the most commonly used.

See Appendix II for example of both acceptable formats.

There is no comparable requirement in the HGB, but certain information is required to be disclosed if the effect of discontinuance of a business activity is presented as an extraordinary item. (See Section 15 Discontinued Operations).

Comparative figures are required for companies (§ 265 (2) HGB) and large business entities (§ 5 (1) PublG).

Statement of capital and reserves

The Companies Act 1985 requires movements in share capital to be shown in the notes to the accounts. Movements on reserves for the current period may be shown either as a separate statement or in a note to the accounts. FRS 3 requires a note reconciling total opening and closing shareholders' funds for the period. This reconciliation may be combined with the note or statement showing movements on reserves.

UK law does not generally require companies to perform procedures in respect of the appropriation of profits similar to those in Germany (other than in respect of dividend entitlements for the year), and the practice of allocation of retained profits to various specific purpose reserves/funds is less common.

A specific case of appropriation of profit in respect of finance costs of non-equity shares is discussed in Section 13 Dividends and Finance Costs of Shares.

Disclosure of profit appropriation

The movements in reserves as a result of profit appropriation are required to be disclosed by AG's and KgaA's on the face of the profit and loss account after net profit or loss for the year or, alternatively, in the notes to the accounts in accordance with the format given in § 158 (1) AktG. Similar disclosure is recommended for GmbHs.

Specifically, the following movements in reserves are required to be disclosed by AG's and KgaA's:

- transfers from capital reserves;
- transfers to and from the following revenue reserves:
 - legal reserves;
 - reserve for own shares;
 - statutory reserve according to provisions of the articles of association;
 - other revenue reserves.

The balance sheet may be prepared to reflect either partial or complete appropriation of the profit for the year.

(§ 268 (1) HGB)

On 2 October 2000 the DSR issued the draft standard E-DRS 7 "Presenting Equity in Consolidated Financial Statements". Under this standard the notes to the consolidated financial statements should include a systematic presentation in matrix format of the

development of group equity, broken down into its significant component parts, and differentiating between groups of transaction types.

Statement of total recognised gains and losses

FRS 3 requires companies to include a Statement of total recognised gains and losses. This is a primary statement with the following components:

- profit or loss before the deduction of dividends;
- adjustments to asset valuations; and
- differences in the net investment in foreign enterprises due to changes in foreign currency exchange rates.

Contributions from or distributions to shareholders are excluded from the statement. These include:

- the proceeds of a share issue;
- redemption or purchase of own shares;
- dividends or distributions; and
- capital contributions.

(FRS 3)

No similar requirement exists in Germany.

Cash flow statement

FRS 1 (revised 1996) requires the presentation of a cash flow statement for all entities except:

- companies and other unincorporated bodies which meet the “small company” limits as defined by the CA 1985;
- subsidiary undertakings where 90% or more of the voting rights are controlled within the group, provided that the consolidated financial statements in which the subsidiary undertakings are included are publicly available;
- pension funds;
- building societies; and
- mutual life assurance companies.

Cash for purposes of the cash flow statement is defined as cash in hand and deposits repayable on demand with any qualifying financial institution, less overdrafts from any qualifying financial institution repayable on demand. Cash includes cash in hand and deposits denominated in foreign currencies. It is the movement in cash so defined that is reconciled in the cash flow statement.

A cash flow statement is not required to be included in individual entity’s (statutory) financial statements.

However, with the introduction of KonTraG in 1998, all listed companies are now required to include a statement of cash flows in the notes to their consolidated financial statements. (§ 297 (1) HGB)

On 31 May 2000, the German Minister of Justice published the standard on cash flow statement (DRS 2) adopted by the DRSC. The requirements of German Accounting Standard No. 2 (DRS 2) are broadly similar to the requirements of FRS 1 in the UK.

The statement of cash flows reconciles the movements in cash and cash equivalents, so-called “cash funds” (“Finanzmittelfond”). Bank overdrafts which are repayable at any time and which are an integral part of an enterprise’s cash management may be included in “cash funds”.

Cash flows are classified under the following headings:

- operating activities;
- dividends from joint ventures and associates;
- returns on investments and servicing of finance;
- taxation;
- capital expenditure and financing and investment;
- acquisitions and disposals;
- equity dividends paid;
- management of liquid resources; and
- financing.

The indirect method of presentation is required, although the information given by the direct method may be added. A reconciliation of **operating profit** to net cash flow from operating activities is shown as a note to the statement.

A statement reconciling the movement of cash in the period with the movement in net debt is required. Such a statement should not form part of the cash flow statement, but it may be given adjoining the cash flow statement; alternatively, it may be shown as a note to the financial statements.

The DRSC recommends to classify cash flows under the following headings:

- current business activities;
- investment activities (including disposals); and
- financing activities.

The cash flow from current activities can be presented either under direct or indirect method.

The composition of the “cash funds” is required to be disclosed in the notes to the accounts.

Cash flows of foreign subsidiaries or branches are translated using the average rate for the period or closing rate whichever is used for the profit and loss account. Foreign cash flows of the entity are normally translated at the current exchange rate at the time of the cash flow.

The effect of exchange rate changes on cash held in foreign currencies is included in the reconciliation of net debt.

Material non-cash transactions are disclosed where such disclosure is necessary to understand the underlying transactions.
(FRS 1 revised 1996)

See Appendix III for example.

Directors' Report

Among other things a directors' report must include:

- discussion of principal activities of the company and its subsidiaries during the financial year and details of any significant change in these activities during the year;
- discussion of the likely future developments in the business of the company and its subsidiaries;
- particulars of any important post balance sheet events;

Cash flows denominated in foreign currencies are, in principle, required to be translated into the reporting currency at the rates ruling at the date of payment. Weighted average rates may be used when this method results in reasonable approximation.

Changes in the "cash funds" due to the effect of changes in exchange rates on consolidated foreign subsidiaries are required to be disclosed as a separate line of the cash flow statement.

Major investment and financing transactions without cash flow impact as well as other non-cash transactions are required to be disclosed in the notes to the accounts.

See Appendix III for example.

Management Report

As a minimum, the management report shall describe the course of business and the state of the corporation in such a way that it presents a factually accurate picture. The disclosure requirements under German law have recently been significantly extended by KonTraG and now include requirement to disclose analysis of the risks of future developments. The DRSC has issued a draft accounting standard E-DRS 5, "Risk Reporting", that deals with the reporting on risks of future developments within the

- the amount of recommended dividend, if any.

management reports in connection with business combinations.

The management report should also deal with:

- events of special importance that took place after the end of the fiscal year;
- the anticipated development of the corporation;
- the activities in the field of research and development;
- branch offices of the company.

Major Differences in Accounting Policies

1. CLASSIFICATION OF CURRENT ASSETS AND LIABILITIES

UNITED KINGDOM

Current assets are defined by law as assets not intended for use on a continuing basis in the company's activities. There is no restriction that such assets must be realised, sold or consumed within a specified period. (1985 CA, Sch. 4)

Current assets which are transferred to fixed assets, are transferred at the lower of cost or net realisable value. (UITF Abstract 5)

Companies Act 1985 requires disclosure in the notes of the size of debtors due after more than one year. Where the amount of debtors due after more than one year is material to the total of net current assets, then that amount is disclosed on the face of the balance sheet. (UITF Abstract 4)

GERMANY

Current assets are not defined by law. However, fixed assets are legally defined in § 247 (2) HGB as assets intended for use on a continuing basis. Consequently, accounting literature defines current assets as assets which are neither fixed assets nor prepaid expenses.

Similar to UK GAAP.

The amount of debtors due after more than one year must be disclosed on the face of the balance sheet (§ 268 (4) HGB), however, in practice disclosure is often made in the notes to the accounts.

Liabilities are classified as amounts falling due within one year or amounts falling due after more than one year. The classification of loans must be based on the earliest date on which the lender can require repayment if he exercises all options and rights available to him. (1985 CA, Sch. 4, FRS 4)

Similar disclosure is required in respect of amounts or creditors due after more than five years. Additional disclosures are required in respect of maturity of total debt. (1985 CA Sch 4:48, FRS 4)

“Provisions for liabilities and charges” and, depending upon the balance sheet format adopted, “Accruals and deferred income” may be excluded from current liabilities. (1985 CA, Sch. 4)

Deferred income can be shown as part of creditors falling due within one year or after one year as appropriate or, alternatively it can be presented as a separate line on the face of the balance sheet. (1985 CA, Sch. 4)

There is no such distinction in classification on the face of the balance sheet. However, the amount of liabilities due within one year must be disclosed on the face of the balance sheet (§ 268 (5) HGB). In practice, disclosure is often made in the notes to the accounts.

Amounts falling due after more than five years must be disclosed in the notes for each balance sheet line relating to the liabilities. (§ 285 no. 1 and 2 HGB)

“Provisions for liabilities and charges” and “accruals” are both included within the balance sheet position “accruals” (Rückstellungen). (See Section 11 Other Provisions.)

Deferred income is shown as a separate line item, “Passiver Rechnungsabgrenzungsposten”.

2. GOODWILL

UNITED KINGDOM

TREATMENT

Goodwill arising on a business combination accounted for as an acquisition is calculated as the difference between the cost of the entity acquired and the fair value of the net identifiable assets acquired. This applies both to the purchases of the companies accounted for in the consolidated financial statements and to the purchases of non-incorporated business accounted for in the individual company's accounts.

In its recently issued FRS 10, the ASB has outlawed the previously preferred treatment of eliminating the full amount of goodwill against reserves at the time of acquisition.

Goodwill is now required to be capitalised as an asset. The useful economic life of goodwill is presumed to be 20 years or less. That presumption may be rebutted and either a longer life or an indefinite life may be substituted if the

GERMANY

Goodwill is calculated as the difference between the cost of the acquisition and the value of the individual assets of the company acquired less the liabilities at the time of the acquisition.

(§ 255 (4) HGB)

Assets and liabilities acquired – irrespective of their previous balance sheet values and the prices agreed between the parties – are valued at the date of take-over (rather than at the first balance sheet date after acquisition) taking into account the intended use; profitability aspects (e.g. in the case of equity investments or land) or liquidation values (where assets will be disposed of shortly after the acquisition). As a consequence of the general principle of prudence the valuation should be conservative.

There are alternative treatments for goodwill in individual company's financial statements. Goodwill can be written off either immediately or by at least 25% a year (i.e. over four years or shorter period) following the year of acquisition. Alternatively, it can be systematically amortised over its estimated useful life. The estimated useful life most commonly assumed in the individual financial statements is fifteen years, being the period

durability of the acquired business can be demonstrated and it justifies estimating the useful economic life to exceed 20 years and the goodwill is capable of continued measurement. If both conditions are met, the goodwill will either be amortised over a period greater than 20 years or remain unamortised. In either case, it becomes subject to the annual impairment reviews discussed in the next Section. If not deemed to have an indefinite life, goodwill is depreciated over its useful life using a straight line method unless another method is shown to be more appropriate.
(FRS 10)

FRS 10 is effective for accounting periods ending on or after 23 December 1998.

Transitional provisions of FRS 10 give several options:

- at one extreme, all goodwill which has been previously eliminated against reserves remains under the old regime, provided it is included as part of an existing reserve;
- at the other extreme, all 'old' goodwill may be capitalised, and become subject to the new rules, with any amortisation which would have been provided in earlier years being shown as prior year adjustment;

allowed for tax purposes. When justified, a longer useful life can be used for amortisation. However, a period of more than 40 years is likely to be seen as not admissible. The straight-line depreciation method is generally applied.

In consolidated financial statements goodwill can be offset against reserves or amortised by at least 25% a year or over a period of its estimated useful life, if longer.
(§ 309 (1) HGB)

In August 2000 the DRSC adopted an accounting standard DRS 4, "Purchase Accounting". Under this standard the maximum useful life for goodwill in consolidated financial statements is set at 20 years. This must be taken through the profit & loss account and may no longer be charged directly against reserves.

- between these two extremes, there are two further options which allow recent goodwill to be capitalised but older goodwill to remain eliminated.

Upon disposal of a previously acquired business (either all or in part) where the attributable goodwill has been eliminated against reserves, the resulting gain or loss is determined by including the attributable amount of goodwill. (FRS 2 and FRS 10)

NEGATIVE GOODWILL

Negative goodwill is initially recognised as a negative asset, and is shown immediately below the goodwill heading and followed by a subtotal giving the net amount of positive and negative goodwill.

Unlike the German accounting principles, UK GAAP requires the same treatment to be applied for both negative goodwill attributed to future costs and losses (that do not represent identifiable liabilities at the balance sheet date; those that do – are accounted separately) and negative goodwill attributed to bargain purchase.

Negative goodwill up to the fair value of the non-monetary assets acquired are recognised in the profit and loss account in the periods in which the non-monetary assets are recovered, whether through depreciation or sale.

Goodwill which was previously written off against the reserves in the consolidated financial statements is required to be included in the calculation of the net gain/loss on disposal which is recognised in the profit or loss account.

Requirements for the presentation of negative goodwill exist for the group accounts only (§ 309 (2) HGB). In individual company's accounts a corresponding accrual (provision) can be set up.

Negative goodwill arising in a business combination can be shown as a separate line, "Unterschiedsbetrag aus der Kapitalkonsolidierung", within the equity section on the liabilities side of the balance sheet. (§ 301 (3) 2 HGB)

Alternative treatments are allowed if negative goodwill can be attributed to one of the two causes:

- future costs or losses; or
- bargain purchase.

FRS 10 does not prescribe the period over which to recognise in the profit and loss account the excess of the negative goodwill over the fair values of the non-monetary assets acquired as it is expected to occur extremely rarely.
(FRS 10)

When negative goodwill relates to future costs or losses it is considered to be similar to an accrual (provision) and is required to be separately disclosed on the balance sheet as part of “Accruals for liabilities and charges”.
(§ 309 (2) 1 HGB)

When negative goodwill arises as a result of a bargain purchase it is disclosed separately within reserves.

In both cases, negative goodwill is released to profit and loss account when:

- an unfavourable development in the results of the enterprise which was foreseen at the time of acquiring the shares (or preparing consolidated accounts for the first time) occurs, or when expenditure anticipated at that time is recognised; or
- it becomes clear at the balance sheet date that it is a realised profit.

IMPAIRMENT REVIEWS

If goodwill is deemed to have an indefinite life, or one of more than 20 years, an impairment review is required at the end of each year. Otherwise an impairment review is only required at the end of the first full year following the acquisition or if there is a change of circumstances in future years indicating an impairment in value.

German GAAP does not have a notion of impairment reviews. However, exceptional amortisation should be provided for a permanent diminution in value.
(§ 253 (2) 3 HGB)

Any impairment loss is recognised in the profit and loss account.

Where an external event caused the recognition of an impairment loss in previous periods, and subsequent external events clearly and demonstrably reverse the effects of that event in a way that was not foreseen in the original impairment calculations, any resulting reversal of the impairment loss is recognised in the profit and loss account.
(FRS 10)

When the circumstances that caused a permanent diminution in value to be recognised change, reversal of the original write down must also be recognised in the profit and loss account.
(§ 280 HGB)

3. OTHER INTANGIBLE ASSETS

UNITED KINGDOM

An internally generated intangible asset can be capitalised, but only where it has a ready ascertainable market value.

Similarly, if an intangible asset has a ready market value it can be carried at a revalued amount.
(FRS 10)

An intangible asset purchased separately from a business is initially recorded at cost.

See Section 21 Business Combinations for a discussion of intangible assets of an acquired business.

AMORTISATION

As for goodwill.
(FRS 11)

IMPAIRMENT REVIEWS

As for goodwill.
(FRS 11)

GERMANY

An internally generated intangible asset (e.g. software, brands etc.) cannot be capitalised.
(§ 248 (2) HGB)

German GAAP does not allow revaluation of assets in excess of original cost as reduced by depreciation.

An intangible asset purchased from a third party is recorded at cost.

Intangibles are required to be amortised over their useful economic lives.

RESEARCH AND DEVELOPMENT

Development costs related to defined projects may be deferred to future periods, provided that the outcome of the projects can be assessed with reasonable certainty as to their technical feasibility and commercial viability (i.e. future expenditure can be recovered from future revenue and adequate resources exist).

Otherwise development costs (except those which are reimbursable under contracts with third parties and those incurred in locating and exploiting mineral deposits) and all research costs are written off as incurred.

(SSAP 13)

START-UP COSTS

The “preliminary” expenses of a company may not be capitalised. However, they may be written off against a company’s share premium account. These expenses normally include any legal fees and other expenses associated with the process of company registration. These expenses do not include operating losses in the first years of operation. (CCA 1985 Sch 4 Pt I and CA 1985 Pt V Ch III)

Certain start-up costs are capitalised as part of acquisition or self-construction of a tangible fixed asset if they relate to the period when the asset is available for use but incapable of operating at normal levels without such a start-up or commissioning period.

Generally, own research and development expenditure is required to be expensed as incurred.

(§ 248 (2) HGB)

Expenses incurred to start up or expand a business, to the extent they are not capitalised as part of other assets, may be carried forward as an accounting convenience. This item is required to be presented on the face of the balance sheet above fixed assets under the heading “Start-up and Business Expansion Expenses” and must be explained in the notes.

Start-up expenses within the meaning of § 269 HGB are defined as all expenses which are incurred during the start-up phase of a business including the initial establishment of the internal and external organisation and the preparation of the business for the start of the regular production of goods and services.

However, operating losses due to lack of demand may not be capitalised. For example the losses incurred by a hotel or a bookshop, which could operate at normal levels almost immediately, but for which experience teaches that demand will build up slowly and full utilisation will be achieved only over the period of several months, may not be capitalised.

(FRS 15)

Other start-up costs that relate to new activities such as opening of a new facility, introducing a new product or service, conducting business in a new territory, etc. are required to be accounted on the basis consistent with the accounting treatment of similar costs incurred as part of on-going activities. In cases, where there are no such similar costs, start-up costs can only be recognised as assets if they meet the recognition criteria in the relevant standards such as those dealing with tangible fixed assets, intangible assets or developments costs.

(UITF 24)

Examples include preliminary market studies and other planning costs, recruitment and training of staff, test runs of production facilities as well as depreciation, rent and rentals, interest and other personnel expenses incurred during the start-up phase.

Even if such expenditure is capitalised it is deducted from profits available for distribution.

(§ 269 HGB)

Amounts recorded in respect of start-up and business expansion expenses must be amortised in each following financial year by at least one quarter.

(§ 282 HGB)

Capitalisation of start-up and expansion costs is not permitted for tax purposes, and therefore it results in recognition of a deferred tax liability. (See Section 10 Accounting for Income Taxes).

(§ 274 HGB)

4. TANGIBLE FIXED ASSETS

UNITED KINGDOM

INITIAL MEASUREMENT

Tangible fixed assets are initially recorded at cost.

REVALUATION

The law permits tangible fixed assets, intangible fixed assets (except goodwill), investments and stocks (inventories) to be recorded at a valuation (generally current cost or market value at the date of the last valuation).
(1985 CA, Sch.4)

FRS 15, which is effective for periods ending on or after 23 March 2000, requires companies revaluing assets to use the following valuation bases for unimpaired tangible fixed assets:

- non-specialised properties – existing use value, with the addition of notional directly attributable acquisition costs, where material;
- specialised properties – depreciated replacement cost;

GERMANY

Tangible fixed assets are initially shown at historic purchase (§ 255 (1) HGB) or manufacturing cost (§ 255 (2) HGB).

Items costing not more than DM 800 (excluding VAT) referred to as “geringwertige Wirtschaftsgüter” or “GWGs” are usually expensed when purchased. This treatment is based on German tax law.

German GAAP does not permit revaluation of fixed assets in excess of original cost as reduced by depreciation.

- properties surplus to an entity's requirements – open market value, after deducting expected directly attributable selling costs, where material; and
- tangible fixed assets other than properties – market value, or depreciated replacement cost where market value is not available.

(FRS 15)

Surpluses arising from upward revaluation are credited directly to a revaluation reserve and shown in the statement of total recognised gains and losses. Deficits are taken to the profit and loss account to the extent that they do not represent a reversal of a previous upwards revaluation.

Generally, revaluation losses which reverse previously recognised revaluation gains related to the same asset are recognised in the statement of total recognised gains and losses to the extent of the previously recognised gain.

However, if the revaluation loss is clearly caused by the consumption of economic benefits, it is considered to be similar to depreciation and recognised in the profit and loss account.

FRS 15 requires other losses to be recognised in the statement of total recognised gains and losses to the extent that the asset's recoverable amount is greater than its revalued

amount. Such losses, which have been demonstrated not to be impairments, are in the nature of losses caused by a general fall in prices.

Where fixed assets are revalued, depreciation is charged to the profit and loss account based on the revalued amounts.
(FRS 15)

FRS 3 requires that recognition of profit or loss on disposal of an asset which has been revalued be based on its net carrying value at the date of disposal. Any past valuation surpluses or deficits in the revaluation reserve relating to the asset are shown as a reserve transfer. The gain or loss calculated on a historical cost basis is shown in a note.

The note of historical cost profits and losses reconciles the reported profit on ordinary activities before taxation to the equivalent historical cost amount, and also shows retained profit on a historical cost basis.
(FRS 3)

CAPITALISATION OF BORROWING COSTS

Interest on capital specifically borrowed to finance the production of an asset may be included in the cost of the asset to the extent it accrues in the period of production. (1985 CA, Sch. 4)

Although many companies capitalise interest, it is equally common practice not to capitalise interest.

DEPRECIATION

Generally, UK GAAP requires depreciation of all assets with finite useful economic life to be recognised in the current period unless neither current year charge nor accumulated amount of such unrecognised depreciation is material.

As in the UK, interest may be included in the cost of an asset to the extent that the interest is incurred during the period of production. (§ 255 (3) HGB)

In practice, however, only few companies opt for capitalisation.

Due to the principle of “umgekehrte Massgeblichkeit” (see Introduction) depreciation rates tend to be tax driven. Although new depreciation tables have recently been issued by the tax authorities with generally longer useful lives than in the past, the tax driven nature of the rates has traditionally resulted in fixed assets being stated at a lower value and the total depreciation charge for the year not necessarily reflecting economic use of the assets.

(§ 273 HGB)

Examples of tax allowed depreciation include:

- special accelerated depreciation;
- reducing balance depreciation;
- write off of moveable assets costing less than DM 800; and
- half year simplification rule.

Companies are required to justify and disclose the amount of depreciation recognised in the income statement that was based solely on tax regulations.
(§ 281 (2) HGB)

Companies are also required to disclose the extent to which results of the current, preceding and future financial years were (are, will be) affected by accounting entries based on tax regulations, including creation of a “special account with characteristics of reserve” (see Section 11 Other Provisions).
(§ 285 No. 5 HGB)

UK GAAP allows the use of both straight-line method and reducing balance method as well as any other method that results in depreciation charge being allocated on a systematic basis over useful economic life.

However, it is expected that the ASB will shortly ban back-end loaded methods such as annuity based depreciation with the only exception of an asset purchased through a finance lease where this asset is subsequently leased out on an operating lease.

There is no specific requirement as to how depreciation is charged in the year of acquisition of an asset.

Both the straight-line and the reducing balance methods may be used, however, the reducing balance method is only permitted to be used for movable fixed assets. Due to these restrictions, buildings and intangible fixed assets are always depreciated/amortised using straight-line method. Other depreciation methods are allowed if they reflect the actual usage of assets.

Movable assets acquired during the first half of the accounting year qualify for 100% of the normal charge; those acquired during the second half, for 50% of the normal charge, based on German tax law.

Where the depreciation method is changed, the unamortised cost of the asset should be written off over the remaining useful life using the new method.
(FRS 15)

Where estimates of useful economic lives of fixed assets are changed, the undepreciated cost should be depreciated over the revised estimates of remaining lives.
(FRS 15)

IMPAIRMENT REVIEWS

FRS 11 requires an impairment review to be carried out if events or changes in circumstances indicate that the carrying amount of fixed assets or goodwill may not be recoverable. The review will compare the carrying amount of a fixed asset or of an income generating unit with its recoverable amount (i.e. the higher of net realisable value, if known, and value in use). Any shortfall (or for revalued assets any fall below depreciated historical cost or one that is clearly caused by a consumption of economic benefit) will be taken to the profit and loss account. For the revalued assets, the other part of the shortfall is set against revaluation reserve and recognised in the STRGL.

An enterprise is permitted to switch from reducing balance to straight-line depreciation at any time, but the reverse change is not permitted. Where the method is changed net book value of an asset is amortised over the remaining useful life.

Similar to UK GAAP.

German GAAP does not have a notion of impairment reviews. However, German GAAP requires exceptional depreciation charge to be charged to the profit and loss account for any permanent diminution in value.
(§ 253 (2) 3 HGB)

Net realisable value will be based on market value. Value in use will be calculated based on the present value of the future cash flows of the asset or income-generating unit.
(FRS 11)

Where, after an impairment loss has been recognised, the recoverable amount of a tangible fixed asset increases because of the change in economic conditions or in the use of the asset, the resulting reversal of the impairment loss is recognised in the current period to the extent that it increases the carrying amount of the fixed asset up to the amount that it would have been had the original impairment not occurred. A reversal of the impairment loss is recognised in the profit and loss account (for revalued assets – to the extent that the original impairment loss, adjusted for subsequent depreciation, was recognised in the profit and loss account; the remaining balance is recognised in the STRGL).
(FRS 11)

Where the circumstances that caused permanent diminution in prior periods change, the amount previously charged in the profit and loss account is reversed. However, the amount of reversal cannot result in an asset carried at value in excess of its historic cost as reduced by the depreciation which would have been charged had the write-down not occurred.
(§ 280 (1) HGB)

5. ACCOUNTING FOR INVESTMENTS

UNITED KINGDOM

UK accounting for investments does not distinguish between interest bearing and equity investments.

Under the historical cost convention, investments classified as fixed (long-term) are valued at cost less provision for permanent diminution in value. Any reduction in value from cost is charged to the profit and loss account. A provision for diminution in value which is no longer required must be written back. Investments carried as fixed assets may also be carried at a valuation.
(1985 CA, Sch. 4)

Under alternative valuation rules (which are relatively rarely used in practice) investments classified as fixed assets may be valued either:

- at market value as determined at the date of their last valuation;
- at a value determined on any basis which the directors consider to be appropriate in the circumstances.

(1985 CA, Sch. 4: 31(3))

GERMANY

Fixed asset investments (long-term investments) are recorded at cost less provision for any permanent diminution in value.
(§ 253 (2) HGB)

Any such reduction in value is charged to the profit and loss account. Provisions for diminution in value which is no longer required must be written back.
(§ 280 (1) HGB)

Where there is an intention to hold to maturity fixed asset securities which bear no coupon rate but carry a premium at maturity it would be normal practice to accrue the premium over the term of the security.

Investments classified as current assets will normally consist of either deposits or short-term loans to institutions, such as building societies and banks, or of marketable securities. Under the historical cost accounting rules, each separate investment held should be valued at the lower of cost and net realisable value with any provision for diminution in value charged to the profit and loss account.

INVESTMENT PROPERTIES

Investment properties (defined as land and/or buildings held for investment potential but excluding property held for own use or leased to group companies) are not depreciated and are included in the balance sheet at their open market value.

(SSAP 19)

In accordance with HFA 1/1986 and accounting literature it is a normal practice to accrue the premium over the term of zero coupon bonds and similar investments.

Current asset investments are valued at the lower of cost or market value. Where investment is listed or publicly traded its quoted price is deemed to be the best estimate of its market value.

(§ 253 (3) HGB)

German GAAP does not make a distinction between investment properties and other fixed assets. The rules relating to fixed assets apply.

ACCOUNTING FOR ASSOCIATED UNDERTAKINGS

An associate is an investment over which the investor exercises significant influence, and significant influence is presumed when an investor owns between 20 per cent and 50 per cent of the voting rights of the investee. However, this is a rebuttable presumption. If the investor does not actively exercise its significant influence in its investee's affairs, the investment may not qualify as an associate. Therefore investments where investors such as banks or venture capitalists have the power to influence financial and operating policies but, in practice, hold the investments as part of a portfolio which will ultimately be sold, are excluded from definition of an associate.

In consolidated accounts investments in associated undertakings are required to be accounted for using equity method. There is no specific exemption for not significant associates. However, UK accounting standards are not intended to apply to immaterial items.

As under UK GAAP, in Germany an associate is defined as an investment over which the investor exercises significant influence. Significant influence may be exercised by virtue of voting rights and business arrangements such as purchase or distribution agreements. It is presumed where investor owns more than 20 per cent but less than 50 per cent of the voting rights of the investee. Similar to UK GAAP, this presumption is rebuttable when it can be demonstrated that a significant influence cannot be exercised. However, unlike under UK GAAP active involvement in the investee's affairs is not required.

Equity method is not required in respect of investments in associates that are not significant for the presentation of a true and fair view of net worth, financial position and results of the group.

(§ 311 (2) HGB)

Under the equity method of accounting, an investment in an associate is initially recorded at cost. Goodwill arising on acquisition of an investment is determined in the same way as on the acquisition of a subsidiary. Goodwill less any amortisation or write-down is included in the carrying amount for the associates. The carrying amount of the investment in an associate is adjusted in each period by the investor's share of any relevant gains or losses, and any other changes in the investee's net assets including distributions to its owners, for example by dividend.
(FRS 9)

In the consolidated balance sheet investment in an associate is valued either:

a) at book value,

in which case, in the first year when investment in the associate is included in the consolidated financial statements the difference between the book value (cost) of the investment and the share in the net equity of the associate (based on book values of assets and liabilities of the associate) should be separately disclosed either on the face of the consolidated balance sheet (through an 'of which' note) or in the notes to the financial statements. This difference should be allocated to the assets or liabilities of the associated enterprise to the extent that their values are higher or lower than carrying values. Remaining unallocated portion of the difference, positive or negative (expected to occur only in exceptional cases), is treated as goodwill or negative goodwill (see below). In subsequent periods, amounts of the difference allocated to various assets and liabilities are amortised/released to the result of the associate in a way that reflects the way these assets and liabilities are realised/settled in the individual accounts of the associated enterprise.

(§ 312 (1) HGB)

or

- b) at the proportionate share of its net equity (subject to the limit equal to the cost of investment).

Under this method, the proportionate share is determined using either the fair values at the time of acquisition or at the date of preparing consolidated accounts for the first time (however this amount cannot exceed cost of the investment). When results of the associate are included in the consolidated financial statements of the investor for the first time, the difference between the book value (cost of the investment) and the share in the equity method is to be shown separately in the consolidated balance sheet on first application or mentioned in the notes to the financial statements. The whole of this difference represents goodwill.

Under both methods, goodwill (residual difference in the book value method) should be amortised in each following year by at least 25% of the original amount. Alternatively, it can be amortised over the period expected to benefit. The method used should be disclosed. (§ 309(1) HGB).

Adjustments are required to be made to achieve consistency with group accounting policies. In practice, such adjustments are restricted to items that have a material impact on the consolidated accounts of the investor.
(FRS 9)

Where profits and losses resulting from transactions between the investor and its associate are included in the carrying amount of assets in either the investor or investee, the part relating to the investor's share should be eliminated.
(FRS 9)

In consolidated accounts, an investor continues to account for an investment in an associate when the associate has net assets of nil or negative net assets unless there is sufficient evidence that an event has irrevocably changed the relationship between the investor and the associate.

Once an investment ceases to be accounted for as an associate under the equity method, it may not be accounted for as an associate again in the future.

Disclosure is required where associate is consolidated using its own accounting policies which differ from the group's policies.
(§ 312(5) HGB)

Unrealised profits and losses on stocks transferred to or from associates should be eliminated to the extent that the appropriate information is known or available.
(§ 312(5) HGB)

German GAAP requires similar treatment.

There is no similar requirement under German GAAP. If the conditions for the treatment as an associate are met it can be accounted for as an associate again.

In the consolidated profit and loss account and statement of total recognised gains and losses, the share of associate items is separately disclosed.
(FRS 9)

JOINT VENTURES

FRS 9 describes two forms of arrangement which involve joint control but which result in fundamentally different accounting treatments:

- Joint venture – a jointly controlled entity (entity meaning a venture with a trade or business of its own, which may or may not be a legal entity);
- Joint arrangement that is not an entity (JANE) – a jointly controlled asset, operation, or legal entity which amounts to an extension of the investor’s own trade.

Joint venture is an entity in which the reporting entity holds an interest on a long-term basis and is jointly controlled (no one entity can alone control but all together can do so) by the reporting entity and one or more other venturers under a contractual arrangement.

In an investor’s consolidated accounts, joint ventures are accounted for on the gross equity method, which is similar to equity method (or net equity method) but

In the consolidated profit and loss account, results relating to associated enterprises shall be shown under a separate heading.

In November the DRSC issued a draft accounting standard E-DRS 8, “Accounting for Investments in Associates”.

Joint ventures are contractual agreements in respect of common economic activities between two or more parties.
(HFA 1/1993)

The basis of accounting for joint ventures will depend on whether it is an incorporated entity, or unincorporated entity, e.g. an entity constituted under civil law (BGB-Gesellschaften) or partnership.

An investment in a joint venture that is an incorporated entity should be accounted for either as an associate or using the rules for consolidated financial statements.

An investment in a joint venture that is an unincorporated entity is accounted as follows:

- proportional consolidation is allowed where an investor jointly manages the joint venture with one or more other investors provided that the accounts of the investee are not being fully consolidated by the other investor(s), and the

requires additional information to be shown on the face of the financial statements: investor's share of turnover in joint venture on the face of the profit and loss account, separately from group turnover; and share of gross assets and liabilities of joint venture on the face of the balance sheet.
(FRS 9)

The requirement for a JANE is that each participant should account for its own assets, liabilities and cash flows, measured according to the terms of the agreement governing the arrangement. Each participant accounts for its share of those items that are not wholly attributable to any one participant. This treatment has an effect which is similar to proportional consolidation.
(FRS 9)

investment itself does not meet criteria for full consolidation in the investor's accounts;

- if the joint venture is managed jointly and is not consolidated on a proportionate basis or if joint venture is not managed jointly but the investor has a significant influence in the joint venture it must be accounted for as an associate.

(HFA 1/1993)

6. STOCKS/INVENTORIES AND LONG-TERM CONTRACTS

UNITED KINGDOM

STOCK VALUATION

Stocks are generally valued at the lower of cost (purchase or production) and net realisable value. (SSAP 9)

Inclusion of foreign exchange gains and losses in cost of stock is generally not permitted under UK GAAP.

Any provision for diminution in value of stocks which is no longer required must be written back. (1985 CA, Sch. 4)

SSAP 9 contains no exceptions to the 'lower of cost and net realisable value' rule. However, Companies Act allows stocks to be valued at current cost, and in certain (very few) industries, such as commodity brokers and plantation companies, it is accepted trade practice to value stocks/inventories at market value. (SSAP 9, Sch. 4))

GERMANY

Stocks are valued at the lower of cost and either of:

- net realisable value;
- market value;
- replacement value; or
- another value permitted by tax rules.

(§§ 253 (3), 254 HGB)

Where stocks purchased in a foreign currency are valued at the lower of cost and replacement value, subsequent fall in the exchange rate results in a corresponding write-down in the carrying value of the stock.

Same as for UK GAAP. (§ 280 HGB)

No similar exceptions are allowed by German GAAP. Stocks are not allowed to be carried at a value that exceeds cost.

Cost of stocks comprise all expenditure which has been incurred in the *normal* course of business in bringing the product or service to its present location and condition.

Production costs include all direct expenses as well as all related *production* overheads, even though these may accrue on a time basis. On these grounds, general administrative and selling expenses are normally excluded. (SSAP 9)

Interest on borrowed capital to finance the production of an asset may be capitalised. In addition to interest, the total cost of finance capitalised may include, for example, the amortisation of the issue costs and/or any premium on redemption of the borrowing instrument(s). (CA 1985 Sch 4: 26)

Cost comprises purchase cost or manufacturing cost. Manufacturing cost must include costs of raw materials and production costs (including special production costs) directly attributable to production. (§ 255 (2) HGB: “Herstellungskosten”)

In addition, the following costs may also be included:

- an appropriate proportion of materials overheads, production overheads and depreciation of tangible fixed assets (these cost are required to be included for tax purposes to the extent that they result from the manufacturing process and are incurred during the period of production);
- costs of general administration including expenditure for social infrastructure and facilities, voluntary staff benefits and pensions.

Selling costs must be excluded. (§ 255 (2) HGB)

Interest on loan capital used to finance the production of an asset, may be included to the extent that it is incurred during the period of production. (§ 255 (3) HGB)

A number of various cost approximation methods are permitted including weighted average, standard cost, FIFO, etc. However, as the LIFO method does not usually provide a fair approximation of actual cost incurred during the period, this method is not generally accepted. (SSAP 9)

LONG-TERM CONTRACTS

One method of revenue recognition on long-term contracts is permitted. Such contracts are assessed on a contract by contract basis, and turnover and related costs recorded as contract activity progresses. The profit recorded reflects the proportion of work completed and any known inequalities of profitability in the various stages of the contract.

No profit is taken where the outcome of the contract cannot be assessed with reasonable certainty. Where no loss is expected, turnover is recognised as a proportion of the total contract value using a zero estimate of profit. When a contract is expected to make a loss, the whole of that loss is recognised immediately.

The definition of long-term contracts includes significant contracts of less than one year's duration where their exclusion from turnover and profits would not give a true and fair view. (SSAP 9)

Weighted average cost and LIFO (§ 256 HGB) are common approximations of cost which are commonly used in practice as both are accepted for tax purposes. FIFO is not permitted for tax purposes, unless it can be shown that it accords with actual pattern of consumption.

The percentage of completion method is generally not permitted in Germany. Normally, profit is recognised when the contract is substantially completed. Conditions for the earlier recognition of profit are more stringent than those in the UK. As in the UK, all foreseeable losses must be recognised immediately. According to a leading commentary on HGB, the method of partial recognition of profit (as opposed to the percentage of completion method) is seen as permitted if *all* of the following conditions are met:

- duration of the contract extends beyond one financial year;
- long-term contracts represent a significant part of the company's activities;
- recognition of the profit on completion of the contract would considerably distort the view of the earnings position of the business;

- expected profit is reasonably determinable (based on comparison of initial forecasts and the actual performance) and there are no risks identified (such as potential claims by the customer) which may materially affect the expected result;
- all potential warranty costs and repairs are carefully taken into consideration;
- performance under the contract can be divided into identifiable components for the purpose of the calculation of profit;
- the profit proportionately related to these components is the maximum allowed to be realised; and
- if actual costs to date differ from the forecasted costs, profit may be recognised only to the extent that the remaining costs to be incurred do not exceed expected income.

7. DEBTORS: IMPUTED INTEREST

UNITED KINGDOM

Debtors are normally recorded at their nominal values without adjustment for imputed interest, except in rare circumstances where an item has clearly been established in such a way that a proportion of that item represents interest receivable or payable.

FRS 7 “Fair Values in Acquisition Accounting” recognises that on acquisition the fair value of amounts receivable or payable should take account of the timing of receipt or payment, either by discounting or by reference to market price.

GERMANY

Debtors are normally recorded at their nominal values less appropriate allowances. If a long-term delay in payment is granted without interest payment or at low interest, the debtor is recorded at its present value. The unwinding of the discount (accruing of interest) is recognised in the profit and loss account as interest income.

In German practice, on acquisition accounts receivable and payable are not revalued.

8. DEBT AND CAPITAL INSTRUMENTS

UNITED KINGDOM

CAPITAL INSTRUMENTS

Capital instruments (other than shares) are classified as debt if they contain an obligation to transfer economic benefits.

(FRS 4)

Convertible debt is shown separately under liabilities. Conversion of the debt should not be anticipated. On conversion, shares issued are recorded at the amount equal to the carrying value of debt at the date of conversion.

(FRS 4)

GERMANY

PROFIT-PARTICIPATION RIGHTS

German GAAP does not generally deal with complex financial instruments with exception of pronouncements in respect of zero coupon bonds (see discussion under 'Discounts and Premiums on Issue of Debt' below) and "profit participation rights". "Profit participation rights" ("Genussrechtskapital") are debt instruments which do not give right of ownership but give right to a return paid by the issuer which is of a nature that would typically be earned by a shareholder: for example, participation in profits and/or on liquidation.

Depending on the type of economic benefits granted in the accounts of the issuing party profit participation rights are:

- recorded as a liability;
- recorded directly within equity; or
- recognised as profit in the profit and loss account.

(HFA 1/1994)

Profit participation rights are recorded in equity if the following requirements are met:

- on liquidation repayments are subordinated to claims of other creditors;

- return (interest) is calculated by the reference to profits only with exposure to losses up to the total amount of capital invested;
- the capital provided is of a long term nature and neither the investor nor the issuer can call on the early repayment.

Profit-participation rights may be credited to the issuing party's income if the investor has no rights to repayment and it has expressly stated its intent to make an income contribution.

In all other cases, profit-participation rights are carried as a liability.

NON-EQUITY SHARES IN SUBSIDIARIES

As an exception to the general rule in UK GAAP of classifying shares within equity, non-equity shares in subsidiaries are disclosed in consolidated financial statements as a liability to the extent that any member of the group has an obligation to transfer economic benefits. In all other cases they are reported as part of minority interests. (FRS 4)

There is no equivalent requirement in Germany.

See Section 12 Share Capital for a discussion of non-equity shares.

DISCOUNTS AND PREMIUMS ON ISSUE OF DEBT

Any instruments issued as a means of raising finance including debentures, loans and debt instruments are initially recorded at net proceeds. The finance costs, being the difference between net proceeds and total amounts payable in respect of the debt, are allocated over the term of the debt at a constant rate on the carrying amount.
(FRS 4)

Generally, liabilities are required to be stated at their redemption amount.
(§ 253 (1) HGB)

If the amount to be repaid in respect of a liability is higher than its value when it arose, the difference may be accounted for as a prepaid expense which must be either disclosed separately in the balance sheet or explained in the notes.
(§§ 250 (3), 268 (6) HGB)

The difference is amortised systematically over the term of the liability.

There is a specific exception from the above rule for the zero coupon bonds, the treatment of which is governed by HFA 1/1986. Initially such liabilities are recorded at the amount of proceeds of issue. Thereafter the difference between both amounts is accrued over the term of the loan.

DEBT ISSUE COSTS

The Companies Act prohibits debt issue costs being recorded as assets. FRS 4 requires the debt to be presented net of debt issue costs.

The Companies Act permits issue costs to be debited to the share premium account (additional paid in capital). This is achieved by means of a reserve transfer each year, for the proportion of the debt finance charge relating to issue costs, from the profit and loss account reserves to the share premium account. (CA 1985, Sec. 130 and Sch. 4:22 and 24)

According to some leading commentaries on HGB, debt issue costs should be charged to the profit account as expenses of the current period due their non-recurring nature.

Discounts may be capitalised and shown as prepaid expenses and subsequently amortised by systematic annual charges spread over the full term of the debt. (§ 250 (3) HGB)

Similarly, premiums may be recorded on the balance sheet as deferred income and subsequently amortised to profit and loss account of the life of the instrument.

9. EMPLOYEE BENEFITS

UNITED KINGDOM

PENSION COSTS

For defined contribution schemes, a charge against profits should be made for the amount of contributions payable to the pension scheme in respect of the accounting period.

(SSAP 24)

For defined benefit schemes, SSAP 24 permits use of a range of actuarial methods and assumptions, providing the resulting annual pension expense is a substantially level percentage of current and expected future pensionable payroll. No specific method of amortisation of variations from regular cost over the service lives of members is required.

(SSAP 24)

GERMANY

PENSIONS

Defined contribution schemes are rarely used in Germany.

Pension obligations are normally recognised in the financial statements. Most of the employee pension schemes in Germany are internally funded with pension assets held directly by the company (direct pension obligations). No separate trust or fund is created but the employer is required to take out mandatory insurance against company insolvency (“Pensionsversicherungsverein” or “PSV”). Consequently, the liability for future benefits (as opposed to liability for contributions to the pension fund set up outside of the company which is recognised by the companies in the UK) is shown in the company’s books rather than in the accounts of a pension fund. This provides a substantial liquidity benefit for the company.

Pension obligations relating to periods prior to 1.1.1987 (Art. 28 EGHGB) do not have to be accrued. However, the amount of the provision that would otherwise be recognised must be disclosed in the notes.

Pension liabilities are usually discounted using an interest rate representing the expected long-term return on plan assets.

In Germany in most cases pension accruals are traditionally calculated in accordance with tax regulations which specify actuarial methods and the basis for the calculation in accounting for pensions.

(§ 6a and section 41 EStR)

Pension obligations are valued on the basis of actuarial calculations of the discounted amount of the future liability to employees.

(§ 253 (1) HGB)

The basis of computation differs from that under UK GAAP, for example, in the following respects:

- German tax law generally fails to take account of future salary increases, future pension plan amendments and ignores employees under 30. Consequently, it may exclude certain parts of total liability reflected under UK GAAP;
- the discount rate is fixed by tax law at 6%.

The amount of accrual determined under § 6a EStG is the minimum amount that must be recognised in the financial statements. The amount of pension obligations recognised in the financial statements may be increased to take into account other valuation bases such as the present value, the cash value, the quoted cash value.

Additionally, a lower discount rate may be used for commitments in respect of future pension increases and other changes in the pension plan.

Some companies fund their pension obligations by purchasing life assurance policies (“Rückdeckungsversicherungen”) for their employees from external insurance and life assurance companies. These are most commonly used to provide pensions for senior executives. Where such policies are purchased they are required to be recognised separately (cannot be set off against pension obligation) and are shown under other assets or long-term financial assets. Their carrying value is determined based on an actuarial valuation.

Variations from regular cost (experience gains and losses, the effect of changes in assumptions, retroactive amendments) can be amortised over remaining employee service lives either in the aggregate or by separately amortising the variation arising from each valuation.

For tax purposes, increases in pension expenses over 25% may be spread over three years. (§ 6a EStG)

In practice, prior service cost and other changes in pension benefits are normally charged to the profit and loss account in full in the year of change.

Companies are encouraged to include anticipated ex-gratia pension increases in actuarial assumptions, with any actual experience variations from assumptions included in the overall experience gain or loss. Alternatively, provided the increases genuinely are ex-gratia and are not the result of an implied commitment, the capitalised cost of the increase not covered by a surplus is expensed at the time of the award. (SSAP 24)

There is no requirement to record a deficiency of net assets compared with the pension obligation (but see transitional provisions below) as a liability. (SSAP 24)

The frequency of plan valuations is not specified but this is normally done triennially. (SSAP 24)

Plan assets may be valued using any reasonable method. (SSAP 24)

Refunds of contributions that are subject to deduction of tax may be accounted for in the period when the refund occurs. (SSAP 24)

German GAAP does not provide guidance for recognition of ex-gratia increases in pensions.

Plan valuations are performed annually by qualified actuaries.

Investments held to satisfy pension obligations in the future are treated in the same way as other investment assets of the company.

When the normal level of contributions is significantly changed in order to eliminate a surplus or deficit resulting from a significant reduction in members, any reduction in contributions is recognised as it occurs, except where the reduction of members is related to the sale or termination of an operation. In such cases, the associated pension cost or credit should be recognised immediately to the extent necessary to provide for any losses not expected to be covered by the future profits of the operation or the disposal of its assets.
(SSAP 24 as amended by FRS 3)

30 November 1999 the ASB issued FRS 17 *Retirement Benefits* which will introduce major changes to the current regime:

- use of market values for scheme assets;
- use of a high-quality corporate bond rate in discounting for pension obligations;
- immediate recognition of deficits and surpluses on the balance sheet and in the STRGL; and
- prescribing the use of projected unit method for actuarial calculation of the liability.

FRS 17 becomes fully effective for accounting periods ending on or after 22 June 2003.

POST RETIREMENT BENEFITS OTHER THAN PENSIONS

Although arrangements to provide post retirement benefits other than pensions are still relatively rare in the UK, many UK holding companies have overseas subsidiaries which do provide such benefits.

Provisions may be set up for direct and indirect obligations that are similar to pensions. As in the UK, such arrangements are rare and normally arise only in foreign subsidiaries.

UITF Abstract 6 extends the scope of SSAP 24 to cover the provision of other post retirement benefits.

ACCOUNTING FOR SHARE OPTIONS

Profit and loss account is charged with intrinsic value of options awarded to employees spread over the relating performance period. Intrinsic value is measured as the difference between the fair value of the options at the grant date less any amount that the employees are required to pay for them.
(UITF 17)

GASC has issued a discussion paper which proposes to spread the cost of granting stock options to the income statement (as staff expense) over the period of related performance. The options will be measured on the grant date and will reflect the fair value (the sum of intrinsic and time value) of the options at that date. The fair value will be calculated with reference to an options-pricing model such as Black-Scholes model.

10. ACCOUNTING FOR INCOME TAXES

UNITED KINGDOM

Deferred taxation is provided for timing differences for which it is probable that a liability or asset will crystallise. If it is not probable that a liability or asset will crystallise, then no deferred taxation provision is made in respect of that timing difference. This is called a partial provision approach. This approach requires assessment of:

- (i) the probability that the reversal of timing differences will be replaced by new (future) timing differences so that a tax liability or asset will not crystallise; and
- (ii) the likelihood that deferred tax assets will be recovered in the future.

The accounting rules for deferred taxation in consolidated financial statements are the same as for single entity financial statements. (SSAP 15)

GERMANY

As financial accounting in Germany is still largely tax-driven, deferred tax is relatively rarely recognised in the individual financial statements, and the amounts involved are usually less significant than in the UK. Additionally, while deferred tax liabilities are generally required to be provided for, recognition of deferred tax assets is optional.

(§ 274 (1) and (2) HGB)

In consolidated financial statements, both deferred tax liabilities and deferred tax assets arising from the consolidation adjustments are required to be recognised to the extent that they will reverse in future years.

(§ 306 HGB)

Deferred tax balances are usually more significant in consolidated financial statements as these are not affected by tax valuation principles and many of the tax-driven accounting entries are usually reversed on consolidation increasing the divergence between accounting and tax profits.

Deferred taxation is calculated using the liability method. This method applies the tax rates likely to be in effect during the periods in which the liability or asset is expected to crystallise.
(SSAP 15)

Deferred tax assets are recognised for future deductions and utilisation of tax credit carryforwards where recovery is assured beyond a reasonable doubt.
(SSAP 15)

Deferred tax provisions should be included in the balance sheet under the heading “Provisions for liabilities and charges” as part of the provision for “Taxation, including deferred taxation”.
(1985 CA Sch. 4:8)

Deferred tax assets and liabilities are calculated based on the probable future tax liability (or tax saving) taking into account expected future changes in the tax law.
(§ 274 (1) and (2) HGB, SABI 3/1988)

Deferred taxes should be calculated taking into account proposed dividend payments (prior to 2001 the tax rate for distributed profits was different from the tax rate that applies to profits transferred to retained earnings).

Recognition of deferred tax assets does not increase the amount of distributable profits: after the distribution, the freely distributable reserves plus retained profits less any accumulated losses must be at least equal to the deferred tax asset.
(§ 274 (2) HGB)

Loss carryforwards are not allowed to be taken into account in the calculation of a deferred tax asset.
(§ 306 HGB)

A deferred tax liability should either be classified in the balance sheet under “Provision for taxation”, separately analysed, or shown as a separate balance before or after provision for taxation.
(SABI 3/1988)

SSAP requires that deferred tax debit balances which are expected to be offset in the future against reversal of a deferred tax liability should be recorded net of that liability. Where any deferred tax is to be carried as asset it should be split between the current and the non current as explained above. Similarly, deferred liabilities are classified as current or non current based on the period in which they are expected to crystallise.

The retention of earnings overseas is a timing difference only if there is an intention or obligation to remit them and remittance would result in a tax liability after taking account of any related double tax relief. Where deferred tax is not provided on earnings retained overseas, this fact should be disclosed.

Either full provision basis (recognising the tax effect of all transactions in the period), or partial provision basis (accounting for the tax which is temporarily deferred or accelerated which will reverse in the foreseeable future without being replaced) may be used in accounting for deferred tax arising from recognition of pension and/or other post-retirement benefit obligations. (SSAP 15, as amended)

A deferred tax asset has to be shown separately on the face of the balance sheet and has to be explained in the notes.

(§ 274 (2) HGB)

Deferred tax assets and liabilities are not generally distinguished between current and non current.

German GAAP does not have specific guidance for these circumstances.

German GAAP does not have specific guidance on this matter.

7 December 2000 the ASB issued FRS 19 *Deferred Tax* which will replace the current partial provision basis for deferred tax with a form of full provisioning called the incremental liability approach. FRS 19 which becomes effective for accounting periods ending on or after 23 January 2002 will:

- require full provision for all timing differences, including, for example, accelerated allowances for depreciation, short-term timing differences and unrelieved tax losses;
- exempt provision for deferred tax on revaluation gains, rolled over gains and unremitted earnings of subsidiaries, associates and joint ventures;
- allow, but not require, deferred tax liabilities and assets to be discounted.

11. OTHER PROVISIONS

UNITED KINGDOM

GENERAL REQUIREMENTS

Provisions are liabilities of uncertain timing or amount. Provisions should be recognised when:

- an entity has a present obligation (legal or constructive) as a result of a past event;
- it is probable that a transfer of economic benefits will be required to settle the obligation; and
- the amount of the obligation can be reliably estimated.

On this principle no provision should be made for future operating losses.

However, provision should be made for the present obligation under an onerous contract. Onerous contracts are narrowly defined, an example is a lease on vacant property.

The amount provided should be the best estimate of the expenditure required to settle the present obligation at the balance sheet date. The provision should be discounted where this has a material effect.

Gains on the expected disposal of assets should not be taken into account in measuring a provision. (FRS 12)

GERMANY

Provisions for liabilities and charges and accruals are both included within the balance sheet position “Accruals” (“Rückstellungen”).

Accruals are required to be set up for liabilities of uncertain nature and for anticipated losses from uncompleted transactions.

(§ 249 (1) HGB)

Accruals for potential losses from pending transactions are no longer allowed to be set up in determining taxable income for business years ending after 31 December 1996. A deferred tax asset may therefore result from their inclusion in the balance sheet.

(§ 274 (2) HGB)

Accruals are also required to be set up also for:

- necessary repairs and maintenance expenditure incurred within the first three months from the end of the preceding financial year. Accrual may also be set up for repairs and maintenance expenditure incurred within one year of the prior balance sheet date, however, this additional accrual is not deductible in the tax accounts;

- land reclamation expense incurred during the following year;
- guarantee expenses which are incurred without legal or contractual obligation.

(§ 249 (1) HGB)

Accruals may also be set up for expenses attributable to the financial year (or a prior period) which can be precisely determined by the type of expense, and which are probable or certain at the balance sheet date, but uncertain in respect of the amount or the timing when they will be incurred (so-called expense equalisation accruals). A typical example is an accrual in respect of the proportionate cost of a major repair which is carried out only every few years. Expense equalisation accruals are not allowable in the tax accounts.

(§ 249 (2) HGB)

RESTRUCTURING COSTS

A restructuring provision is restricted to the direct expenditures arising from the restructuring, which are those that are both:

- necessarily entailed by the restructuring; and
- not associated with the ongoing activities of the entity.

Under German GAAP, a restructuring accrual may only be set up if there is a commitment to a third party. An example of this is a social plan commitment (i.e. a commitment to employees), which is only to be recognised in the financial statements if an appropriate resolution has been taken by management.

Restructuring costs should be provided for only when the general recognition criteria for provisions are met. A constructive obligation to restructure arises only when the entity has a detailed formal plan for the restructuring and has raised a valid expectation in those affected that it will carry out the restructuring, by starting to implement that plan or announcing its main features to those affected by it.
(FRS 12)

SPECIAL ACCOUNT WITH CHARACTERISTICS OF RESERVE

There is no equivalent concept in the UK. It is not normally required, or in most cases permitted, to recognise tax related provisions in the statutory financial statements of UK companies. In fact, over the last few years Inland Revenue in UK has moved closer to accepting income and expenses recognised in “true and fair” financial statements to be used in calculation of corporation tax. This, for example, relates to provisions recognised in accordance with FRS 12.

Due to existence of the principle of “Massgeblichkeit” in Germany (see Introduction), balance sheet may include provisions which are deductible for tax purposes but not necessarily reflect economic substance. These provisions may be deducted from relevant asset in the balance sheet. Alternatively, they may be recorded separately and included in a “special account with characteristics of reserve” (“Sonderposten mit Rücklageanteil”). If created, this special account should be disclosed as a separate item on the balance sheet and the reason for this account should be explained in the notes.

The balance in this account is reversed when amount previously accrued for tax purposes is actually incurred, as, for example, in the case of tax write down being replaced by economic depreciation of fixed assets (see Section 4 Tangible Fixed Assets).

In practice, many German companies prefer to show all tax related provisions in one account to make their financial statements more transparent.

Expense and income recognised in the profit and loss account as a result of transfers to and from the special account are required to be shown separately as part of other operating expenses or other operating income.
(§ 281 (2) HGB)

12. SHARE CAPITAL AND RESERVES

UNITED KINGDOM

Although many shares have features which make them economically similar to debt, because of their legal status, UK GAAP requires them to be classified as shares and included in shareholders' funds. While this categorisation reflects the legal form of the instruments, FRS 4 requires additional analysis between equity and non-equity interests on the face of the balance sheet to reflect economic substance. Shares are classified as equity or non-equity shares on the following basis:

- non-equity – shares having any right which limits the amount of dividends (other than by reference to profit or assets), or limits the amount of capital repayable (if this has a commercial effect), or which are redeemable at the request of the holder;
- equity – unrestricted shares. (FRS 4)

Under UK GAAP, any instrument which is capable of being separately transferred or redeemed is separately accounted for. For example, if a debt instrument is issued with warrants and the warrants are capable of being separately transferred, a value is allocated to the warrants and reported within equity.

GERMANY

German GAAP does not generally distinguish between the equity and non-equity shares. Preference shares ("Vorzugsaktien") are generally presented within shareholders funds. See also Section 8 Debt and Capital Instruments for a discussion of a specific type of capital instruments – profit participation rights – which may be classified as equity or liability depending on their particular features.

CAPITAL RESERVES AND LEGAL RESERVES

If a company issues shares at a premium, the amount received in excess of the nominal value should be transferred to a share premium account, which is required to be shown separately on the face of the balance sheet.

(CA 1985 s 130 (1), CA 1985 Sch 4)

There is no similar requirement in the UK.

Share premium account can be used to:

- issue fully paid bonus shares;
- write off preliminary expenses;
- write off expenses, commission or discount on any issue of shares or debentures;
- provide for any premium payable on the redemption of shares and debentures of the company.

(CA 1985 s 130(2))

Capital reserves include:

- amounts received in excess of nominal value, on issue of shares (including rights);
- amounts received on issue of convertible debentures and share options;
- amounts paid by shareholders in consideration of preferential rights to shares;
- other capital contributions from shareholders.

(§§ 150 (1) AktG, 272 (2) HGB)

AG and KGaA are required to transfer 1/20 of the profit for the year (reduced by accumulated losses brought forward) to a legal reserve until such time as the legal reserve and capital reserves together reach 10% of subscribed capital.

(§§ 150 (2), 278 (3) AktG)

Legal reserves and capital reserves may be used by AG and KGaA to eliminate loss for the year, to issue bonus shares and for other limited purposes. Details are described in § 150 (3) and (4) AktG.

REVALUATION RESERVE

This reserve is used to record any gains and losses (subject to limitations) arising from revaluation of assets. The balance of the revaluation reserve represents unrealised surplus and is not distributable.

Revaluation of assets is not permitted in Germany.

PURCHASE OF OWN SHARES

Company law requires that shares redeemed or purchased must be cancelled.

Own shares are only allowed to be acquired in the cases specified in § 71 (1) AktG. The company is not entitled to any rights from own shares (§ 71 b AktG).

A public company is required to make the redemption or repurchase only from distributable profits. In addition to writing off any premium on redemption/ repurchase, a capital redemption reserve is created and an amount equal to the nominal value of the shares redeemed or repurchased is transferred to this reserve from distributable profits. (CA 1985 ss 160(1)(a), 170 and 171(1))

In certain circumstances a company may hold its own shares through a specially created trust, for example, to satisfy its obligations under an employee share option scheme. In this case, such shares should be shown as an asset on the balance sheet in accordance Companies Act 1985 formats for accounts. (UITF 13)

A reserve for own shares has to be set up for an amount equivalent to the amount of own shares included in assets. It may be created from existing revenue reserves. (§ 272 (4) HGB)

Reserve for own shares is also required to be created in respect of interest in shares of the parent entity. (§ 272 (4) HGB)

REVENUE RESERVES AND REVENUE RECOGNITION

UK GAAP does not currently have any specific guidance on revenue recognition. However, in accordance with the Companies Act 1985, only profits realised at the balance sheet date should be included in the profit and loss account and, consequently, in the net profit or loss for the period.

A company may also create other reserves such as, for example, special reserves as provided for by the company's Articles of Association. However, this is not common in the UK.

Accumulated profits or losses should be shown in the balance sheet separately.
(CA 1985 Sch 4: 8)

Revenue reserves may only include amounts transferred from profits of the financial year or earlier years.
(§ 272 (3) HGB)

Companies are required to show separately on the face of the balance sheet:

- retained profits/accumulated losses brought forward;
- net profit or loss for the year.
(§ 266 (3) HGB)

13. DIVIDENDS AND FINANCE COSTS OF SHARES

UNITED KINGDOM

The total of dividends paid and proposed is shown as a separate item in the profit and loss account, any unpaid amounts are shown in the balance sheet as a current liability. (1985 CA, Sch. 4)

It is a normal practice for listed and big non-listed companies in the UK to pay interim dividends. Generally, the same rules apply for interim dividends as for the final dividends.

Dividend entitlements calculated by reference to time are accrued and included in the dividends proposed, or other finance charge appropriation, based on whether it is intended to be paid in the next period or not.

Dividend income on shares held in employee share ownership trust is excluded from the aggregate profit before tax. Instead, it is deducted from the aggregate of dividends paid and proposed.

GERMANY

The disclosure of dividends generally comprises only dividends paid or for which a formal shareholders' resolution exists. A simple proposal of dividend is not generally sufficient for recognition of the related liability.

There is no precise equivalent to interim dividends in Germany, with distributions being made annually. However, some GmbHs make advance dividend payments which are, in effect, similar to interim dividends in the UK.

FINANCE CHARGE IN RESPECT OF NON-EQUITY SHARES

The finance charge in respect of non-equity shares is calculated in the same way as for debt (see Section 8). The difference between the initial net proceeds and the total amounts to be paid on the shares are recognised over the term of the shares at a constant rate on the carrying amount. The finance charge therefore includes amortisation of any premium or discount on the redemption of redeemable shares.

The amount of finance charge in respect of non-equity shares is normally shown as the appropriation of profit at the bottom of the profit and loss account (with credit entry going to appropriate reserve). As the total amount of dividends paid in respect of each year is required to be shown on the face of the profit and loss account (see above), any difference between the finance charge for the period and dividends paid or proposed is shown as an appropriation of profit.

DIVIDENDS RECEIVABLE FROM EQUITY INVESTMENTS

In the UK, it is not normal practice to recognise dividends receivable unless the dividend was declared before the receiving company's year end. However, dividends receivable from subsidiaries and associates in respect of accounting periods ending on or before that of the parent company are normally accrued in the parent's financial statements, even if declared by the subsidiary or associate after the parent's year end (on the basis of decision of the European Court).

Dividends are shown including withholding taxes (gross) but excluding (net of) tax credits and other applicable taxes including underlying taxes. Withholding tax is defined as tax deducted by the payer of dividends or other income and paid to the tax authorities wholly on behalf of the recipient.

(FRS 16)

In Germany, similar rules would generally apply.

However, special rules apply for non-incorporated subsidiaries. Profits of such subsidiaries are normally required to be shown as receivable in the parent's balance sheet.

Dividends received are shown gross in the profit and loss account, i.e. including the withholding tax.

Companies must also gross up the dividend receivable to include the corporate income tax charge relating to the dividend which was suffered by the subsidiary.

Under the recent German tax reform, the above remains valid only for dividends received in 2001 and in exceptional cases (e.g. year end deviates from fiscal year end December 31) in 2002.

From 2002 in case of domestic incorporated subsidiaries dividends received are completely tax-free.

14. EXTRAORDINARY AND EXCEPTIONAL ITEMS

UNITED KINGDOM

EXTRAORDINARY ITEMS

FRS 3 includes a very restrictive definition of extraordinary items. Extraordinary items are defined as material items possessing a high degree of abnormality which derive from events or transactions outside the ordinary activities of the company and which are not expected to recur. In practice, there are no examples.

Extraordinary items are shown after profit on ordinary activities. (FRS 3)

GERMANY

There is no distinction in Germany between extraordinary and exceptional items. Extraordinary income or expenses which are defined as those which arise outside the normal course of business activities of the company. They are required be disclosed separately in the profit and loss account. To qualify as extraordinary, such items must be unusual and material. However, materiality in this context is not legally defined. (§ 277 (4) HGB)

Examples of extraordinary items include:

- profit/loss on sale of affiliates;
- closure of part of business; or
- severance pay in the case of mass redundancies.

Extraordinary items are required to be shown after results from ordinary activities but before taxes on income (see appendix for an illustration of the presentation of extraordinary items).

The amount of each extraordinary item and related income tax income or expense is required to be disclosed on the face of the balance sheet or in the notes.
(FRS 3)

EXCEPTIONAL ITEMS

FRS 3 defines exceptional items as, material items which derive from events or transactions that fall within the ordinary activities of the reporting entity and which individually or, if of a similar type, in aggregate, need to be disclosed by virtue of their size or incidence if the financial statements are to give a true and fair view. All exceptional items are included in profit or loss from ordinary activities. Exceptional items are required to be included under appropriate headings in arriving at operating profit unless they are one of the three 'non-operating exceptional items,' namely: profits or losses on the sale or termination of an operation; costs of a fundamental reorganisation or restructuring; and exceptional profits or losses on the disposal of fixed assets.
(FRS 3)

Medium sized and large companies must additionally disclose in the notes the amount and nature of each extraordinary item if such items are material for evaluation of the results of the company for the period.
(§§ 277 (4) and 326 HGB)

Most items included in extraordinary category in Germany would require disclosure as exceptional items under UK GAAP (see above).

15. DISCONTINUED OPERATIONS

UNITED KINGDOM

Profits and losses on discontinuance of a business segment and other gains or losses from sale or abandonment of fixed assets may not be reported as extraordinary items under FRS 3.

An operation is treated as discontinued if it is sold or terminated and it meets all of the following conditions:

- sale or termination is completed within the year or before the earlier of the end of the three month period after the year end or the approval date of the financial statements;
- if a termination, activities have ceased permanently;
- the sale or termination has material effect on the nature and focus of the reporting entity's operations and represents a material reduction in operating facilities resulting from either withdrawal from a particular market or a material reduction in turnover from continuing markets; and
- the discontinued assets, liabilities and operations are clearly distinguished physically, operationally and for financial reporting purposes.

GERMANY

Discontinued operations are not defined in the commercial code. Profits and losses on discontinuance of a business segment may be classified as an extraordinary item, if the criteria defined under § 277 (4) HGB are met (see Section 15 Extraordinary and Exceptional Items).

Additional disclosures may be required in the notes to the accounts if because of the effect of discontinuance of an operation the annual financial statements do not present a true and fair view of the net worth, financial position and results.
(§ 264 (2) 2 HGB)

The standard requires that as a minimum, turnover and operating profit for the current period be analysed between continuing operations, acquisitions and discontinued operations on the face of the profit and loss account; with analysis for the remaining statutory headings to operating profit shown in the notes. Comparative figures must be similarly analysed either on the face of the profit and loss account or in the notes.
(FRS 3)

See Appendix II for example presentation.

16. CHANGES IN ACCOUNTING POLICIES/PRINCIPLES

UNITED KINGDOM

The cumulative effect of a change in an accounting policy is shown as an adjustment of the opening balance of reserves. The prior year comparative information is restated under the new policy.

The cumulative adjustment is to be noted at the bottom of the statement of total recognised gains and losses of the current period, and included in the reconciliation of movements in shareholders' funds of the corresponding period.
(FRS 3)

In addition to disclosure of the effect on the results for the preceding period, UITF 14 requires disclosure of the effect on the current year's results.

Exceptions to this general rule may occur when an accounting policy changes because of a new standard. Transitional provisions in applicable standards specify the acceptable approach(es) to record such changes.

GERMANY

Adjustments in respect of prior years are included in the profit and loss account of the current period. Indeed, any adjustments to the opening balances would conflict with the "balance sheet continuity" principle ("Bilanzidentität") according to which amounts included in the opening balance sheet must agree to the closing balance sheet of the preceding financial year.
(§ 252 (1) 1 HGB)

If adjustments in respect of prior years are material their amount and nature must be disclosed in the notes to the financial statements.
(§ 277 (4) 3 HGB)

However, accounting methods and policies may be amended only in exceptional circumstances, e.g.:

- changes in commercial or tax law or other legal changes;
- material changes in shareholder structure or management; and
- debt restructuring activities.
(IDW HFA 3/1997)

Consequently, the cumulative result of a change in accounting policy is required to be included in the profit and loss account of the current period. The effect of such change must be disclosed in the notes.
(§ 284 (2) 3 HGB)

17. EARNINGS PER SHARE

UNITED KINGDOM

FRS 14 requires all listed and would be listed companies to disclose on the face of the income statement basic and diluted earnings per share based on the amount of net profit for the period. Companies making this disclosure on a voluntary basis are required to follow requirements of the standard.
(FRS 14)

GERMANY

German GAAP does not contain any requirements concerning calculation and disclosure of earnings per share.

A private institution called DVFA developed a formula that is disclosed by listed companies in their annual reports voluntarily. The components of the calculation and reconciliation to the reported net profit or loss for the period are not necessarily disclosed in the accounts.

18. FOREIGN CURRENCY TRANSLATION

UNITED KINGDOM

Companies legislation does not place any restrictions on companies willing to prepare their accounts denominated in a different currency.

IN INDIVIDUAL COMPANY'S FINANCIAL STATEMENTS

UK GAAP requires the use of temporal method to translate foreign currency transactions of individual companies. As in Germany, foreign currency transactions are initially recorded using the exchange rate ruling at the date of each transaction unless amounts are going to be settled at an agreed fixed rate or where a hedging instrument is used, in which case the rate appropriate for the transaction is used.

Approximations are permitted when the rates do not fluctuate significantly.

Subsequently, all monetary assets and liabilities are retranslated using the exchange rate ruling at each balance sheet date unless amounts are going to be settled at an agreed fixed rate (or when they are fixed through hedging).

Non-monetary assets and liabilities normally remain at the fixed recorded amount and are not retranslated.

GERMANY

German financial statements must be expressed in Deutsche Marks or in Euro, and as from financial years ending in 2001 – in Euro only.

(§ 244 HGB)

Foreign currency transactions undertaken by a company are recorded at the rate ruling at the date on which each transaction occurs.

At each balance sheet date, in accordance with the German principle of "Imparitätsprinzip":

- cash and bank balances in foreign currency may be translated using the year end rate;
- foreign currency monetary assets and liabilities are retranslated using the year end rate but only to the extent that it results in a loss, recognition of unrealised gains is not permitted;
- if an amount of foreign currency balance is going to be settled at an agreed fixed rate or for which there is a related and matching forward exchange contract, this rate/ (forward contract rate) may be used and the balance does not have to be retranslated.

(§ 252 (1) 4 HGB).

Exchange differences arising from translation of foreign currency transactions are recognised in the profit and loss account. (SSAP 20)

IN CONSOLIDATED FINANCIAL STATEMENTS

SSAP 20 requires one of two translation methods, the closing rate/net investment method or the temporal method, depending upon the economic environment in which that enterprise operates. The net investment method is applied to the financial statements of foreign enterprises in the group which operate as a separate or quasi-independent entities from that of the investing company. The temporal method should be applied to foreign enterprises whose affairs are so closely connected with those of the investing company as to constitute an extension of the economic environment of the investing company.

Under the net investment method the translation adjustments arising from exchange rate fluctuations on the net investment in a foreign enterprise which does not normally transact business in the reporting currency of its parent (and which, therefore, have no impact on cash flows) are not included in the consolidated profit and loss account but are treated as adjustments to equity and recognised in the statement of total recognised gains and losses.

German law (HGB) does not require any particular method to be used. In literature and practice, the following methods for the translation of financial statements of foreign companies were developed:

- closing rate/net investment method;
- modified closing rate method (balance sheet at closing rate, profit and loss account at average rate);
- temporal method.

The HFA submitted a draft statement on foreign currency translation in consolidated financial statements in 1998. This statement is based on SFAS 52 in the US and IAS 21. It essentially follows a similar approach to the one in SSAP 20 in the UK:

- the method used to translate the financial statements of a foreign operation depends on the way in which it is financed and operates in relation to the reporting enterprise;
- a foreign operation that is integral to the operation of the reporting enterprise and carries

The profit and loss account may be translated using either the average rate for the period or the closing rate. (SSAP 20)

on its business as if it were an extension of the reporting company's operation should apply the temporal method;

- a foreign entity which has substantially all of its cash and other monetary items, income and expenses as well as substantially all borrowings denominated in its local currency should apply the net investment method.

Treatments of translation differences vary, with some companies taking these directly to reserves, others taking them to the profit and loss account.

In circumstances of high inflation (where the distortions affect the true and fair view and in any event where cumulative inflation rate approaches 100% or more in a three year period), the local currency financial statements should be adjusted to reflect current price levels before translation.

There are currently no specific requirements, but in practice, treatment in Germany is similar to UK GAAP.

Two acceptable methods are to:

- adjust the local currency financial statements to reflect current price levels; or
 - use a stable currency as the functional ("local") currency.
- (UITF Abstract 9)

In consolidated financial statements, exchange differences arising from foreign currency borrowings used to finance or provide a hedge against foreign equity investments may be offset against reserve movements representing the exchange differences arising on the net investments in foreign enterprises. This treatment is available for all types of foreign equity investments, and foreign currency borrowings may be in a different currency from that of the investment providing that such borrowings do not exceed the amount of cash which the investment is expected to generate. Similar treatment is used in the company's own financial statements where foreign currency borrowings are used to finance or hedge the company's investment in a foreign entity.
(SSAP 20)

The cumulative translation adjustments related to an investment which has been sold or substantially liquidated are not reported on disposal as part of the gain or loss on sale or liquidation.
(FRS 3)

Hedges are not specifically dealt with in German accounting rules, and a variety of treatments are adopted in practice.

19. LEASES

UNITED KINGDOM

A lease is treated as a finance lease if it transfers substantially all the risks and rewards of ownership of the asset to the lessee. Where the present value of the minimum lease payments equals 90% or more of the asset's fair value, it is presumed that the lease is a finance lease. (SSAP 21)

In more complicated arrangements even if the "90% test" is not met, the substance of the arrangement may be one of financing. In this situation the lessee capitalises the asset at the net present value of the lease payments. (FRS 5)

Lessors classify leases as finance or as operating based on the same criteria used by lessees. (SSAP 21)

GERMANY

There are no regulations in Commercial Law dealing with leases and, in practice, most companies use the tax rules as the basis of their accounting. Complex definitions within tax law distinguish between operating and finance leases, and these definitions are applied both in financial accounting and in the drafting of lease agreements.

Relatively few leased assets are capitalised by lessees. This is largely due to unfavourable tax treatment for a lessee in a finance lease as depreciation deductions generally remain with the lessor. Consequently most leases are designed to qualify as operating leases in order to avoid capitalisation.

In contrast to UK GAAP, German accounting rules do not require to consider the present value of minimum lease payments as a criterion for classification of leases.

Where leased assets are capitalised, they are frequently not disclosed separately, unless material.

FULL AMORTISATION CONTRACTS

No UK equivalent.

A lease is considered to be a *full amortisation* contract when the following three criteria are met:

- a lease contract is for a basic lease term (fixed contractual lease period);
- during this term the lease is non cancellable;
- the lease payments are equal or exceed lessor's acquisition or manufacturing costs (including all direct expenses and finance costs).

Full amortisation contracts are further distinguished between contracts for moveable and non-moveable property.

For moveable property, a leased asset generally remains on the balance sheet of the lessor unless any of the following apply, in which case it is capitalised by the lessee:

- the basic lease period is either less than 40% or more than 90% of the economic useful life of the asset;
- the basic lease period is more than 40% but less than 90% of the economic useful life of the asset and the lessee has an option to purchase the asset at a price lower than the expected residual net book value (assuming a straight line depreciation) or fair market value of the asset at the time when the option becomes exercisable;

- the basic lease period covers between 40% and 90% of the economic useful life of the asset and the lessee has an option to extend the lease and the sum of the lease payments is less than the reduction in value over the extension period;
- Special Leasing agreements exist under which the asset has been tailored to suit the requirements of the lessee and at the end of lease term the asset will have no economic benefit to any other party.

The same criteria apply to buildings (“non-movable property”), except that where there is an extension option the criterion is whether the lease payments in the extension period are more or less than 75% of the usual rent which would be paid for similar property.

Land is always recorded on the balance sheet of the lessor, except where there is a purchase option at the end of the lease term, in which case the land is treated in the same way as the buildings.

PARTIAL AMORTISATION CONTRACTS

No UK equivalent.

Leases are classified as partial amortisation contracts where the costs of the lessor are not fully covered by the lease payments over the period of the basic lease term. Accounting for these leases by the lessor or by the lessee is determined by the economic characteristics of the contract. Who derives the benefits of a leased asset and therefore records an asset on its balance sheet is determined as described below.

A “moveable asset” is recorded on the balance sheet of the lessor where:

- there is an option for the lessor to sell the asset to the lessee at a price determined already when the contract is concluded;
- the asset is sold for a price below the difference between the total costs of the lessor and the lease payments over the periods of the basic lease and the lessee has to pay this amount to the lessor;
- the asset is sold for a price exceeding the difference between the total costs of the lessor and the lease payments over the periods of the basic lease and the lessee receives less than 75% of this amount.
- the leasing contract is cancelled by the lessee and the lessee has to pay an amount covering the difference between the total costs of the lessor and the sum

of the lease payments, reduced by 90% of the gain from the sale of the lease asset; if the gain exceeds the difference between the total costs of the lessor and the sum of the lease payments, the lessor will keep the exceeding amount.

Land and buildings are normally recorded on the balance sheet of the lessor, unless one of the following is true:

- there is a Special Leasing agreement;
- the lessee has an option to purchase the asset and either the basic lease term is more than 90% of the asset's useful economic life or the option price is less than the residual book value assuming straight-line depreciation;
- the lessee has an option to extend the lease and either the basic lease term is more than 90% of the asset's useful economic life or the lease payments over the extension period are less than 75% of the normal rent for such property;
- there is either a purchase or extension option and the lessee bears the risk of partial or complete deterioration of the asset or it has to reimburse costs to the lessor in cases where the lease agreement is terminated early.

An asset under finance lease is required to be capitalised by the lessee. The amount capitalised should be equal to the present value of the minimum lease payments, discounted at the interest rate implicit in the lease. Fair value of the leased asset may be used if it approximates the present value of the minimum lease payments.

The total finance charge is allocated to the accounting periods so as to produce a constant periodic rate on outstanding liability.

An asset is depreciated over the shorter of the lease term and the asset's useful economic life.
(SSAP 21)

Unearned income on a finance lease is amortised to earnings by the lessor based on the *net cash investment* in the lease (i.e. the amount invested in the lease after taking into account all cash flows including those arising from grants, taxation and interest from related borrowings).
(SSAP 21)

If a lease is required to be capitalised in the accounts of the lessee, the lessee records the asset and sets up a corresponding liability. The amount capitalised as an asset should be equal to the acquisition cost used by the lessor for determining the lease payments. The lease payments have to be separated into a portion containing interest and costs and a portion reflecting the repayment of the accrued liability.

The leased asset is depreciated in accordance with the usual rules for capitalised fixed assets.

SALE AND LEASEBACK

A gain or loss on the sale of an asset which is leased back is deferred if the leaseback is a finance lease, and is recognised immediately when the leaseback is an operating lease (but in the latter case, some of the gain or loss is deferred if the sale price is not the fair value). Measurement of gain or loss is made after providing for any permanent diminution in value based on the asset's fair value prior to the leaseback.

(SSAP 21)

Sale and leaseback transactions are not specifically dealt with in German GAAP. In practice, both sale and leaseback are accounted for as separate transactions. Profit on sale is recognised immediately. Consideration is then required as to whether the lessee should make a provision for any losses which will be incurred as a result of the leasing agreement.

20. BUSINESS COMBINATIONS

UNITED KINGDOM

MERGER (POOLING-OF-INTERESTS) ACCOUNTING

FRS 6, effective for combinations first accounted for in years beginning on or after 23 December 1994, introduced more restrictive qualitative criteria than the old standard, SSAP 23, and requires merger accounting to be used in the rare situations of a 'true merger'. (The old SSAP 23 rules still apply to business combinations in earlier periods.)

The qualitative criteria which are intended to restrict merger accounting to true merger situations are:

- no party is portrayed as either acquirer or acquired;
- all parties participate in establishing the management structure for the combined entity;
- the relative sizes of the combining entities are not so disparate that one dominates by virtue of size;
- no more than an immaterial proportion of the consideration received is represented by non-equity consideration (including any consideration received for equity acquired in the two years prior to the combination); and
- no shareholder of the combined entity retains an interest in only part of the combined entity.

GERMANY

Business combinations are usually accounted for as acquisitions of one company by another. Merger accounting is sometimes permitted (see conditions below), but is rarely adopted in practice.
(§ 302 HGB)

The conditions that have to be satisfied in order for a company to be able to use merger accounting are as follows:

- the business combination is substantially achieved through a share-for-share exchange;
- the shares to be eliminated amount to at least 90% of the total amount of share capital;
- any cash consideration does not exceed 10% of the nominal value of share issued.

(§ 302 (1) HGB)

To use merger accounting the quantitative criteria set out in the Companies Act also have to be met:

- as a result of the offer, the offeror has secured at least 90% of all equity shares; and
- the fair value of any consideration other than equity shares does not exceed 10% of the nominal (par) value of the equity shares issued.

Where both sets of criteria are met FRS 6 requires merger accounting to be used.

(FRS 6)

There is a specific exemption from the above criteria for group reconstructions. These business combinations can be accounted for by using merger accounting provided that:

- the use of merger accounting is not prohibited by law (see above);
- the ultimate shareholders remain the same, and relative rights of each are unchanged;
- minority interests in the net assets of the group are not affected.

ACQUISITION (PURCHASE) ACCOUNTING

Under the acquisition accounting rules, UK GAAP requires the *identifiable* assets and liabilities of the acquired entity to be included in the consolidated financial statements of the acquirer at their fair values at the date of acquisition. The difference between these and the cost of acquisition is recognised as goodwill or negative goodwill (see Section 2 of this book). The results of the acquired entity are included in the profit and loss account of the acquiring group from the date of acquisition.

Minority interests are recorded at fair value.
(FRS 7)

At the time of the initial consolidation there is the choice of valuing the assets at the value of the date of acquisition or at the time of the initial consolidation (for example, at the end of the year for which first consolidated accounts are prepared).

There are two acceptable variations of the purchase method:

- the book value method; or
- the new valuation method.

Under both methods it is necessary to determine the fair value of the assets and liabilities acquired. Under both methods, investor's share of the net assets of the acquired company adjusted for their fair value cannot exceed the cost of acquisition.

Under, the book value method, consideration paid in respect of the acquisition recorded in the parent's own financial statements is initially offset against the equity capital of the subsidiary. The resulting difference is first allocated to the fair values of individual assets or liabilities of the acquired entity (so-called "hidden reserves").

Residual debit difference is recognised in the balance sheet as goodwill.

(§ 301 (1) 2 No.1 HGB).

Minority interests are shown at the pre-acquisition book value of the minority's share of net equity of the acquired entity.

(§ 307 (1) HGB)

Under the new valuation method of accounting, the balance sheet items of the subsidiary are restated to their fair values before the actual consolidation.

(§ 301 (1) 2 No. 2 HGB).

Under the new valuation method minority shareholders have a partial share in hidden reserves, as opposed to the new value method when this is not the case.

(§ 307 (1) HGB)

The cost of an acquired enterprise is allocated to its assets and liabilities based on their fair values that reflect the conditions at the date of acquisition. FRS 7 'Fair values in acquisition accounting', effective for business combinations in accounting periods beginning on or after 23 December 1995, provides rules and guidance on assigning fair values to specific types of assets and liabilities. (The old rules still apply to transactions entered into in earlier periods.)

There is currently no specific guidance in Germany in relation to the determination of fair value of the assets and liabilities of the acquired entities.

In August 2000, the new accounting standard, DRS 4 "Purchase Accounting", was adopted.

Specifically:

- monetary assets and liabilities should take into account the timing of amounts expected to be received or paid. Where a market value exists this would be used. Where there is no market value, the amount will be determined by looking at an equivalent item or by discounting. The unwinding of any discount is treated as interest;

- on consolidation the deferred tax balance of the acquired company will be determined on the basis of the new group, i.e. revised where the new group structure changes the amount of tax liabilities or assets expected to crystallise in the future; an additional provision for deferred taxation is made for the difference between the fair value assigned to assets and their book values only to the extent that a tax liability is expected to crystallise;
- tax benefits of losses carried forward by an acquired enterprise not recognised at the acquisition date are recognised in the profit and loss account when they give rise to a benefit;
- an intangible asset which can be sold separately from the underlying business acquired is valued separately. If, however, an asset can be disposed of only as part of the revenue-earning activity to which it contributes, it is regarded as indistinguishable from the goodwill relating to that activity and is accounted for as goodwill.

(FRS 10)

Where a business is acquired which sponsors a defined benefit pension plan, fair values are attributed to an asset in respect of an actuarial surplus expected to be realised in cash terms, or by a reduction in future contributions, and a liability in respect of a deficit.

Changes in benefits accruing to the members of acquired schemes, whether negotiated as a condition of the acquisition or not, are accounted for as a post-acquisition item.

When settlement of cash consideration is deferred, the fair value of consideration is obtained by discounting to present value.
(FRS 7)

FRS 7 requires the cost of acquisition to include a reasonable estimate of the fair value of any amount of contingent consideration expected to be payable in the future. These estimates should be reviewed and adjusted, if necessary, at each balance sheet date subsequent to acquisition, with consequential corresponding adjustments to goodwill.

Where deferred or contingent consideration is to be satisfied by the issue of shares, there is no obligation to transfer economic benefits, and therefore, amounts recognised are reported in the balance sheet as part of shareholders' funds as a separate caption representing shares to be issued.

Liabilities and provisions may only be established for liabilities and contingencies which exist in the acquired company at the date of acquisition. In particular the following are treated as post-acquisition expenditure:

- changes resulting from the acquirer's intentions or future actions; and
- provisions or accruals for future operating losses or for reorganisation and integration costs (including closing duplicate facilities) expected to be incurred as a result of the acquisition, whether they related to the acquired entity or the acquirer.

The fair value assigned to assets and liabilities acquired may be amended with a corresponding adjustment to goodwill until the end of the first year after the date of acquisition. Any subsequent adjustments are recognised in the profit and loss account.
(FRS 7)

21. CONSOLIDATION

UNITED KINGDOM

The legal definition of a subsidiary undertaking requiring consolidation includes undertakings (corporations, partnerships and unincorporated associations) in which the parent (directly and with its subsidiaries' holdings):

- holds a majority of its voting rights; or
- is a member and has the right to appoint or remove directors holding a majority of the votes at a meeting of the board of directors; or
- is a member and controls alone, pursuant to an agreement with other shareholders or members, a majority of its voting rights; or
- has the right to exercise a dominant influence by virtue of its constitution or a control contract; or
- has a participating interest (generally a holding of 20% or more, including convertible securities and options) and actually exercises a dominant influence or manages the undertaking on a unified basis with its own operations.

(CA 1985 Sec. 258)

GERMANY

All German companies which are parent companies within the meaning of § 290 HGB or which meet the criteria under the PubLG are required to prepare consolidated financial statements.

A parent company is a company that has uniform control over another company (its subsidiary).
(§ 290 HGB)

Uniform control means that a domestic company has a participation in another entity (defined as long-term interests in shares, normally in excess of 20% of share capital) and exerts uniform control over this entity.
(§ 290 (1) HGB, § 271 (1) HGB)

A domestic company is also required to prepare consolidated accounts (whether it has participating interest or not) if it has the following legal rights indicating control:

- majority of the voting rights in the subsidiary;
- the right to appoint or dismiss the majority of members of a management or supervisory board;

Consolidated accounts are mandatory for all parent companies unless one of the following three conditions applies:

- the UK parent claiming the exemption does not have any securities listed on a EU stock exchange, and the investing company is a wholly owned or majority owned subsidiary of a parent incorporated in an EU member state, which prepares audited consolidated financial statements in English complying with law based EU Seventh Directive, and the minority shareholders holding more than half the remaining shares or 5% of the total shares have not requested group accounts;

(FRS 2, 1985 CA Sec. 228)

- the company and the group headed by it qualifies as small or medium sized and the group is not ineligible. Ineligible groups for the purposes of this exemption are:
 - a group in which any of its members is a public limited company;

- the right to exercise a controlling influence over the investee under a control contract or by virtue of the Articles of Association.

(§ 290 (2) HGB)

A company does not have to prepare consolidated financial statements if:

- consolidated financial statements which include the parent company and its subsidiaries (subgroup) are prepared at a higher level in the group (§§ 291, 292 HGB);
- consolidated financial statements which comply with IAS or US GAAP are prepared by the ultimate parent company and it is listed (§ 292a HGB); or
- it is a small company (§ 293 HGB).

- a banking institution;
- an insurance company;
- an authorised person under the Financial Services Act 1986;
- where all of the subsidiaries individually are excluded from consolidation (see subsidiary undertakings below).

A subsidiary undertaking is not consolidated where:

- it is held solely for subsequent resale and has not been previously included in consolidation; or
 - severe long-term restrictions substantially hinder the parent exercising control over its assets and management;
- (FRS 2 and CA 1985 Sec. 229)

In the UK there is a similar exemption in respect of a subsidiary with dissimilar activities. However, it is virtually never used in practice as exclusion from consolidation on these grounds is likely to result in financial statements of the parent not giving true and fair view.

In certain circumstances, subsidiaries may or must be excluded from consolidation.

A subsidiary may be excluded where:

- significant and continuing limitations inhibit control on a long-term basis;
- the information required cannot be obtained without unreasonable expense or delay; or
- where shares are held solely for resale or where subsidiaries are immaterial.

(§296 HGB)

A subsidiary is required to be excluded from consolidation where its activities are dissimilar to those of its parent and its consolidation would result in financial statements not presenting a true and fair view. In practice this exemption is rarely used.

(295 HGB)

Certain specific disclosures in respect of excluded subsidiaries are required, including the reason for excluding from consolidation.
(1985 CA Sch 7, FRS 2)

If subsidiaries are excluded from consolidation, the reason for exclusion is required to be disclosed in the notes to the accounts.



Appendices

APPENDIX I

CONSOLIDATED BALANCE SHEET – BRITISH HOLDINGS PLC
BALANCE SHEET – GERMANY COMPANY

APPENDIX II

CONSOLIDATED PROFIT AND LOSS ACCOUNT – BRITISH
HOLDINGS PLC
PROFIT AND LOSS ACCOUNT – GERMAN COMPANY

APPENDIX III

CONSOLIDATED CASH FLOW STATEMENT – BRITISH
HOLDINGS PLC
RECONCILIATION OF NET CASH FLOW TO MOVEMENT IN NET
DEBT – BRITISH HOLDINGS PLC
CASH FLOW STATEMENT – GERMAN COMPANY (INDIRECT
METHOD)

APPENDIX I

CONSOLIDATED BALANCE SHEET – BRITISH HOLDINGS PLC

31 December

	NOTE	20X1 £'000	20X1 £'000	20X0 £'000	20X0 £'000
FIXED ASSETS					
Intangible assets			XX		XX
Tangible assets			XXX		XXX
Investments in joint ventures:					
Share of gross assets		XX		XX	
Share of gross liabilities		(XX)		(X)	
		<u>XX</u>		<u>XX</u>	
Investments in associate undertakings		XX		XX	
Other investments		<u>X</u>		<u>XX</u>	
			<u>XX</u>		<u>XX</u>
			XXX		XXX
CURRENT ASSETS					
Stocks		XXX		XXX	
Debtors		XXX		XXX	
Investments		X		X	
Cash at bank and in hand		XX		XX	
		<u>XXXX</u>		<u>XXXX</u>	
CREDITORS: amounts falling due within one year					
Debtenture loans		XXX		XXX	
Bank loans and overdraft		XX		XX	
Trade creditors		XXX		XXX	
Proposed dividend		X		X	
Accruals and deferred income		XX		XX	
		<u>XXX</u>		<u>XXX</u>	
NET CURRENT ASSETS			<u>XXX</u>		<u>XXX</u>
TOTAL ASSETS LESS CURRENT LIABILITIES			<u>XXX</u>		<u>XXX</u>
CREDITORS: amounts falling due after more than one year					
			XX		XX
PROVISIONS FOR LIABILITIES AND CHARGES					
			XX		XX
MINORITY INTERESTS					
Equity minority interests			X		X
Non-equity minority interests			X		X
			<u>XXX</u>		<u>XXX</u>
CAPITAL AND RESERVES					
Called up share capital			XX		XX
Share premium account			XX		XX
Revaluation reserve			X		X
Other reserves			X		X
Profit and loss account			<u>XXX</u>		<u>XXX</u>
SHAREHOLDERS' FUNDS			<u>XXX</u>		<u>XXX</u>
Attributable to equity shareholders			XX		XX
Attributable to non-equity shareholders			XXX		XXX

These financial statements were approved by the Board of Directors on [].

Signed on behalf of the Board of Directors

BALANCE SHEET – GERMAN COMPANY
As of December 31

Assets

- A. Fixed assets
 - I. Intangible assets
 - 1. Concessions, industrial and similar rights and assets and licences in such rights and assets
 - 2. Goodwill
 - 3. Payments on account
 - II. Tangible assets
 - 1. Land, land rights and buildings including buildings on third party land
 - 2. Technical equipment and machines
 - 3. Other equipment, factory and office equipment
 - 4. Payments on account and assets under construction
 - III. Financial assets
 - 1. Shares in affiliated enterprises
 - 2. Loans to affiliated enterprises
 - 3. Participations
 - 4. Loans to enterprises in which participations are held
 - 5. Long term investments
 - 6. Other loans

Aktivseite

- A. Anlagevermögen
 - I. Immaterielle Vermögensgegenstände:
 - 1. Konzessionen, gewerbliche Schutzrechte und ähnliche Rechte und Werte sowie Lizenzen an solchen Rechten und Werten
 - 2. Geschäfts- oder Firmenwert
 - 3. geleistete Anzahlungen
 - II. Sachanlagen
 - 1. Grundstücke, grundstücksgleiche Rechte und Bauten einschließlich der Bauten auf fremden Grundstücken
 - 2. technische Anlagen und Maschinen
 - 3. andere Anlagen, Betriebs- und Geschäftsausstattung
 - 4. geleistete Anzahlungen und Anlagen im Bau
 - III. Finanzanlagen
 - 1. Anteile an verbundenen Unternehmen
 - 2. Ausleihungen an verbundene Unternehmen
 - 3. Beteiligungen
 - 4. Ausleihungen an Unternehmen, mit denen ein Beteiligungsverhältnis besteht
 - 5. Wertpapiere des Anlagevermögens
 - 6. sonstige Ausleihungen

Assets

- B. Current assets
 - I. Inventories
 - 1. Raw materials and supplies
 - 2. Work in process
 - 3. Finished goods and merchandise
 - 4. Payments on account
 - II. Receivables and other assets
 - 1. Trade receivables
 - 2. Receivables from affiliated enterprises
 - 3. Receivables from enterprises in which participations are held
 - 4. Other assets
 - III. Securities
 - 1. Shares in affiliated enterprises
 - 2. Own shares
 - 3. Other securities
 - IV. Cash-in-hand, central bank balances, bank balances and cheques
- C. Prepaid expenses

Aktivseite

- B. Umlaufvermögen
 - I. Vorräte
 - 1. Roh-, Hilfs- und Betriebsstoffe
 - 2. unfertige Erzeugnisse, unfertige Leistungen
 - 3. Fertige Erzeugnisse und Waren
 - 4. geleistete Anzahlungen
 - II. Forderungen und sonstige Vermögensgegenstände
 - 1. Forderungen aus Lieferungen und Leistungen
 - 2. Forderungen gegen verbundene Unternehmen
 - 3. Forderungen gegen Unternehmen, mit denen ein Beteiligungsverhältnis besteht
 - 4. sonstige Vermögensgegenstände
 - III. Wertpapiere
 - 1. Anteile an verbundenen Unternehmen
 - 2. eigene Anteile
 - 3. sonstige Wertpapiere
 - IV. Kassenbestand, Bundesbankguthaben, Guthaben bei Kreditinstituten und Schecks
- C. Rechnungsabgrenzungsposten

Equity and liabilities

A. Equity

- I. Subscribed capital
- II. Capital reserves
- III. Revenue reserves
 1. Legal reserve
 2. Reserve for own shares
 3. Statutory reserves
 4. Other revenue reserves
- IV. Retained profits/accumulated losses brought forward
- V. Net income/net loss for the year

B. Accruals

1. Accruals for pensions and similar obligations
2. Tax accruals
3. Other accruals

C. Liabilities

1. Loans, including convertible
2. Liabilities to banks
3. Payments received on account of orders
4. Trade payables
5. Liabilities on bills accepted and drawn
6. Payables to affiliated enterprises
7. Payables to enterprises in which participations are held
8. Other liabilities, including taxes, including relating to social security and similar obligations

D. Deferred income

Passivseite

A. Eigenkapital

- I. Gezeichnetes Kapital
- II. Kapitalrücklage
- III. Gewinnrücklage
 1. Gesetzliche Rücklage
 2. Rücklage für eigene Anteile
 3. satzungsmäßige Rücklagen
 4. andere Gewinnrücklagen
- IV. Gewinnvortrag/Verlustvortrag
- V. Jahresüberschuß/Jahresfehlbetrag

B. Rückstellungen

1. Rückstellungen für Pensionen und ähnliche Verpflichtungen
2. Steuerrückstellungen
3. sonstige Rückstellungen

C. Verbindlichkeiten

1. Anleihen, davon konvertibel
2. Verbindlichkeiten gegenüber Kreditinstituten
3. erhaltene Anzahlungen auf Bestellungen
4. Verbindlichkeiten aus Lieferungen und Leistungen
5. Verbindlichkeiten aus der Annahme gezogener Wechsel und der Ausstellung eigener Wechsel
6. Verbindlichkeiten gegenüber verbundenen Unternehmen
7. Verbindlichkeiten gegenüber Unternehmen, mit denen ein Beteiligungsverhältnis besteht
8. sonstige Verbindlichkeiten, davon aus Steuern davon im Rahmen der sozialen Sicherheit

D. Rechnungsabgrenzungsposten

APPENDIX II

CONSOLIDATED PROFIT AND LOSS ACCOUNT – BRITISH HOLDINGS PLC

Year ending 31 December

	NOTE	20X1 £'000	20X1 £'000	20X0 £'000
TURNOVER				
Continuing operations		XXX		
Acquisitions		XX		
		XXX		
Discontinued operations		XXX		
Total turnover			XXX	XXX
Less: share of joint ventures			(XX)	(XX)
GROUP TURNOVER			XXX	XXX
Cost of sales			(XXX)	(XXX)
Gross profit			XXX	XXX
Distribution costs			(XXX)	(XXX)
Administrative costs			(XX)	(XX)
OPERATING PROFIT				
Continuing operations		XX		
Acquisitions		X		
		XX		
Discontinued operations		(XX)		
Less release of provision made in 19XX		XX		
Group operating profit		XX		
Share of operating profit in joint ventures and associate undertakings		XX		
Total operating profit			XX	XX
Profit on sale of properties in continuing operations			X	X
Provision for loss on operations to be discontinued				(XX)
Loss on disposal of discontinued operations		(XX)		
Less release of provision made in 19XX		XX		
			X	
Profit on ordinary activities before interest			XX	XX
Interest payable			(XX)	(XX)
PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION			XX	XX
Tax on profit on ordinary activities			(XX)	(X)
PROFIT ON ORDINARY ACTIVITIES AFTER TAXATION			XX	XX
Minority interests			(X)	(X)
Profit before extraordinary items			XX	XX
Extraordinary item			(X)	
PROFIT FOR THE FINANCIAL YEAR			XX	XX
Dividends paid and proposed including amounts in respect of non-equity shares			(X)	(X)
Difference between non-equity finance costs and dividends			(X)	(X)
Profit retained, transferred to reserves			XX	XX
Earnings per share			XXp	XXp
Adjustments [to be itemised and an adequate description given]			Xp	Xp
Adjusted earnings per share			XXp	XXp
[Reason for calculating adjusted earnings per share]				
Diluted earnings per share			XXp	XXp

PROFIT AND LOSS ACCOUNT – GERMAN COMPANY

Format 1 – Expenses classified by their nature (*Gesamtkostenverfahren*)

Profit and loss account

1. Sales
2. Increase or decrease in of finished goods inventories and work in process
3. Own work capitalized
4. Other operating income
5. Cost of materials
 - a) Cost of raw materials, consumables and supplies and of purchased merchandise
 - b) Cost of purchased services
6. Personnel expenses
 - a) Wages and salaries
 - b) Social security and other pension costs, including in respect of old age pensions:
7. Depreciation
 - a) on intangible fixed assets and tangible assets as well as on capitalized start-up and business expansion expenses
 - b) on current assets to the extent that it exceeds depreciation which is normal for the company
8. Other operating expenses
9. Income from participations, of which from affiliated enterprises:
10. Income from other investments and long term loans, including relating to affiliated enterprises:
11. Other interest and similar income, including relating to affiliated enterprises
12. Amortisation of financial assets and investments classified as current assets
13. Interest and similar expenses, including relating to affiliated enterprises

Gewinn- und Verlustrechnung

1. Umsatzerlöse
2. Erhöhung oder Verminderung des Bestands an fertigen und unfertigen Erzeugnissen
3. andere aktivierte Eigenleistungen
4. sonstige betriebliche Erträge
5. Materialaufwand
 - a) Aufwendungen für Roh-, Hilfs- und Betriebsstoffe und für bezogene Waren
 - b) Aufwendungen für bezogene Leistungen
6. Personalaufwand
 - a) Löhne und Gehälter
 - b) soziale Abgaben und Aufwendungen für Altersversorgung und Unterstützung, davon für Altersversorgung
7. Abschreibungen
 - a) auf immaterielle Vermögensgegenstände des Anlagevermögens und Sachanlagen sowie auf aktivierte Aufwendungen für die Inangestaltung und Erweiterung des Geschäftsbetriebs
 - b) auf Vermögensgegenstände des Umlaufvermögens, soweit diese die in der Kapitalgesellschaft üblichen Abschreibungen überschreiten
8. sonstige betriebliche Aufwendungen
9. Erträge aus Beteiligungen, davon aus verbundenen Unternehmen
10. Erträge aus anderen Wertpapieren und Ausleihungen des Finanzanlagevermögens, davon aus verbundenen Unternehmen
11. sonstige Zinsen und ähnliche Erträge, davon aus verbundenen Unternehmen
12. Abschreibungen auf Finanzanlagen und auf Wertpapiere des Umlaufvermögens
13. Zinsen und ähnliche Aufwendungen, davon an verbundene Unternehmen

Profit and loss account

4. Results from ordinary activities

15. Extraordinary income
16. Extraordinary expenses
17. Extraordinary results
18. Taxes on income
19. Other taxes
20. Net income/net loss for the year

Gewinn- und Verlustrechnung

14. Ergebnis der gewöhnlichen Geschäftstätigkeit

15. außerordentliche Erträge
16. außerordentliche Aufwendungen
17. außerordentliches Ergebnis
18. Steuern vom Einkommen und vom Ertrag
19. sonstige Steuern
20. Jahresüberschuß/Jahresfehlbetrag

Format 2 – Expenses classified by function (*Umsatzkostenverfahren*)

- | | |
|---|---|
| 1. Sales | 1. Umsatzerlöse |
| 2. Cost of sales | 2. Herstellungskosten der zur Erzielung der Umsatzerlöse erbrachten Leistungen |
| 3. Gross profit on sales | 3. Bruttoergebnis vom Umsatz |
| 4. Selling expenses | 4. Vertriebskosten |
| 5. General administration expenses | 5. allgemeine Verwaltungskosten |
| 6. Other operating income | 6. sonstige betriebliche Erträge |
| 7. Other operating expenses | 7. sonstige betriebliche Aufwendungen |
| 8. Income from participations, of which from affiliated enterprises: | 8. Erträge aus Beteiligungen, davon aus verbundenen Unternehmen |
| 9. Income from other investments and financial assets, including relating to affiliated enterprises | 9. Erträge aus anderen Wertpapieren und Ausleihungen des Finanzanlagevermögens, davon aus verbundenen Unternehmen |
| 10. Other interest and similar income, including relating to affiliated enterprises | 10. sonstige Zinsen und ähnliche Erträge, davon aus verbundenen Unternehmen |
| 11. Amortisation of financial assets and investments classified as current assets | 11. Abschreibungen auf Finanzanlagen und auf Wertpapiere des Umlaufvermögens |
| 12. Interest and similar expenses, including relating to affiliated enterprises | 12. Zinsen und ähnliche Aufwendungen, davon an verbundene Unternehmen |
| 13. Results from ordinary activities | 13. Ergebnis der gewöhnlichen Geschäftstätigkeit |
| 14. Extraordinary income | 14. außerordentliche Erträge |
| 15. Extraordinary expense | 15. außerordentliche Aufwendungen |
| 16. Extraordinary results | 16. außerordentliches Ergebnis |
| 17. Taxes on income | 17. Steuern vom Einkommen und vom Ertrag |
| 18. Other taxes | 18. sonstige Steuern |
| 19. Net income/net loss for the year | 19. Jahresüberschuß/Jahresfehlbetrag |

APPENDIX III

CONSOLIDATED CASH FLOW STATEMENT – BRITISH HOLDINGS PLC

Year ended 31 December

	NOTE	20X1 £'000	20X0 £'000
NET CASH FLOW FROM OPERATING ACTIVITIES (NOTE [])		<u>XX</u>	<u>XX</u>
RETURNS ON INVESTMENTS AND SERVICING OF FINANCE			
Interest received		X	X
Interest paid		(XX)	(XX)
Interest element of finance lease rentals payments		(X)	(X)
Dividend received from associated undertaking		X	X
Net cash outflow from returns on investments and servicing of finance		<u>(XX)</u>	<u>(XX)</u>
TAXATION			
UK corporation tax paid		(XX)	(XX)
Overseas tax paid		(X)	(X)
Tax paid		<u>(XX)</u>	<u>(XX)</u>
CAPITAL EXPENDITURE AND FINANCIAL INVESTMENT			
Payments to acquire tangible fixed assets		(XX)	-
Receipts from sale of tangible fixed assets		XX	X
Payments for additions to investments		(XX)	(X)
Receipts from sale of investments		XX	XX
Net cash inflow from capital expenditure and financial investment		<u>X</u>	<u>X</u>
ACQUISITIONS AND DISPOSALS			
Purchase of subsidiary undertakings (see note [])		(X)	-
Sale of business (see note [])		XX	X
Net cash inflow from acquisitions and disposals		<u>XX</u>	<u>X</u>
EQUITY DIVIDENDS PAID		<u>(XX)</u>	<u>(XXX)</u>
MANAGEMENT OF LIQUID RESOURCES			
Net movement in short term deposits		X	XX
Net purchase of short term investments		(X)	(X)
Net cash inflow from management of liquid resources		<u>X</u>	<u>XX</u>
FINANCING			
Issue of ordinary share capital		-	XX
Net repayment of loans		(XX)	(XX)
Capital element of finance lease rental payments		(X)	(X)
Net cash outflow from financing		<u>(XX)</u>	<u>(XX)</u>
DECREASE IN CASH AND CASH EQUIVALENTS		<u>(XXX)</u>	<u>(XX)</u>

RECONCILIATION OF NET CASH FLOW TO MOVEMENT IN NET DEBT
– BRITISH HOLDINGS PLC
Year ended 31 December

	NOTE	20X1 £'000	20X0 £'000
Net debt at the start of the year		(XXX)	(XXX)
Decrease in cash		(XXX)	(XX)
Net movements in short-term deposits		X	XX
Net purchase of short-term investments		(X)	(X)
Change in market value of investments		(X)	X
Net repayments of loans		XXX	XX
Foreign exchange effects		XX	X
Net debt at end of the year		<u>(XXX)</u>	<u>(XXX)</u>

CASH FLOW STATEMENT – GERMAN COMPANY (INDIRECT METHOD)

1.		Net income/loss for the period (including minority interest) before extraordinary items
2.	+/-	Depreciation on/write-ups to fixed assets
3.	+/-	Increase/decrease in accruals
4.	+/-	Other cash outflows/inflows (e.g. depreciation on discounts capitalised)
5.	-/+	Gain/loss on disposal of fixed assets
6.	-/+	Increase/decrease in inventories, trade receivables and other assets not related to investment or financing activities
7.	+/-	Increase/decrease in trade payables and other liabilities not related to investment or financing activities
8.	+/-	Cash inflows and outflows from extraordinary items
9.	=	Cash flow from current business activities (= total 1 to 8)
10.		Cash inflow from disposal of tangible assets
11.	-	Cash outflow from capital expenditure on tangible assets
12.	+	Cash inflow from disposal of tangible assets
13.	-	Cash outflow from investments in intangible fixed assets
14.	+	Cash inflow from disposal of financial assets
15.	-	Cash outflow from investments in financial assets
16.	+	Cash inflow from disposal of consolidated enterprises and other business units
17.	-	Cash outflow from acquisition of consolidated enterprises and other business units
18.	+	Cash inflow from financial investments within the scope of short-term cash management
19.	-	Cash outflow from financial investments within the scope of short-term cash management
20.	=	Cash flow from investment activities (= total 10 to 19)
21.		Cash inflow from equity contributions (capital increases, disposal of own shares, etc.)
22.	-	Disbursements to owners of the enterprise and minority shareholders (dividends, acquisition of own shares, repayment of equity capital, other distributions)
23.	+	Cash inflow from granting of loans and raising of (finance) loans
24.	-	Cash outflow from repayment of loans and (finance) loans
25.	=	Cash flow from financing activities (= total 21 to 24)
26.		Change in cash and cash equivalents (= total of 9, 20, 25)
27.	+/-	Changes in cash and cash equivalents on account of changes of exchange rates, to the group of consolidated entities and valuation-related changes
28.	+	Cash and cash equivalents at beginning of period
29.	=	Cash and cash equivalents at end of period (= total 26 to 28)



Liaison Resources

Deloitte Touche Tohmatsu provides audit, tax and consulting services to many companies operating throughout the world. In both Germany and in the UK, we have a large group of professionals skilled at serving German subsidiaries of UK companies, UK subsidiaries of German companies, UK companies and German companies involved in M&A activities across Europe, etc. We also have specialised support resources available to assist German companies doing business in the UK and UK companies doing business in the Germany.

Offices in the United Kingdom, Channel Islands and the Isle of Man

Aberdeen

66 Queen's Road, Aberdeen AB1 6YE
Tel: 01224 325375 Fax: 01224 313611

Belfast

19 Bedford Street, Belfast, Northern Ireland BT2 7EJ
Tel: 02890 322861 Fax: 02890 234786

Birmingham

Colmore Gate, 2 Colmore Row, Birmingham B3 2BN
Tel: 0121 200 2211 Fax: 0121 236 1513

Bracknell

Columbia Centre, Market Street, Bracknell, Berks RG12 1PA
Tel: 01344 54445 Fax: 01344 422681

Bristol

Queen Anne House, 69-71 Queen Square, Bristol BS1 4JP
Tel: 0117 921 1622 Fax: 0117 929 2801

Cambridge

Leda House, Station Road, Cambridge CB1 2RN
Tel: 01223 460222 Fax: 01223 350839

Cardiff

Blenheim House, Fitzalan Court, Newport Road, Cardiff CF2 1TS
Tel: 02920 481111 Fax: 02920 482615

Crawley

63 High Street, Crawley, West Sussex RH10 1BQ
Tel: 01293 510112 Fax: 01293 533493

Edinburgh

39 George Street, Edinburgh EH2 2HZ
Tel: 0131 225 6834 Fax: 0131 225 4049

Glasgow

39 St Vincent Place, Glasgow G1 2QQ
Tel: 0141 204 2800 Fax: 0141 221 1864

Leeds

10-12 East Parade, Leeds LS1 2AJ
Tel: 0113 243 9021 Fax: 0113 244 5580

Liverpool

Martins Buildings, 4 Water Street, Liverpool L2 8UY
Tel: 0151 236 0941 Fax: 0151 236 2877

London

Stonecutter Court, 1 Stonecutter Street, London EC4A 4TR
Tel: 020 7936 3000 Fax: 020 7583 1198

Hill House, 1 Little New Street, London EC4A 3TR
Tel: 020 7936 3000 Fax: 020 7583 8517

Manchester

201 Deansgate, Manchester M60 2AT
Tel: 0161 832 3555 Fax: 0161 829 3806

Milton Keynes

Ashton House, Silbury Boulevard, Central Milton Keynes MK9 2HG
Tel: 01908 666665 Fax: 01908 690510

Newcastle upon Tyne

Gainsborough House, 34-40 Grey Street, Newcastle upon Tyne NE1 6EA
Tel: 0191 261 4111 Fax: 0191 232 7665

Nottingham

1 Woodborough Road, Nottingham NG1 3FG
Tel: 0115 950 0511 Fax: 0115 959 0060

Southampton

Mountbatten House, 1 Grosvenor Square, Southampton SO1 2BE
Tel: 02380 334124 Fax: 02380 330948

St Albans

Verulam Point, Station Way, St Albans, Herts AL1 5HE

Tel: 01727 839000 Fax: 01727 831111

Jersey

P.O. Box 403, Lord Coutanche House, 66-68 Esplanade, St. Helier, Jersey,
Channel Islands

Tel: 01534 37770 Fax: 01534 34037

Guernsey

P.O. Box 137, St. Peter's House, Le Bordage, St. Peter Port, Guernsey,
Channel Islands GY1 3HW

Tel: 01481 724011 Fax: 01481 711544

Isle of Man

Grosvenor House, P.O. Box 250, 66/67 Athol Street, Douglas,
Isle of Man IM99 1XJ

Tel: 01624 672332 Fax: 01624 672334



Offices in Germany

Bahnstraße 16
40212 Düsseldorf

Tel. (0211) 87 72-01
Fax (02 11) 87 72-2 77

Schumannstraße 27
60325 Frankfurt am Main

Tel. (0 69) 7 56 95-01
Fax (0 69) 7 56 95-3 33

Georgstraße 52
30159 Hannover

Tel. (05 11) 30 23-0
Fax (05 11) 30 23-1 70

Isartorplatz 1
80331 München

Tel. (0 89) 2 90 36-0
Fax (0 89) 2 90 36-1 08/1 13

Weißburger Straße 20
63739 Aschaffenburg

Tel. (0 60 21) 3 86 61-0
Fax (0 60 21) 3 86 61-11

Werner-Haas-Straße 2
86153 Augsburg

Tel. (08 21) 5 68 69-0
Fax (08 21) 5 68 69-19

Katharina-Heinroth-Ufer 1
10787 Berlin

Tel. (0 30) 2 54 68-01
Fax (0 30) 2 54 68-2 07

Otto-Brenner-Straße 209
33604 Bielefeld

Tel. (05 21) 92 76-3 11
Tel. (05 21) 92 76-3 10

Theresienstraße 29
01097 Dresden

Tel. (0351) 8 11 01-0
Fax (0351) 8 11 01-99

Weihenstephaner Berg 4
85354 Freising

Tel. (0 81 61) 51-1 00
Fax (0 81 61) 51-1 25/5 55

Am Kirchtor 7 06018 Halle/Saale	Tel. (03 45) 21 99-6 Fax (03 45) 21 99-8 00
Neuer Wall 63 20354 Hamburg	Tel. (0 40) 3 77 00-4 Fax (0 40) 3 77 00-5 11
Czernyring 22/11 69115 Heidelberg	Tel. (0 62 21) 1 30-5 Fax (0 62 21) 1 30-6 06
Großer Brockhaus 1 04103 Leipzig	Tel. (03 41) 9 92 70 00 Fax (03 41) 9 92 71 00
Hasselbachplatz 3 39104 Magdeburg	Tel. (03 91) 5 68 73-0 Fax (03 91) 5 68 73-10
Q 5, 22 68161 Mannheim	Tel. (06 21) 1 59 01-0 Fax (06 21) 15 29 58
Willy-Brandt-Platz 20 90402 Nürnberg	Tel. (09 11) 2 30 74-0 Fax (09 11) 2 30 74-26
Wilhelmsplatz 8 70182 Stuttgart	Tel. (07 11) 1 65 54-01 Fax (07 11) 1 65 54-50



International Offices

Albania	Brazil	Denmark	Hong Kong
Algeria	British Virgin Islands	Dominican Republic	Hungary
Angola	Brunei Darussalam	Ecuador	Iceland
Anguilla	Bulgaria	Egypt	India
Argentina	Cambodia	El Salvador	Indonesia
Aruba	Cameroon	Estonia	Ireland
Australia	Canada	Finland	Isle of Man
Austria	Canada	France	Israel
Bahamas	Cape Verde Islands	The Gambia	Italy
Bahrain	Cayman Islands	Gaza Strip	Ivory Coast
Bangladesh	Channel Islands	Germany	Jamaica
Barbados	Chile	Ghana	Japan
Belarus	China	Gibraltar	Jordan
Belgium	Colombia	Greece	Kazakstan
Belize	Cook Islands	Greenland	Kenya
Bermuda	Costa Rica	Guam	Korea
Bhutan	Croatia	Guatemala	Kuwait
Bosnia & Herzegovina	Cyprus	Guyana	Laos
Botswana	Czech Republic	Honduras	Latvia
			Lebanon

Lesotho	Northern Mariana Islands	Switzerland
Libya	Norway	Syria
Lithuania	Oman	Taiwan
Luxembourg	Pakistan	Tanzania
Macau	Palau	Thailand
Macedonia	Panama	Trinidad & Tobago
Madagascar	Papua New Guinea	Tunisia
Malawi	Paraguay	Turkey
Malaysia	Peru	Turks & Caicos Islands
Malta	Philippines	Uganda
Marshall Islands	Poland	Ukraine
Mauritania	Portugal	United Arab Emirates
Mauritius	Qatar	United Kingdom
Mexico	Romania	United States
Micronesia	Russia and New Independent States	Uruguay
Moldova	San Marino	Venezuela
Mongolia	Saudi Arabia	Vietnam
Montenegro	Singapore	Yemen
Morocco	Slovak Republic	Zambia
Mozambique	Slovenia	Zimbabwe
Myanmar	South Africa	
Namibia	Spain	
Nepal	Sri Lanka	
Netherlands	Sudan	
Netherlands Antilles	Sweden	
New Zealand		
Nicaragua		
Nigeria		



Notes



Notes



Notes

This publication contains general information only and Deloitte & Touche (UK) and Deloitte & Touche GmbH Wirtschaftsprüfungsgesellschaft (Germany) are not, by means of this publication, rendering accounting, business, financial, investment, legal, tax or other professional advice or services. This publication is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business or your clients' businesses. Before making any decision or taking any action, you should consult a qualified professional advisor. Please contact any Deloitte Touche Tohmatsu firm for further information.

Neither Deloitte & Touche (UK) nor Deloitte & Touche GmbH Wirtschaftsprüfungsgesellschaft (Germany) shall be responsible for any loss sustained by any person or entity who relies on this publication.

The authors express their gratitude to all their colleagues participating in this project both in Germany and the UK. We are particularly grateful to Andy Simmonds for his technical advice and Michael Barber for his help in co-ordinating our efforts across the borders.

© Deloitte & Touche 2001. All rights reserved.

Design, typesetting and electronic film output by the Deloitte & Touche Studio, London.

