Differences between IFRS and German GAAP

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IFRS

History

Many of the standards forming part of IFRS are known by the older name of International Accounting Standards (IAS). IAS were issued between 1973 and 2001 by the Board of the International Accounting Standards Committee (IASC). In April 2001, the new IASB took over from the IASC the responsibility for setting International Accounting Standards. During its first meeting the new Board adopted existing IAS and SICs. The IASB has continued to develop standards calling the new standards IFRS[1].

Accounting Framework and accounting principles

The only applicable standards are the International Financial Reporting Standards (IFRS) adopted by the International Accounting Standards Board (IASB). The valuation at historical cost is the primary basis of accounting. However, IFRS permits the revaluation to fair value of intangible assets, property, plant and equipment, investments property and inventories. IFRS also requires that certain categories of financial instruments and certain biological assets be reported at fair value[2].

Companies can deviate from a standard according to IFRS, if the company's management determines that compliance with the standard or interpretation would be misleading financially. The reasons for such a conclusion and departure and the financial implications must be disclosed[3].

For the first time after adopting the accounting frameworks, a full retrospective application of all IFRS effective from the reporting date for an entity’s first IFRS financial statements,

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[1] Source: www.wikipedia.org
[2] Source: www.pwc.com
[3] Source: www.pwc.com

with some optional exemptions and limited mandatory exceptions has to be performed. Almost all adjustments arising from the initial application of IFRS are adjusted and plotted against opening retained earnings for the first period of an IFRS basis. Some adjustments can be made to goodwill or other classes of equity[4].

German GAAP

History

Precursor to the Commercial Code was the General German Commercial Code (ADHGB) of 1861. The Commercial Code was adopted in May 1897, and joined together with the Civil Code in January 1900 in force. Currently, the commercial law is strongly influenced by the legislation of the European Union[5].

Legislative changes had a major impact on the HGB in the past; the main changes were the introduction of the Handelsrechtsformgesetz (HRefG) in 1998, the introduction of the Gesetz zur Kontrolle und Transparenz im Unternehmensbereich (KonTraG) in 1998, the introduction of the Transparenz- und PublizitätsGesetz (TransPuG) in 2002, the introduction Bilanzrechtsformgesetz (BilReG) in 2004 an the Bilanzrechtsmodernisierungsgesetz (BilMoG) in 2009.

Accounting Framework and accounting principles

The only applicable standard is the Commercial Code (HGB). The valuation at historical cost accounting convention is the most important when using German GAAP. There are no revaluations allowed. An exception applies to banks / financial institutions, where all financial instruments are held for trading to be carried at fair value. A second exception applies to assets that are withdrawn from all other creditors and only accessed to the pension liability or comparable long-term liabilities. You must also be accounted for at fair value.

If the result of special circumstances in the financial statements does not give a true and fair view, additional information in the notes is required.

[4] Source: www.pwc.com
[5] Source: www.wikipedia.org

Comparison between IFRS and German GAAP

Components of financial statements

In accordance with IFRS, financial statements have to consist of a statement of financial position, statement of comprehensive income, notes, statement of cash flows, statement of changes in equity and a management report. In accordance with German GAAP the balance sheet, profit and loss account, notes has to be part of the financial statements. Determined by the size of the company, the financial statements have to be extended by a management report. Furthermore, a cash flow statement and a statement of changes in equity are required for entities preparing consolidated financial statements or annual financial statements of publicly traded companies not presenting consolidated financial statements[6].

Assets

Internally generated intangible assets

In accordance with IFRS and German GAAP intangible assets that are developed or produced internally, the criteria to satisfy recognition (probability that future economic benefits will flow to the enterprise and the cost of the asset can be reliably determined). Difficulties in distinguishing most anticipated future economic benefits to the intangible assets which have to make the economy as a whole. General meaning of the difficulties in identifying internally generated intangible assets and the satisfaction of the recognition and measurement criteria found that such assets are either indistinguishable from the rest of the company or are not measured reliably.

Intangible assets

In accordance with IFRS regulations the initial recognition of intangible assets are stated at cost, all of which can be directly attributed or allocated to meet creating, producing and preparing the asset from the date of recognition comprises. Subsequently, intangible assets are accounted for using the cost model or the revaluation model. Intangible assets may be finite or indefinite. Under German GAAP, intangible assets are initially measured at cost being paid the fair value of the consideration. Subsequently,

[6] Source: www.pwc.com

intangible assets are stated at historical cost depreciation. Revaluations are permitted only if the impairment is permanent.

<u>Property, plant and equipment</u>

In accordance with IFRS, the initial evaluation, real estate, machinery and equipment include the purchase price plus costs directly attributable to bringing the asset to the location and condition for its intended use. Under German GAAP, tangible assets, initially valued at acquisition or production costs.

<u>Investment Property</u>

Investment property can be accounted for by historical-cost bases, or on the basis of fair value under IFRS. The use at fair value, the gain or loss from a change in fair value in the profit and loss account and the carrying value is depreciated. The German GAAP has no specific guidance for an investment property. Such property is accounted for accommodation and tangible assets.

<u>Asset held for sale</u>

If an asset is in line with the criteria of IFRS from 5.6 to 14 it is classified as assets held for sale. The IFRS valuation takes the lower between book value and fair value less selling costs. Asset held for sale has no specific criteria under HGB.

<u>Capitalization of borrowing costs</u>

Under IFRS, borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset required to be part of the cost of the asset are capitalized. While determining the amount of borrowing costs that act directly to an otherwise qualifying asset is required due discretion. According to German GAAP, borrowing costs are recognized only to the extent that they may be used to finance the production of an asset and if they directly affect the production period. Capitalization of borrowing costs that are prohibited at cost.

<u>Inventories</u>

In accordance with IFRS, inventories are valued by lower cost and net realizable value. The evaluation model of first-in, first-out and the weighted average method is used to determine costs. Last-In-First-Out is prohibited. Cancellation is required for the subsequent appreciation of the recent depreciation. Under German GAAP, valuation at the lower of assessed market value is not required. As for production costs, materials, directing, producing; special manufacturing costs and a reasonable share of indirect costs, that have directly to the manufacturing process, must be capitalized. Research costs and marketing costs are excluded from capitalization. The evaluation model of the last-in, first out, first in, first out and weighted average can be used. Also, constant values can be used under certain conditions.

Equity and liabilities

Equity

In accordance with IFRS equity is the remaining balance of the assets of the entity after deducting all liabilities. An equity instrument is only available if the investor has no individual entitlement to repayment of the invested capital. A financial liability is recognized, if the issuer of a financial instrument has the right to repurchase, or the instrument for cash or other financial assets. Special rule for redeemable capital stock of the Issuer qualify as equity if certain criteria are met, contrary to general rules. Under German GAAP equity has the same definition as under IFRS (the remaining balance of the assets of the entity after deducting all liabilities). Under German GAAP, the equity position has to be qualified subordination, full of loss sharing, performance-based compensation and long-term capital commitment.

Provisions

Under IFRS a provision is recorded if three criteria are met. The first criterion is that, it is an obligation from a past event. The commitment must be probable and a reliable estimate can be made. The term is probably describes a situation in which the result will more than likely occur. In general, the more words for it than not be called a chance of more than 50%. Recognition criteria for provisions under German GAAP to IFRS are similar. Provisions for contingent liabilities must be recognized, expected losses from executor contracts, necessary repair and maintenance costs in the first three months of the end of the previous fiscal year. Expenses incurred for the removal of earth, and ensure buildings destroyed within the next year and incur expenses without legal or contractual obligation. For purposes other than the above mentioned, recognition of a provision is prohibited

Liabilities

According to IFRS, liabilities must be separated in financial liabilities and other liabilities. Financial liabilities are recognized when the entity becomes a party to the provisions of the instrument be. They are valued at fair value. Other liabilities of a company at amortized cost using the effective interest method. Under German GAAP, liabilities on its merits and its value liabilities of the company, in cash or tangible assets, are fixed.

Contingent liabilities

A contingent liability is a possible obligation whose outcome is limited only by the occurrence or non occurrence of one or more uncertain future events that are defined to be confirmed beyond the control of the company. A contingent liability is a present obligation that is not detected, because it is not probable that it may be an outflow of economic benefits, or the amount of run-off will not be evaluated reliably. They are discounted when the probability of outflows is unlikely. Under German GAAP, the management of contingent liabilities is similar to IFRS. You can issurance and transfer of notes, bonds, bills and checks of sureties and guarantees, and involve the granting of security for third party liabilities. Because of the importance of the precautionary principle, more terms are recognized as provisions reveals, not just a coincidence.

Other relevant issues

Leasing

The classification of leases under IFRS will depend on the substance of the transaction not the form of the contract. A finance lease is a lease, the asset is substantially all risks and rewards of ownership in one. Several criteria should be taken into account (useful life, present value criteria) are otherwise apply to operating leases. There are no specific regulations and economic classifications under German GAAP.

Deferred taxes

Both GAAP' s the recognition of deferred tax follow the temporary concept. This means that, only the differences between book value and tax value of assets and liabilities and deferred taxes. According to estimates of the difference in tax rates expected to apply for the period when the asset is realized or the liability is settled, based on tax rates that have been enacted or adopted in substance from the balance sheet date, are added.