

Finance & Investment



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Any company doing business in Germany is subject to federal and state laws. A number of federal and state ministries are responsible for the regulation of industry and commerce. These include the Ministries of Economic Affairs, Justice, Social Affairs and Employment and Environmental Protection.

Requirements for doing business and trade

Requirements for doing business and trade The German constitution and the Commercial Code enable every German citizen to carry out a trade or business in Germany wherever he or she likes. This principle, however, is limited by the requirement to obtain a trade permit from the local trade office, which will be granted in general if the businessman or woman applying is at least 18 years of age, has full legal capacity and is a EU resident.

Before starting normal trade or business all the general conditions have to be met. For handicraft and craft businesses additional proof of qualification is required. There are also some trades that may only be carried out after a special licence has been granted. A foreign-owned business or trade may be set up in any part of the country. It will be subject

to the same rights and restrictions that apply to locally owned businesses.

Price controls

Under the Price Control Act the Federal Government can establish price ceilings. At the moment, however, there are only a few items that are subject to price controls, such as certain medicines.

Monopolies and anti-competitive practices

Germany provides for a basically competitive business environment.

Regulations ensuring a competitive environment are set out in the law against unfair competition (*Gesetz gegen unlauteren Wettbewerb – UWG*). The main provisions are:

- Information on goods must be true, correct and not misleading
- Comparative advertising is only allowed under certain restrictions
- Special sales and discounts are allowed only under certain circumstances.

Other regulations ensuring a competitive environment are set out in the law against restraints on competition (*Gesetz gegen Wettbewerbsbeschränkungen – GWB*). The Federal Cartel Office, for example, can prohibit agreements between companies which result in a restraint of trade. This office may also intervene in cases of concerted conduct or conscious parallelism (*abgestimmtes Verhalten*) between firms, and in cases of

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discrimination or boycotts against competitors.

Mergers

Fundamentally companies are free to merge in Germany. There are, however, restrictions set out in the law against restraints on competition.

Mergers have to be reported to the Federal Cartel Office if at least one of the companies involved in the merger meets certain size and market share criteria. If a dominant position in the market would be obtained or strengthened, the office may prohibit the merger or acquisition, or even require a segregation of the companies involved. The ruling of the Federal Cartel Office can be overruled by the Federal Minister of Economic Affairs. In this case, special permission for a merger can be issued by the Minister of Economic Affairs, if the advantages to the German economy as a whole would be more important than the restraint of trade.

The legislation of the European Community in the area of fair trade practices and against monopolies must be observed, also the national anti-monopoly regulations and the extensive case law on these issues. This is enforced by the European Commission's Competition Directorate, which is allowed to impose fines on companies that do not comply with these regulations.

If a merger affects competition in other

EU countries, EU authorities must approve or disallow the merger. If the EU authorities approve a merger, Germany cannot enforce its domestic law to the contrary, unless the EU authorities delegate jurisdiction over the case to the German Federal Cartel Office.

Consumer and environmental protection

Despite the existence of a single European market, consumer and environmental protection seems more important in Germany than elsewhere. The main areas of consumer protection include product liability, labelling of products, advertising, guarantees and warranties and consumer rights, and duties with respect to instalment sales contracts. According to civil law, certain clauses in the general conditions of commercial enterprises are deemed to be unfair if they are applied to contracts between commercial enterprises and consumers. The supply of certain goods requires the prior approval of state bodies (e.g. drugs) or is subject to control (e.g. food products).

Matters of environmental protection have become more and more important during the past few years. The legislation in this field covers the protection of the quality of water and air, and is also aimed at the reduction of noise levels. Special industrial plants, for example, which could endanger the quality of water or air, or which can produce too much noise, can only be installed after a special licence has been granted. All such plants and business operations are subject to state

supervision, and in some cases to federal supervision. Companies and managers operating such industrial plants can be liable for damage caused to the environment. In some cases the law provides for fines and penalties. Foreign investors intending to operate such plants need to make themselves familiar with these strict German laws for environmental protection.

Import and export controls

In general Germany enjoys free foreign trade, according to which imports and exports are usually not restricted. Certain laws and governmental directives impose special restrictions, however, particularly on sensitive goods such as arms or nuclear equipment. Germany imposes no import restrictions or licensing requirements, except for a few sensitive products such as wildlife products of protected species. German requirements relating to food and drug labelling, packaging, trademarks etc. may sometimes constitute import barriers.

Since Germany is a member of the European Union, special import and export regulations determined by the European Commission are also applicable for trade to and from Germany. Within the EU, customs duties have been abolished. The EU member countries apply a common external tariff to imports from outside the EU. However, the EU has entered into numerous preferential trade agreements with other countries by which import duties are considerably reduced

or abolished. Germany is also member of the World Trade Organisation (WTO).

Exchange controls

The euro is freely convertible into foreign currencies. The Federal Government can impose, under certain conditions, restrictions on foreign money or loan capital coming into Germany by requiring a cash deposit with the Federal Central Bank (Deutsche Bundesbank), if this is not prohibited by existing EU regulations. At present there are no such restrictions in force.

There are, however, extensive reporting requirements for statistical purposes to be met on:

- Purchase and sale of a participation in foreign companies and branches by residents
- Purchase and sale of a participation in domestic companies and branches by non-residents
- Payments, liabilities and claims between residents and non-residents.

Banking and local finance

Banking system

The Deutsche Bundesbank is the central bank of Germany, regulating the money supply in Germany and insuring settlement of international payments. It is independent of government and maintains nine regional offices (Hauptverwaltungen). Since January 1999, the responsibility of the Deutsche Bundesbank for monetary and currency

policy has been transferred to the European Central Bank in Frankfurt. The Deutsche Bundesbank has become an integral part of the European system of central banks.

The banking system is well developed and is one of the most dynamic sectors in the German economy. Many of the major banks have a large number of branch offices throughout the country, good international relations, and subsidiaries, branches or representative offices in many foreign countries.

Germany has a universal banking system, which means that German banks are typically engaged in the full scale of banking activities, providing a complete range of services. Recent developments have led to the founding of direct (internet) banks without expensive offices, but with phone and computer access. The most important types of banks are: the big private banks which operate nationwide (e.g. Deutsche Bank, HypoVereinsbank, Dresdner Bank, Commerzbank), state dependent banks with special knowledge and a function for setting up businesses, and savings banks.

Another recent development is the increased competition between banks and insurance companies. As banks become engaged in the insurance business, some insurers want to provide a full range of financial services and are, therefore, engaged in banking business either in the form of co-operation with,

or shareholdings in, banks.

Banking secrecy

According to the contracts between banks and their customers, banks are not allowed to disclose or make use of secrets that have been entrusted or made accessible to them by their customers. Exceptions are limited to cases where criminal proceedings have been instituted. German banking secrecy also applies in relation to the tax authorities. The tax authorities can, however, request information from a German bank in relation to a specific person who is subject to German tax liability, if criminal proceedings have already been instituted because of presumed tax fraud, or in cases in which that person did not provide the requested information. In recent years, private investment in Luxembourg was a major field of investigation by tax auditors, and banking secrecy did not prohibit disclosure in most cases.

Banking regulations and banking supervision

Banking in Germany (domestic and foreign banks) is extensively regulated under the Banking Act, which aims to protect customers. The enforcement of the regulations contained in the Banking Act is closely supervised by the Federal Supervisory Agency for Banks in Berlin.

Equity markets

Equity markets are well developed in Germany. The Frankfurt stock exchange ranks second in Europe after the International Stock Exchange in London

and has a computer market as well as floor trading. Regional stock exchanges operate in Berlin, Bremen, Hannover, Hamburg, Düsseldorf, Munich and Stuttgart. Going public has become a normal financing option for larger companies. The activities of the stock market are regulated by the stock exchange law and by special regulations.

Accounting and audit requirements

Statutory requirements

Most of the EU directives on accounting are incorporated in the third Part of the Commercial Code. The first Chapter of the law contains provisions for all legal forms and types of businesses relating to bookkeeping rules, the preparation of financial statements and the valuation of assets and liabilities.

The second Chapter of the law contains specific provisions relating to the form and content of financial statements, consolidated financial statements and statutory audit and disclosure requirements which apply to entities such as joint-stock companies (AG), partnerships limited by shares (KGaA) and limited-liability companies (GmbH), and to certain general partnerships (OHG) and limited partnerships (KG) where there is not at least one individual as general partner (especially GmbH & Co. KGs) or OHGs, KGs or other partnerships as general partner with not at least one individual as general partner. In addition, some specific rules can be found in

special laws and for certain industries as for example in the Joint-Stock Company Act (AktG), the Limited-Liability Companies Act (GmbHG), the Banking Act (KWG) and Insurance Supervisory Act (VAG).

In principle, tax accounting is based on the commercial accounts. There may be deviations resulting from tax law. However, tax law frequently requires that options taken for tax purposes (e.g. accelerated depreciation) also be considered in the commercial accounts. Therefore, companies usually account in accordance with their preferred tax results, and see if it fits with the following demands of commercial accounting.

Accounting requirements for all businesses

Preparation of financial statements

All businesses, with the exception of certain small trade businesses, are required to keep books and records in accordance with generally accepted accounting principles (*Grundsätze ordnungsmässiger Buchführung – GOB*) and to prepare financial statements, including a balance sheet, a profit and loss statement and for companies and certain general and limited partnerships also the notes to the financial statements. The books and records and the financial statements must be drawn up in such a way that an independent expert can obtain an overview of the assets and liabilities and an insight into the

operations of the business within a reasonable time. Books and records must be kept in a living language and financial statements must be prepared in the German language using the euro as the unit of account (before 1 January 2002 the use of the Deutsche Mark was also allowed). Entries into the books must be made in a complete, correct, chronological and orderly form. The financial statements must be prepared within a reasonable time after the end of the fiscal year. The fiscal year is specified in the statutes of the company. It can comprise less than 12 months in the case of start-ups, but never more than 12 months.

Contents of financial statements

In general all assets, liabilities, reserves, revenues and expenses must be recorded completely. Some specific items to be included in financial statements include the following:

- Intangible fixed assets acquired for a consideration must be capitalised;
- Purchased goodwill can be capitalised. Any amount capitalised must be written down over a four-year period, or in accordance with its expected useful life. Income tax law requires capitalisation and permits a write-off of purchased goodwill over a 15-year period;
- Full pension obligations resulting from direct pension promises must be accrued;
- Necessary repairs and maintenance carried out within the first three months of the following financial year

must be accrued;

- Guarantee expenses that are incurred without contractual obligation must be accrued;
- Necessary industrial reclamation costs must be accrued, in so far as the expenses are incurred during the following fiscal year.

Accounting methods

Besides the double-entry bookkeeping system (*Doppelte Buchführung*), in exceptional cases an open-item system (*Offene-Posten-Buchhaltung*), an EDP-based bookkeeping system (EDV-Buchhaltung) and a looseleaf bookkeeping system (*Loseblatt-Buchführung*) are allowed if certain requirements are met.

Inventory methods

Inventories of goods must be counted, measured and recorded in the books at the balance sheet date. Permanent stocktaking is acceptable if certain requirements are met. For movable fixed assets a physical stocktake must be performed at each balance sheet date, unless permanent records are maintained.

Valuation principles for valuation of assets and liabilities

The major valuation principles are as follows:

- The values included in the opening balance sheet of one fiscal year must

agree with those of the closing balance sheet of the preceding fiscal year;

- The valuation should assume the going concern principle, if not prohibited de facto or de jure;
- Assets and liabilities must be valued at the balance-sheet date on an item by item basis;
- Values must be determined prudently, all foreseeable risks and losses that have arisen up to the balance-sheet date must be taken into account, even if these become known only between the balance-sheet date and the date on which the financial statements are prepared. Profits may only be taken into account if they have been realised by the balance-sheet date;
- Income and expenses of the fiscal year must be shown in the profit and loss account, regardless of when they are received or paid;
- The valuation methods applied in the preceding financial statements should be retained.

Fixed assets are to be valued at their purchase price or manufacturing cost and depreciated over their useful lives according to generally accepted depreciation methods. An extraordinary depreciation charge is required in the case of a permanent diminution in value, or to adjust to a lower value for income tax purposes. Extraordinary depreciation is recaptured up to the amount of historic cost if the value increases again. Current assets are to be valued at the lower of

cost and market value, or a lower value permissible for income tax purposes. Recapture up to the amount of historic cost is necessary in cases of an increase in value. Share capital must be stated at par value. Liabilities are to be valued at the repayment amount. For tax purposes non-interest bearing liabilities must be shown at their discounted net present value. Accruals must be set up at amounts deemed necessary according to reasonable business judgement.

Retention of documents and retention period

All businesses are obliged to retain books of account, inventories, opening balance sheets, financial statements, management reports as well as descriptions of procedures and other organisational matters to understand the foregoing, correspondence received, copies of outgoing correspondence and accounting documents for ten years.

Accounting, audit and disclosure requirements for companies and certain partnerships

Categorisation of companies and certain partnerships

For accounting, audit and disclosure requirements companies and certain partnerships are classified as small companies, medium-sized companies or large companies, depending on their balance-sheet totals, their turnover and the average number of staff employed. If

the shares of a company are quoted on a stock exchange it is always presumed to be large.

In December 2003 the German Ministry of Justice introduced a Bill, which will probably be enacted towards the end of 2004, regarding the introduction of international accounting standards and the safeguard of audit quality (Bilanzrechtsreformgesetz). This Bill provides among other things for an increase in the minimum balance-sheet totals and turnover.

Accounting requirements

Companies and certain general partnerships (OHG) and limited partnerships (KG) where there is not at least one individual as general partner (especially GmbH & Co. KGs) have to fulfil all requirements set out in the first part of the third Part of the Commercial Code – as described above – which are applicable to all businesses (that is sole proprietorships, partnerships and other non-corporate companies). In addition, they have to fulfil more specific provisions set out in the second Chapter of the third Part of the Commercial Code.

Preparation of financial statements

The managers or the board of directors of German companies and certain partnerships are obliged to prepare financial statements consisting of a balance sheet, a profit and loss statement, notes to the accounts (Anhang) and a management report

(Lagebericht) within the first three months after the end of the fiscal year. If the company is categorised as small the period of time is extended to six months.

Additional classification requirements

Some of the additional classification requirements for companies and certain partnerships are:

- A clear and more flexible classification is prescribed with simplification permitted for smaller companies;
- Fixed assets are to be shown using the gross method, with accumulated depreciation as a deduction from assets acquisition cost;
- A holding company associate relationship is presumed if the shareholding exceeds 20 %;
- Additional information is required for debt or balances with a maturity of more than one year, and for liabilities with a maturity of less than one year;
- The total liabilities with a remaining term of more than five years must be disclosed in the notes to the financial statements;
- The provision for doubtful debts must be deducted from the total amount of trade debtors;
- Companies' capital is divided into subscribed capital (gezeichnetes Kapital), capital reserves (Kapitalrücklage) revenue reserves (Gewinnrücklagen), retained profits/ accumulated losses brought forward (Gewinnvortrag/Verlustvortrag) and net income/ net loss of the year (Jahresüberschuss/Jahresfehlbetrag);

- The capital of certain partnerships is divided into capital shares (Kapitalanteile), reserves (Rücklagen) retained profits/accumulated losses brought forward and net income/ net loss of the year;
- The profit and loss statement can follow the type of expenditure format (Gesamtkostenverfahren) or the operational format (Umsatzkostenverfahren).

Comparative figures for the previous year must be shown in the balance sheet and the profit and loss statement.

Additional items in the financial statements and additional valuation principles (examples):

- Companies have an option whether to capitalise business start-up expenses, with an equivalent limitation on distributions;
- They have an option to capitalise deferred taxes with an equivalent limitation on distributions;
- There is an additional requirement to accrue deferred tax liabilities;
- In specific cases, tax law provides tax advantages – for example higher depreciation rates – but these will only be allowed if the same value has been used as a basis for the financial statements;
- Extraordinary depreciation of intangible and tangible assets is only allowed where a permanent impairment in value is recorded. An extraordinary depreciation on

financial assets does not require a permanent diminution in value;

- There is a requirement to reinstate original values where the reasons for earlier write-downs no longer exist.

Management report

The management report has to present the development and the situation of the company in such a manner as to provide a true and fair view. The management report has to deal with risks of future developments. Furthermore the management report has to give information about the events subsequent to the end of the fiscal year, the prospective developments, research and development activities and segments of the company.

Audit requirements

The financial statements, including the notes and the management report, of medium-sized and large companies must be examined by an auditor. The audit must be of sufficient scope to determine whether the accounting regulations and additional terms of the articles of association have been observed and to detect in the ordinary course of examination major errors and violations of the abovementioned provisions. The financial statements, including the notes and the management report, have to be examined to check whether they are in compliance with the auditor's report and provide a true and fair view of the net worth, the financial position and the results of the company. Furthermore the

auditor has to examine whether the risks of future developments to be stated in the management report have been presented appropriately.

The Bill of December 2003 mentioned earlier, regarding the introduction of international accounting standards and the safeguard of audit quality (Bilanzrechtsreformgesetz) provides that an auditor shall be excluded from the audit of a company if he renders certain advisory and other services to this company. These inadmissible services comprise the bookkeeping and drawing up of financial statements – this is already the case according to current law –, management and financial services, actuarial services and evaluation services provided these services are not of secondary importance. In case of companies of public interest (capital market companies, banks, insurance companies) auditors are excluded from the audit if they render legal and tax advisory services that have a creative and significant influence on the net assets, financing and results of operations of the company, and also if they provide legal representation and if they have a considerable role in the introduction of IT systems of accounting.

Disclosure requirements

Large companies have to file their financial statements together with the auditor's report with the Commercial Register. In addition, they have to publish their financial statements in the Federal

Gazette (*Bundesanzeiger*). There are certain simplifications for medium-sized and for smaller companies as far as the publication rules are concerned.

Branches of foreign banks and corporations situated in the EU and EEA are allowed to submit their financial statements, the management report as well as the consolidated financial statements and consolidated management report of their main office in the English language, provided that German is not the official language at the seat of the main office.

Consolidated financial statements

The Commercial Code requires a domestic parent company and certain partnerships to prepare consolidated financial statements to the extent that there exists a relationship to a subsidiary enterprise of uniform control and, additionally, a participation in the form of a qualifying shareholding (normally exceeding 20 % of the nominal capital). The requirement to prepare consolidated financial statements always exists – i.e. it cannot be refuted in the case of

- holding a majority of the voting rights,
- a controlling personal influence,
- a domination contract,
- a controlling influence based on a by-law provision.

The consolidated financial statements consist of a consolidated balance sheet, a consolidated profit and loss statement and supplementary notes to the

consolidated financial statements. In addition, companies are required to publish a management report giving a true and fair view of the development of the business and of the future prospects of the group. The accounting methods for consolidated statements include the consolidation of capital and investments in subsidiaries, the elimination of inter-company balances, the elimination of unrealised inter-company gains or losses and separate disclosure of minority interests. Companies are freed from the requirement to prepare consolidated financial statements only if certain limits of balance sheet totals, turnover or number of employees are not exceeded.

A parent enterprise that is at the same time a subsidiary of another parent enterprise resident in a Member State of the EU is not obliged to prepare consolidated financial statements if consolidated financial statements (including a group management report) of the parent enterprise, including an audit opinion or disclaimer opinion, are published in the German language in accordance with the relevant rules.

A parent enterprise cannot make use of this exemption if the parent enterprise to be exempted is a joint-stock company whose shares are admitted to trading on the official market or where shareholders whose participation exceeds certain percentages have applied for the preparation of consolidated financial

statements and a group management report no later than six months before the expiration of the fiscal year of the group of companies. If one parent enterprise owns at least 90 % of the parent enterprise to be exempted the exemption may be claimed only if the other shareholders have approved the exemption.

Up to 31 December 2004 certain quoted parent enterprises are not required to prepare consolidated financial statements and a group management report according to the provisions of the Commercial Code (HGB), provided that they prepare their consolidated financial statements and a group management report pursuant to internationally accepted accounting principles (IAS, US-GAAP) and publish them in the German language and in euros. According to an EU Regulation the application of IAS is mandatory for the preparation of consolidated financial statements of quoted companies from 1 January 2005 onwards.

This FactSheet has been prepared by BDO. Its aim is to provide background information for setting up and running a business in Germany in compliance with legislation in force in September 2004.

It is written in general terms and is not intended to be comprehensive. Before taking decisions advice should be sought from

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