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“Modernising“ commercial accounting law in Germany – effects on public sector accrual accounting?

An analysis of the federal government legislation on
the reform of the German Commercial Code



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Abbreviations

Art.	article
BGBI.	German Federal Law Gazette
BilMoG	“Bilanzrechtsmodernisierungsgesetz”, (Act to modernise commercial accounting law), legal status: Government draft, May 2008
BiRiLiG	“Bilanzrichtliniengesetz” (Act on accounting principles – transfer of 4., 5. and 8. EC directive) from 19 December 1985 (BGBI. I, p. 2355)
Cf.	compare
CIGAR	Comparative International Governmental Accounting Research
ComC	German Commercial Code, in German: “Handelsgesetzbuch” (HGB), from 10 May 1897, latest modification 23 October 2008 (BGBI. I, p. 2026); used as generic abbreviation for the German Commercial Code
DEB	double entry bookkeeping (with T-accounts)
EC	European Community
e.g.	for example
et seq(q).	and the following
GAAP	Generally Accepted Accounting Principles (in German: “GoB”)
GAPSAP	Generally Accepted Public Sector Accounting Principles (in German: “GoöB”)
GemHVO / GemHKVO	“Gemeindehaushaltsverordnung / Gemeindehaushalts- und Kassenverordnung” (Municipal accounting and budgeting code; in some federal states named like that – equal to KommHVO/KommHKVO)

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GG	“Grundgesetz” (Constitution of the Federal Republic of Germany), from 23 May 1949 (BGBl. p. 1), latest modification 28 August 2006 (BGBl. I, p. 2034)
GO	“Gemeindeordnung” (Municipal code; in some federal states named like that)
HGB	“Handelsgesetzbuch” (German Commercial Code), from 10 May 1897, latest modification 23 October 2008 (BGBl. I, p. 2026); abbreviation is used only for exact quotations of legislation; for generic references see “ComC”
HGrG	“Haushaltsgrundsätze-gesetz” (Law on budgetary principles for the federal government and the federal states), from 19 August 1969 (BGBl. I, p. 1273), latest modification 31 October 2006 (BGBl. I, p. 2407)
HGrGMoG	“Haushaltsgrundsätze-gesetzmodernisierungsgesetz” (Act to modernise the law on budgetary principles for the federal government and the federal states), legal status: Government draft, February 2009
IAS	International Accounting Standards
IFRS	International Financial Reporting Standards
IMK	“Innenministerkonferenz” (Conference of the Secretaries of the Interior of the German federal states)
IPSAS	International Public Sector Accounting Standards
KommHVO/ KommHKVO	“Kommunale Haushaltsverordnung / Kommunale Haushalts- und Kassenverordnung” (Municipal accounting and budgeting code; in some federal states named like that – equal to GemHVO/GemHKVO)
KSVG	“Kommunalselbstverwaltungsgesetz” (Municipal autonomy law; in some federal state – equal to GO)
KVerf	“Kommunalverfassung” (Municipal code; in some federal states named like that – equal to GO)

NKFG	“Neues Kommunales Finanzwesen Gesetz” (Law on the new municipal finance; in some federal state – equal to GemHVO)
p./pp.	page/pages
para.	paragraph
SME	small and medium-sized enterprises
US-GAAP	United States Generally Accepted Accounting Principles
vs.	versus

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1. Introduction

In view of the massive increase of public debt, governmental accounting in a broader sense – including the entire chain of activities: Budgeting → Accounting → Financial Reporting → Auditing¹ – has come under criticism and reform pressure in Germany over the last decade. So far there are four reactions on that situation by German governmental authorities. First, with reference to budgeting, new rules to limit or even to stop getting into public debt have been discussed and lately also enacted (see the work of the federalism commission II²). Second, from a pure technical point of view in accounting, a transition from (traditional administrative) cameral accounting technique to double entry bookkeeping with T-accounts (DEB) has started. In conjunction with that, third, there is a shift from a payment-orientated (cash) to resource-orientated (accrual) financial reporting.³ Fourth and last, which is relevant for both budgeting and auditing, there is now a tendency in German public sector of turning away from input-orientated budgetary planning and management, focusing now towards output-orientation.

1 As defined by *Chan/Jones/Lüder* (1996), p. 13.

2 Germany is a federal republic. Therefore, the federal states have in some political areas high autonomy and certain spheres of influence. The task of the “federalism commission” has been to adjust the relation between the Federation and the states governments. The idea was to reach a more efficient and faster policy-making by reducing participation of one player in legislation process and assigning political areas either to the Federation or to the federal states.

3 Due to the recording of revenues and expenditures in the income statement (and indirectly in the balance sheet) there is a connection between double entry bookkeeping and resource-orientation. However, the bookkeeping technique is not crucial. As it was proved by WALB, accrual / resource-orientated information could also be generated by adapting administrative cameral accounting. Cf. *Walb* (1926). In contemporary academic literature also see e.g. *Monsen* (2008). This was also the reason why the Secretaries of the Interior of the German federal states (which are responsible for municipal accounting) decided in favour of an option model. It permits local entities to decide between the so called “extended” cameral accounting (with a resource focus) and the double entry bookkeeping technique. Though, due to efficiency reasons and a higher fail-safety most federal states opted for the double entry bookkeeping method.

At the same time, also the accounting of enterprises in Germany changes: there is a strong influence of the International Financial Reporting Standards (IAS/IFRS) on commercial accounting. Some enterprises are already obliged to assess their annual financial statements according to international rules and regulations. Others do it voluntarily because they hope to gain essential advantages when raising “fresh capital” on the capital markets. Lately, there has been a bill to “modernise” the German Commercial Code (in German: “Handelsgesetzbuch” – abbreviation used in this paper: ComC) in the legislation process. The aim is to open the ComC for ideas and principles coming from the Anglo-Saxon accounting sphere. It is intended to introduce these ideas and principles into the ComC where it is reasonable and adequate without entailing the disadvantages of existing international accounting standards.

These two simultaneous trends – one in business and one in public sector accounting – and especially their potential relations are the content of this paper. CIGAR research should be devoted to “(1) identifying the attributes of governmental accounting systems; (2) defining what constitutes innovations; (3) documenting the process that generates and implements innovations; (4) tracking the consequences of innovations; and (5) tracing the diffusion of innovations internationally.”⁴ Guided by these ambitions, section 2 is summarising the status quo of accrual accounting reforms and by doing that it is providing a picture of the current accounting system in the entire German public sector. Then, in section 3 there is a brief report on the two new legal impulses on public sector accounting in Germany, namely the “act to modernise the law on budgetary principles” (HGrGMOG) and the “act to modernise commercial accounting law” (BiMoG). Both acts will definitely interact with each other. Therefore, it is necessary to consider both when analysing the development of public sector accounting in Germany. However, the paper will mainly focus on the latter and its possible impacts on the public sector accrual accounting (reforms), respectively. Selected areas of interests and the consequences will be highlighted in section 4. Subsequently, section 5 is dealing with the “mechanisms of action” or – in other words – the possible ways of impact of the BiMoG. For this purpose it is necessary to describe the different ways how the ComC had or still might have an influence on the public sector and to analyse the fitting of the

4 Cf. Chan/Jones/Lüder 1996, pp. 12 et seq.

ComC as a reference model in the public sector. The potential changes on both aspects caused by the BilMoG are added. Finally, based on the results of the analysis, further prospects on the development of public sector accounting in Germany are described, tracing the diffusion and putting it into an international context (section 6).

The transition to accrual accounting has fairly advanced only in the municipal sector in Germany. This is why it is necessary mainly focusing the following analysis on the municipalities. However, where possible, the paper tries to analyse the effects of the new legal regulations on the “core units” (the public entities without the “outsourced” public enterprises) of all German territorial authorities.

2. Status of accrual accounting reforms in the German public sector – Heterogeneity and need for standardisation

The German public sector is facing a time of fundamental transition from cash (the so called administrative cameralist's bookkeeping) towards accrual accounting.⁵ According to an international analysis undertaken by the Fédération des Experts Comptables Européens (FEE), it is common that accrual accounting is implemented first at a local level and only later transferred to national government level. "Local and regional public bodies follow some form of the accrual principles, even when the national government is still on a cash basis"⁶. This is also applicable for Germany.

It is important to mention that from a constitutional point of view the municipalities in Germany are not an independent subnational power; they are part of the federal states.⁷ Therefore it is also the Secretaries of the Interior of these states who decide on the accounting of the particular municipalities. Starting with a pilot scheme in the federal state of Baden-Württemberg in 1994⁸, more states (Hesse, Lower Saxony and North Rhine-Westphalia) followed to develop own accrual accounting "models" (in sense of principles, rules and procedures) for their municipalities the following years. Due to a sneaking reform process and the idea of diversification, resulting from the strongly "cultivated" German tradition of federalism, these models showed a broad

5 The accrual principle belongs to the so called frame principles that are equal in commercial and public sector accrual accounting. It says that revenues and expenditures should be recorded independently from the point of time when the linked cash in- or outflows occur.

6 Cf. *Fédération des Experts Comptables Européens (FEE)* (2007), p. 6.

7 The Federal Republic of Germany is characterised by the separation of state power between the Federation ("Bund") and the 16 state governments ("Länder"). The "Länder" are also in charge of the roughly 12.300 local authorities ("Kommunen"). Concerning the state and administrative structure of Germany, see *Budäus/Behm/Adam* (2003), pp. 282 et seqq.

8 The intention of this first pilot scheme in the city of Wiesloch was to prove that accrual accounting is applicable in German municipalities. The accounting model adopted in Wiesloch was scientifically monitored by LÜDER from the German University of Administrative Science Speyer and was therefore called "Speyer procedure" (in German: "Speyerer Verfahren"). The opening balance sheet of Wiesloch was published in 1996.

range of different solutions on specific accounting matters. In 2003 then, the responsible Conference of the Secretaries of the Interior of the federal states officially agreed on an overall conversion of German municipalities to accrual accounting and output orientation. The secretaries however could neither agree on a uniform accrual accounting model nor even on the technique to use. So double entry bookkeeping as well as the extended cameral accounting technique was permitted and all federal states could keep their “do-it-yourself” accounting models which they had developed so far. Aware of the resulting problems caused by heterogeneity, the secretaries made an effort to stop further diversification of accrual accounting methods by providing non-binding guideline texts that the subnational legislators should respect.⁹ However, none of the federal states stuck to the guidelines completely. Hence there was not a substantial standardising effect.

On the one hand almost all German federal states have now implemented accrual accounting on the municipal level (see table 1 – right column) and a large number of the local authorities have changed or are in the conversion phase. The remaining local authority districts will follow – with only few exceptions – during the next years. On the other hand, there is a situation in German (local) public sector accounting that might be called “legal confusion”. Three basic types of heterogeneity can be observed, especially on municipal level. First, there is the described heterogeneity with regard to the accounting style (extended cameral vs. double entry bookkeeping). That might be called a “technical heterogeneity”. In Hesse and Schleswig-Holstein local authorities can decide between these two basic styles. It is surprising that in Bavaria and Thuringia the local authorities can also keep the traditional administrative cameral accounting method (cash accounting) although this option was abandoned in the guideline texts in 2003. Secondly, the accrual municipal-juridical regulations on basis of double-entry-bookkeeping differ with regards to their implementation (“heterogeneity in content”). As it was proven by a research project¹⁰, there are no uniform local public sector accounting rules in German federal states concerning inclusion and valuation of assets and debts, the structuring of the integrated accounts and the rules how to reach a balanced budget. Third, there is a difference in the usage of technical expressions (“heterogeneity in terminology”) even when

9 Cf. particularly *Innenministerkonferenz der Länder* (2003).

10 Cf. *Glöckner/Mühlenkamp* (2009).

talking about the same contents. That contributes to a situation in which politicians, treasurers and academics are to some extent (according to their origin) not able to understand each other anymore.

The latest conversion from cash to accrual accounting currently takes place on federal states level or is planned there (see table 1 – central column). However, it is wrong to assume that federal states' governments automatically agreed on accrual accounting reforms on DEB basis when asking their municipalities to do so. So far only the states of Hesse and Hamburg have adapted or are still in process to adapt accrual accounting on a double entry bookkeeping base.¹¹ The triggers for the introduction of accrual accounting at state level resemble those at municipal level (an initial situation of deep indebtedness and the goal to achieve intergenerational justice). Also North Rhine-Westphalia and Bremen are working on an adaption of accrual accounting with double entry bookkeeping on federal state level.

Also the federal government took a low-key approach towards the modernisation of accounting. However, the 2006 report on efficiency in federal administration by the German Federal Court of Auditors was criticising the administrative cameral accounting technique underlining also the advantages of an accrual system based on double entry bookkeeping.¹² Contrary to this report, the federal government now decided to modernise accounting by adapting the extended cameral accounting technique (accrual accounting on the basis of cameral accounts) on federal government level.

11 Hamburg was the first state that disclosed an accrual opening balance in 2006 and the consolidated accrual accounts in 2008. However, the reforms focused only on accounting in a narrow sense so far. Hesse started earlier than Hamburg but is still working on the implementation of accrual accounting on the state level since Hesse is also reforming budgeting at the same time.

12 Cf. *Bundesrechnungshof* (2006), pp. 9 et seq.

	Federal states level	Municipal level
Baden-Württemberg	Accrual accounting (cameral base) ¹³ ?	Accrual accounting (DEB) ¹⁴
Bavaria	Traditional cash accounting ¹⁵	Option: Accrual accounting (DEB) or traditional cash accounting
Berlin	Accrual accounting (cameral base)	
Brandenburg	Accrual accounting (cameral base)	Accrual accounting (DEB)
Bremen	Accrual accounting (DEB) ?	Accrual accounting (DEB) ? Unclear if separate municipal accounting and budgeting law for Bremerhaven planned
Hamburg	Accrual accounting (DEB), first balance sheet and consolidated report on states level	
Hesse	Accrual accounting (DEB)	Option: Accrual accounting (cameral base or DEB)
Mecklenburg-Western Pomerania	Accrual accounting (cameral base)	Accrual accounting (DEB)
Lower Saxony	Accrual accounting (cameral base)	Accrual accounting (DEB)
North Rhine-Westphalia	Accrual accounting (DEB)	Accrual accounting (DEB)
Rhineland-Palatinate	Accrual accounting (cameral base)	Accrual accounting (DEB)
Saarland	Traditional cash accounting	Accrual accounting (DEB)
Saxony	Accrual accounting (cameral base)	Accrual accounting (DEB)
Saxony-Anhalt	Traditional cash accounting	Accrual accounting (DEB)
Schleswig-Holstein	Accrual accounting (cameral base)	Option: Accrual accounting (cameral base or DEB)
Thuringia	Traditional cash accounting	Option: Accrual accounting (DEB) or traditional cash accounting

Table 1: Overview of the status quo in the accounting reforms of federal states and municipal level

Source: Own table

13 Accrual accounting on the basis of cameral accounts = extended, output oriented cameral accounting.

14 DEB = Accrual accounting on the basis of double entry bookkeeping (with T-accounts).

15 Traditional cash accounting = Administrative cameral accounting.

3. An overview of the new legal impulses on public sector accounting in Germany

3.1 Act to modernise the law on budgetary principles for federal government and federal states (HGrGMoG)

3.1.1 Intention of the law – An attempt to reach better comparability

In 1969, a common law on budgetary principles for the Federal government and the federal states was adopted: the law on budgetary principles for federal government and federal states (“Haushaltsgrundsatzgesetz”, in the following abbreviated to “HGrG”). The aim of this law was to standardise federal states and central federal government accounting (in a broader sense) by providing compulsory common general principles and state accounting rules.¹⁶ However, confirmed by the German Federal Court of Auditors, there is now a need for a global approach that systematically faces the necessity, embodiment and implementation of a top-to-bottom state accounting reform in Germany¹⁷. The reason is that the HGrG was based exclusively on input budgeting as well as cash accounting. Though, as mentioned in the section before, there are federal states that were affected by the reforms in the municipal sector and also pushed then for an accrual accounting system on federal states level. According to § 33a HGrG^{current version} it was permitted to keep the state accounts on base of ComC and German commercial GAAP¹⁸ (that means to operate an accrual accounting system¹⁹), however, up to now it was obligatory to have a cash based, cameral accounting combined with a

16 The legislative competency of federal state in case of HGrG is founded by Art. 109 of the German Constitution (GG): “Via federal law, where an agreement of federal states council is necessary, federal government and federal states might establish principles for public sector accounting and budgeting law, (...)” Cf. Art. 109 GG, translated from German into English.

17 Cf. *Bundesrechnungshof* (2006), p. 13.

18 Generally Accepted Accounting Principles, in German: GoB.

19 When this paragraph was added to HGrG, there was no GAPSAP (public GAAP) or public sector accounting and budgeting code / principles on accrual basis the law could refer to. Therefore there is the reference to the private sector ComC and its basic principles, the German GAAP – called “GoB”.

input budgeting system anyway.²⁰ Also federal states like Hamburg and Hesse that were modernising their accounting system by establishing the accrual method and an output budget were forced to prepare cash based cameral accounts additionally. This is technically feasible but caused high and unnecessary costs. Therefore, the federal government cabinet has adopted an act to modernise the law on budgetary principles (Haushaltsgrundsätze-gesetzmodernisierungsgesetz”, usually abbreviated to “HGrGMoG”) in December 2008.²¹ The act is still in the legislative process.

3.1.2 Content

Henceforth, according to the HGrGMoG draft, the federal government or the states governments might *alternatively* decide for either a traditional cash accounting (cameral accounting) or an accrual accounting system (based on DEB or extended cameral accounting).²² That means that the HGrGMoG is enabling but also sealing the coexistence of different accounting systems on state level.²³ At the same time the revised law will stress the necessity that state accounts remain comparable and that the fulfilment of financial-statistical requirements (also those obligations towards the EU) is guaranteed furthermore.²⁴ For this purpose the federal government considers it inevitably to develop a

20 § 33a was inserted in the HGrG in 1997 due to a legislative initiative of the state of Hesse in the German Federal Council, the “second chamber” of German parliament. Because of the fact that it was still obligatory after the amendment to keep the accounts on a cameral base and that accrual accounts were only tolerated as *additional*, LÜDER called the reform a “missed chance”. Cf. Lüder (1998), pp. 285 et seq. Another initiative for an *exclusive* mode of DEB by the federal states Hamburg and Hesse were refused again by German Federal Council in 2006. Cf. Bundesrat (2006). Summing up, the HGrGMoG faced many obstacles before it was passed by the federal government now.

21 Cf. Bundesministerium der Finanzen (2008), HGrGMoG.

22 Cf. the new § 1a together with § 7a HGrG^{revised version} (Principles of state double entry bookkeeping).

23 Cf. Statement of motivation for the HGrGMoG government draft, Bundesministerium der Finanzen (2008), HGrGMoG, p. 1.
The “state level” comprises the Federation and the federal states.

24 Cf. the new § 49b HGrG^{revised version}.

“common frame” in spite of accepting different accounting models. As a consequence, it is intended to assign a federal state committee (“standardisation board”) and install an additional advisory experts committee.²⁵ The aim of these two bodies will be to develop this state accounting framework. The latter should include “clear and a minimum of uniform” standards and principles as first step towards the embodiment of a more standardised state accounting system. To sum up, the HGrGMoG is targeted on a more comparable and sum-mable accountancy at state level.²⁶

However, it would be desirable that the work of the two committees will also affect the deeply heterogeneous municipal level. Due to the manifold financial linkages between the federal state government, federal states and municipalities there is a need for coordination of the complete accounting system of all public sector entities in Germany (see section 6). As it is explained in section 5.1, the BilMoG would be of higher relevance also for state level when the revised HGrG passed the legislative process. This is why it is important to broach the issue of HGrGMoG and keeping it in mind when now analysing the effects of the BilMoG on public sector accrual accounting.

3.2 Act to modernise accounting law for enterprises (BilMoG)

3.2.1 Intention of the act – “Modernisation” of commercial accounting law?

Besides the HGrGMoG, there is another significant new legal impulse on public sector accounting in Germany. In May 2008, the Federal Government of Germany resolved a draw bill to modernise accounting law for enterprises in Germany – the “Bilanzrechtsmodernisierungsgesetz” (in the following abbreviated to “BilMoG”). This act is also in the legislation process at the moment and it was anticipated to be en-

25 Cf. the new § 49a HGrG^{revised version} (Committee for the standardisation of state accounting). It is intended to enhance the status of the already existing “Bund-Länder-Arbeitskreis KLR/Doppik” committee that already drafted minimum standards for the implementation of double entry bookkeeping. Cf. *Bund-Länder Arbeitskreis KLR/Doppik* (2008).

26 Cf. *Bundesministerium der Finanzen* (2008), Government Release HGrGMoG, p. 1.

acted in April/May 2009.²⁷ Maybe some regulations will be set into force retroactively.²⁸ However, most of the new rules will become effective for fiscal years beginning 1 January 2010.²⁹ Although the BilMoG focuses on the German business sector, it will also have impacts on public sector accounting as this paper is going to explain.

The *intended* aim of this reform however is to “modernise” the German Commercial Code by adapting German accounting rules and regulations to European and international accounting standards. Those international ideas and principles should be introduced into the ComC where it is reasonable and adequate to improve the informative value of ComC financial statements (the government even specifies it as “qualitative validity”) without entailing the existing disadvantages of the international accounting standards at the same time.³⁰ The German commercial accounting law is not only seen in Berlin as a proven, clearly structured and compact alternative to the highly regulated and extensive case law of US-GAAP and IAS/IFRS (that mainly “serves information needs of financial analysts, professional investors and other participants in the capital markets”³¹). Therefore, the German Commercial Code is significantly more cost-efficient and easier to handle in practice (especially for SME but also for public sector entities reporting according to HGB). Nevertheless the international standards gain ground in private sector.³² By undertaking the BilMoG-

27 Cf. *Bundesministerium der Justiz* (2008), BilMoG. The government draft was sent for approval to Federal Council in September 2008. On 17 December 2008 a parliamentary hearing of authorised accounting experts took place. Both consultations resulted in some amendment requests. It is therefore expected that the final version of the law will include some corrections compared with the current government draft.

28 An earlier application is only expected for the increase of the threshold values (§ 267 HGB).

29 Cf. *Deutsche Bundesbank* (2008), pp. 3 et seq.

30 Cf. *Bundesministerium der Justiz* (2007), Government Release BilMoG, p. 1.

31 Cf. *Federal Ministry of Justice* (2008), p. 2.

32 One reason of this development lies in the EU regulation on the application of international accounting standards from 2002. It commits all enterprises whose stocks are traded on a regulated market to prepare the *consolidated* annual financial statements according to IAS/IFRS starting with business year 2005 and 2007 respectively (the latter applies if accounts have been prepared according US-GAAP so far). Other enterprises might use IAS/IFRS voluntarily.

reform, the German legislation therefore wants to take away “the pressure to use international standards”, to strengthen the ComC in the competition and thus to ensure that it will be maintained in the future. Finally, the BilMoG is transposing existing EU directives into national legislation.³³ The BilMoG is therefore widely seen as having the heaviest impact on commercial accounting law for the last decades (at least since the adoption of the last EU directives on the ComC in 1985)³⁴ and due to multiple ways (see section 5) it will also have a bearing on German public sector accounting.

3.2.2 Content

The Federal Ministry of Justice claims that the emphasis of the bill is on: a) Deregulation and b) Improvement of the qualitative validity of financial statements.³⁵

Ad a) The bill exempts facilitations for sole merchants conducting only a small business operation. Already existing thresholds determining the obligation to keep accounts and records are raised so that more enterprises can avoid keeping accounts and therefore can reduce costs. Also for bigger corporations there are measures for accounting exemptions or facilitations. Another point is that keeping ComC accounts will become less demanding since it is less necessary to pay attention to tax regulations anymore.³⁶ The annual financial statement drawn up under the German Commercial Code remains, however, the basis for distributing profits and for calculating profits for tax purposes. But the “reverse authoritativeness principle” is eliminated.³⁷

33 Directive for certified public accountants 2006/43/EC combined with 2008/30/EC and the amendment directive 2006/46/EC.

34 Cf. *Deutsche Bundesbank* (2008), p. 4.

35 Cf. *Federal Ministry of Justice* (2008), p. 1.

36 Cf. *Bundesministerium der Justiz* (2007), Government Release BilMoG, pp. 2 et seq.

37 The “authoritativeness principle” states that financial statements are the basis for the tax accounts. So far there was also the “reverse authoritativeness principle” which stated that certain options from tax rules must also be followed in the financial statements. Therefore, the effect of the BilMoG is that the influence of German tax rules on business financial statements is reduced. Cf. *Deutsche Bundesbank* (2008), p. 9.

Ad b) The Ministry of Justice claims an “improvement of quality” due to BilMoG. However, it simply means the convergence of the ComC accounting law towards the IAS/IFRS regulations – especially as there is a shift to the “true and fair view” principle (see section 5.1.2). Within this target course the draft of the bill includes the following eleven main measures (see table 2).

Measures of the BilMoG	Category
1. Introduction of new reporting duties in balance sheet (options eliminated) - deferred taxes (assets), - goodwill; 2. New duty to reveal own shares according to “treasury-stock-method”; 3. Partly abolition of prohibition to record accrued costs for internally generated intangible fixed assets in the balance sheet; 4. Requirement to net out plan assets and liabilities (from retirement pension plans and comparable commitments);	Introduction of new reporting requirements / possibilities
5. Abolition of several accounting options: - accrual funds to cover future expenditures, - deferrals for start-up and extension costs, - diverse valuation enhancement methods for stocks;	Introduction of new reporting bans
6. Changes in the definition of “manufacturing costs”; 7. Valuation of financial instruments at “fair value”; 8. Changes in the valuation of provisions; 9. Possible use of extraordinary temporary impairments also for a part of the fixed assets (financial investment assets); 10. Requirement to reverse depreciations (“write-ups”) where the reasons for them no longer exist;	Differences in valuation methods
11. Changes in the method to prepare consolidated accounts	Changes in consolidation process

Table 2: Modifications of commercial accounting according to the BilMoG

Source: Own table

This is just a very brief overview of all the innovations adopted with the BilMoG. However, many of the new rules and regulations are not relevant (e.g. no. 1 and 2 in table 2 above) for the core-units of the public sector entities (without the “outsourced” units). And the focus of this paper is – as stated before – on them. Therefore only selected areas of potential interests for territorial authorities (No. 3, 4, 5, 6, 7, 8, 9, 10, 11 in table 2 above³⁸) will be more thoroughly presented and analysed in the following section. The structure of the analysis in section 4 is as follows: First, the impact of the BilMoG measures on business companies will be described and in a second step there will be a description how they might be also relevant for public sector entities. It remains to be seen that the relevant measures might somehow counterbalance each other regarding the possible impacts on financial statements of public sector entities.

38 The numbers underlined are those potential reform measures of particular importance for the core public units. Those measures are also displayed in the table with **bold** print. The measures that probably only have an impact on enterprises are labelled by using grey print.

4. Analysing the BilMoG – selected areas of interests for public sector entities

4.1 Implementation of new reporting requirements / possibilities

So far, it was obligatory for business companies to record the accrued costs for the production of internally generated intangible fixed assets (such as patents or know-how) directly as expenditures in the year when they occur. Due to the missing objectivity proved via market transactions, it was prohibited to record them as assets in the balance sheet (cf. § 248 para. 2 HGB^{current version}). Like in IAS 38, the BilMoG draft introduces a capitalisation provision for costs incurred in conjunction with development activities. But the costs of research are not recognisable.³⁹ By doing so the equity position should be expanded (higher assets – existent liabilities = higher “net assets” or equity) and the enterprises should improve their capacity to raise new funds at lower cost from the capital markets.⁴⁰ However, federal government still wants to ensure the protection of the creditors and associates. Therefore enterprises have to record a revenue reserve to the extent that those development costs are recognised as an asset (cf. § 268 HGB^{draft version}).⁴¹ This should prevent enterprises to distribute unrealised profits.

The importance of this new accounting rule for public sector entities is rather low. Usually there is no production of intangible fixed assets in those institutions. However, the possibility should not be ruled out. In the past, there were some municipalities that developed software in order to run a new accrual accounting system on their computers. But there is also a danger when applying the new rule to the public sector. Now the public is focusing – like they are used from private sector – on the balance sheet (and here especially on the equity position). But the main focus of public sector accounting should lie on the income statement. The possibility to record more intangibles could mislead public sector entities to “prettify their balance sheets”. They could do that by recording unsubstantial values when hoping

39 Cf. *Deutsche Bundesbank* (2008), p. 11.

40 Cf. *Federal Ministry of Justice* (2008), p. 2.

41 Cf. *Kleibold* (2008), p. 40.

for a bigger response from the public. Therefore it is quite doubtful if internally generated intangibles with a questionable value should be recognised in public balance sheets.

Moreover, the BilMoG includes a requirement for companies to net out liabilities and plan assets (e.g. from employee benefit plans, cf. § 246 para. 2 Sentence 2 HGB^{draft version}). Plan assets are investments that should generate revenues. Those revenues should then be used to fulfil respective future payment obligations (benefits to employees and comparable commitments).⁴² The sense of the netting out is to recognise only assets that are disposable / liquidable and to provide a “true and fair view”⁴³.

This new requirement would have no effect on the drawing up of public financial statements (but on the disclosure). However, there might be a social reaction by the general public. The state has no employee benefit plans for its civil servants like it is common in the private sector. If there is a need to net out the already existing huge amounts of commitments the state has made to its current and former employees it will be more than obvious that state has made no precautions for the day when it is necessary to fulfil its future payment obligations. Usually public assets are not sellable due to different juridical and virtual reasons. Then, it will be obvious that there are no (plan) assets balancing the state pension obligations. Also the recognition of pension provisions that is now obligatory when applying the accrual accounting method is useless if there is no cash to fulfil the commitments in the future.

4.2 Implementation of new reporting bans

The BilMoG also introduces the abolition of several accounting options in the ComC: until now there is the possibility to capitalise start-up costs and expenses for extending the business (cf. § 269 HGB^{current version}). Furthermore there is the option of building up reserves to cover future expenditures (in German: “Aufwandsrückstellung”, cf. § 249 para. 2 HGB^{current version}). This is not a liability regarding third parties but covering one's own future expenditures on repairs, renovations and

42 Cf. *Oser/Roß/Wader/Drögemüller* (2008), p. 677.

43 Please find the definition of this phrase in section 5.1.2.

the like. The future expenditures necessarily need to be caused in the past. Therefore the drawing up of those accrual funds used to be highly manipulative. Next, so far there are diverse valuation enhancement methods for the valuation of stocks (§ 256 HGB^{current version}). In future only two methods will be permitted according to BilMoG: the “Last in first out” (LIFO) and “First in First out” (FIFO) method. All other options should be eliminated. The ministry of justice calls the abolition of the following accounting options as “clearing out-process” in order to relieve “the ‘ballast’ of past years”⁴⁴. The various options are seen as “an obstacle to the provision of informative and, in particular, comparable annual financial statements.”⁴⁵ In the past all these options were used to keep profits inside the entities, building up hidden reserves (for “income smoothing”⁴⁶ and creditor / investor protection). This, however, does not suit the aim to provide a “true and fair view” of the economic situation.

To return to the public sector: The first option (capitalisation of start-up costs) was especially used by municipalities to capitalise the transition costs to accrual accounting. Therefore this is relevant for some public entities. The second option (building up reserves to cover future expenditures), however, is permitted according to all public accrual accounting and budgeting codes. Since there is a high default of maintenance (in the past especially the planned maintenance of infrastructure was not accomplished) most public entities with accrual accounting have extensively used the possibility to draw up those funds. As a consequence, the effects of this ban on public accounts would be quite heavy. The maintenance default would necessarily have to reduce the value of the assets then directly instead. Another effect is that deferred maintenances will not be so obvious anymore to the general public. There are pros and cons for both methods (the recognition of the maintenance defaults at both sides of the balance sheet). The third option (valuation enhancements) is again less of importance. Usually public sector entities do not have big stocks. However, it will definitely also has an impact on some bigger municipalities and the federal states which usually have a professional financial instruments management.

44 Cf. *Bundesministerium der Justiz* (2007), Government Release BilMoG, p. 7.

45 Cf. *Federal Ministry of Justice* (2008), p. 3.

46 Cf. *Kleibold* (2008), p. 42.

4.3 Changes in valuation methods

The most discussed⁴⁷ measure of the BilMoG is the general rule that financial instruments such as shares, debt securities, fund units and derivatives held for trading purposes should be recorded at “fair value” in the balance sheet (cf. § 253 para. 1 HGB^{draft version} – the definition of “fair value” see section 5.1.2).⁴⁸ The reason is again the adjustment to internationally prevailing methods. However, the current financial crisis has shown that unrealised profits might disappear over night at the stock markets. The “fair value” is generally problematic because it has a pro-cyclic reinforcing-effect both in good and bad economic times. Consequently, it seems sure that in the legislative process the “fair value” will be restricted only to the banking sector.

No matter which decision the responsables come to, the fair value method will not have a deep impact on core territorial authorities⁴⁹ since they usually have a poor financial instruments trading portfolio. Even if they own financial instruments these are rather part of a liquidity reserve or the public asset pool.

There is also a change related to the definition of “manufacturing costs”. Up to now there have been different options to include or exclude cost components. Due to § 255 para. 2 sentence 3 HGB^{draft version} the volume of obligatory cost recognition should be expanded.⁵⁰

Since territorial authorities do not belong to the manufacturing industry and do not produce many tangible products that might be traded on markets this reform measure is not of insignificant relevance either.

The following valuation measures however have a higher significance for the public sector. First, there is the change in the valuation of provisions, in particular pension provisions. According to BilMoG, the provisions of business companies should be assessed more in line

47 Cf. *Deutscher Bundestag* (2008).

48 See also *Bundesministerium der Justiz* (2007), Government Release BilMoG, pp. 5 et seq.

49 Of course they would have an impact on public enterprises like public banks.

50 For further information about the adaptation of manufacturing costs see *Küting/Pfitzer/Weber* (2008), here: *Küting, Karlheinz*: Chapter VIII Herstellungskosten, pp. 135 et seqq.

with IFRS rules – that means more realistically. § 253 para. 1 HGB^{draft version} states that “provisions should be assessed with the necessary amount of money that is needed according to a sensible judgement of a merchant”. According to the current draft version of the BilMoG, the calculation and disclosure in the financial statement will include components of future increases for prices and costs (e.g. salary/wage increases the inflationary process and personnel developments). Furthermore, all provisions will be discounted at adequate market rates (cf. § 253 para. 2 HGB^{draft version}).⁵¹ The new regulations should disclose “the true burden”⁵² and will therefore lead to an increase of provisions (at least with respect to the pension ones). However, in order to alleviate the effects, the BilMoG allows spreading the “catch-up costs” over a term of 15 years. There will be a considerable rise of pension provisions in the balance sheet of business enterprises.

This also applies to public sector entities⁵³, especially since so far they have usually used an interest rate of around 6 %, which is much higher than the current market rate. Consequently, provisions are recorded on a valuation level which is far too low. Due to the continuous increasing of expenditures for pensions it will also be harder for those entities to reach a balanced budget in the future if they have to draw up the accounts according to legislation that is influenced by the BilMoG.

Next, the (upward) revaluation of fixed assets is not permissible under current German GAAP (cf. § 253 para. 1 HGB^{current version}). The BilMoG will change that for existing undervaluation. There will be a requirement to reverse depreciations (so called “write-ups”) both for fixed and floating assets where the reasons for them no longer exist (cf. § 253 para. 5 HGB^{draft version}).⁵⁴ At the same time § 253 para. 3 HGB^{draft version} will permit the use of extraordinary temporary impairment for financial investment assets (until now it was only possible for

51 The market rates should be published by the German Central Bank. Provisions that last longer than 5 years shall be discounted with an average rate of the last 5 years in order to prevent significant (but not relevant) yearly fluctuations. However, the Central Bank suggests increasing the approach to a seven year average to gain an even higher stability. Cf. *Deutsche Bundesbank* (2008), p. 13.

52 Cf. *Federal Ministry of Justice* (2008), pp. 2 et seq.

53 Cf. *Schroeder* (2008).

54 Also see *Oser/Roß/Wader/Drögemüller* (2008), p. 684.

floating assets). The reason for these measures is again to provide a more realistic picture of the economic situation and to expand the asset position with the results as described in section 4.1.

The consequences for public sector entities are quite obvious. If the existing public sector accounting and budgeting codes include the ban on upward revaluation for fixed assets and the BilMoG will be judged as relevant for public sector then also the values of assets will rise.

4.4 Modification of the consolidation method

There will be also changes in the process to draw up consolidated financial statements. According to § 290 para. 1 HGB^{current version} there are two preconditions for a private company to get inside the consolidation circle of a parent company: 1. As soon as the parent company exercises uniform control and 2. If there is an existence of a participating interest.⁵⁵ In the future the second precondition however will no longer qualify. This new practice follows the “substance over form principle” (juridical issues are no longer relevant). As a consequence, there will also be a higher transparency of so called special purpose entities.⁵⁶ Another modification is that the methods how to conduct the consolidation will be restricted. In the future, capital consolidation with subsidiaries is to be based on the “revaluation method” only and associated companies are consolidated according to the “book value

55 Also see Küting/Pfitzer/Weber (2008), here: Küting, Karlheinz/Koch, Christian: Chapter XV Aufstellungspflicht Konzernabschluss, pp. 373 et seqq.

56 Usually those are legal entities that are in such a way linked to the mother that they do not need to be included (consolidated) in the group financial statement. There might be several reasons for that such as that the mother can shift assets and debts to the special purpose entity in order to shorten its own balance sheet. The BilMoG draft will reach more transparency in such relations with the adoption of the substance over form principle. Cf. *Federal Ministry of Justice* (2008), p. 3.

method”.⁵⁷ Also the netting out of credit and debit differences and of differences with reserves are no longer permitted.⁵⁸

The assessment of consequences of these changes for the public sector can be found in section 5.2.

57 Before, there were more possible methods; the book value method could also be used for the consolidation of daughter companies. See *Kleibold* (2008), p. 43.

58 For further details see *Küting* (2008), pp. 1396 et seqq. Also see *Oser/Roß/Wader/Drögemüller* (2008), pp. 690 et seq.

5. Mechanisms of action – (Possible) impacts of the BilMoG

5.1 The German Commercial Code as a reference model!?

The private sector's influence on a nation's governmental accounting system defines – relating to CHAN / JONES / LÜDER 1996 – a factor of the institutional framework in which it takes place. Besides, tracking reforming pressure from the private sector and its consequences is seen as a major future research direction of the Comparative International Governmental Accounting Research (CIGAR) community.⁵⁹

In Germany, the Commercial Code has exerted a dominating influence on public sector accrual accounting reform from the very beginning. First, the reason was that initiators of accrual accounting reform in the public sector needed something to build on (at that time there were also no IPSAS⁶⁰). And later already existing codes (based on ComC) were influencing those ones that were developed subsequently. Of course the ComC can only be used as an approved reference model where the new public sector accounting and budgeting law is based on the same accounting technique: double entry bookkeeping. In total there are 18 more or less different accounting and budgeting codes on municipal and federal states level (all 14 federal states that have a municipal level and so far 4 federal states; see table 1 and figure 1) where this applies. It is also these codes we speak about in the following when analysing in which way the BilMoG could now influence public sector accounting. The core analysis of this paper will be splitted in two parts: First, in section 5.1.1 there is a description how the ComC has already influenced the development of the existing public

59 The influence of the private sector is therefore part of the questionnaire developed by CHAN/LÜDER in 1996 in order to determine the “institutional framework” of governmental accounting system of a country. Cf. *Chan/Jones/Lüder* 1996, pp. 12 et seq.

60 The Public Sector Committee (PSC), predecessor of the IPSAS Board, was founded in 1986 it focused the first ten years only on the elaboration of special scientific papers. With the hope that general public pays more attention to more tangible accounting standards then it started to publish its “core set” of IPSAS that were that time only adapted copies of IAS/IFRS. Cf. *Adhémar* (2002), p. 61. In 1996, however, the first German municipality was already in the transition process to accrual accounting.

sector accrual accounting and budgeting codes (DEB) and how the ComC still has an impact on public sector accounting by existing linkages in the current legal texts. Secondly, in section 5.1.2 there will be an assessment if the ComC serves the public purposes at all and how the BilMoG will change German commercial accounting from a public sector accounting point of view.

5.1.1 Description of the influence of the ComC on public sector accounting

All developed public sector accrual accounting and budgeting codes using the double entry bookkeeping technique show more or less a homogeneous structure: a network of T-accounts (including a balance sheet and an income statement, usually also an integrated cash flow account) and equivalents on the planning side (see figure 1). And the embodiment of the accounting rules and principles build up on the (old) German ComC. However, there are multiple ways how the ComC was influencing public law. Coming back to section 2, also on that matter the principle of federalism and sometimes almost even “obsessive tendency” of diversification led to a broad range of references.

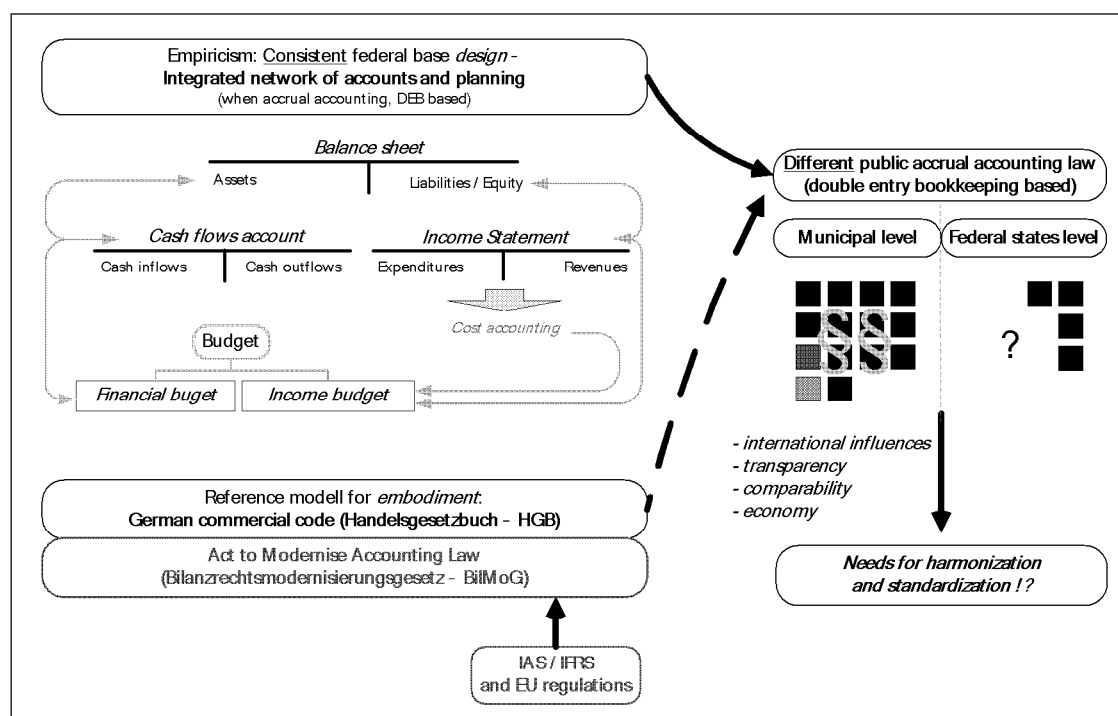


Figure 1: Developments in accrual accounting reforms (DEB) in the German public sector

Source: Own figure

Usually the public sector accounting and budgeting law was phrased from scratch by the legislator without using extensive references to the ComC.⁶¹ However, there are multiple examples where federal states just took over some parts of it in new municipal or states accounting and budgeting law (“copy reference”) or adapted it by simply modifying some words. Also another formal enactment method was applied. In all codes so called static and dynamic references to ComC can be found.⁶² A reference is called “static” if a code refers to a special version of the ComC. Then ComC has to be applied with the particular valid legal status named. It is important to mention that the legislators of federal states usually refer to different versions of the ComC. “Dynamic” means that there is a direct reference to the ComC. As a result of that there is a simple mechanism: if federal government is altering the ComC, also the public sector accounting and budgeting law of federal states changes automatically. However, according to a general decision of the German Federal Constitutional Court in another case⁶³, the latter is a problematic way of reference. The court stated that the legislator might use only direct references to other laws that were enacted by itself (because of the necessary separation of powers in a federal state). The ComC is federal state law. But it lies within the responsibility of regional parliaments to decide about their own accounting and budgeting law and the one of the municipalities located in the particular state. Nevertheless, there are dynamic references in almost all local and regional accounting and budgeting codes and it is those references that might in fact enable the BilMoG to directly influence public law. Some institutions even argue for a general use of dynamic references to ComC.⁶⁴ An opposite well-defined position is that the public sector accounting and budgeting codes have to be read from a “contextual point of view”. The responsible ministries of the interior and the local legislators do not have an interest to pass the legal com-

61 Cf. *Bolsenkötter* (2008), p. 307.

62 Cf. *Vogelpoth/Poullie/Voß* (2009), p. 85.

63 Cf. the Decision of German Federal Constitutional Court from 1 March 1978 – 1 BvR 786/70, BVerfGE 47, p. 285.

64 See for instance the statement of the *Institute of chartered accountants in Germany (IDW)* regarding the draft version of the law on the reform of municipal accounting and budgeting law in the federal state of Baden-Württemberg, here the synopsis of statements (status: 23 January 2009), p. 2.

petencies to the federal state. Therefore it would be necessary to ask “what the legislator actually wanted”.

A more precise and definite legislation would be preferable instead. A way to make references more precise is to add the phrase “respectively in the current version” when using dynamic references to other laws.⁶⁵ However, both possible specifications are missing: those ones determining which version should be applied (if the references are to be interpreted as “static”) or specifications in terms of using the phrase above (if the references are to be interpreted as “dynamic”). Some few ministries of the interior and experts already emphasised that the vague references should be interpreted as “static” ones.⁶⁶ Probably that might be the most probable reaction from the responsible legislators in order to prevent that the BilMoG has an influence on accounting of the “core-units” of territorial authorities. However, so far it is not definitely clear if the BilMoG has an impact on those core administrative units *via that way*.

Alternatively, even if denying the existence of dynamic references there is another, last way how the BilMoG might influence public sector accounting and budgeting law. That is if there are references to the specific German Generally Accepted Accounting Principles (“Grundersätze ordnungsmäßiger Buchführung”⁶⁷, abbreviated to “GoB”). Also this “GAAP reference” is a highly discussed way of reference. Generally it is important to mention that, unlike IAS/IFRS or IPSAS, the German Commercial Code is not case law. There is no “en detail“-regulation on all individual accounting cases. On the contrary, the ComC basically consist of legislative guidelines and general principles. Therefore, the ComC is more compact while ensuring at the same time that new unforeseen accounting cases are covered by those German “Generally Accepted Accounting Principles”. You can find some of the German GAAP mentioned within the Commercial Code. However, they are also determined by non-legal accounting standards

65 Cf. *Vogelpoth/Poullie/Voß* (2009), p. 87.

66 Cf. e.g. *Bolsenkötter* (2008), p. 307.

67 This is the conventional phrase which is also used in the ComC even though it might be translated to “Generally Accepted Principles of *Bookkeeping*”. However, the more precise expression and also literal translation from the English phrase is “Grundsätze *ordnungsgemäßer Rechnungslegung*”, abbreviated to “GoR”. The latter is defined by some academics (see for instance MOXTER).

that prevailed in practice or given by judgements. Therefore German GAAP are called an “indefinite legal term”. That makes it more difficult for outsiders and foreigners to work with the German Commercial Code since it is necessary to know also the prevailing legal practice. However, for people educated on that system it is more straightforward and because of its compact style a more efficient way to regulate accounting. In the following section 5.1.2 an analysis is carried out to see if those commercial GAAP also fit the public sector needs.

Table 4 in section 5.2 shows examples of static, dynamic and GAAP references with the German Commercial Code in *loca*/ public sector accounting (budget) law, here for the consolidation of the “core” administrative units and public enterprises.

Only if there is a dynamic or the GAAP reference in the public sector accounting and budgeting law code, the BilMoG is having a direct influence on the accounting of the territorial entities. Of course there are also other indirect ways of manipulation. Those issues are broached in the following sections, 5.2 seq. So far it is not definite which of those effects will prevail. Also the mentioned committee that will be assigned by the HGrGMOG with the task to develop common principles for state accrual accounting (DEB) – the “Bund-Länder Arbeitskreis KLR/Doppik”⁶⁸ – remarks that there might be changes and impacts due to the BilMoG. Those should be evaluated after coming into force and considered in the new standards for state public sector accounting.⁶⁹

5.1.2 Assessment of fitting accuracy of the ComC as a reference model for public sector accounting and potential changes caused by the BilMoG

There was and still is a controversial discussion on the question if the ComC rules and also the German commercial GAAP have to be adapted to meet the specific public needs. There are two conflicting opinions: One side argues for a development of rules and regulations that are totally released from the ComC. The other side does not see a (necessary) difference between private and public sector. This group

68 The translation of the committee’s title is as follows: “The workshop on cost and accrual accounting of the Federation and the federal states”.

69 Cf. *Bund- Länder Arbeitskreis KLR/Doppik* (2008), p. 9.

would like to precisely adopt the German Commercial Code also for public sector entities – unaware of the adaptations needed.

However, the entire existing public sector accrual accounting and budgeting law is somehow in between those two extremes. It is a mixture of discrete rules and principles tailored on the public sector if the commercial German GAAP do not fit and those simply taken over from ComC.⁷⁰ The legislators of all territorial authorities are aware of the need to adapt parts of the ComC in order to use it in the public sector.⁷¹ For instance, there is a draft municipal accounting and budgeting code stating that the commercial GAAP could be transferred to public sector “to a large extent but not without exceptions”⁷². Also federal state legislation is stating in § 33a HGrG^{current version} that private sector Generally Accepted Accounting Principles should be respected in “analogous application” to the Commercial Code when applying accrual accounting (DEB based) also at states level. However, just like GAAP, also “analogous application” is an indefinite legal term. What does it mean to apply German commercial GAAP in state accounting “analogously” to the ComC? On that matter there was and still is a lively discussion. It is important to mention that therefore the disputed phrase “analogous application” is withdrawn from the draft version of the HGrGMoG (cf. § 7a para. 1 HGrG^{draft version}). Now there is an unrestricted claim that the state accrual accounting (DEB based) should “follow the regulations of the ComC”.⁷³ This might be understood as a drift of state accounting towards the ComC. Even though it is also said that differing rules should be worked out by the new committee due to the characteristics of the public sector (cf. § 7a para. 2 HGrG^{draft version},

70 Cf. *Eibelshäuser* (2006), p. 618. Somehow this is comparable with the idea of IPSAS: to lean on a proven practice (there IAS/IFRS) and adapt and/or amend it if and where necessary.

71 See e.g. *Innenministerium des Landes Nordrhein-Westfalen* (2006), p. 189.

72 Cf. the draft version of the municipal accounting and budgeting code of the state of Baden-Württemberg, legal status: 21 December 2007. Here see explanatory statement regarding § 34, p. 90, own translation from German into English.

73 At this juncture it is added that the rules for state accounts also follow the tightened principles in the ComC that are mainly aimed for corporations. The accounting part (third book) of ComC is divided in two parts: the first part (§§ 238-263 HGB) is relevant for all merchants; the second part, however, consists of additional rules that only apply for corporations and some kind of registered commercial partnerships (§§ 264-342a HGB).

also see section 3.1.2). But the need for adaptation of commercial accounting rules is trivialised as need for additional “technical specifications”⁷⁴ in the explanatory statement of this paragraph. To sum up, until now the state level has been accepting that there is a need for adaptations if taking over the ComC in public sector accounting. Most of the legislators of the federal states still state that there is a need for adaptation before applying commercial codes in public sector. Especially the municipal codes and the municipal accounting and budgeting codes are usually stressing that point of view. However, the HGrGMoG does not reflect that insight.⁷⁵

The consequential questions are: How and to what extend is there a need of adaptation? Especially, which of the commercial GAAP can be transferred to public sector accounting, which of those have to be adapted and which principles are specific private ones? The resulting revised set of principles is then usually called “Generally Accepted Public Sector Accounting Priniples” (abbreviated to GAPSAP; in German: “Grundsätze ordnungsmäßiger öffentlicher Buchführung”, abbreviated to “GoöB”). Besides scientific papers⁷⁶, we find this or similar expressions also in current laws, such as the HGrGMoG⁷⁷, municipal codes as well as in municipal accounting and budgeting codes (see table 3)⁷⁸. There are institutions complaining that so far there are no generally accepted principles specific for the German public sector and that hence it is unclear what is appropriate. According to their opinion, therefore, there should be no reference to GAPSAP but to

74 Cf. *Bundesministerium der Finanzen* (2008), HGrGMoG, p. 32. The original phrase in German is as follows: “weitere (...) technisch-fachliche Festlegungen”.

75 Also the committee that will be assigned by the revised HGrG with the task to develop principles for state accrual accounting (DEB) states in its latest version of those standards that HGB has priority. The developed principles are directly effective “only if the complete application of ComC is not of overriding importance”. Cf. *Bund-Länder Arbeitskreis KLR/Doppik* (2008), p. 8.

76 See e.g. *Arbeitskreis „Integrierte Verbundrechnung“* (2005).

77 In the revised version of the HGrG then it is called “Principles of state double entry bookkeeping”. Cf. Art. 1 HGrGMoG and § 7a HGrG ^{draft version}.

78 There are other, special public indefinite legal terms used such as “GAAP for municipalities” or “Municipal double entry bookkeeping principles”. Also see footnote below.

commercial GAAP.⁷⁹ Though, knowing that the latter were also developed little by little (and the development is still continuing), it should be obvious that it will probably also take some time to develop a widely accepted GAPSAP system. It is therefore useful to insert the terminus “GAPSAP” into public sector accounting and budgeting codes. This emphasises that there is a need for academic research, judicature and practical experience. The development of GAPSAP is therefore a topic apart from the paper in hand, but it is necessary to briefly explain in the following the differences of the ComC general principles, the needed public principles and how the BilMoG will shift commercial accounting from a public point of view.

The purposes of German commercial and public sector accounting are quite different (see table 3). The German private sector accounting law has two primary goals: protection of creditors plus associates and measurement of profit for distribution (to investors and to the state due to tax liabilities). It is important to say that the ComC pursues also another, subordinate objective: Accounting should give its addressees (mainly investors, creditors but also state) a “true and fair view” of the economic situation of the enterprise. However, “true and fair view” is not to be understood in this paper as the legal phrase used in some sets of accrual-based Anglo-Saxon GAAP but explains the general idea of providing a complete, true and therefore reliable picture of the economic substance and situation.⁸⁰ According to § 264 para. 2 HGB the annual account of a corporation should provide “a complete and true picture of its financial position and performance” for the financial year. But this was no initial goal of the ComC, it has been added in 1985 by the “Act on accounting principle” (BiRiLiG). As already mentioned in section 4, the provision of a “true and fair view” is originally one central

79 See for instance statement of *Institute of chartered accountants in Germany (IDW)* regarding the draft version of the law on the reform of municipal accounting and budgeting law in the federal state of Baden-Württemberg, here the synopsis of statements (status: 23 January 2009), p. 8. The IDW is arguing for using the phrase “GAAP” in the ComC version in the municipal accounting and budgeting code. However, then people could tend to use the ComC GAAP without adaptation. As reaction on that statement the legislator will now use the phrase “GAAP considering special municipal accounting and budgeting code regulations”.

80 The literal phrase “true and fair view” is only one of a few such phrases used internationally in different sets of accrual-based GAAP. “Presents fairly” and “Properly presents” are other examples.

function of the Anglo-Saxon accounting. To conclude, the ComC has already been influenced by international accounting principles before, however it could still keep its own “purpose-paradigma”.

Contrary to that, within public sector accounting providing a complete and true picture of the economic situation is a basic purpose. Addressees are the citizens (as financier and quasi-shareholder/associates). There is no need to protect creditors.⁸¹ Another point to consider is that it is the aim of public sector entities to fulfil public tasks. Also the public sector should aim for formal goals – but only as side condition. Consequently, it might be possible that the result of an efficiently working public sector also has a net surplus at the end of the year. However, this was not the objective to pursue and it also might show that citizens have paid too many taxes that year. This guides us to the second predominant objective of public sector accounting: The protection of tax payers and future generations against exploitation from the state.

With the BilMoG the purpose hierarchy of the ComC changes. The result of a further opening of the ComC to IAS/IFRS practices is that the protection of creditors/associates becomes less important and that the “true and fair view” (as defined above) gains more significance. Therefore – considering only that point of view – it seems clear to say that due to the BilMoG there is a convergence of public and commercial accounting in Germany. However, there is another opposed argument by MOXTER. He states that providing information should be the common intended purpose of *all* accounting models and that the protection of general addressees by granting information lies within the nature of accounting.⁸² Considering Moxter’s opinion, it seems clear that there is only a slight convergence between private and public sector accounting in Germany. Also the author thinks that is more important that the primary goals are still the same on both sides and that they are incompatible.

Finally, it is probably not necessary to emphasise that also the concrete central principles might be not fully compatible when the ab-

81 There is no risk for those that public sector entities can become insolvent in Germany. Moreover, there is – at least a factual – obligation to assume each others liabilities for the public sector entities in federal state. Cf. e.g. *Nierhaus/Gebhardt* (1999), pp. 13 et seqq. for the relationship between federal states and their municipalities.

82 Cf. *Moxter* (2009), p. 8.

stract goals are not comparable in public and private sector. It is the “material principles” that make the difference. The most important ones of those in German commercial accounting law are the “realisation and the imparity principle” (see § 252 para. 1 No. 4 HGB). These two principles affect the way *how* the basic accrual principle is implemented. In short, the “realisation principle” specifies when revenues are recorded in the accrual accounts. According to the common strict version of the realisation principle, this is the case when they are realised, not when they are realisable. Furthermore, in commercial accounting the realisation of revenues is linked with sales in order to enter only “quasi-certain” increases of assets into the balance sheet and the income statement. The “imparity principle” determines that expenditures and revenues have to be treated differently (in Latin “impar” means unequal): all predictable expenditures should be recorded in the accounts as early as possible (when they arise but they have not been realised yet), revenues however should be registered when they are predominantly certain (when they are realised). Both principles aim to protect creditors by preventing an early distribution of profits. They are affected by the BilMoG now.

In the public sector there is no need at all for the principle of imparity since there is no need to protect creditors. It is more important that a “principle of reality / objectivity” is realised.⁸³ In spite of that, the realisation principle is also necessary in public sector accounting but it needs some adjustment.⁸⁴ If there is a causal relationship between expenditures and revenues there is no difference between public and commercial accounting. However, usually there are none of these causal relationships in public sector (less importance of matching principle). Therefore cash flows should be recorded when a legally effective claim accrued (not when value is proven via sales).⁸⁵ Furthermore, since there are usually no markets for public goods or they should not be realised, it is sufficient if revenues are realisable. With regard to BilMoG, we face a weakening of both principles. As a result,

83 However, there are also opinions that the imparity principle is extremely important in public sector because it is necessary to record all public liabilities. Cf. *Bolsenkötter/Detemple/Marettke* (2002), pp. 29 et seq. and *Eibelschäuser* (2006), p. 623.

84 Cf. *Lüder* (2006), p. 607.

85 See e.g. *Arbeitskreis “Integrierte Verbundrechnung”* (2005), p. 889.

one can argue that there is a convergence of private and public sector accounting.

	ComC accounting ^{current version}	ComC after BilMoG	Public sector accounting
Purpose	<ul style="list-style-type: none"> – Protection of creditors / associates – Measurement of profit for distribution (investors and state because of taxes) – (Low relevance: “true and fair view” information since 1985 BiRiLiG) 	<ul style="list-style-type: none"> – Less protection of creditors – Without difference: Measurement of profit for distribution – “True and fair view” gains more importance 	<ul style="list-style-type: none"> – Protection of tax payers and future generations – Provision of a complete and true picture of the economic substance and situation / fairly presentation of information
Central GAAP: Implementation of accrual principle	Strong realisation principle Strong imparity principle	Realisation and imparity principles are softened	Customised / softened realisation principle Imparity principle irrelevant
Tendency	Already influenced by Anglo-Saxon accounting principles; however still own paradigma	Towards IAS/IFRS (IPSAS)	strongly influenced by old version of ComC; no influence by international accounting standards

Table 3: Relations between German commercial and public sector accounting

Source: Own table

5.2 Impacts on the consolidation of the accounts of territorial authorities’ “core units” and the accounts of public domain companies

There is another, more precise possibility how and to what degree the new ComC might influence the public sector: the preparation of consolidated financial statements.

A major reason for the application of accrual accounting (DEB) in the public sector was also the importance of public enterprises under private legal form. The number of those enterprises have considerably risen in Germany since the foundation of the Federal Republic. More and more territorial authorities were and are outsourcing parts/tasks of the former core administration to private individual or limited companies (in Germany called “Einzelunternehmen”, “Gesellschaften mit

beschränkter Haftung” (GmbHs)), sometimes even stock corporations (“Aktiengesellschaften” (AGs)). Therefore it was one goal of the reforms to make commercial and public sector accounting more comparable so that the consolidation of core and “satellite” units of public entities would be enhanced. Another goal was to regain an complete and true picture of the economic situation of the public entities by preparing consolidated public accounts. Especially territorial authorities with financial problems were outsourcing public tasks because at the same time they could also transfer the liabilities in these new enterprises. As a consequence, it seemed that not even the public entities have a general idea about their own property and the total amount of liabilities anymore.

Therefore, most municipalities just started with the preparations for the consolidation of the accrual accounts. In other federal states there are still pilot schemes on that specific accounting matter.

Of course the outsourced units of public entities in private legal form have to prepare their accounts according to the German Commercial Code and the commercial GAAP. There is only one exception to that rule: Enterprises of a municipality, local authorities association or special purpose association without legal personality might not follow ComC if there are special federal states codes (this is called the “caveat of federal states law”).⁸⁶ Usually the federal states legislators have not made use of that exception in the ComC so that almost all public enterprises have to observe the ComC rules and principles. Consequently, also the BilMoG will have a direct impact on these. But even if there are special rules and regulations for public enterprises/institutions there are many “dynamic” references to ComC in those (e.g. the law on city-owned companies and the law on public-law institutions). However, due to the BilMoG, it is not sure if those references are still valid or if they also have to be interpreted as “static”. That might lead to the paradox situation that some public companies might have to respect different versions of the ComC (the current version because of the fiction nature as “merchant” according to ComC and a dated version due to references from particular public laws).⁸⁷ However, there is not enough space in this paper also to

86 Cf. § 263 HGB.

87 Cf. *Bolsenkötter* (2008), p. 308.

consider all these changes the BilMoG might also cause for public enterprises.

In general, from the view of a territorial authority, the BilMoG might have two potential ways to influence the consolidation process: First, in the future the data that is handed in by the enterprises (owned by the public sector entities) for consolidation will be presented according to new ComC rules and principles. Secondly, there are the changes about the preparation of consolidated accounts that can be found in section 4.4. It is possible to allay the first concern: According to most of the regulations in the federal states, the public enterprises have to hand in their data for consolidation to the finance departments of the public authorities according to current public sector accounting and budgeting law. As a consequence, the municipalities or federal states do not have to deal with the BilMoG implications – at least due to that reason. However, it is necessary to check for the second concern: Here, the described mechanisms of influence that the ComC might have on public sector accounting are relevant (see section 5.1.1). There are also different ways of reference concerning the consolidation of public accounts and the accounts of public companies. The following table 4 provides an excerpt of the possible cross references with the German Commercial Code in *local* public sector accounting (budget) law concerning the consolidation of accounts.⁸⁸ In short, also concerning the consolidation issue it is not sure if there is a need to apply the new BilMoG rules. There are some federal states⁸⁹ that only permit their municipalities to prepare a consolidated account by using the book value method. However, this is exactly the consolidation method that should be prohibited according to the BilMoG. At the same time those federal states have different kinds of references to ComC. On the whole, the question if the BilMoG rules on consolidation are relevant for the core units of the public sector will be determined by answering the questions raised about the legitimacy of dy-

88 There is no analysis on the federal states accounting and budgeting law since those federal states that already adapted accrual accounting (DEB) based on § 33a HGrG^{current version} have not changed their accounting and budgeting codes (“Landeshaushaltsordnungen”) yet. So far there was a need that the accounting and budgeting code on federal level (“Bundeshaushaltsordnung”) has to be adapted first. That seems to be the case with HGrG^{draft version}MoG and the new § 7a HGrG^{draft version} right now.

89 It is the federal states of Mecklenburg-Western Pomerania, Rhineland-Palatinate, Saarland and Thuringia.

namic references and the interpretation of the references to commercial GAAP.

	Reference to a certain ComC version	Reference to particular ComC regulations, unclear reference date	Common reference to common German commercial GAAP
	<u>STATIC reference</u>	<u>DYNAMIC reference</u>	<u>GAAP reference</u>
Baden-Württemberg		Art. 95a para. 1 No. 2 GO* and para. 3 (*according to government draft, status 23 January 2009)	Art. 95a para. 1 GO*
Bavaria		Art. 102a para. 2 GO	Art. 61 para. 4 GO ("Municipal double entry bookkeeping principles") § 57 para. 2 KommHVO ("Generally accepted municipal double entry bookkeeping principles")
Berlin			
Brandenburg		§ 83 para. 1, para. 3 KVerf	§ 63 para. 3 KVerf ("Double entry bookkeeping principles") § 82 para. 1 KVerf §§ 32 para. 2, 49 para. 1 KommHKVO
Bremen	Unpublished financial reporting and consolidation principles		
Hamburg	Unpublished financial reporting and consolidation principles		
Hesse		§ 114s para. 5 and para. 7 GO	§ 114s GO § 32 para. 2 GemHVO
Mecklenburg-Western Pomerania	§ 55 para. 2 GemHVO	§ 61 para. 5 and para. 6 GO	§ 43 para. 5, 60 para. 1 GO § 25 para. 2 GemHVO
Lower Saxony		§ 100 para. 5 GO	§§ 82 para. 3, 100 para. 1 GO § 34 para. 2 GemHKVO

	Reference to a certain ComC version	Reference to particular ComC regulations, un- clear reference date	Common reference to common German commercial GAAP
	<u>STATIC reference</u>	<u>DYNAMIC reference</u>	<u>GAAP reference</u>
North Rhine- Westphalia	§ 49 para. 4 GemHVO	§ 50 para. 1 und 3 GemHVO	§§ 93 para. 1, 95 para. 1 GO, § 27 GemHVO
Rhineland- Palatinate	§ 116 para. 4 GO § 54 para. 2 GemHVO	§ 109 para. 5 GO	§§ 93 para. 2, 108 para.1 GO (“GAAP for municipalities”)
Saarland	§ 46 para. 2 KommHVO	§ 100 para. 4 KSVG	§ 99 para. 1 KSVG § 26 para. 2 KommHVO (“GAAP for municipalities”)
Saxony	§ 88a para. 6 GO	§ 88a para. 3 GO	§§ 72 para. 2, 88 para. 1 GO
Saxony-Anhalt		§ 108 para. 6 GO	§§ 106 para. 1, 108 para. 1 GO
Schleswig-Holstein		§ 95o para. 3 GO	§§ 95k para. 1, 95m para. 1 GO §§ 33 para. 1, 44 para. 1 GemHVO
Thuringia	§ 20 para. 1 NKFG	§ 20 para. 5 NKFG	§ 19 para. 1 NKFG

Table 4: Excerpt of existing references in local public sector accounting (budget) law to the German Commercial Code, here concerning the consolidation of accounts

Source: Own table, based on *Vogel/poth/Poullie/Voß* (2009), p. 87

6. Conclusion: Future prospects on the development of public sector accounting in Germany

The uniformity of accounting in the German public sector was forsaken in the course of the accrual accounting reforms of the last decade (see section 2). In this regard, there were and still are many influences on German public sector accounting. And therefore it is also unclear in which direction public sector accounting in Germany will further develop. The paper in hand broached the issue of two current important legal factors (see section 3). The analysis of their common effects (see section 4) needs now to be set in the context of the other important past and probable future national and international impacts on German public sector accounting. The result is a picture of the status quo and the future prospects on the development of the accrual accounting reforms (see figure 2).

In a nutshell, the IAS/IFRS are influencing the German Commercial Code via the BilMoG. Then, there are two possible mechanisms the new version of the ComC might directly or indirectly influence the accrual accounting of municipalities in future (see section 5): The different kinds of references to the ComC (especially “dynamic” and “GAAP references”) and the process to compile consolidated financial statements. Due to the dynamic references in the revised version of the “act on the modernisation of the law on budgetary principles” (HGrGMOG) there are also connections between the BilMoG and state accounting.

It is quite surprising that IAS/IFRS may have a direct or indirect influence on public sector accounting now while at the same time the specific public version of those international standards, the International Public Sector Accounting Standards (IPSAS), didn't have any kind of influence on the previous developments in German public sector accounting at all.⁹⁰ And this will also not change in the near future

90 Until now IPSAS is only mentioned once in the German accrual accounting reforms. The city of Hamburg states in its first annual report on accrual basis that IPSAS were taken into account. However, it was also said that annual financial statements are conform to ComC, German GAAP, IAS/IFRS and the guidelines of the Institute of chartered accountants in Germany (IDW ERS ÖFA 1). It is therefore questionable to which extent the IPSAS had a stake in the preparation of this report. Cf. *Hansestadt Hamburg* (2007), p. 32.

since the new “standardisation board” for state accounting – as planned by the federal government and legally fixed in the HGrGMoG draft – will explicitly *not* orientate its work at the IPSAS.⁹¹ In the draft of the HGrGMoG it is said that there are neither relevant nor fundamental differences in the accounting purposes of the ComC and the IPSAS. Therefore, an orientation or at least a back coupling between the further development of state accounting in Germany and the activities in the IPSAS-Board are seen as unnecessary. Furthermore, it is said that the ComC should be applied as basis for German public sector accounting reforms.⁹²

On the one hand it is quite understandable that the German public sector cannot perform two extremely demanding tasks simultaneously (the introduction of accrual accounting and a transition to international standards). From an efficiency and consolidation point of view it is also reasonable to use the proven ComC text as a master copy for the embodiment of the public sector accounting codes and to adapt it only where necessary. However, as it was shown in section 5.1.2, the ComC and the international accounting standards (either IAS/IFRS or IPSAS) definitely differ in the purpose of accounting. On the other hand the federal legislator denies that there are differences between the IPSAS and the ComC concerning the accounting purpose while at the same time adopting an act with the accentuated aim to shift the German commercial accounting principles and purposes in the direction of the IAS/IFRS. That proceeding is not self-consistent – until now IPSAS is even based on the IAS/IFRS conceptual framework. Also the complete undocking from the experiences abroad is not sensible with respect to the worldwide convergence of public entities towards IPSAS or IPSAS-based regulations and the tendency within the European Union. The European Commission is already applying IPSAS. It is a matter of time until there is the proposal that also European member states should apply common accounting standards.

91 Cf. *Müller-Marqués Berger* (2009), p. I.

92 Cf. *Bundesministerium der Finanzen* (2008), HGrGMoG, p. 18.

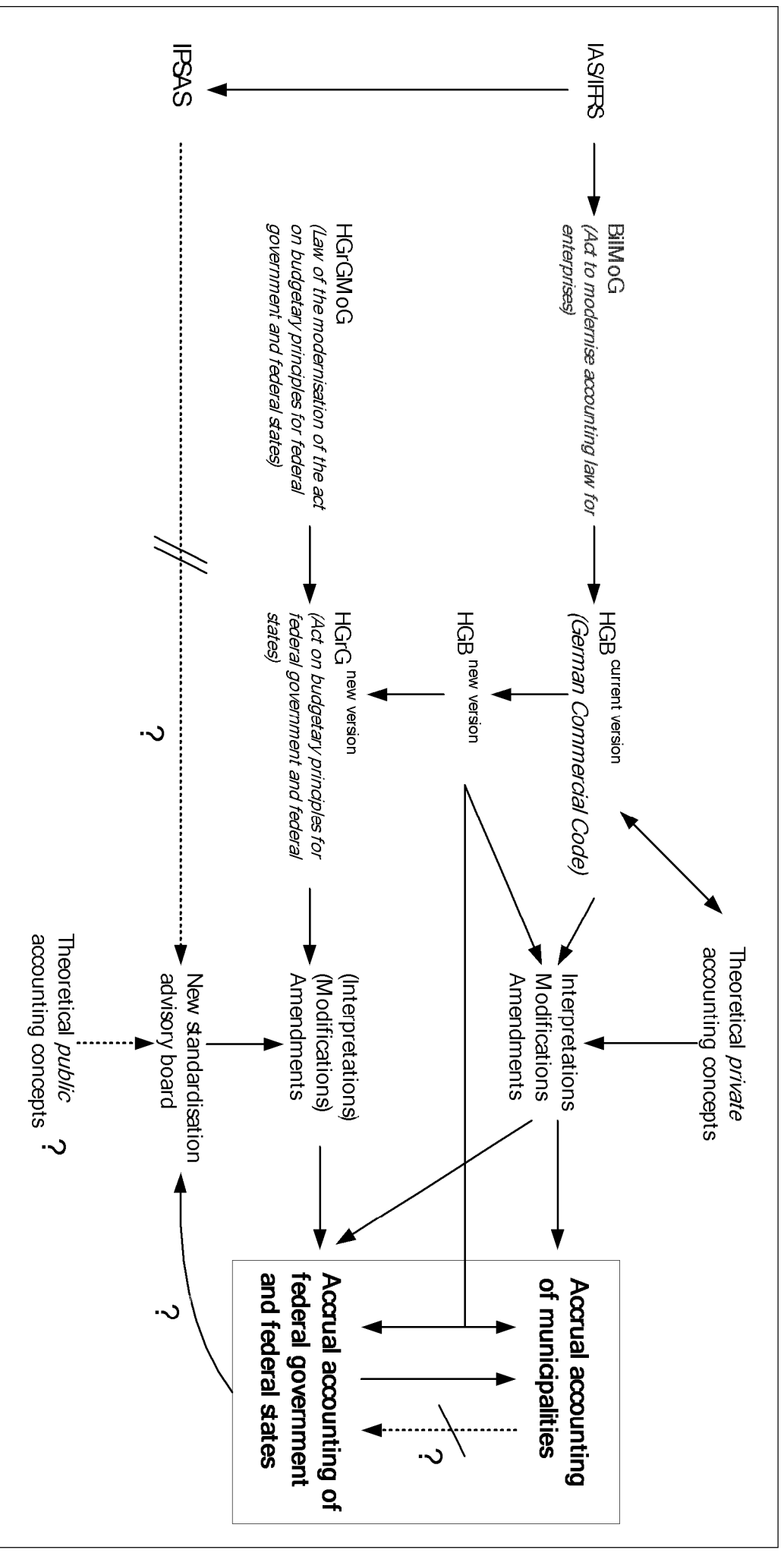


Figure 2: Past and future impacts on public sector accounting in Germany

Source: Own figure, based on Lüder (2009), p. 12

The existence of the IPSAS also proves that there is a need for accounting standards adapted on specific public sector needs. If there are ever trials to merge the different German public sector accounting models or developing a single one that is appropriate for all German territorial authorities it will be necessary to consider the specifics of the public sector. Intensifying tendencies of a noncritical transfer from commercial accounting principles and mindset can be observed. If the BilMoG is also directly relevant for territorial authorities that tendency will be strengthened. This, however, is inappropriate and most problematic. As stated in section 5.1.2, public sector accounting serves different objectives / needs and has different characteristics and users. The addressees of accounting information from the federal government, the federal states and the municipalities are not private investors but citizens / taxpayers. It is in their interest that public tasks are efficiently and sustainably accomplished. According to LÜDER, the purpose of public sector accounting is that information is fairly presented (accountability) and that taxpayers and future generations of citizens / tax payers (not creditors, associates or investors) are protected (stewardship).⁹³ To sum up, there is a need for a (more – that means to the extent possible) homogenous public sector accounting that is adjusted on specific public needs and objectives.

The establishment of a “standardisation board” was claimed by German academics⁹⁴ and the Federal Courts of Auditors⁹⁵ for some time now. It is a step in the right direction. However, the new committee should be in charge of the *entire* public sector accounting (also the local level and the territorial authorities that still use cameral accounting). This might cause, however, some trouble from a juridical point of view since – as mentioned before – the municipalities are part of the federal states and therefore the federal states have the (legal) authority in local public sector accounting. The latter is therefore regarded as “intrastate issue”. Though, it remains to be seen if this new committee will use the “lessons learned” (especially the experiences

93 Cf. Lüder (2006), p. 607.

94 For instance cf. Lüder (2006), p. 612.

95 For instance cf. *Bundesrechnungshof* (2006), p. 14. The Federal Court of Auditors is claiming for a more homogenous accounting and for a preferably broad integration of knowledge in the reform process by consulting as well as embedding academics and experts from other countries and international institutions.

made in the municipal but also in international public sector) and how independent it will be from the federal government. In contrast to commercial accounting, there is still a lack of theoretical public sector accounting concepts in Germany. Public sector accounting is predominantly not a matter of a broad academic research in Germany anymore. It is not clear if and maybe to what extent the new standardisation board will use the results of already existing academic research projects and theoretical bases or even promote new ones. However, it is most probably that once there are common accounting standards for federal government and federal states these will also have an impact on municipal accounting. In all likelihood, the federal states will then also make the local level to adapt to these common standards. So in the long run there is still hope for a more homogenous – maybe even uniform – accounting in the German public sector.

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