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# Accounting in Germany\*

BY KURT SCHMALTZ

Two facts have recently brought new impetus to the discussion of accounting in Germany. The first is the draft of a new corporation law and the second is the establishment of the Institut für Revision- und Treuhandwesen,† which is faced with a future problem similar to that of the American Institute of Accountants.

## 1. DAS INSTITUT FÜR REVISION- UND TREUHANDWESEN

The collapse of German business during the inflation and the subsequent rationalization after the stabilization of the money unit showed more and more forcibly the need for real experts in economic matters. The problems to be solved were no longer purely technical, such as the audit of the books and of the balance-sheet, but to an increasing degree the auditor and the Treuhandgesellschaft were drawn into tax conferences, into the reorganization of costing and industrial accounting, and finally into questions of organization.

At this time, there arose discussion of the question of obligatory, legally regulated, verification of balance-sheets as it exists in England but not in the United States. In the hard times which have lasted from 1924 even up to the present, many firms went into bankruptcy, among them the enormous Stinnes consolidation. As a consequence, ever more vigorous publicity was directed through the commercial press to the idea that corporations be required to publish better business reports and that the balance-sheets be audited by independent accountants. The fraudulent bankruptcy of the great insurance company, Frankfurter Allgemeine Versicherungs Aktiengesellschaft, the directors of which falsified the balance-sheet for years and speculated with the funds of the company, gave increasing support to the idea of the obligatory audit of balance-sheets.

There is yet another point of view to mention. In the period after 1924, the municipalities had carried on expansion in public

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\* Translated by Catharine De Motte Greene.

† "*Institut für Revision- und Treuhandwesen*" may be roughly translated as Institute of Auditors and Trustees. However, *Treuhand* is used in a somewhat more extensive sense in Germany than is implied by our word trustee. Cf. *Proceedings of the International Congress on Accounting*, New York, 1929, p. 110. Further instances of the use of this word, pp. 16ff, 99, and 106. (Translator's note.)

construction and undertakings which often went beyond their actual financial strength. The result of this was that to an increasing extent they were obliged to finance permanent improvements with temporary loans and thereby became involved in ever greater difficulties. Although the condition today has passed the critical point, there is a plan to establish in the near future a yearly obligatory audit of the books of municipal administrations.

Under the pressure of this discussion, the minister of justice took up the question of reform of German corporate organization and the proposed law, which will be discussed later, provides for an obligatory verification of the balance-sheets of corporations by independent auditors.

This required audit of the balance-sheet should not be of a purely formal nature, should not limit itself to a reconciliation between the balances of the ledger and the balance-sheet; it should undertake complete verification of the accounts, including valuation. The auditors must be chosen by the stockholders of the company. The audit itself is regarded as the concern of the company; therefore the report is submitted to the managing board (Vorstand) of the company and the members of the supervisory board (Aufsichtsrat) have the right of inspection. The auditor's report may not reach the stockholders but the managing board is responsible for reporting to the stockholder whether or not the auditor has raised fundamental objections.

The fear had been expressed in Germany that there might not be available a sufficient number of qualified auditors to handle these problems. In this way there arose the idea of creating a completely new professional rank, with substantially higher requirements, for which the new name "Wirtschaftstreuhänder" has been proposed. The several ministries of the Reich, the chambers of commerce of the states, the Conference of German Industrialists (Deutscher Industrie- und Handelstag) as the central organ of the chambers of commerce, and the department of commerce of Prussia (the largest state in Germany) held conferences to decide the requirements which are to determine the preparation for the future Wirtschaftstreuhänder. The deliberations are not yet completed but will surely lead, shortly, to a special law.

In the near future, then, these authorities will create a so-called board of admissions for Wirtschaftstreuhänder before which

those who wish to win the title of Wirtschaftstreuhänder will have to undergo an examination.

To strengthen this development, the influential German Verbände der Revisoren und Treuhandgesellschaften which always take a leading part in the discussion of these questions have established the Institut für Revision- und Treuhandwesen already mentioned, into which only such auditors can be elected as have previously been admitted as Wirtschaftstreuhänder by the official body which is yet to be set up.

So much for the development up to today. It evidently runs parallel to that in the United States in spite of the absence of the obligatory balance-sheet there. However, the professional standing of accountants will be improved if Germany also requires an education at the Handelshochschule as well as the customary practical training with a practising accountant. For the transition period, of course, special regulations will be provided to give the older accountant who is already experienced in active practice an opportunity to enter the new rank of Wirtschaftstreuhänder.

#### THE DRAFT OF A NEW GERMAN CORPORATION LAW

The reasons for the need of a new German corporation law have already been mentioned in part. In part they lie also in the necessity of adapting the technique of financing to systems of law outside Germany, particularly to that of the United States. Let it be recalled that up to now the corporate organization in Germany has been regulated by the general commercial code. The plan is now to withdraw from the commercial code the law of corporations, which will be regulated by a special statute. Naturally it is not possible here to go into the new draft completely. I may touch on only the points that are of special importance to accountancy and the accountant.

*Financing.* The two-fold division of stock into common and preferred shares remain unchanged. These stocks must have a nominal value and may not be issued below par. There was a general effort to secure provision for the issue on no-par stock but this was unsuccessful.

The provision for the so-called "genehmigtes Kapital" which corresponds to authorized capital stock in the United States is new. Also a so-called "contingent" increase in capital will be provided for the case of the issue of convertible bonds, for later

mergers, or for shares with subscription or exchange rights. Such an innovation was urgently needed in Germany because until now it has been impossible to issue convertible bonds under the law except with the help of complex and strained legal interpretations.

Preferred shares without voting rights or with limited voting rights, which have not been permitted by German law until now, have been introduced. Even though they were used only lately in the Siemens bonds which were also floated in the United States, they were used only by circumvention and not without strong opposition. This will be remedied by the new law.

Reserved or provisional shares (Vorratsaktien)\* are forbidden and heavier limitations are proposed for shares with multiple voting rights.

*Balance-sheet and profit-and-loss account.* In contrast to the old commercial code which gave no directions for the balance-sheet and prescribed the method of valuation only to a limited extent, the draft of the new law provides absolutely definite instructions for the structure of the balance-sheet and the profit-and-loss account.

The relation to subsidiaries is justly considered of especial importance. Apart from this consideration, the draft has dispensed with narrower prescriptions for consolidated balance-sheets because it is believed that this question needs further clarification.

#### Arrangement of the balance-sheet

The following is the basic arrangement of the published balance-sheet if the business does not use a yet more detailed arrangement:

- I. Subscriptions in arrears to the original capital stock.
- II. Fixed assets.
  - 1. Real estate, exclusive of buildings.
  - 2. Buildings.
    - (a) Office or shop building and dwelling houses.
    - (b) Factory building and other buildings.
  - 3. Plant and equipment.
  - 4. Tools, factory and office fixtures.
  - 5. Concessions, patents, licences, trade marks and similar rights.

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\* See *Entwurf eines Gesetzes über Aktiengesellschaften und Kommanditgesellschaften auf Aktien* page 119.

III. Participation in subsidiaries including such securities as are defined as constituting participation.

Holding shares whose par value equals one-fourth of the par value of the original capital stock of a corporation or holding one-fourth of the shares (Kuxe) of a cost-book mining company (Gewerkschaft) constitutes participation.

IV. Current assets.

1. Raw materials, supplementary materials and supplies.
2. Work in process.
3. Finished goods, merchandise.
4. Securities, with a detailed statement of the specific shares, except those to be entered under III or IV, 10.
5. Mortgages and other securities based on land, Grundschulden, Rentenschulden.
6. Prepayments made by the company.
7. Trade debtors.
8. Claims against subsidiaries.
9. Claims on members of the managing board, the supervisory board and salaried officers.
10. Bills of exchange and cheques.
11. Cash, including balances in banks of issue and postal deposits.
12. Other bank deposits.

V. Deferred charges to expense.

On the credit side, there must be shown among other items, the liabilities classified as follows:

1. Loans to the company listed according to their hypothecated security.
2. Mortgages on the real estate of the company, Grundschulden, Rentenschulden. Mortgages which serve as security for loans and Sicherungshypothecken, a type of obligation which is not customary in the United States, are excluded from this heading.
3. Prepayments by customers.
4. Trade creditors.
5. Obligations to subsidiaries.
6. Obligations to members of the administration and to salaried employees.
7. Obligations for the acceptance or issue of bills of exchange.
8. Obligations to banks.

In the case of fixed assets, both the additions to and the deductions from the several accounts are to be shown. The balancing of claims against debts is not permissible; the same is true of mortgage obligations not based on a personal claim. Reserves for replacement, other reserves and valuation accounts may not

be shown under the liabilities of the company. In so far as claims or obligations fall under several headings, their interrelation with other entries is to be made clear under the heading where they are exhibited. Commitments on account of surety bonds, guaranteed drafts or guaranty contracts are to be indicated in full on the balance-sheet together with the equivalent claims to recourse on the opposite side.

#### Arrangement of the profit-and-loss account

In this case also the prescribed arrangement applies only when the business does not employ a more detailed scheme or when the peculiar nature of the undertaking does not require a divergent scheme. Thus banks, for example, would have to use another arrangement. Aside from these instances, at least the following facts are to be shown:

1. Wages and salaries.
2. Taxes for social purposes.
3. Depreciation of plant.
4. Other depreciation.
5. Interest—excess of interest expense over income.
6. Property tax of the company.
7. All other expenses with the exception of expenses for raw material, supplementary material and supplies, or, in the case of commercial enterprises, with the exception of cost of merchandise purchased.

On the side of revenue:

1. Revenue from participations.
2. Interest—excess of income over expense—and other capital revenue.
3. Unusual revenue and donations.

It is not possible to add here a detailed review or criticism; in contrast to the usual practices in Germany at present, these regulations, if they become law, signify vast improvement. The American reader, who is accustomed to his well-arranged profit-and-loss account, will miss first of all the showing of income from sales. Actually, the arrangement in the present form is a compromise between the detailed statement of all income figures which is usual in the United States and the showing of a net figure for income which is usual in Germany. It is not impossible that the demand for the publication of the figures for operations will yet be taken up, especially as the point plays an important part in the public discussion on all sides.

*Rules for valuation.* It is a special merit of the proposed law, in contrast to the provisions of the old statute, that it has given precise instructions for valuation. In particular, the following is prescribed in regard to valuation for the balance-sheet:

1. Plant, securities and other objects of value which are permanently connected with the operations of the business may be stated, without consideration of a lower value, at the purchase price or production cost if the probable loss in value which results from distributing the cost of the asset through its entire life is brought into the statement as a deduction or in the form of a valuation account. In calculating production cost, depreciation may be taken into consideration to a reasonable extent and a reasonable share of the operative and management costs which applies to the period of the production may be allowed for; selling costs do not rank in this case as part of the operative and management costs.

2. Merchandise, securities and other objects of value which are not permanently connected with the operation of the business may not be shown at a higher value than the purchase price or production cost. Production costs are calculated as for permanent assets. If the purchase price or production cost is higher than the market or exchange price on the day of the balance-sheet, market or exchange price is to be used. In the case where there is no established exchange or market price, if the purchase or production price is higher than the value to the business which may be attributed to the asset, this latter value is to be used.

3. Debts of the company, listed under liabilities are to be appraised at the amount to be repaid. If the repayment amount is higher than the price at which they were issued, the difference may be shown separately under the assets. The debit account hereby set up must be written off yearly by amortizing it over the life of the debt or in any case in such a way that the debit account is written off by maturity.

4. The costs of organization may not be set up as assets.

5. Entries may not be made among the assets for goodwill or going concern value. If the actual payment for the purchase of an enterprise exceeds the sum of the values of the individual assets as ascertained at the moment of purchase, the difference may be shown separately among the assets. From the debit entry thus set up there must be written off yearly at least an amount corre-



sponding to the decrease in value which has taken place during the balance-sheet period.

6. The amount of the share capital is set up under the liabilities at the nominal figure.

The American reader will find a precise basis and definition of the well-known rule "cost or market, whichever is lower." Here is a clear definition of the concept of cost, over which there has been so much discussion. Cost includes wages and materials with the overhead costs of management and administration, but not the selling costs. It can even be said that the draft includes under cost the total costs, exclusive of selling costs.

The provision that the organization expenses may not be shown as assets and that goodwill may be included only when it originates through the purchase of an enterprise as a whole has remained the same. American practice proceeds somewhat differently here also. According to German law, capitalizing goodwill without the purchase of the enterprise as a whole is not permissible.

The question of secret reserves, so important in Germany in contrast to the United States, has become so regularized that these reserves are allowed now as previously, but they may not appear in the form of fictitious or fabricated liabilities.

#### SUPPLEMENTARY INSTRUCTIONS ON BUSINESS REPORTS

The proposed law requires supplementary statements in the business reports. The corporation is required to report on its relations to other companies if it is decisively influenced by such relations. This applies especially to relations with subsidiaries. Further, it is to be stated whether and by what office an audit of the yearly closing of the books has been made and whether the audit raised any essential objections. Finally, the following statements are to be made in the business reports:

1. Stocks issued before or after the law goes into effect which have been taken over from the shareholder as promoter or underwriter or in the exercise of a subscription right for the account of the corporation, the amount realized on these stocks and the use made of the proceeds.
2. Stocks with suspended voting rights (*gebundene Aktien*), their amount and the use made of the proceeds.
3. In the case of the issue of shares in exchange for other securities, the amount of shares acquired in the past fiscal year.

4. The authorized capital stock.
5. Participation certificates (*Genuszscheine*) issued before or since the law went into effect.
6. The maturity date of long-term obligations.
7. Indorsement relationships, including hypothecations and Sicherungsübereignungen, which are not evident in the balance-sheet and other legal relationships not taken into consideration in the balance-sheet, according to the rights or obligations that exist or will arise for the corporation.
8. Loss that will probably result from the later completion of sale or purchase commitments or in any other way.
9. The association of the corporation with syndicates and cartels, business agreements and similar affiliations.
10. Occurrences of particular significance since the end of the period of the report.

I must forego a review of the other new regulations at this time. The American reader will be able to perceive from the above review of the text that the new regulations are welcomed in Germany in spite of their many defects. Public opinion must first occupy itself with the draft and then a second, more conclusive draft will be laid before the reichstag for passage.