



Newsletter

For our clients and business associates

July 2009

Editorial

Ladies and Gentlemen:

In the process of steering a company, you take risks aimed at generating values from opportunities. To this end, under the impact of changing corporate conditions, a suitable security standard must be found and continually adjusted. However, an overly high security standard may prevent the realisation of opportunities inherent in a competitive environment and may itself become a dangerous risk. The security level in companies should therefore be sufficiently flexible to ensure an acceptable scope of risk exposure at all times. Business processes and information systems form the basis for both risk-weighted activities and also for the accompanying necessary security processes.

Financial and accounting-related corporate data are communicated to internal and external addressees. The degree of detail and swift availability are becoming ever more important in this respect. Due to amendments to the law and changed accounting standards on the one hand, and to technological challenges on the other, companies are acting in a very complex environment. The requirements placed on the Supervisory Board and Management as the steering corporate bodies are increasing steadily, as has been reflected in "Corporate Governance Legislation" (Corporate Sector Supervision and Transparency Act [KonTrAG], Transparency and Public Disclosure Act [TransPuG] u. a.) in recent years. How are risks assessed and monitored at your company? With the appropriate interdisciplinary knowledge, the required capacities of

experienced advisers, an international network and suitable tools, we assist you in the determination of Corporate Governance, in the introduction of an efficient risk management system, in establishing an internal audit function or in optimising internal auditing processes.

When carrying out other projects (e.g. outsourcing, project management, Sarbanes Oxley Act SOX 404), our specialists will assist you in order to combine efficient corporate action and suitable risk monitoring through the optimisation of business processes and information systems.

Our "Risk Consulting" staff offers you comprehensive services in this field, and our network association, Crowe Horwath International, provides these services at international level, as required.

We place particular emphasis on the field of information technology within the scope of IT audit support and IT consulting. We also provide support for colleagues in the profession.

We have structured our services in the form of a modular system which permits us to prepare a customised proposal for you. We would be happy to compile a suitable combination of various advisory products according to your specific requirements at any time. More extensive information can be found on our homepage. If interested, you may also contact Mr. Wolf-Dietrich Richter directly.

With compliments,
Andreas Haas



Andreas Haas



Wolf-Dietrich
Richter

Events

On 29 May 2009 a comprehensive modernisation of German accounting was agreed upon. Take advantage of the possibility to discuss with us the effects and opportunities arising from the modernisation of accounting law. We would like to invite you to join us in adjusting to the significant changes in good time.

While most of the adaptations to the accounting and valuation provisions initially apply to financial years beginning after 31 December 2009, practical implementation should begin at an early stage. We would like to support you in this process and offer you various events within the scope of a modular concept:

- 19 October 2009, 4:00-7:00pm
Key issues of practical relevance to individual financial statements pursuant to the accounting modernisation law [BilMoG]
- 10 November 2009, 4:00-7:00pm
What changes does the BilMoG bring with respect to consolidated financial statements prepared according to German commercial law [HGB] and where is there a need for action?
- 23 November 2009, 4:00-7:00pm
Practice workshop on deferred taxes pursuant to BilMoG

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AWT HORWATH NEWS

Christian Salzberger Sworn in as Wirtschaftsprüfer

We are pleased to inform you that our staff member, Christian Salzberger was sworn in as a German Public Accountant [Wirtschaftsprüfer] on 20 July, 2009.

This will further broaden our professional auditing competence. We congratulate Mr. Salzberger on his performance and wish him much future success in his professional activities. ■

WP/StB
Christian Salzberger


AUDITING

BilMoG and ISA Adoption

Modernisation of the accounting law (in short: BilMoG) has not only brought changes in the field of HGB [German Commercial Code] accounting, but also with respect to financial statements audits (Sections 316 et seq. HGB). One of these changes is still on hold, as it were, but it will have some effects on all audits of financial statements:

Section 317 (5) HGB in the BilMoG version implements Art. 26 (1) of the revised 8th EU Directive (so-called Statutory Audit Directive) into German law.

Accordingly, statutory annual audits are to be performed in direct compliance with International Standards on Auditing (in short: ISA).

As a precondition for direct application of ISA, the international auditing standards must be adopted by the EU Commission in a so-called comitology procedure; i.e. they must be elevated to the status of European Law by an Act of State. Only after the ISA have been adopted can they be applied directly within the scope of financial statement audits in German companies.

What does this legal obligation mean with respect to direct application of ISA in the audit of financial statements?

In Germany, all audits of financial statements are already performed in general compliance with ISA. However, the ISA are not valid directly; instead the standards "transformed" into national auditing standards (IDW auditing standards) by the German Institute of Certified Public Accountants [Institut der Wirtschaftsprüfer in Deutschland e.V. (in short: IDW)] are used.

The significant difference concerning the IDW auditing standards relates to the more principle-oriented implementation of international auditing provisions.

Accordingly, implementation options regarding the extent of compliance with national auditing standards within the scope of individual annual audits are also dependent on the discretionary scope exercised by the auditor. While this discretionary scope is already very limited today, not every single audit specification needs to be processed in each audit if not justified by the circumstances. The IDW auditing standards represent generally accepted principles of appropriate financial statements auditing and do not have the character of law.

The ISA, by contrast, are structured in a different manner. Historically, they originate from a rather individual case-oriented viewpoint. Within the framework of the "Clarity Project" which was intended to create the preconditions for ISA adoption, the ISA were to be more uniformly structured in a more principle-oriented way.

The "Clarity Project", which was concluded at the end of 2008, led to a standardised ISA structure classified into "Requirements" (obligatory requirements) and "Application Material" (additional material/application aids). However, the declared goal of the "Clarity Project" – a more principle-oriented build-up – was not achieved, according to the opinion of experts: Instead of the existing ca. 330 requirements, the ISA now include more than 660 requirements, i.e., twice as many obligatory individual requirements concerning the performance of audits are to be processed per audit.

The reason for this is that the ISA concept is oriented towards the annual audits of listed corporations.

What is the present status of the ISA adoption process?

In June 2009, the EU Commission* presented a consultation paper on ISA adoption where the focus is on the following questions:

1. Should the ISA be adopted in the currently presented form (according to the Clarity Project)?
2. Should the ISA be applied uniformly to all financial statement audits (statutory and voluntary, at listed and non-listed companies)?
3. When should the ISA be applied at national level for the first time?

In connection with these questions, our profession stressed that the legislative procedure aimed at the adoption of ISA into national law must provide for the possibility to adjust the ISA to the conditions prevailing at the specific company.

"Customizing", i.e. "scalability", must be possible when applying ISA in individual annual audits.

This "scalability" must be permitted to the respective auditor without the requirement of providing extensive additional documentation.

Without the possibility of customising ISAs as individually required, this would involve considerably increased efforts when performing annual audits, which would not only concern us as the annual auditors but all companies which, in the end, are the addressees of risen audit evidence and documentation requirements.

A study conducted by the Duisburg-



WP/StB
Andrea Bruckner,
Partner

* http://ec.europa.eu/internal_market/consultations/2009/isa_en.htm

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Essen University on ISA adoption, which was commissioned by the EU Commission, indicates cost increases of between 6 % and 10 % at the major auditing companies Europe-wide. However, according to the study, these cost increases will be matched by increased benefits which, overall, will lead to an advantage when EU auditing standards are standardized.

When can we expect first-time application of ISA in annual audits?

We estimate that, at latest, ISA will have to be applied in 2012 for annual audits for financial year 2011 since the auditing tools of all auditors/auditing companies must be adapted. However, in the opinion of the EU Commission, uniform auditing standards should be applied Europe-wide as

quickly as possible. Therefore, application may also take place earlier. This would then have to be done parallel to first-time application of accounting standards pursuant to BilMoG.

We will pay careful attention to all respective developments and hope that the ISA will be implemented moderately at national level. ■

ACCOUNTING

■ IDW RH HFA 1.016: Admissibility of a Component-based Depreciation of Property, Plant and Equipment in Accordance with Commercial Law

On 29 May 2009, the IDW Central Committee [HFA] passed the IDW accounting note: Commercial admissibility of component-based scheduled depreciation of property, plant and equipment (IDW RH HFA 1.016). This was instigated by the BilMoG, which revokes the possibility to set up accu-

mulated accruals. The HFA comments on the preconditions required to permit accumulated accruals in the commercial financial statements in accordance with the "component approach" defined under IAS 16, specifically to determine the amounts of scheduled depreciation of a property,

plant and equipment item on the basis of components. The "component approach" is characterised by the splitting up of physical assets to individual components, each with separate valuation, for balance sheet valuation purposes. ■

INCOME TAX

■ Change in Legal Practice: Maintenance of Two Households Even in the Event of Relocation of the Principal Place of Residence

As a result of a change in the jurisdiction of the Federal Fiscal Court [BFH], income-related expenses incurred for a second home that is maintained for occupational reasons can also be claimed for tax purposes in cases where the maintenance of two households was a consequence of relocation of a family's place of residence away from the place of work.

To date, income-related expenses were tax-recognised only if the maintenance of two households was due to the fact that a job was taken on at another location. If the family's place of residence

was relocated away from the place of work and, for this reason, a place of residence was maintained or newly occupied at the place of work, the deduction of income-related expenses incurred due to relocation for private reasons was permitted only under very limited preconditions.

The Federal Fiscal Court changed its jurisdiction in two recent decisions of 5 March 2009 (VI R 23/07 and VI R 58/06). According to these decisions, the only prerequisite for the tax deductibility of income-related expenses is that the second home is maintained for

job related purposes at the location of work and the family residence must represent the centre of vital interests. Consequently, whether or not the maintenance of two households resulted from taking on an activity at another place or from relocation of the family's place of residence is no longer a decisive criterion. When giving reasons for the decision, attention was once again drawn to the fact that rental expenses to be incurred for the upkeep of two homes should not exceed the amount of the average rental expenses for a 60 sq.m. apartment at the place of work. ■

CORPORATE INCOME TAX

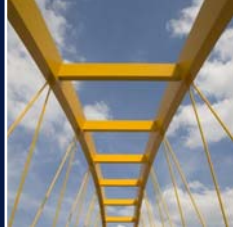
■ Reorganisation Concerning Loss Deduction

The loss deduction limitation pursuant to section 8c KStG [German Corporate Income Tax Act] which was tightened as a consequence of the 2008 Corporation Tax Reform, is currently proving

to be an economic impediment in the reorganisation of weakened companies.

The current provision of section 8c KStG, for example, provides for com-

plete abolition of losses in the event that more than 50 % of shares are transferred. If more than 25 %, and not more than 50 % of shares are transferred, the losses are abolished on



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a prorated basis. Moreover, in contrast to the predecessor regulation of section 8 (4) KStG, section 8c KStG does not include a reorganisation clause so far.

This was changed by the Citizens' Relief Act [Bürgerentlastungsgesetz], which was announced in the Federal Official Gazette on 22 July 2009. In accordance with this Act, Section 8c KStG was supplemented retrospectively by a limited reorganisation clause stipulating that losses will not be abolished in the event of an investment acquisition undertaken for reorganisation purposes. This involves acquisitions made in the period from 1 January 2008 to 31 December 2009. It is therefore advisable to examine acquisitions made during this period in consideration of this amendment. In detail: According to the wording of Section 8c KStG, reorganisation is a measure aimed at

- preventing or eliminating the inability to pay or indebtedness, and
- maintaining the significant corporate structures at the same time.

Hence, the reorganisation clause presupposes that, at the time of acquisition of the investment, an entity is in need of - and capable of - being reorganised. Moreover, the new shareholder's intention to reorganise must be apparent, and the measures planned for reorganisation must be suitable for actually leading the entity out of the crisis. However, making use of the reorganisation clause is independent from the reorganisation success. Since these preconditions are formulated in vague terms only, it is advisable to document all measures planned in a reorganisation plan.

In the view of the legislator, maintaining significant corporate structures presupposes that

- the entity acts in compliance with a concluded company agreement involving a workplace regulation; or
- the sum total of the decisive annual wage amounts is not less than 400 % of the initial wage amount within 5 years after acquisition of the shares. The initial wage amount is the average wage total for the past 5 years. A Small Company provision applies in this context, however, according to which the wage total regulation shall not apply if

the initial wage total is € 0.00 or if the business has not more than 10 employees; or

- the entity is provided with significant operating assets within 12 months after the acquisition either through contributions to capital or the waiver of (value-containing!) liabilities. The new operating assets must represent at least 25 % of the assets reported in the tax balance sheet at the end of the preceding financial year, which means that the tax-based book values are decisive. It should be noted in this context that this quota relates to the acquisition of all shares. If not all shares are transferred, the amount to be contributed to the operating assets will be reduced correspondingly. Moreover, the new regulation stipulates that payments of the corporation made between 1 January 2009 and 31 December 2011 reduce the value of the operating assets contributed. This is a means of preventing that contributed operating assets are repaid to the shareholders. According to prevailing opinion, the term "payment" should include all payments made as a result of the corporate relationship, i.e., it includes both open and hidden profit distributions, the return of contributions to capital or capital repayments.

In contrast to the initial discussions, these prerequisites now represent an alternative in the final version of the law, i.e., at least one of the prerequisites mentioned must be met.

In the event of multi-stage entities, the reorganisation clause will probably also be applied to controlled companies if the controlling company is involved in an investment acquisition. This means that, in such a case, the resulting indirect change in the shareholder structure with respect to the controlled company may also be impacted by this regulation. However, as an important criterion, the prerequisites of the reorganisation clause must be met by the controlled company that wishes to maintain the loss carryforward.

The reorganisation clause is of no effect if the corporation has already ceased activities at the time of the investment acquisition or if the sector of industry is changed within 5 years after

the investment acquisition.

It has further been announced already that fundamental reworking of the loss deduction limitation is planned for the years from 2010 onwards, but most likely not before the election for the "Bundestag" in September.

In addition to the newly introduced reorganisation clause of Section 8c KStG, the reorganisation decree (BMF communication of 27 March 2003) provides for additional tax relief options in the context of corporate reorganisations.

Specifically, the taxes relating to the proportion of reorganisation gains that cannot be set off against losses can be deferred or may even be waived in the event of reorganisation. ■

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Editorial Staff: Andrea Bruckner, Manuel Rauchfuss, Friedrich Schröder, Günter Wagner, Dr. Susanne Scharpf.
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AWT Horwath GmbH Wirtschaftsprüfungsgesellschaft
Leonhard-Moll-Bogen 10 | 81373 Munich
Phone +49 89 76906 0 | Fax +49 89 76906 144
awt@awt-horwath.de

Berlin Branch
Zimmerstraße 69 | 10117 Berlin
Phone +49 30 203929 0 | Fax +49 30 203929 66
berlin@awt-horwath.de

Chemnitz Branch
Sophienstraße 7 | 09130 Chemnitz
Phone +49 371 4348 0 | Fax +49 371 4348 300
chemnitz@awt-horwath.de

Mönchengladbach Branch
Vierhausstraße 18 | 41236 Mönchengladbach
Phone +49 2166 6205 0 | Fax +49 2166 6205 31
moenchengladbach@awt-horwath.de

AWT Seltmann GmbH Rechtsanwalts-gesellschaft Steuerberatungsgesellschaft
Leonhard-Moll-Bogen 10 | 81373 München
Phone +49 89 74325 0 | Fax +49 89 74325 544
info@awt-seltmann.de

AWT Horwath Steuerberatungsgesellschaft mbH
Sophienstr. 7 | 09130 Chemnitz
Phone +49 371 4348 0 | Fax +49 371 4348 300
chemnitz@awt-horwath.de

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