



JURISTISCHE FAKULTÄT



UNIVERSITÄT
HEIDELBERG
ZUKUNFT
SEIT 1386

Zusammenfassung der Dissertation mit dem Titel

„IFRS, Bilanzrechtsmodernisierung und Überschuldung“

Dissertation vorgelegt von Nikita Litsoukov

Erstgutachter: Prof. Dr. Dres. h.c. Werner F. Ebke

Zweitgutachter: Prof. Dr. Carl-Heinz Witt

Institut für deutsches und europäisches Gesellschafts- und Wirtschaftsrecht

IFRS, accounting law modernization and bankruptcy
(IFRS, Bilanzrechtsmodernisierung und Überschuldung) – Nikita Litsoukov,
Ruprecht-Karls-Universität Heidelberg, 2013

The scientific work at hand discusses a subject which has so far been rarely discussed in the German legal literature. While German law, especially as far as German listed companies are concerned, is already familiar with the International Financial Reporting Standards (IFRS), it has until recently not allowed large room for discussion regarding the application of IFRS at the level of non-listed companies. As a first step towards IFRS, in 2009 the German legislator decided to implement certain provisions and principles laid down in the IFRS and codify part of such principles in German law (without fully adopting entire accounting standards). The Accounting Law Modernization Act (*Bilanzrechtsmodernisierungsgesetz*, BilMoG) paved the way for a comparative law analysis of the IFRS in relation to the other applicable German GAAP provisions under the German Commercial Code (*Handelsgesetzbuch*, HGB).

Against this background, the center of analysis of this scientific work has been the question whether or not an application of IFRS to the balance sheet test, which is prepared in order to determine whether a German company is insolvent, would be permitted and feasible under German law. A German company does not only have to file for bankruptcy in case of a lack of liquidity (Section 17 of the Bankruptcy Act, *Insolvenzordnung*, InsO). Limited liability companies (GmbH) and stock corporations (*Aktiengesellschaften*, AG) also have to file for bankruptcy, if – after a balance sheet test – the assets of the company are not at least equal to its liabilities (Section 19 InsO). This balance sheet test has been subject to discussion in the course of the financial crisis. The German legislator after the collapse of Lehman Brothers, like other governments, introduced financial stabilization measures contained in the Financial Stabilization Act (*Finanzmarktstabilisierungsgesetz*, FMStG). In the Act, the German legislator in effect questioned the feasibility of the balance sheet test, as applied before, since it amended Section 19 InsO in order to provide that a company is not insolvent under German law even if its assets are not equal to its liabilities, if a cash flow estimate (*Fortführungsprognose*) would permit the company to survive in the future. Bearing in mind these changes, which were subject to a limited time of application at first, the analysis of this scientific work focused on whether IFRS could be applied in the course of the balance sheet test under German bankruptcy law (Section 19 InsO).

The InsO does not contain accounting provisions. The applicable principles within the balance sheet test therefore are based on case law and legal literature. Often times

courts tended to apply German GAAP subject to certain modifications. These modifications mainly focused on the prudence principle under German GAAP (*Vorsichtsprinzip*) and related accounting principles. The prudence principle was deemed inconsistent with the purposes of the balance sheet test under Section 19 InsO, as the application of the prudence principle often lead to the existence of hidden assets (*stille Reserven*) in the balance sheet. While this consequence under the German GAAP applicable to annual financial statements was deemed acceptable (as there is no solvency test under German law in order to determine the permissibility of dividends to shareholders of a company), from a creditor protection perspective, German insolvency law was headed a different path. From the perspective of the creditors, a too early insolvency of a limited liability company is not always beneficial. A company which has the potential to survive should not be put under the bankruptcy regime, which until recently (until the Act on the Further Easing of Turnarounds, *Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen*, ESUG), meant that the debtor was excluded from the control of its company and a insolvency administrator (*Insolvenzverwalter*) was in control of the company's business and assets. IFRS, while also applicable to annual financial statements of certain European companies, are not mandatorily applicable to the annual financial statements of German companies. The reason for this is, that they do not follow a similar prudence principle as German GAAP. Hidden assets under IFRS exist more rarely than under German GAAP as many assets are not only recognized at cost but also every year (or more often) measured at fair value. This concept was criticized in the financial crisis as many commentators argued that a fair value valuation was also responsible for a large scale deterioration of financial assets during the financial crisis (such as asset backed securities, ABS).

1. In a first step, this scientific work compiles and analyzes the applicable principles under German law to the balance sheet test under Section 19 InsO. Taking into account the various definitions of „asset“ under German insolvency law, commercial law and tax law, the author suggests that the concept of definition of „asset“ under the balance sheet test of Section 19 InsO should be similar to the commercial law concept of „asset“ under German GAAP. Divergences were unmerited from a creditor perspective and from the perspective of management. However, the predominant view in the legal literature is not (without more) willing to apply the concept of economic ownership in German bankruptcy law. This, in the authors view, is leading to unwarranted divergences in relation to German GAAP.

From a liability perspective, however, the concepts under German GAAP and under bankruptcy law are similar. The rules for provisions (Section 249 HGB) are in fact applied by courts on a regular basis within the balance sheet test under Section 19 InsO. This in the authors view is correct.

As to the goodwill provisions, the author thinks that only derivative goodwill should be considered in the balance sheet test. Considering original goodwill would lead in effect to an application of the corporate valuation principles in German bankruptcy law. The author sets out that the purposes of corporate valuation are applicable in order to evaluate the shares of a company and are serving the shareholders' interests and the purposes of an acquirer of the company much more and better than the purposes of the creditors in advance of insolvency.

The author takes a differentiated view on the application of the cost model at the level of measurement within the balance sheet test of Section 19 InsO. The author thinks that the cost model in certain cases is better suited for the creditors' interests than a mark to model approach under the fair value concept, as the mark to model approach would under certain circumstances allow for accounting judgment.

2. After this initial analysis, the author in a second step moves on to analyze the changes of the Accounting Law Modernization Act (*Bilanzrechtsmodernisierungsgesetz, BilMoG*). The Act modified certain accounting principles under German law and is considered to be the largest accounting law reform in Germany for over 20 years. For example, it introduced a fair value concept in German law, which however mandatorily only applies to banks and other financial institutions (*Kreditinstitute und Finanzdienstleistungsinstitute*). The assessment of the effects on the annual financial statement was the first task of this second step of the analysis. The author's assumption was that if the changes of the BilMoG were leading to a decrease in hidden assets under German GAAP, the BilMoG would potentially be better suited for an application within the balance sheet test under Section 19 InsO than the previous German GAAP.

However, the author finds that the changes, although affecting a wide array of provisions (i.e. pension provisions, intangible assets, goodwill, hedge accounting, deferred taxes) did not result in a complete change of the prudence principle. The prudence principle still continued to apply as to most of the assets and liabilities with only minor modifications.

From the perspective of Section 19 InsO, however, the author thinks that the introduction of the fair value concept under Section 255 para. 4 HGB would suit the needs of the balance sheet test. This is because, in the absence of a reliable value under the mark to model concept, Section 255 para. 4 HGB requires to apply the cost model, which the author previously has determined to be in part consistent with the creditors' interests. The creditors, in particular, are also interested in the valuation of the assets of a company to be reliable when applying the balance sheet test of Section 19 InsO. Otherwise the balance sheet test of Section 19 InsO would be subject to a wide array of management's judgment.

Largely, the BilMoG improved the consistency of the balance sheet test under Section 19 InsO and German GAAP due to the abolition of optional accounting methods (*Bilanzierungswahlrechte*). The application of optional methods within the test of Section 19 InsO would subject the balance sheet test to even more judgment of the management. Therefore, the author finds German GAAP as modified by the BilMoG to be more compatible with the balance sheet test under Section 19 InsO than prior to the BilMoG.

3. After this review, in a third step the author discusses the application of IFRS to the balance sheet test. This question could become relevant as European companies may prepare their annual financial statements in accordance with IFRS and may at the same time be subject to German insolvency law, if doing business in Germany. In this case the balance sheet test under German law would also apply to them. The initial step of the balance sheet test would, however, attach to the IFRS numbers contained in their balance sheet.

The asset liability approach of the IFRS (including the fair value model) theoretically suits the needs of the balance sheet test better than German GAAP. However, IFRS do not only follow an asset liability approach but also a deferral matching approach. This approach has the purpose of allocating revenues and expenses to different time periods (i.e. to this and the next financial year). This concept is inconsistent with the balance sheet test. The balance sheet test of Section 19 InsO serves the sole purpose of showing the debt servicing potential of a company at a given point in time. It does not also serve the purpose of informing the creditors of the assets and liabilities of the company in regular intervals (i.e. on an annual basis). Therefore, the IAS 11 rules on the percentage of completion method, as they constitute outflows of the deferral matching approach, should be

applicable to the balance sheet test under Section 19 InsO only to a limited extent. Due to a lack of reliability of the IAS 39 rules (several categories of financial instruments which in the past could be used to recategorize financial instruments) and the IAS 36 rules (too much judgment in identifying cash generating units) these rules were also determined to be inconsistent with the balance sheet test under German insolvency law.

Overall however, IFRS are suited for an application to the balance sheet test. However, neither IFRS nor German GAAP (as amended by the BilMoG) are not directly applicable. A transitional calculation to the principles under German bankruptcy law is still required. Without giving a definite preference to one or the other concept, the author thinks that German insolvency courts will in the future face IFRS more often in their jurisprudence, as on the one hand certain principles of IFRS were codified in the BilMoG and on the other hand European companies who prepare their annual statements in accordance with IFRS could be subject to German insolvency law.

4. In sum, the author thinks that the BilMoG has opened German law for comparative analysis with the IFRS. This is a new development which German GAAP were unaware prior to the adoption of BilMoG. However, BilMoG itself cannot be fully traced to the IFRS. Therefore an interpretation of the BilMoG provisions, solely based on IFRS would also not be suitable. As to Section 19 InsO it remains to be seen which importance the balance sheet test will have in the future. It is, in the author's view, clear that the international developments in the law of accounting will continue to influence the application of accounting provisions within the boundaries of Section 19 InsO in the future. The limited compatibility of the IFRS with Section 19 InsO, although based on a theoretical concept which is suitable from the creditors' perspective in advance of insolvency, results from the nature of IFRS as being primarily accounting provisions for the consolidated balance sheet of listed companies. This makes it questionable to apply these standards to non-listed companies with little experience in the application of IFRS. However, as has been shown in relation to European companies which apply IFRS to their annual financial statements, the application of IFRS to their balance sheet test of Section 19 InsO is not a theoretical question. In the author's view, German legal literature should in the future investigate the applicable standards to the insolvency balance sheet tests of foreign companies further.