NOT ONLY A DIFFERENT POINT OF VIEW...

"The Financial Statements of the company must, in compliance with generally accepted accounting principles, present a true and fair view of the net worth, financial position and results of the company" (§ 264).

"Historically, German financial reporting has not claimed to provide a "true and fair view" of economic reality for the company. The accounting does not present a clear picture of divisional profits at any level". Haskins Ferris Selling: International Financial Reportings and Analysis, Irwin 1996

POINT OF VIEW ON VOLKSWAGEN AG 1994

- Inside the front cover is a mass of "key figures", void of any narrative or extensive statement of mission, vision or strategy;
- the first piece of text is the report of the Supervisory Board followed by a letter of stockholders from Mr. Piëch, a person not identified;
- Mr. Piëch's letter is factual, to the point, and in no way inspirational or constituent-relationship building;
- the Board of Management is all male;
- the asset side of the balance sheet begins with fixed assets and the equity side begins with stockholders' equity;

POINT OF VIEW ON VOLKSWAGEN AG 1994

- basically, all liabilities are collapsed into one line on the face of the balance sheet;
- goodwill is not capitalized but rather charged to reserves;
- depreciation expense is tax-code driven for the Group Companies;
- long-term financial investments are reported at cost, not market;
- loans are stated at cash value, not market or present value;
- a very large equity account called “revenue reserves” is akin, at least in part, to retained earnings;

POINT OF VIEW ON VOLKSWAGEN AG 1994

- there is no management statement taking responsibility for the integrity of the financial statement;
- the auditors' report is very terse and gives no indication of audit approach;
- pages 88-91 provide 10 years' of <u>detailed</u> key data.

LEGAL BASIS

- German Law; basically Third Book of German Commercial Code; special laws apply, determined by the entity's legal form and industry.
- Supreme Tax Court decisions, etc.
- Generally accepted accounting principles; general practice.

- FASB statements and Interpretations, APB-Opinions, CAP-ARB's
- Other professional pronouncements with authoritative support.
- General Practice.
- SEC requirements (Regulations S-X, ASR) for publically traded companies.

COMPONENTS OF FINANCIAL STATEMENTS

1. Balance Sheet
2. None
3. Profit and Loss Statement
4. Notes to the Financial Statements
5. Optional
6. Comparative figures of last year required.

1. Balance Sheet
2. Statement of Shareholders' Equity
3. Profit and Loss Statement
4. Notes to the Financial Statements
5. Statement of Cash Flows
6. For SEC registered companies, comparative figures are required for previous two years (B/S only one year) (regulation S-X, Rule 3-01). Non-public companies are not required to disclose comparative figures.

COMPONENTS OF FINANCIAL STATEMENTS

7. Management report does not form part of the Financial Statements but is required for the annual reporting. The management report generally addresses business in a more global way and does not contain detailed information.

7. Management's discussion and analysis of financial condition and results of operations as required by Regulation S-K does not form part of the Financial Statements but is to be included in the annual report: comprehensive discussion of liquidity, capital resources, results of operations, and other information necessary to an understanding of a company's situation.

GENERAL ACCOUNTING PRINCIPLES AND CONCEPTUAL ENVIRONMENT
Background

Financial Statements oriented towards protection of creditors with emphasis on prudence concept.
Authoritative position of the Financial Statements for tax return purposes drives valuation and presentation.

Capital market orientation with emphasis on periodic income measurement.
Generally no book-tax conformity.

GENERAL ACCOUNTING PRINCIPLES AND CONCEPTUAL ENVIRONMENT
General Accounting Principles

• TRUE AND FAIR VIEW

"The Financial Statements of the company must, in compliance with generally accepted accounting principles, present a true and fair view of the net worth, financial position and results of the company…" (§ 264 (2)). This general rule applies if no specific provisions exist.

• FAIR PRESENTATION

Dominant principle determining the presentation of U.S. Financial Statements to which all individual rules and methods must conform. Primary focus of financial reporting is to provide information about an entity's performance that is useful to present and potential investors, creditors, and others when they are making financial decisions. Although information in financial reports is information about past

GENERAL ACCOUNTING PRINCIPLES AND CONCEPTUAL ENVIRONMENT
General Accounting Principles

performance investors, creditors and others use that information to predict future performance.

GENERAL ACCOUNTING PRINCIPLES AND CONCEPTUAL ENVIRONMENT

Basic Classification, Valuation and Accounting Principles

• COMPLETENESS AND CLARITY

Assumption that compliance with disclosure and valuation rules will result in a true and fair view. The materiality principle is of lesser importance.

• MATERIALITY

Magnitude of an omission or misstatement in the financial statement that makes it probable that a reasonable person relying on those statements would have been influenced by the information or made a different judgement if the correct information have been known.

GENERAL ACCOUNTING PRINCIPLES AND CONCEPTUAL ENVIRONMENT

Basic Classification, Valuation and Accounting Principles

Accounting transactions so insignificant that they would not influence Financial Statement users are recorded as is most expedient. To this extent, classification, disclosure and valuation may deviate from GAAP if the impact is not material. Importance of substance over form.

GENERAL ACCOUNTING PRINCIPLES AND CONCEPTUAL ENVIRONMENT

Basic Classification, Valuation and Accounting Principles

- OFFSETTING of assets and liabilities or income and expenses is prohibited, even to the extent of showing as income releases of accruals for expenses from previous accounting periods.
- CONTINUITY

Amounts included in the opening balance sheet must agree to the closing balance sheet of the preceding financial year.

- OFFSETTING is generally prohibited. However, it may in some cases be allowed (e.g., interest, income and expense) and is required in specific situations (e.g., extraordinary losses shown net of taxes).
- CONTINUITY

The same principles as in Germany apply, but not stated as a principle as considered a basic bookkeeping requirement.

GENERAL ACCOUNTING PRINCIPLES AND CONCEPTUAL ENVIRONMENT

Basic Classification, Valuation and Accounting Principles

• GOING CONCERN
The accounting and valuation principles assume a going concern unless disproved by facts or actions of law.

• GOING CONCERN
As in Germany.

GENERAL ACCOUNTING PRINCIPLES AND CONCEPTUAL ENVIRONMENT

Basic Classification, Valuation and Accounting Principles

• ITEM BY ITEM VALUATION
Each asset and each obligation must be valued on a stand-alone basis. However, for certain assets (e.g. inventories) simplified valuation procedures are permitted. This method of simplification (e.g. lifo, fifo, weighted average cost method) must be disclosed in the notes.

• PORTFOLIO VALUATION
Groups of assets or liabilities may be considered collectively as a portfolio for valuation purposes. Portfolio valuation may lead to an offsetting of unrealized profits and losses within each portfolio.

GENERAL ACCOUNTING PRINCIPLES AND CONCEPTUAL ENVIRONMENT

Basic Classification, Valuation and Accounting Principles

- PRUDENCE CONCEPT

All anticipated risks and losses which may occur up to the balance sheet date shall be recognized. Profits may only be recognized if they are realized at the balance sheet date (realization principle and imparity principle). Due to the importance of the prudence concept valuation tends to be lower than under US GAAP.

- CONSERVATISM

Accounting measurements take place in the context of significant uncertainties, and possible errors in measurement of net assets and income should tend toward understatement rather than over statement. Conservatism is restricted by the overriding principle of fair presentation.

GENERAL ACCOUNTING PRINCIPLES AND CONCEPTUAL ENVIRONMENT

Basic Classification, Valuation and Accounting Principles

• ACCRUAL CONCEPT AND MATCHING PRINCIPLE
For accounting purposes, the period in which income is earned rather than the time of payment applies.
Matching is limited by prudence.

• ACCRUAL CONCEPT AND MATCHING PRINCIPLE
The accrual concept equally applies to US GAAP.

Matching is less limited by prudence. Items which from a German point of view would not be recognized as assets can be capitalized.

GENERAL ACCOUNTING PRINCIPLES AND CONCEPTUAL ENVIRONMENT

Basic Classification, Valuation and Accounting Principles

• CONSISTENCY
Valuation methods and classification of previous Financial Statements should continue to be applied. Changes are disclosed in the Notes to the Financial Statements.

• HISTORICAL COST
Historical cost is the basis for valuation of assets and may never be exceeded.

• CONSISTENCY
US GAAP is more restrictive concerning changes in accounting methods. Changes in accounting principles are only permitted to the extent they are preferable.

• HISTORICAL COST
Historical cost forms the basis for asset valuation but may be exceeded in a number of instances.

ACCOUNTING FOR ASSETS

• PURCHASE COST
Comprises expenditures incurred to acquire an asset and place it in usable condition to the extent that these costs can be directly allocated to the specific asset.

• MANUFACTURING COST
Refers to the expenditure incurred through the consumption of goods and the use of services to manufacture, enlarge or improve an asset significantly beyond its original state.

• PURCHASE COST
The sum of the applicable expenditures and charges directly or indirectly incurred in bringing an asset to its existing condition and location.

• MANUFACTURING COST
Includes all direct or indirect costs related to the production of an asset.

ACCOUNTING FOR ASSETS

Manufacturing cost includes at least all direct costs. Capitalization of appropriate portions of indirect costs and overhead (except for selling expenses) is optional. Interest on loan capital used to finance the production of an asset may be included to the extent that it is incurred during the period of production. To meet German tax requirements, however, manufacturing costs should include material and production overheads.

Interest costs must be included for assets produced for own use or produced as discrete projects (“qualifying assets”). General administrative and selling expenses must not be included. US GAAP theoretically does not allow options.

ACCOUNTING FOR ASSETS
Fixed Assets

Fixed assets are valued at purchase or manufacturing cost reduced by systematic depreciation for Fixed Assets whose use is limited by time. Extraordinary depreciation only has to be provided where a permanent impairment in value is anticipated. In instances where exceptional depreciation has been recorded for any type of Fixed Assets and the depreciation is no longer valid, the depreciation need not be reversed if the lower

Basically the same principles as in Germany apply. Write-downs just because of falling replacement prices are not allowed. Write-downs of Fixed Assets due to permanent impairment may not be reversed. Tax and book depreciation is usually different.

ACCOUNTING FOR ASSETS
Fixed Assets

Valuation can be maintained for tax purposes and equal treatment in the Financial Statements is a prerequisite for its tax recognition; the effect on income must be disclosed.

ACCOUNTING FOR ASSETS
Fixed Assets
Intangible Assets

Germany	USA
Purchased intangible assets must be capitalized; self-generated intangible assets may not be capitalized.	Purchased intangible assets must be capitalized, self-generated intangibles can be capitalized in specific instances (separately identifiable, determined useful life, not dependent on the current business).
Formation expenses and cost of raising equity may not be capitalized.	Formation expenses may be capitalized and amortized.
Start-up and business expansion expenses may be capitalized with restrictions as to dividend distributions.	Start-up and business expansion expenses cannot be capitalized unless the changes of recovery are beyond doubt (FAS 7, Para 10).

ACCOUNTING FOR ASSETS
Fixed Assets
Intangible Assets

They must be amortized within a five-year period and separately disclosed in the balance sheet.
Goodwill in single entity Financial Statements -
Where shares are purchased goodwill is not recorded as a separate component of the investment and is not amortized unless a permanent impairment in value of the underlying investment has occurred. Where assets and liabilities of a company are acquired, goodwill arising may be

Goodwill is recorded and amortized over its useful life, not exceeding 40 years, in single entity and consolidated Financial Statement and even where shares have been purchased.

ACCOUNTING FOR ASSETS
Fixed Assets
Intangible Assets

written off immediately or, more commonly, amortized over 5 years or the estimated useful life, which will typically not exceed 15 years (its deemed life for tax purposes). Goodwill in consolidated Financial Statements – Amortization is required similar to above rules. The goodwill may also be deducted from reserves on the face of the balance sheet.

A negative goodwill may only be released to profit and loss account under specific conditions.

Negative Goodwill should be offset against tangible/intangible asset.

ACCOUNTING FOR ASSETS
Fixed Assets
Tangible Assets

Germany	USA
Because of the general focus on tax requirements depreciation periods and methods do not necessarily reflect economic reality. They are generally conservative.	The determination of periodic income clearly governs depreciation methods and periods.
Following German tax rules, assets purchased during the first 6 months of the year may be depreciated at the full annual rate; those acquired during the second half of the year at the half year rate.	Whether an item should be capitalized or expensed is influenced by materiality.

ACCOUNTING FOR ASSETS

Fixed Assets

Tangible Assets

Low value items (DM 100-800) may be fully depreciated in the year of acquisition or over their useful lives.

The caption “Property, Plant and Equipment” may also include items not necessary for operating the business.

Tangible assets not related to the operating business must be classified as “other investments”.

ACCOUNTING FOR ASSETS
Fixed assets
Financial Assets and Investments

Valuation must be performed on an item-by-item basis. A permanent impairment of long-term financial assets must be recognized. Recognition of a temporary impairment of financial assets is optional. If the circumstances warranting the write-down are no longer valid the extraordinary depreciation must be reversed (subject to the tax rules).

The accounting for Equity and Debt securities follows in principle not the current/non-current but other classification criteria. Securities not held for trading purposes, are initially recorded at cost and subsequently measured at either amortized cost, if the securities are classified as “held-to-maturity”, or aggregate fair value (portfolio basis) for “available-for-sale” securities.

ACCOUNTING FOR ASSETS
Fixed assets
Financial Assets and Investments

In single entity Financial Statements investments are never stated above cost, equity accounting with regard to associated enterprises is only applied in consolidated Financial Statements.

Related unrealized gains and losses for the latter category are recorded in a separate component of equity until realized. Permanent impairment is recorded in the P/L Statement. Subsequent fair value recoveries of "available-for-sale" securities are posted to the above equity component (FAS 115).
Equity accounting is applied to investments over which the investee can exercise significant influence.

ACCOUNTING FOR ASSETS
Current Assets

Current assets are stated at lower of cost or market/fair value (item by item), even if impairment is only temporary.
Further write-downs are optional:
- to avoid future valuation adjustments as a result of value fluctuations
- if recognition of depreciation for tax purposes requires equal treatment in the Financial Statements.

No general rules applicable to all current assets are defined in US GAAP. Methods to be used are prescribed for individual items.
No optional write-downs exist in US GAAP.

ACCOUNTING FOR ASSETS
Current Assets

Optional write-downs must be disclosed in the notes.

If the reason for the write-down is no longer valid, reinstatement of original values is mandatory (unless tax rules dictate otherwise)

Write-downs (permanent impairment) to lower market value may not be recovered. Profit can only be realized through sales. Allowances for temporary impairment are reversed; in general, cost may not be exceeded.

ACCOUNTING FOR ASSETS
Current assets
Inventories

For lower of cost or market considerations, market is defined as the lower of repurchase/reproduction cost or NRV, reduced optionally by the normal gross profit margin. For raw materials replacement cost is the usual measure; for work-in-progress and finished goods normally the NRV will be relevant rather than replacement cost.

Lower of cost or market, whereas market shall not exceed NRV and should not be less than NRV reduced by a normal profit margin.

ACCOUNTING FOR ASSETS
Current assets
Inventories

Further allowances are made for obsolete and excess stock.	Accounting for obsolete and excess stock is influenced by fair presentation rather than by prudence.
In defined circumstances the Commercial Code permits valuation at fixed values and by groups.	Lower of cost or market may properly be applied either directly to each item or to the total inventory (or, in some cases, to the total of the components of each major category).

ACCOUNTING FOR ASSETS
Current assets
Inventories

The method selected should be the one which most clearly reflects periodic income.

Weighted average method of valuation predominates. Fifo, lifo are permitted for tax and therefore Financial Statement purposes if actual usage follows these assumptions.

As tax authorities allow a more liberal use of cost flow assumptions most companies use combinations of lifo, fifo and average. Other variations of cost flow assumption are permitted by US GAAP. If lifo is used for tax purposes it must also be used in statutory Financial Statement.

ACCOUNTING FOR ASSETS
Current assets
Inventories

For long-term construction-type contracts profit is generally realized on a completed contract basis. Specific exceptions exist.

For long-term construction-type contracts profit may be realized using either percentage of completion (preferred method) or completed contract method.

ACCOUNTING FOR ASSETS
Current assets
Receivables and Other Assests

Specific foreseen losses are provided for.	As in Germany.
Lump-sum bad debt allowances are usually set up at the 1% level allowed for tax purposes unless actual experience justifies a higher level.	Lump-sum allowances based on estimates of probable losses are possible, but rare.
Basically, receivables denominated in foreign currencies are translated at the lower of historical rate or exchange rate at balance sheet date.	Foreign currency receivables have to be translated at the rate as of the balance sheet date. Both profits and losses are realized currently.

ACCOUNTING FOR ASSETS
Current assets
Receivables and Other Assests

As a simplification, short-term foreign currency receivables can be translated at current rates unless periodic income would be substantially misstated.
Future losses may in certain cases be anticipated.

ACCOUNTING FOR ASSETS
Current assets
Marketable Securities (current)

Lower of cost or market on an item-by-item basis. Future losses may be anticipated. Reinstatement of original values is mandatory except if lower value is prerequisite for tax recognition.

Trading securities are initially recorded at cost and subsequently measured at aggregate fair value (portfolio basis). Related unrealized gains and losses are recorded in the P/L Statement (FAS 115). Mark to market principle.

ACCOUNTING FOR ASSETS
Current assets
Cash and Banks

Generally cash in banks and bank overdrafts may not be offset; bank overdrafts must be reclassified to liabilities to banks.

Cash in banks and bank overdrafts within the same bank are offset and the net amount is disclosed. Balance of different banks may only be netted if immaterial.

ACCOUNTING FOR EQUITY AND LIABILITIES
Equity

Equity comprises subscribed capital, capital reserves, revenue reserves, retained profits/accumulated losses brought forward and net income/net loss for the year. Distributions of profit and creation or release of reserves is subject to laws regulating the different legal forms and to the by-laws of individual companies.

The most general classification of equity comprises contributed capital and retained earnings. A more detailed classification may be subject to legal constraints and special accounting guidelines.

ACCOUNTING FOR EQUITY AND LIABILITIES

Equity

Only distribution of profit, contribution to capital and reduction of capital is booked directly against equity.
All changes in valuation and prior year adjustments are booked through profit and loss accounts.

ACCOUNTING FOR EQUITY AND LIABILITIES

Special Item with an Equity Portion

This position contains both income, that has not yet been subject to income taxes, and portion of depreciation which has been booked under tax considerations (authoritative principle) to the extent the amount exceeds statutory depreciation. Therefore it partly constitutes equity and partly tax liabilities.

There is not comparable line item in US Financial Statements.

ACCOUNTING FOR EQUITY AND LIABILITIES

Accruals

Pension Accruals

Pension plans do not have to be funded.
Unfunded pension plans are stated at their actuarial present value. Underlying assumptions usually comply with tax requirements. Accounting for pension liabilities incurred before 1987 is optional. However, any shortfall must be disclosed in the Notes.

US pension plans must be at least partly funded in independent pension funds.
Unfunded pension liabilities and excess funds are accounted for in the B/S.

ACCOUNTING FOR EQUITY AND LIABILITIES

Accruals

Pension Accruals

	US calculation methods (FAS 87) applying the projected unit credit method may result in higher pension liabilities compared to German pension liabilities as the German calculation does not include the effect of future wage and salary increases, unless the trend is reflected in the discount rate.
Changes in pension benefits are charged in full to the year of change.	Effect of changed assumptions and plan benefits is spread over the active years of service.

ACCOUNTING FOR EQUITY AND LIABILITIES

Accruals

Deferred Taxes

Deferred tax liabilities must be accrued for, Capitalization of deferred tax assets is optional in single entity Financial Statements but required in consolidated Financial Statements, if deferred taxes are based on adjustments made in accordance with the consolidation rules (§ 306). Only timing differences may lead to deferred taxes.

Deferred tax liabilities, as well as assets, must be accounted for. Currently, the balance sheet orientated liability method (FAS 109) is used to calculate deferred taxes.
Deferred tax assets may result from tax loss carry forwards, however, they may need to be stated after deducting a valuation allowance.
Deferred taxes are classified into current and non-current portions.

ACCOUNTING FOR EQUITY AND LIABILITIES

Accruals

Deferred Taxes

Expected future changes in tax rates are to be considered in the deferred tax calculation.

Due to general book/tax conformity, deferred taxes rarely occur in single entity German Financial Statements, although they usually are significant in consolidated Financial Statements.

Due to the significant difference between results per the Financial Statements and calculation of taxable income, deferred taxes are included in most Financial Statements.

ACCOUNTING FOR EQUITY AND LIABILITIES
Accruals
Other Accruals

Accruals *must* be set up for:
-Uncertain liabilities.
-Anticipated losses from uncompleted transactions.
-Repair and maintenance expenses omitted in the fiscal year but incurred within the first three months of the following year.
-Omitted land reclamation incurred during the following year.
-Guarantee expenses incurred without contractual obligation.

Accruals must be set up for uncertain liabilities and loss contingencies.

Planned repair and maintenance expenses not yet incurred cannot be accrued for.

Loss contingencies must be accrued if:

ACCOUNTING FOR EQUITY AND LIABILITIES
Accruals
Other Accruals

-Information available before issuance of the Financial Statements indicates that it is probable that an asset had been impaired or a liability incurred by the B/S date, and
-the amount of loss can be reasonably estimated.

Accruals *may* be set up for:
-Expenses for the fiscal year or of a prior period which are precisely determined by type of expense and are probably or certain at the B/S date but uncertain in respect

Note disclosure is required when the amount cannot be reasonably estimated or the occurrence of the loss is only reasonably possible and no probable.

ACCOUNTING FOR EQUITY AND LIABILITIES
Accruals
Other Accruals

of the amount or the timing when they will be incurred. -Omitted repair & maintenance incurred within 4-12 months after the B/S date.	Remote possibilities of losses should not be accrued or disclosed.
Accruals must be stated at the amount required, based on sound business judgement. The prudence concept is to be observed. Accruals are usually generously made because of their impact on taxable income.	The most probably amount within a range of possible losses should be accrued. If no single amount within the range appears to be the best estimate of the loss, the minimum amount should be accrued and the range of possible loss disclosed in the notes.

ACCOUNTING FOR EQUITY AND LIABILITIES
Payables

Liabilities must be stated at redemption amount, not at net present value even if bearing a below-market or zero rate of interest. This results in the most conservative recording of the liability.	Long-term liabilities are generally stated at face value less discount/plus premium. The premium/discount is amortized over the life of the liability.
Liabilities denominated in foreign currency are valued at historical rate or the exchange rate as of the B/S date, whichever is higher.	Foreign currency liabilities are translated at the rate as of the balance sheet date. Both profits and losses are realized currently.

ACCOUNTING FOR EQUITY AND LIABILITIES
Payables

Losses from prior years may be reversed to the extent that the remaining liability may never be less than the amount originally recorded.
As a simplification, short-term foreign currency liabilities can be translated at current rates unless periodic income would be substantially misstated.

ACCOUNTING FOR EQUITY AND LIABILITIES
Payables

Germany	US
Debt issue costs are generally expensed. Deferral is not allowed.	Debt issue costs are deferred and amortized over the life of debt as an interest factor, classified as a deferred charge in the B/S. The current portion of long-term liabilities is classified as a current liability.
Debt discount may be capitalized as a deferred charge and amortized over the life of the debt.	Debt discount must be capitalized as a reduction of the related debt and amortized over the life of the debt.

ACCOUNTING FOR EQUITY AND LIABILITIES
Payables

Premium on convertible debt must be allocated to capital reserve (equity).

Premium is recorded as additional debt and amortized as a yield adjustment over the life of the debt.

PROFIT AND LOSS STATEMENT

The profit and Loss account is presented in vertical form following the method of total costs (type of expenditure) or cost of sales (operational). The text of the individual captions for both forms is prescribed by law.

The profit and Loss Statement can only be presented following the cost of good sold method. US GAAP allows more flexibility concerning classification of income statements, captions are adapted to individual circumstances (substance over form).

PROFIT AND LOSS STATEMENT

Usually the “type of expenditure” format is used. It presents all expenses incurred by the production of the period classified by type of expenses. The difference between sales and production is disclosed as changes in finished goods and work in progress and as own work capitalized.

Usually expenses are split into the production related costs of sales and expenses related to selling, administration, research and development, etc.. Extraordinary, operating and nonoperating income and expenses are disclosed separately.

PROFIT AND LOSS STATEMENT

Main captions in the expenditure format include:

-Sales are shown net of discounts, customer bonuses, rebates granted etc.. No operating or other expenses may be offset against sales.

- Increase/decrease in finished goods and work in progress includes the net change of these two B/S items compared to prior year amount after write-downs for obsolescence and NRV concerns.

PROFIT AND LOSS STATEMENT

-“Own work capitalized” represents the expenses incurred, such as employee wages and materials, for internally constructed tangible assets.

- Other operating income and expenses must not be netted. The amounts must be stated at their gross value. The same principle applies to non-operating income and expense and to extraordinary items.

Extraordinary items are shown net after income taxes, the tax effect must be disclosed.

Prior years adjustments are usually booked against retained earnings.

NOTES TO THE FINANCIAL STATEMENTS

The Notes are equivalent to Anglo-Saxon disclosure practice. By providing additional information, the notes assume an interpretative function and supplement the Financial Statements. However, the notes may also contain information which would otherwise need to be presented in the balance sheet or profit and loss account.

Many mandatory disclosures are prescribed in various APB and FASB statements, such as:
-Accounting policies
- Changes and deviations in policies
-Related party transactions
-Pensions
-Taxes
-Capitalization of interest cost.

NOTES TO THE FINANCIAL STATEMENTS

The notes, therefore, also serve a replacement function. Accounting policies, changes in and deviation from accounting policies and optional accounting methods applied must always be disclosed. Further detailed requirements are prescribed in the Commercial Code and other applicable laws.

Public companies must meet additional disclosure requirements promulgated by the SEC.

CONSOLIDATION

Consolidated Financial Statements are only for information purposes. Distributable profits and taxable income are usually calculated based on single entity Financial Statements.

Consolidated Financial Statements are the prevailing form of financial reporting in the U.S.. Distributable profit is calculated based on consolidated Financial Statements. Even taxes are often calculated based on consolidated taxable income.

CONSOLIDATION

Consolidated Financial Statements only have to be prepared by groups exceeding a certain size defined by B/S total, total revenues and number of employees.

Consolidated statements are prepared regardless of the size of a group. US GAAP considers consolidated Financial Statements as the appropriate general-purpose Financial Statements.

CONSOLIDATION
Entities to be Consolidated

All enterprises either under uniform control or majority owned (over 50%) by a parent company must be consolidated on a world-wide basis.

Subsidiaries whose activities differ so significantly from the group's business that their inclusion conflicts with fair presentation shall not be consolidated.The definition of differing activities is very restrictive.

Consolidated Financial Statements are required when a parent directly or indirectly controls the majority voting interest (over 50%) of a subsidiary (domestic and foreign).

CONSOLIDATION
Entities to be Consolidated

Subsidiaries need not be consolidated if:
-significant and continuing limitations inhibit the exercise of the parent's rights
-necessary information cannot be obtained without unreasonable delay or expense
-shares are held only for the purpose of resale
-their inclusion is insignificant in order to present a true and fair view.

Subsidiaries should not be included if:
-control is likely to be temporary
-where there is significant doubt about the reporting entity's control over the subsidiary

CONSOLIDATION
Acquisition Accounting and Consolidation Methods

Acquisition of majority owned entities is usually accounted for following the purchase method. Under certain circumstances the pooling of interests method may be allowed. For joint ventures proportionate consolidation is permissible but rare. Associated entities (20%-50%) are accounted for following the equity method.

Although details vary, the same principles as in Germany apply.

No proportionate consolidation is allowed, but in the oil industry.

CONSOLIDATION
Acquisition Accounting and Consolidation Methods

Investments below 20% are valued following the principles applied for financial assets and investments. Payables, receivables and transactions must be consolidated. All inter-company profits must be eliminated if material.

CONSOLIDATION
Accounting and Valuation Policies

Accounting and valuation policies must be uniform within the group and in accordance with methods applicable for the preparation of the Financial Statements of the parent company. But these may deviate from the methods actually applied for the parent company's single entity Financial Statements.

The consolidated Financial Statements of the reporting entity must be prepared using uniform accounting principles, US GAAP.

CONSOLIDATION
Accounting and Valuation Policies

For entities accounted for under the equity method application of group policies is optional. If consolidated income differs from the sum of the individual results and the effect will reverse in the future, deferred tax assets or deferred tax liabilities must be recognized in the consolidated Financial Statements.

CONSOLIDATION
The Fiscal Year

The consolidated Financial Statements shall be prepared as of the B/S date of the parent company or as of the B/S date of the most important or the majority of the enterprises included. The B/S date for enterprises included shall not be more than three months prior to the B/S date of the consolidated Financial Statements.Otherwise interim Financial Statements must be prepared for consolidation purposes.

The consolidated Financial Statements shall be prepared at the parent's B/S date. Otherwise there are no differences to the German rules.

CONSOLIDATION
Foreign Currency Translation

German accounting rules do not prescribe a specific method. The method applied has to be consistent and must be described in the notes.

Balance sheet items are usually translated at year-end rates; profits and loss accounts at weighted average rates. The effect of changes in exchange rates is included as a component of equity.

ACCOUNTING WEBSITES

AICPA: www.aicpa.ogr

ELECTRONIC ACCOUNTANT: www.electronicaccountant.com

SEC: www.sec.gov

PRO2NET: www.pro2net.com

NASBA: www.nasba.org

GASB: www.rutgers.edu/accounting/raw/gasb/index.html

FASB: www.rutgers.edu/raw/fasb

AMER. ACC. ASSOC. www.rutgers.edu/accounting/raw/aaa

EDGAR: www.edgar-online.com