PKF
Accountants & business advisers

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Editorial

Dear Readers,

At the end of the year, the German legislator traditionally puts forward an **Annual Tax Act**. However, this year the legislator was comparatively early. The draft law was passed by the *Bundestag* (lower house of German parliament) on 8.11.2018 and was already approved on 23.11.2018 by the Bundesrat (upper house of German parliament). Consequently, in the Focus section of this issue there is a report on the most important changes, particularly since they will mostly come into force with effect from 1.1.2019. The biggest consequences will probably be for **online retailers**, as they will have to collect even more data and, in future, they will be made liable for VAT revenue losses. By contrast, something that is encouraging is the tax **relief for families**, which we have listed in the Tax section that follows. In another, subsequent, report we then explain the planned legal adjustments to the (possibly) impending **Brexit**.

The articles in our Legal section concern views on journey times that will please employees as well as a ruling on **parental leave**.

In the Accounting & Finance section, following the article on **GDPR**, we focus on two particular areas. Firstly, we present the important new guidelines from the **German standard setter under the German accounting standards 25, 26 and 27**. These apply to the **foreign currency translation** in consolidated financial statements and the consolidation of **associates**. Next up, we review the important outstanding issues with respect to **IFRS 16 - lease accounting standards**. Incidentally, these rules - which companies will have to apply in international financial statements from 2019 - will also have consequences for lessees that do not prepare accounts according to IFRS.

It is not only 2018 that is drawing to a close. After more than 13 years, this is the last time that you will receive the PKF Newsletter in a format that, over time, has hardly changed. In January, our newsletter will then be published in a new layout.

We would like to wish you a happy holiday season and a good start to a prosperous 2019

Your PKF Team

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FOCUS

Changes to business taxation from 2019

In the course of the legislative procedure, the 2018 Annual Tax Act was renamed the "Tax Act for the Prevention of VAT Revenue Losses from Trading in Goods over the Internet and Amendment of Further Tax Provisions". The particular aims of this legislative package, which was passed by the Bundesrat (upper house of German parliament) on 23.11.2018, include:

- **preventing VAT revenue losses of the type mentioned above,**
- **enshrining in law the taxation of restructuring profits as well as**
- **making other necessary adjustments to align with the latest tax case law and practices of the tax authorities.**

Overall, businesses can expect a series of improvements to ensue.

Details of the key new legal provisions are presented in the overview below. The main focus is on changes related to income tax, corporate tax, trade tax and VAT. The section references specified in each case relate to the (new) version that is applicable from 1.1.2019.

1. Income Tax

(1) Company car taxation for electric vehicles and hybrid vehicles (Section 6(1) no. 4 clauses 2 and 3 of the German Income Tax Act (Einkommensteuergesetz, EStG)) – Up to now, employees who use company cars privately have had to pay tax on a lump sum of 1% of the list price per month. The rate for the blanket taxable amount will be reduced to 0.5% for electric vehicles and hybrid vehicles that are acquired or leased between the 1.1.2019 and 31.12.2022; although, for the so-called driver's log book method only half the expenses will likewise be applied.

(2) Tax-exempt private use of company bicycles (Section 3 no. 37 EStG, Section 6(1) no. 4 clause 6 EStG) – The tax exemption applies to bicycles and electric bikes that are not deemed to be motor vehicles under transport guidelines (e.g. speeds of less than 25 km/h). No withdrawal may be carried out when calculating profits. The tax exemption is limited up to the 2021 assessment period.

(3) Tax exemption for short-distance public transport season tickets for employees (Section 3 no. 15 EStG) – The subsidies granted by employers, in addition to the remuneration that will in any case be due, for season tickets for scheduled short-distance public transport services to enable employees to travel to their primary workplace locations will become tax-exempt once again from 1.1.2019 and employees will now be allowed to use these tickets for private journeys, too. The tax-exempt benefits will be credited against the distance-related tax allowance.

(4) Tax exemption for restructuring profits (Section 3a EStG) – Increases in business assets or operating income from debt waivers granted for the purpose of a restructuring will become tax-exempt; under certain circumstances, this will also apply to so-called legacy cases prior to 9.2.2017. The new legal provisions also relate to trade tax because, from now on, the tax authorities will be responsible for determining the trade tax assessment base.

(5) Interest payments in the case of a lack of reinvestment (Section 6b(2a) clause 4 et seq. EStG) – This penalty interest will apply if disposal gains from financial years after 31.12.2017 have not, or only partially, been reinvested in the EU or EEA.

Various new regulations that should encourage electromobility, in particular

» **Please note:** Other amendments concern, in particular, the expansion of the international basis of tax assessment for the disposal gains of property companies (Section 49 EStG), supplements to the anti cum/cum regulations (Section 36a EStG) as well as expenditure arrangements for provisions that comply with EU law (Section 10(2) clause 1 no. 1 EStG).

2. Corporate Tax

(1) Constitutional regulation on loss deduction (Section 8c(1) clause 1 of the German Corporation Tax Act (Körperschaftsteuergesetz, KStG)). The partial derecognition of losses is being completely revoked without any time limit right from the start, thus from the 2008 assessment period; this will also be the case for trade tax (Section 36(2d) of the Trade Tax Act (Gewerbesteuergesetz, GewStG)).

» **Note and Recommendation:** On 29.8.2017, the Hamburg tax court (case reference: 2 K 245/17) referred to the Federal Constitutional Court for a decision (2 BvL 19/17) the issue of whether or not the full derecognition of losses because of a direct transfer of shares is compatible with the principle of equality pursuant to Section 3(1) of the Basic Law. We recommend holding open all assessment notices where a derecognition of losses has been determined because of a change of ownership.

(2) Retroactive re-application of the so-called restructuring clause (Section 8c(1a) KStG) – Tax loss carry-forwards will no longer be derecognised – retroactively from the 2008 assessment period – if an otherwise 'harmful' (i.e. detrimental from a tax point of view) transfer of a shareholding takes place for restructuring purposes.

(3) Introduction of a fictitious profit transfer (Sections 14(2), 34(6b) clauses 2 to 4 KStG) – In accordance with the amended version of the Act, it will be permissible, within certain limits, to agree variable compensation payments (related to the results of the consolidated tax group) for external shareholders. For the recognition of a consolidated tax group for income tax purposes and, concurrently, agreeing compensation payments to external shareholders it would not be deemed to be harmful (from a tax point of view), if in addition to the fixed amount pursuant to Section 304(2) clause 1 of the German Stock Corporation Act a further payment component were to be included. However, this will only apply if the total compensation payment does not exceed the (normal) share of the profits that corresponds to the external shareholder's stake in the share capital. Should the tax authority, in a deviation from the new regulation, have already recognised agreements on compensation payments in the case of a consolidated tax group then these principles shall apply up to the 2021 assessment period. Should a profit transfer agreement for a consolidated tax group, which has been recognised up to now, be terminated after 1.8.2018 but prior to the expiry of a minimum term of five years then this would constitute a termination for good cause within the meaning of Section 14(1) clause 1 no. 3 clause 2 KStG.

» **Recommendation:** Existing profit transfer agreements will therefore have to be adjusted by 31.12.2021; such an adjustment would not be deemed to be a newly concluded agreement and would not initiate a new minimum term.

3. Value Added Tax

(1) Trading in goods over the Internet on electronic marketplaces (Section 22f, Section 25e of the German VAT Act (Umsatzsteuergesetz, UStG)) – Under these new provisions, – which because of their commercial importance have given their name to the new act – operators of online platforms will be obliged to record information about those users whose transactions could be deemed to be subject to VAT in Germany. In particular, the tax numbers and the VATINs for these retailers will have to be recorded by the platform and retained for 10 years.

» **Please note:** The operators of platforms will become liable for VAT revenue losses that have been caused by retailers on their platforms from 28.2.2019, or from 30.9.2019 for legal transactions by companies headquartered in Germany, the EU or the EEA.

(2) VAT regulation for vouchers (Section 3(13) to (15), Section 10(1) UStG) – According to this, a single purpose voucher is a voucher where the place of supply of the items and the VAT liability for these items is certain on the date when the voucher is issued. Therefore, the actual supply has already been made on this date and its subsequent redemption as well as the delivery of the items would no longer trigger any VAT consequences. If there is no single purpose voucher then the voucher should be expressly treated as a multi-purpose voucher.

(3) Payment of copyright fees – The revocation of Section 3(9) clause 3 UStG means that the obligation to pay copyright fees pursuant to Section 54 of the German Copyright Act will no longer be considered as other payments as defined in the UStG and will therefore no longer be taxable.

4. Other provisions

Another area covered by the provisions that is worth mentioning is the needs assessment in order to obtain a tax-exemption for inheritance and gift tax. The extended holding period of seven years will also apply to cases of needs assessments in order to obtain a tax-exemption (Section 28a(1) clause 1 of the German Inheritance Tax Act). Moreover, the following aspects are likely to be of greater importance for the taxpayers that are affected in each case:

- reporting of additional data for real estate transfer tax purposes (Section 20 of the Real Estate Transfer Tax Act),
- consequential amendments to the Act to Strengthen Company Pensions,
- allocation of child allowance (Section 85(2) EStG),
- tax exemption for the organisational services of umbrella organisations for sports.

» **Please note:** Pursuant to the approval given by the Bundesrat on 23.11.2018, the changes will mostly come into force with effect from 1.1.2019.

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TAX

Tax relief resulting from the German Family Relief Act

Who for: Families with children.

Issue: In the preamble to the Family Relief Act (*Familienentlastungsgesetz*, FamEntlastG), as a starting point, reference is made to the fact that because parents have to provide for, look after and educate their children they do not enjoy the same degree of financial power as childless people. Therefore, in order to strengthen families and provide them with relief, when income is being assessed, family benefits will be taken into account more appropriately than previously.

(1) The main focus here is on **child benefit** and the **child allowance.** As of 1.7.2019, child benefit will go up by € 10 per month and per child (Section 66(1) of the German Income Tax Act (*Einkommenssteuergesetz*, EStG). Moreover, child allowance will be increased for the 2019 assessment period to € 2,490 for each parent and, for 2020, to € 2,586 (Section 32(6) clause 1 EStG).

(2) There are plans to adjust the income tax brackets (Section 32a(1) EStG) to the effect that the **basic tax-free allowance** will be raised to € 9,186 for 2019 and to € 9,408 from 2020.

(3) The maximum amount for the deduction of **maintenance payments** (Section 33a(1) clause 1 EStG) will be raised, as of 1.1.2019, from € 9,000 to € 9,168 and, as of 1.1.2020, to € 9,408. Furthermore, for the calculation of payroll tax, the changes to the assessment base for church tax (Section 51 a(2a) clause 1 EStG) and the solidarity surcharge (Section 3(2a) clause 1 of the German Solidarity Surcharge Act) will take effect after increased child allowance has been taken into account.

Child benefit and the child allowance will boost the family coffers

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*RA [*German lawyer*]* *Johannes Springorum*

Introduction of the Brexit Accompanying Tax Act

Who for: Taxpayers with connections to the United Kingdom.

Issue: After Brexit, the United Kingdom will become a third country. From this point in time onwards, it will generally not be possible to claim any tax concessions available to EU member states. The "Act on the Tax Provisions to Accompany the Exit of the United Kingdom of Great Britain and Northern Ireland from the European Union", abbreviated to the Brexit Accompanying Tax Act (Brexit-Steuerbegleitgesetz, Brexit-StBG), which is currently being prepared, will usher in changes to various acts in order to limit, as far as possible, the negative consequences for taxpayers in Germany.

(1) Withdrawals at UK-based permanent establishments – Under Section 4g(1) of the German Income Tax Act (Einkommenssteuergesetz, EStG), upon request, those with unlimited tax liability may create a balancing item if a noncurrent asset is deemed to have been withdrawn because it has been assigned to a permanent establishment in a different EU member state. The balancing item would have to be reversed evenly and profitably in the year in which it was created and the four subsequent financial years (Section 4g(2) clause 1 EStG). This concession would however not apply if the asset assigned to the permanent establishment were to be excluded from EU taxation. Through the introduction of a new Section 4g(6) EStG the mandatory reversal of the balancing item in the event of a Brexit would be prevented. It should still be possible to evenly reverse the item.

(2) Blocking period in the case of reorganisations – A newly created Section 22(8) of the German Reorganisation Tax Act (*Umwandlungssteuergesetz*, UmwStG) provides that in the case of a contribution in kind or an exchange of shares at below fair market value (Section 22(1) clause 6 no. 6, (2) clause 6 UmwStG) the blocking period of seven years would not be interrupted despite the expected Brexit. Otherwise the corresponding contribution gain would have to be retroactively taxed because the residency requirements for the entity under Section 1(4) UmwStG would not longer be satisfied. The 7-year period should only continue to apply if the reorganisation decision was made or the contribution agreement was concluded prior to the Brexit date.

» **Please note:** For the time being, no changes have to be made to Section 6(5) of the German Foreign Transaction Tax Act and Section 12(3) of the German Corporation Tax Act as Brexit should not be regarded as a "harmful event" and thus there will be neither a discontinuation of deferments nor taxation of liquidation gains.

Tax changes are supposed to close up the gaps that Brexit will open up

More Information: Furthermore, other changes are likely, in particular, to the German VAT Act. Moreover, it will remain interesting to see what the future arrangements for customs clearance between the EU and the United Kingdom will be. We will keep you informed in this regard.

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LEGAL

Employers have to remunerate journey time as working time for foreign postings

» **Who for:** Business owners with international connections and employees with alternating work locations.

» **Issue:** A technical employee of a building firm had been regularly deployed by his employer at alternating construction sites in Germany and abroad. In 2015, he worked for several months on a construction site in the People's Republic of China. At the employee's own request, his employer had booked a business class flight with a stopover in Dubai instead of direct outward and return flights in economy class. Therefore, for the purposes of this foreign posting, the employee's overall journey time came to four travel days of which, however, merely eight hours each way were taken into account in accordance with the agreed remuneration at a total of € 1,149.44. By his action, the employee demanded remuneration from his employer for the further 37 hours of travel that were actually incurred. He argued that the entire time taken to travel from his home right up to the foreign place of work and back again should be remunerated as working time. After the state labour court (*Landesarbeitsgericht*, LAG) upheld the employee's complaint, the appeal by the building firm before the Federal Labour Court (*Bundesarbeitsgericht*, BAG) was partially successful. Employers do indeed serve solely their own interests when they post employees to foreign places of work and, therefore, they have to remunerate the journeys as working time. However, the relevant basis for this is the travel time incurred when taking a direct flight in economy class. Consequently, the additional journey time that was incurred because of the stopover that the employee wished to

Journey time as working time, but not for privately motivated diversions

make in Dubai should not be remunerated as working time.

Furthermore, in the case in question, because there were insufficient statements about the journey time that is actually required, the case was referred back to the LAG in Rhineland-Palatinate for a renegotiation and a decision.

» Recommendation: We would strongly recommend drawing up guidelines for the remuneration of journey times, or updating guidelines that already exist, to ensure that they can be consistently applied.

» More Information: Further details about the decision by the BAG (ruling from 17.10.2018, case reference: 5 AZR 553/17) can be found online at www.bundesarbeitsgericht.de in the press release 51/18 from 17.10.2018.

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Early termination of parental leave due to the birth of another child

» Who for: Employers as well as employees with children.

» Issue: The Federal Labour Court (*Bundesarbeitsgericht*, BAG), in its ruling from 8.5.2018 (case reference: 9 AZR 8/18), has specified the conditions under which parental leave may be terminated early. In this case, the claimant had initially scheduled two years of parental leave. However, during her parental leave, she became pregnant once again and, therefore, wished (at short notice) to terminate her parental leave early after one year. She put forward the argument that it was possible to terminate the leave early without the consent of the employer "because of the birth of another child".

The BAG established that parental leave may not be terminated early already for pregnancy but, instead, only once the child has been born. The law is not based on someone being pregnant but rather on the birth of a further child. This is clear from the wording of the law and the regulatory framework as well as its intention and purpose. The aim of the law is to avoid several periods of parental leave overlapping and to enable full use to be made of the parental leave for each child.

However, it would only be possible for several periods of parental leave to overlap after the birth of a further child. If parental leave is terminated early then the portion of the parental leave that has not been used would not be lost. This portion could be taken subsequently after the parental leave for the second child in order thus to reduce the burden that increases with a greater number of children.

Elternzeit – rechtlich eine Wissenschaft für sich

» Recommendation: The BAG ruling has resulted in greater legal certainty for employers and employees and should be taken into account, in particular, for requests at short notice for changes with respect to parental leave.

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ACCOUNTING & FINANCE

Implementation of the data protection standards – An audit will protect against fines

There was a great deal of agitation in May of this year when the new data protection principles under the EU General Data Protection Regulation (GDPR) were applied. There were two main reasons for this. Under the GDPR and the Federal Data Protection Act (*Bundesdatenschutzgesetz*, BDSG), besides the significant increase in bureaucratic and documentary requirements, companies of all sizes and from all industries risk considerable sanctions. Very specifically, great financial risks could arise for companies in the form of fines that, in the case of serious violations, could reach up to four percent of the consolidated group revenues that were generated worldwide in the previous year. In view of this, it is essential to ensure compliance with the provisions under GDPR and BDSG. This presents companies with the challenge of aligning their data protection-related procedures and measures. At the same time, there is a growing need for audits of these technical and organisational procedures and measures by *Wirtschaftsprüfer* (German public auditors) or other competent experts.

1. Management's accountability for compliance with the GDPR

In order to comply with the data protection principles mentioned in the GDPR (lawfulness, processing in good faith, transparency, purpose limitation, data minimisation, accuracy, storage limitation as well as integrity and confidentiality) companies have to design numerous processes and measures – that will be solidly established in the structural and workflow organisation – and then implement them. Moreover, it has to be possible to provide documentary evidence of this – it is referred to as the accountability of the person responsible, thus of the company represented by its management.

Audit of compliance with standards is a protection against high risks

2. New IDW Auditing Practice Statement

The Expert Committee on Information Technology of the Institute of Public Auditors in Germany (*Institut der Wirtschaftsprüfer*, IDW) took up the topic of GDPR and has come up with an Auditing Practice Statement that provides for an audit of policies, procedures and measures in accordance with the GDPR and BDSG (IDW AuPS 9.860.1). This includes examples for ensuring GDPR compliance as well as possible audit procedures for assessing the adequacy and effectiveness of the policies, procedures and measures. Here, depending on the engagement agreement there is the option of

- either an audit of the statement by the legal representatives, within the scope of a compliance management system, on the policies, procedures and measures in accordance with the GDPR and BDSG, or
- a direct audit being carried out of the adequacy and effectiveness of these policies, procedures and measures.

The subject of an audit in accordance with IDW AuPS 9.860.1 includes the criteria of the data protection objectives and data protection culture derived from a company's business model, its structural and workflow organisation, the framework set of rules together with risk analysis, training initiatives and measures for raising awareness as well as measures for monitoring and improving the system. Moreover, the Auditing Practice Statement contains a specific catalogue of requirements that consists of 43 pages with 12 sections in the form of preliminary requirements and, by way of example, a total of 86 policies, procedures and measures for complying with the criteria, including the corresponding audit procedures. The catalogue of requirements thus serves as comprehensive guidance for a GDPR audit. If, in individual cases, other data protection laws and regulations have to be taken into account (e.g. industry-specific regulatory requirements) their application would be determined in accordance with the definition provided in the engagement agreement. In these cases, the catalogue of requirements should be expanded accordingly.

Furthermore, the Auditing Practice Statement describes how to formulate the report, how to structure it, depending on the type of engagement, and how to write up the constituent parts of the report about the responsibility of the legal representatives and the *Wirtschaftsprüfer*, the audit opinion and the criteria used as a basis.

3. What are the benefits of such an audit?

By carrying out such an audit companies will obtain, within the framework of a standardised report, a reliable assessment of the adequacy and effectiveness of their data protection management system as well as transparency about its degree of implementation. Furthermore, any need for action will be identified and can be addressed. In particular, the company can be provided with support during the process of proactively identifying gaps in its data protection in order to head off warnings and prosecution.

These are crucial aspects of the accountability postulated by the GDPR. Moreover, on the basis of the audit, the company will, at all times be comprehensively verifiable vis à vis supervisory authorities, service providers, affected parties, supervisory committees and other stakeholders. For example, in the event of an order being processed, customers can assure themselves of the data protection compliance status.

Last but not least, functioning data protection promotes trust in a company and provides valuable insights into the lawful use of the stored data within the scope of digitisation – a benefit that should not be underestimated.

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Foreign currency translation in consolidated financial statements – The application of the new German Accounting Standard 25

For internationally oriented companies foreign currency transactions are part of everyday life, however, in the context of accounting for such transactions, various problems have to be tackled. This is particularly true for the integration of subsidiary companies, e.g., subsequent to an acquisition. Guidance is available in the form of the German Accounting Standard (GAS) 25, which was published by the Federal Ministry of Justice and Consumer Protection on 3.5.2018. This standard fleshes out the principles of foreign currency translation in accordance with section 308a of the Commercial Code (Handelsgesetzbuch, HGB) and, in this connection, deals with outstanding issues. The overview below serves as an introduction to the application of GAS 25, which extends to no less than 109 (!) marginal numbers. Besides the translation of foreign currency based financial statements, overall, the main focus is on foreign currency translation in the case of individual consolidation adjustments.

1. The aims behind the drawing up of the new standard and its scope of application

1.1 Background and main aims

In view of the numerous application problems and questions of interpretation in the case of foreign currency translation in consolidated financial statements, the Expert Committee on HGB at the Accounting Standards Committee of Germany (ASCG) decided, already a few years ago, to include in its work programme a GAS on the subject of foreign currency translation. Following its unanimous adoption in February 2018, the new GAS 25 "Foreign currency translation in consolidated financial statements" was then published by the BMJV, on 3.5.2018, in accordance with Section 342(2) HGB. For consolidated financial statements, GAS 25 fleshes out the translation of foreign currency transactions in the single-entity financial statements adjusted to conform to uniform group accounting policies for consolidated companies. Furthermore, it regulates the principles of foreign currency translation in accordance with section 308a HGB.

The main aims consist in ensuring the consistent application of the rules and strengthening the information function of the consolidated financial statements. Therefore, additionally, the Standard sets out in detail the requirements governing the disclosures on foreign currency translation in the notes to the consolidated financial statements in compliance with Section 313(1) clause 3 no.1 HGB.

1.2 Scope of application

GAS 25 should be adopted by all parent entities that are required to prepare

- German GAAP consolidated financial statements in accordance with sections 290 et seq. HGB, or
- consolidated financial statements in accordance with sections 11et seq. of the German Public Disclosure Act, or
- that do so voluntarily.

Please note: The appropriate application of the rules under the Standard for translating foreign currency transactions and for disclosing information in the notes with respect to the single entity financial statements is recommended. In terms of timing, the rules under this Standard will have to be applied for the first time for financial years beginning after 31.12.2018. Earlier application in full is permitted and is recommended by the ASCG.

2. Key principles for the translation of foreign currency transactions in single-entity financial statements adjusted for uniform group accounting policies

2.1. Recognised transactions

The scope of GAS 25 with regard to the translation of foreign currency transactions extends both to the translation of foreign currency transactions at the date of initial recognition as well as the translation in the course of subsequent measurement in accordance with Section 256a in conjunction with Section 298(1) HGB.

2.2 Rate of exchange to be applied for initial recognition

Assets, liabilities, prepaid expenses and deferred income, or special items resulting from a foreign currency transaction shall be initially recognised at the spot rate (the applicable bid or ask rate) at the transaction date. If there are any gains and losses arising on the initial recognition of a foreign currency transaction then these shall be translated at the same exchange rate as the underlying balance sheet items.

2.3 Subsequent measurement

For the purposes of a sub-

Foreign currency translation in accordance with GAS 25 should strengthen the information function of consolidated financial statements

sequent measurement, the Standard provides for different requirements for foreign currency translation for non-monetary and for monetary assets and liabilities.

(1) Non-monetary assets – If these were originally acquired in foreign currency then the subsequent measurement should be performed on the basis of the acquisition cost recognised in local currency at the date of addition. When determining the lower of cost or market value to be applied, in accordance with Section 253(3) clauses 5 and 6 and (4) HGB, a distinction has to be made as to whether the assets acquired in foreign currency can be replaced or sold exclusively in that foreign currency, or also/only in local currency.

(2) Monetary assets and liabilities – In accordance with section 256a clause 1 HGB, these shall be subsequently measured at the mid-market spot rate at the reporting date. If the remaining maturity is one year or less then, in accordance with Section 256a clause 2 HGB, the realisation principle and the principle of historical cost shall not be applied. This exception applies only in the case of exchange rate-related changes in carrying amounts.
Please note: Currency translation differences resulting from foreign currency translation for the subsequent measurement shall always be recognised as income or expenses if they do not qualify for hedge accounting within the meaning of Section 254 HGB.

3. Translation of foreign currency based financial statements

The applicable method for the translation of foreign currency based financial statements of subsidiaries and joint venture companies shall be the modified closing rate method in accordance with Section 308a HGB, potentially also in conjunction with Section 310(2) HGB. When applying Section 308a clauses 1 and 2 HGB, translation into Euro for

- all assets, liabilities, prepaid expenses or deferred income, and special items of a foreign subsidiary shall generally be at the mid-market spot rate at the reporting date of the consolidated group accounts,
- items of equity shall be at historical mid-market spot rates and
- income statement items at average rates.

Section 308a clause 3 HGB specifies that the currency translation difference recognised in equity shall be reported in group equity after group revenue reserves.

» **Please note:** It is recommended that Section 308a HGB be applied to the foreign currency based financial statements of associated companies that are measured in the consolidated financial statements using the equity method in accordance with Section 312 HGB.

4. Currency translation in the case of individual consolidation adjustments

4.1 First-time consolidation of subsidiaries

Hidden reserves and liabilities identified in the course of this, as well as any resulting goodwill (provided that it is realised in the currency of the subsidiary concerned) and/or negative consolidation differences are part of the assets invested abroad. They shall be measured consistently in the currency of the subsidiary. On the reporting dates following the date of initial consolidation, the carrying amounts – which shall be calculated in accordance with Sections 301 and 309 HGB as well as the rules under GAS 23 that clarify and define these – shall be translated into Euro in accordance with Section 308a HGB.

4.2 Deconsolidation

If a subsidiary is deconsolidated, the currency translation difference recognised in equity and adjusted in subsequent periods until the disposal date shall be reclassified to profit or loss (Section 308a clause 4 HGB). This shall apply both to the sale of shares (share deal) as well as to the disposal of all assets and liabilities of a foreign subsidiary (asset deal).

4.3 Other aspects of individual adjustments covered in GAS 25

The Standard also contains rules on foreign currency translation for disposals/acquisitions of shares without a change in status (the company remains a subsidiary, associate or shareholding), a change in the method of consolidation or inclusion (switch from full consolidation to proportionate consolidation or at equity measurement) as well as capital consolidation in a multi-level group. The elimination of intercompany profits or losses in accordance with Section 304 HGB for intercompany transactions as well as the consolidation of expenses and income are likewise addressed as are specific issues relating to the measurement of equity.

5. Other areas of regulation

Financial statements from hyperinflationary economies shall be adjusted for the effects of inflation before they are included in the parent entity's consolidated financial statements. To this end, GAS 25 lists indicators for identifying a hyperinflationary economy as well as methods of inflation adjustment. Finally, the Standard focuses on the notes to the consolidated financial statements if there is a connection between the translation of foreign currency items and of foreign currency based financial statements.

» **Recommendation:** Even for smaller businesses, foreign currency translation in consolidated financial statements can already constitute an extremely difficult and complex task. GAS 25 provides practitioners with answers to a wide range of application-related questions for which we have only been able to provide an overview. Our consolidation experts are available to provide you with in-depth guidance, also in case of problems that almost inevitably occur in the course of, or subsequent to M&A transactions due to complexity of the issues.

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Accounting guidelines in accordance with GAS 26 "Associates" and GAS 27 "Proportionate Consolidation"

The Expert Committee on HGB at the Accounting Standards Committee of Germany (ASCG) has adopted German Accounting Standard (GAS) 26 "Associates" and GAS 27 "Proportionate Consolidation", these replace the previous standards GAS 8 and GAS 9. Both the new standards apply to all entities that are required to prepare consolidated financial statements or that do so voluntarily. Besides providing definitions of associates as well as joint venture companies, GAS 26 and GAS 27 focus particularly on the equity consolidation method as well as proportionate consolidation. A range of outstanding issues has been dealt with here and suggestions for practicable solutions, within the basic legal framework, have been developed.

1. Definitions

1.1 Associates

In contrast to the definitions in the former standards, the new definitions are significantly more closely aligned with the statutory provisions of Section 311(1) and Section 310(1) of the Commercial Code (*Handelsgesetzbuch*, HGB).

An associate is defined

- as a company that is not included in the consolidated financial statements,
- over which an entity included in the consolidated financial statements exerts significant influence with respect to the operating and financial policies, or
- over which such influence is expected and
- in which, at the same time, the entity included in the consolidated financial statements holds an equity investment in accordance with section 271(1) HGB.

There shall be a presumption of significant influence if the shareholding company holds, directly or indirectly, at least 20% of an entity's voting rights. The positive presumption of associate status in the case of at least 20% of the voting rights being held does not have to be rebutted. However, GAS 26 also contains a negative presumption of associate status. If the shareholding company holds, directly or indirectly, less than 20% of an entity's voting rights, there is a rebuttable presumption that it does not have significant influence.

Please note: Holding less than 20% of an entity's voting rights should therefore only be regarded as an indicator of the non-existence of significant influence and thus of the non-existence of associate status. Furthermore, where there is a shareholding, the overall circumstances shall be taken into consideration on a case-by-case basis in order to establish whether or not significant influence is indeed being exercised. Details of the criteria to be applied for this purpose can be found in subsection 17 et seq. of the GAS 26.17.

1.2 Joint venture company

According to GAS 26.7 and GAS 27.7, a joint venture company is deemed to exist if the operating and financial policies of such a company are jointly managed by two or more independent companies, although one of the companies has to be the parent entity or a subsidiary company that is included in the parent entity's consolidated financial statements by way of full consolidation in accordance with Section 300 et seq. HGB. In GAS 27 a particular emphasis is placed on the clarification and discussion of the definitional elements of a joint venture company. Specifically, here this includes:

- the existence of the characteristic of an undertaking of being a joint venture (in the broadest sense of GAS 19.6);
- the actual exercise of joint management on the basis of a permanent contractual arrangement with respect to joint management by the shareholders involved in the joint venture and
- joint management by the parent entity or a subsidiary company that is included in the parent entity's consolidated group as well as
- one or more entities that do not belong to the parent entity's consolidated group.

2. Application of the equity method

GAS 26 contains a range of clarifications with respect to the application of the equity method and these are outlined below:

(1) No necessity to use annual financial statements that have been adopted and/or approved consolidated financial statements for the application of the equity method; however, all binding decisions related to the accounting and measurement that are material for the financial statements used for the equity method will have to have been taken.

(2) No necessity to align the reporting date of the entity that is included "at equity" with the reporting date of the consolidated financial statements. Generally, even for events of particular importance that occur after the reporting date of the associate's financial statements and before the reporting date of the consolidated financial statements there is no obligation to take these into consideration within the scope of the equity method. An exception does however apply to share capital measures at the associate, such as capital increases and the repayment of capital, or similar events; here, an event-driven, non-periodic adjustment to the carrying value of the equity has to be made even if this adjustment is only made after the reporting date of the financial statements that form the basis of the equity method, but before the reporting date of the consolidated financial statements.

(3) No restriction with respect to the option to align the accounting recognition and measurement policies applied by the associate with the group-wide accounting recognition and measurement policies. Consequently, an associate's financial statements drawn up in accordance with, in particular, IFRS or US GAAP can form the basis for the application of the equity method in HGB consolidated financial statements. While information has to be provided in the notes to the consolidated financial statements pointing out that the option has been waived to adjust the measurement policies in the associate's financial statements that deviate from those in the consolidated financial statements, nevertheless, no information is necessary about the adjustments that are potentially required and have been omitted in the consolidated financial statements.

(4) The identification of all the hidden reserves and hidden liabilities is required for the initial application of the equity method even if, as a result of this, the costs of acquiring the equity interest in the associate are exceeded. A key argument for abandoning the restriction on the costs of acquisition was that, with respect to identifying (pro-rated) hidden reserves and liabilities when using the equity method, it was not conceptually possible to apply stricter criteria than for full consolidation.

(5) Supplementary rules on **negative equity carrying values** (c.f. GAS 26.54 – 56 in this respect) that arise in the context of an adjustment to the carrying value of equity have to be complied with.

(6) Consolidation with respect to intercompany profits or losses – This can be omitted on the grounds of the facts being unknown or not accessible. If individual items of information that are required for the elimination of intercompany profits or losses are missing then these may also be supplemented by appropriate plausible assumptions and estimates if, from a Group perspective, the service and supply relationships are deemed to be material.

The application of the equity method raises questions

(7) Reporting income tax – The equity result may be reported in the consolidated income statement either net of income tax or stated on a gross basis under the equity result and the income tax expense attributable to the equity result included in the income tax expense for the group. The latter option is recommended for reasons of performance analysis, as this enables a clear separation between, on the one hand, profit before income tax and, on the other hand, income tax.

3. Application of Proportionate Consolidation

The key points that GAS 27 regulates with respect to consolidation techniques for proportionate consolidation, in particular, are:

- taking the consolidated financial statements of the joint venture company as the basis for the proportionate consolidation if the joint venture company, on its part, prepares consolidated financial statements;
- using the size of the economic interest for proportionate consolidation if this deviates permanently from the size of the capital share in the joint venture company;
- in the case of the proportionate consolidation of liabilities, reporting as balance sheet items that exist vis-à-vis third parties that portion of the balance sheet items that has not been netted (liabilities, receivables or loans); the same then also has to apply for the consolidation of expenses and income (i.e. reporting interest income and/or expenses vis-à-vis third parties);
- requirement for proportionate elimination of intercompany profits or losses not only in the case of the existence of "upstream" and "downstream" deliveries, but also for "cross-stream" deliveries;
- treating increases in shareholdings in joint venture companies without a change in the status of the joint venture company as purchase transactions that trigger an additional capital consolidation. Conversely, a decrease in shareholdings in joint venture companies without a change in status shall be shown as a sales transaction through profit or loss.

4. Disclosures in the notes to the financial statements and the period of application

Furthermore, it should be noted that, in contrast to the previous standards GAS 8 and GAS 9, the disclosures in the notes to the consolidated financial statements are considerably more closely based on the requirements under commercial law.

Mandatory application of both standards, for the first time, shall be for financial years beginning after 31.12.2019. Earlier application is recommended. The new regulations have to be applied prospectively. Applying the standards retroactively is not permitted.

WP/StB [German public auditor and tax consultant] Benjamin Sauerhammer

Accounting for leases under IFRS 16 – New rules from 1.1.2019 will provide relief, but there are also unresolved issues

From 1.1.2019, IFRS 16 will replace the previous standards and rules under IAS 17, IFRIC 4, SIC-15 and SIC-27. The new standard, IFRS 16, will entail far-reaching changes – at least for lessees – with respect to accounting for leases. Significant changes to balance sheets and important performance indicators are expected.

1. An overview of the new regulations

With the aim of creating transparency in lease accounting, the previous requirement for lessees to classify a lease as an operating lease or a finance lease has been abolished. Instead, the new standard requires lessees to recognise almost all leases on their balance sheets. As a result, not only will there be significant changes to balance sheets but there will also be consequential effects on important performance indicators, such as, e.g., the equity ratio, the gearing ratio as well as EBIT and EBITDA. By contrast, lessor accounting will be subject to minor changes only. The distinction between an operating lease and a finance lease, as previously under IAS 17, will continue to exist here.

The IFRS 16 definition of a lease in IFRS 16.9 is as follows: "A contract, or part of a contract, that conveys the right to use an identified asset for a specific period of time in exchange for a consideration." The requirement is, on the one hand, that there is a clearly determinable and identifiable asset. On the other hand, in the definition of a lease, IFRS 16 places emphasis on the criterion of "control". The control over the use lies with the lessee if the latter has the right to obtain all the economic benefits from the asset during the term of the lease and is able to decide how and for what purpose the asset is used.

On the reporting date of the initial application, IFRS reporting entities are not required to assess whether, based on the criteria of IFRS 16, their existing contracts are leases. Instead, – as a simplification provision – IFRS 16 can be applied to all previous situations that resulted in a contract being classified as a lease under IAS 17 and IFRIC 4, while previous situations that resulted in a contract not being classified as a lease do not have to be reassessed. The definition criteria of IFRS 16 will then have to be applied to all the agreements that are newly concluded after the date of initial application (1.1.2019).

» **Please note:** In view of the sweeping changes with respect to lease accounting for lessees, the Standard provides for the option of a "modified retrospective approach" of adoption. Optionally, there can also be full retrospective adoption of IFRS 16 in accordance with the requirements under IAS 8. With the "modified retrospective approach" of adoption, the information for the previous year does not have to be restated. Instead, at the start of the period of initial application, the equity is adjusted for the cumulative effect.

2. Important aspects of lease accounting for the lessee

2.1 Recognition and measurement of the asset

In the case of an identified asset, the lessee shall recognise the value of the lease as a ROU asset (right-of-use asset) on the balance sheet. The ROU asset is initially recognised at the amount of the lease liability. Furthermore, lease payments that have already been made prior to the commencement of the agreement less any lease incentives received are also to be taken into consideration. Moreover, for the initial recognition, the lessee's direct costs shall be included as well as the expected costs related to the restoration obligations, which shall be recognised in accordance with IAS 37 "Provisions, Contingent Liabilities and Contingent Assets".

The subsequent measurement of the ROU asset is usually performed on the basis of the historical cost model in accordance with IAS 16 "Property, Plant and Equipment". The ROU asset is depreciated, on a scheduled basis, over the shorter period of the economic useful life or the term of the lease agreement. If at the start of the term it is already likely that ownership will indeed be transferred to the lessee then the depreciation period has to relate to the entire useful life of the asset.

» **Please note:** The applicable standard for the determination and recognition of an impairment loss is IAS 36 "Impairment of Assets".

2.2 Recognition and measurement of the lease liability

The lease liability is recognised on the balance sheet at the present value of the future lease payments. To determine this amount the interest rate implicit in the lease is used. If this rate cannot be readily determined then the incremental borrowing rate may be used. The incremental borrowing rate is the interest rate the lessee would have to pay for a loan for a direct purchase of the asset with similar terms as in the lease contract. Future lease payments include the following components, if applicable:

- fixed lease payments;
- variable lease payments that are linked to an index or reference value;

- amounts expected to be payable under a residual value guarantee;
- the exercise price of a purchase option if the lessee is reasonably certain that it will be exercised;
- penalties for terminating the lease if, for the determination of the lease term, the exercise of the right of termination is assumed.

In the subsequent measurement the lease liability decreases as a result of the lease payments that have been made and increases due to the compounding using the effective interest method.

Reassessments of the lease liability initially result in an adjustment to the carrying amount of the ROU asset that does not affect income, although, adjustments that exceed the carrying amount have to be recognised in the income statement.

Changes to the carrying amount of the lease liability arise when lease agreements are reassessed and also when the underlying lease is modified.

» **Please note:** This includes, in particular, a change to the term of the contract or a reassessment with respect to the exercise of a purchase option. For such cases, IFRS 16 provides for a re-measurement with a newly calculated discount rate for the remaining maturity.

2.3 Presentation

ROU assets have to be presented either separately on the balance sheet, or also combined with other owned property, plant and equipment. If there is no separate presentation then the ROU asset should be shown in the line item where an asset would be recognised if the company owned it. Information has to be provided in the notes to the financial statements as to which balance sheet item contains the ROU assets. The lease liability should be presented either in the balance sheet or reported separately from other liabilities in the notes to the financial statements. If there is no separate presentation in the balance sheet then there has to be an explanation in the notes to the financial statements as regards the line item where the lease liabilities have been shown. In the income statement, the resulting interest expense has to be reported separately from the depreciation on ROU assets. The interest expense is an integral part of the financing costs and has to be stated in the notes to the financial statements.

Do usage rights to wagons constitute a lease?

3. Unresolved issues despite a fundamental simplification

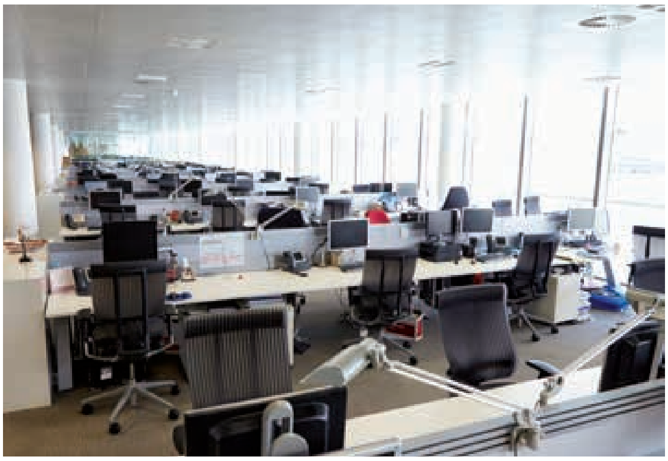
The previous requirement, under IAS 17, to make a distinction between an operating lease and a finance lease, in practice, had led to considerable discretionary leeway. At first glance, the uniform accounting rules that have now been introduced and according to which all leases are treated similarly to finance leases would appear to have resulted in a simplification. However, on closer examination, it should be noted that there is still a range of outstanding issues that will open discretionary leeway in the future, too.

3.1 Defining a lease – Identifiable assets

An identified asset is necessary for the definition of a lease. An asset is regarded as identified if the supplier does not have a substantive right to substitute the asset during the term of the leasing arrangement. The right to substitute an asset is substantive if the supplier is able to substitute the asset and if the supplier would obtain a benefit from the exercise of its right to substitute an asset that exceeds the respective costs. Furthermore, it has to be possible to distinguish an asset physically.

This definition question is relevant for agreements that include the provision of a service involving the use of an asset. If the outcome of the service is important for the customer and not the asset with which this is provided then there could potentially be contracts that would not have to be recognised under IFRS 16.

» **Example:** A transport company grants a customer the right to use ten railway wagons over a specific time period. In this case, a lease would be deemed to exist if the supplier made available to the customer specific wagons that it would be able to use in accordance with its own needs during the term of the contract. Contractual restrictions – such as, for example, the prohibition on the transport of hazardous materials – are not detrimental for entering into a lease agreement. Furthermore, it is not detrimental for the presumption that a lease agreement has been entered into if, upon request by the lessee, the transport company provides an engine and a driver who it has instructed. Finally, clauses that provide for wagons to be substituted in the case of repairs or servicing would also not change the lease classification. By contrast, no lease would be deemed to exist if the contract for the transport of a given quantity of goods provides for the use of wagons of a particular type as long as the supplier is able to decide which wagons will be specifically used. As only the wagon type is specified it would not be possible to identity the asset.



IT and office equipment as leased items

3.2 Scope of application and affected contracts

The scope of application of IFRS 16 in principle extends to all leases. There are exceptions for leases for the exploration of mineral deposits, for biological assets in accordance with IAS 41, service concession arrangements under IFRIC 12 as well as license agreements covering intellectual property and other rights whose accounting treatment is regulated by IFRS 15 and IAS 38. Lessees have the option of applying IFRS 16 to lease agreements for intangible assets other than the ones just mentioned above.

» **Please note:** In this respect, the scope within which the application of IFRS 16 is mandatory is effectively restricted to leases for property, plant and equipment.

The IASB has provided for exemptions in IFRS 16 in terms of the scope of application as follows:

(1) Short-term leases – Short-term leases are understood to be agreements that have a term of less than 12 months. The application of IFRS 16 to these agreements is optional, i.e. in keeping with the current standard IAS 17, these agreements may continue to be treated as operating leases (therefore as executory contracts). When determining the maximum term of a lease agreement, any extension options that might exist have to be included if, from the perspective of a lessee acting rationally, it would appear to be reasonably certain that these options would be exercised. Likewise, an option to terminate the lease will have to be taken into account if it is reasonably certain that it would be used and would result in the reduction of the lease term. However, agreements with a purchase option generally do not qualify as short-term leases. It should be noted that the short-term lease option may only be exercised consistently for each grouping of assets of a similar nature. Up to now, in practice, most leases have not fulfilled the criterion of being short-term. Nevertheless, it remains to be seen to what extent there will be modifications here, in the future, to the usual terms of lease contracts.

(2) Low-value assets – IFRS 16 itself does not define the term “low-value assets”, however, in the “Basis for Conclusions” (IFRS 16.BC100) the IASB states an amount, when new, of up to US$5,000 as the ceiling in value terms. This benchmark should potentially be adjusted for country-specific or industry-specific features. Frequent cases of the application will be IT equipment, other technical business equipment or other office equipment. This option can be exercised separately for each leased item. The assets are then recognised in a similar way as for operating leases under the current standard IAS 17.

Despite the use of the option (for reporting purposes) the Standard cannot be completely ignored. Accordingly, information has to be provided in the notes to the financial statements on current expenses for short-term leases (IFRS 16.53 c)) and on current expenses for leases of low-value assets (IFRS 16.53d)).

» **Example:** A furniture manufacturer has the following leases:

- IT equipment for employees (laptops, desktop PCs, tablets, printers, mobile telephones);
- servers, including various individual modules that increase the storage capacity, which can be added over time;
- office equipment (desks, chairs, water dispenses, copiers).

The furniture manufacturer determines, on the basis of the value when new, that the IT equipment for employees and some of the office equipment (desks, chairs, water dispenses) are low-value assets for which IFRS 16 is only optionally applicable. If the separate modules in the server are considered individually they could likewise be classified as low-value assets. However, as each module is heavily dependent on the server and the furniture manufacturer would not lease the individual modules without also leasing the server then these should not be considered separately. Based on an overall analysis, the server does not qualify as a low-value asset.

3.3 Leasing period

The leasing period within the meaning of IFRS 16 is defined as the non-cancellable basic term of the lease. If a contract is automatically extended after the expiry of the basic lease term then, unless notice of termination is given by one of the parties, a contract will exist within the meaning of IFRS 16 only for the non-cancellable basic lease term as it is only for this period that there are enforceable rights and obligations.

The basic term can be extended if prolongation options exist of which the reporting entity can be reasonably certain that they will be exercised. By the same token, the basic lease term will be reduced if a lease provides for termination options of which the reporting entity is reasonably certain that it intends to make use. In any case, determining an extension to or a reduction in the lease period implies a discretionary decision that, nevertheless, has to be reasonably certain on the basis of rational considerations. A mere intention to exercise extension or termination options is irrelevant as long as there are no demonstrable grounds to suggest that it is reasonably certain that an extension option or a termination option will indeed be exercised. The standard setter has created a list, as an example, of a range of factors for the assessment of this criterion, these include:

- leasehold improvements,
- termination costs,
- the importance of the leased item to the lessee's operations,
- residual value guarantees and also
- a lessee's past practice with leases particularly with respect to lease periods.

» **Please note:** An assessment made at the commencement of a lease always has to be adjusted if, due to an event during the lease term, there is a change in the assessment that there is reasonable certainty that an extension option or a termination option will be exercised. For the evaluation, all the relevant facts and circumstances that could result in an economic incentive to exercise the option have to be taken into consideration.

If a change to the assessment of the options takes place then the lessee is required to re-measure the lease liability to take into account changes to the lease payments. The lessee has to adjust the amount that results from the re-measurement of the lease liability against the ROU asset. If the value of the ROU asset goes down to zero and if the measurement of the lease liability goes down further then the lessee has to recognise the excess amount in the income statement.

3.4 Variable lease payments

Variable lease payments, which are linked to an index (e.g. a price index) or reference value (e.g. market interest rate), are included in the measurement of the liability and the ROU asset. On first-time recognition, these are included on the basis of the index or reference value as at the effective date of the commencement of the lease. Other circumstances that have to be factored into the lease payments (e.g. residual value guarantees) likewise lead to the variability of lease payments. The amount that a lessee would expect to pay from a residual value guarantee results from the difference between the guaranteed amount and the expected residual value estimated by the lessee at the end of the term of the lease.

» **Please note:** When determining the expected residual value there is thus discretionary leeway, which will be greater, the longer the lease term and the fewer specific market prices there are for the leased item.

By contrast, variable lease payments that the lessee is able to avoid (such as, for example, performance-based or usage-based lease payments) may not be included in the measurement of the lease liability and should be recognised in the income statement only at the point in time when they are incurred. This rule is based on the general definition criteria for a liability. If the lease agreement provides exclusively for variable lease payments, without stipulating a minimum amount, then it could be possible that even under IFRS 16 the lease would still have to be treated as an off-balance sheet transaction. However, in order to prevent abusive structures, IFRS 16 stipulates that lease payments that, in form, contain variability but, by their nature, are unavoidable – so-called "in-substance fixed payments" – do however have to be included in the measurement of the liability.

» **Please note:** Distinguishing between genuine variable lease payments and in-substance fixed payments will have to be done on a case-by-case basis and usually requires a discretionary assessment. In the future, the expenses arising from variable lease payments that have not been included in the measurement of the lease liability will have to be disclosed in the notes to the financial statements.

Subsequent changes in variable lease payments due to a modified assessment with respect to the amount that has to be paid as a residual value guarantee, or due to changes in the index or reference value that underlies the lease usually lead to a reassessment of the lease liability and, therefore, also the ROU asset.

3.5 Separating the lease and non-lease components of a contract

Frequently, besides a lease agreement, contracts contain other components, such as, for example, services or insurance costs. In the past, at least in the case of operating leases, separating out these components was not relevant because they both constituted executory contracts and would thus not have been recognised on the balance sheet.

In the future, as a result of IFRS 16, the distinction between leasing and services will be of great importance.

» **Please note:** For the purpose of simplification, IFRS 16.15 provides for the option to combine the "non-lease components" with the lease components and thus recognise them in their entirety. Despite the balance sheet inflation that ensues as a consequence – with the corresponding implications for the performance indicators -, recognising the components in their entirety can constitute an advantage if, in this way, it is possible to avoid complicated separation procedures or if the operating result is supposed to be favourably impacted.

If the option of combining the components as a single lease is not exercised then the lessee has to allocate the contractually agreed consideration – similarly as for IFRS 15 – among the separate elements of the contract on the basis of observable standalone selling prices. If there are no observable standalone selling prices then the allocation has to be performed using estimates.

3.6 Modifications to lease contracts

If a lease agreement is extended by granting a right to use one or more additional assets and if the lease payments that have to be made correspond to the standalone selling price of the asset(s) then this would constitute a new lease and, consequently, it would have to be recognised separately.

If one of these two conditions is not satisfied then separate recognition is precluded. Accordingly, there would be a reassessment of the existing extended lease with adjustments to the lease liability and the ROU asset.

4. Conclusion

IFRS 16 will entail considerable changes for lessees with respect to their accounts, performance indicators and internal reporting. The basic approach to recognition (thus the representation of the leased asset and the lease liability in the balance sheet) has been standardised and will thus lead to greater comparability.

However, via its definition of a lease, its simplification provisions and, last but not least, the estimates that have to be made with respect to extension options, termination options and residual values, the new standard also provides much discretionary leeway for the reporting entity.

It thus remains to be seen, or observed whether or not and how the market will use the options under IFRS 16 to design leases and what accounting practices will be established.

WP/StB [German public auditor and tax consultant] *Annika Fröde / Jennifer Rosentreter*

AND FINALLY...

"In my own work, I've tried to anticipate what's coming over the horizon, to hasten its arrival, and to apply it to people's lives in a meaningful way."

Paul Allen, Microsoft co-founder and former board member, 21.1.1953 – 15.10.2018

Impressum

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