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Accounting Requirements for Banks in Germany

Similarities and Differences between German GAAP and IFRS

Financial Statements in Germany
Legal requirements and applicable GAAP

Basic requirements to prepare financial statements according to German and European regulation

- A bank (legal entity, e.g. a “GmbH” or an “AG”) based in Germany is generally required to prepare, have audited and publish stand-alone financial statements in accordance with German GAAP in German language.
- A bank which is a parent company generally has to prepare, have audited and publish consolidated financial statements in accordance with German GAAP or voluntarily in accordance with IFRS in German language. If the parent company is a publicly traded company, it has to prepare, have audited and publish consolidated financial statements in accordance with IFRS.
- Even a Germany-based branch of a foreign bank has to prepare a statement of assets and liabilities in accordance with German GAAP.
- Representative offices neither have to prepare financial statements nor a statement of assets and liabilities.

Exemptions regarding preparation of consolidated financial statements

- There are exemptions releasing parent companies from the obligation to prepare consolidated financial statements if these companies at the same time are subsidiaries to another ultimate parent company.
- These exemptions only apply if certain criteria are met. These criteria are different for ultimate parent companies located inside the EU/EEA and for ultimate parent companies located outside the EU/EEA (e.g. Switzerland or possibly a post-Brexit United Kingdom).
- Publicly traded parent companies are never released from the obligation to prepare consolidated financial statements (in accordance with IFRS).

Principles of Accounting
Principles of German GAAP compared to IFRS

German GAAP

- Accounting under German GAAP is largely characterised by the principle of prudence and the principle of protecting creditors.
- In general acquisition costs form an upper limit for subsequent measurement of assets.
- There is an explicit and comprehensive taxonomy for the balance sheet and the profit or loss account which needs to be followed strictly.
- Every German corporation is obliged to set up annual financial statements according to German GAAP.
- Basis for distribution; under German GAAP there are certain restrictions regarding distributions.
- Tax accounts depend on annual financial statements prepared in accordance with German GAAP.

IFRS

- The main focus of IFRS is to provide information which is useful to investors in making economic decisions.
- Fair value is used as basis for subsequent measurement of several assets and liabilities.
- IFRS does not prescribe a comprehensive taxonomy for the statement of financial position and the statement of profit or loss.
- Publicly traded German parent companies are obliged to publish consolidated financial statements in compliance with IFRS.
- German companies may voluntarily publish annual financial statements according to IFRS for information purposes.
- IFRS is not relevant for distributions in Germany.
- IFRS is not relevant for taxation in Germany.

Credit Business
Loans to Customers & Credit Derivatives (Banking Book)

Basic principles of German GAAP

- Loans are initially recognised at acquisition cost. Banks may recognise mortgage loans and other loans issued at a premium or discount at their nominal value as far as the premium or discount is similar in nature to interest.
- Loans are subsequently measured at amortised cost. As loans originated by banks are generally classified as current assets the strict lower-of-cost-or-market principle applies. Credit risk is addressed by way of specific loan loss provisions as well as general loan loss provisions. The general loan loss provision must cover latent risks. Interest rate risk is not taken into account, but loans are subject to the macro interest rate risk test of the banking book.
- A purchased credit derivative which is part of the banking book and neither designated as hedging instrument nor treated as loan collateral (stand-alone credit derivative) is required to be measured on an individual basis. If the fair value is positive, it is not recognised. If the fair value is negative, a provision is recognised. A purchased credit derivative which is part of the banking book and not designated as hedging instrument but treated as loan collateral is only taken into account when measuring specific or general loan loss provisions.

Similarities and Differences between German GAAP and IFRS

- The basic concept of measuring loans to customers at amortised cost is equally used under German GAAP and IFRS.
- The impairment calculation under IFRS 9 (expected credit loss) might be used for accounting under German GAAP as well. However this is subject to an analysis of the individual facts and circumstances and is currently considered by the German accounting profession.
- Whereas transaction cost attributable to the acquisition of a loan are accounted for using the effective interest method under IFRS, they are generally recognised as expense under German GAAP if they are borne by the bank.
- While under IFRS some loans have to be subsequently measured at fair value through profit or loss or at fair value through other comprehensive income and a loan may be designated as measured at fair value through profit or loss (Fair Value-Option), loans are always subsequently measured at amortised cost under German GAAP if they are part of the banking book.
- Under IFRS all credit derivatives are recognised in the balance sheet and subsequently measured at fair value through profit or loss.

Trading Business & Treasury
Securities

Basic principles of German GAAP

- Securities are initially recognised at acquisition cost. The subsequent measurement and the presentation in the balance sheet as well as in the profit or loss account further depends on the classification of the securities.
  - **Securities classified as non-current assets:** Securities can be classified as non-current assets at the discretion of the bank if they are intended to be held to maturity. They are subsequently measured according to the diluted lower-of-cost-or-market principle, i.e. a loss has to be recognised when there is a decrease in value of the securities which is expected to be permanent whereas a loss may be recognised when the decrease is expected to be only temporary. A reclassification as held for trading is not possible.
  - **Securities held for trading:** Securities can be classified as held for trading at the discretion of the bank at the date of initial recognition if the bank intends to realise trading results from the instrument on a short-term basis. They are subsequently measured at their fair value less a deduction for risk. A reclassification as non-current assets or held as liquidity reserve is not possible, but securities held for trading might subsequently be designated as part of a hedging relationship.
  - **Securities held as liquidity reserve:** Securities neither classified as non-current assets nor held for trading are automatically classified as securities held as liquidity reserve. They are subsequently measured according to the strict lower-of-cost-or-market principle i.e. a loss has to be recognised when there is a decrease in value of the securities. A reclassification as held for trading is not possible.

Similarities and Differences between German GAAP and IFRS

- There is no Fair Value-Option available under German GAAP, i.e. all securities not held for trading are subsequently measured at cost. Under German GAAP there is also no classification available which is comparable to a classification at fair value through other comprehensive income under IFRS.
- Under IFRS the fair value of a security is not subject to a deduction for the risk of measurement uncertainties, i.e. the fair value of a security recognised under IFRS is ceteris paribus higher than the fair value recognised under German GAAP.
- Unlike under IFRS securities are not subject to the same impairment regulations as loans under German GAAP. Specifically no general loan loss provision is recognised on securities under German GAAP.

Trading Business & Treasury
Derivatives & Hedge Accounting

Basic principles of German GAAP

- The accounting for derivatives depends on whether the derivatives are part of the banking book or part of the trading book. Derivatives can be classified as held for trading at the discretion of the bank at the date of initial recognition if the bank intends to realise trading results from the instrument on a short-term basis.
  - **Derivatives in the trading book:** Derivatives held for trading are subsequently measured at their fair value (less/plus a deduction/addition for the risk of measurement uncertainties regarding trading assets/liabilities).
  - **Derivatives in the banking book:** Stand-alone derivatives in the banking book which are not designated as hedging instruments, are generally required to be measured on an individual basis. If the fair value is positive, it is not recognised. If the fair value is negative, a provision is recognised.

  Interest bearing derivatives, that are not treated like stand-alone derivatives or designated as hedging instruments are part of the macro interest rate risk of the banking book and are not measured on an individual level. The interest bearing positions of the banking book are considered on a portfolio basis.

Similarities and Differences between German GAAP and IFRS

- The general principles of hedge accounting are similarly applied under German GAAP and under IFRS.
- Whereas the accounting for derivatives under German GAAP depends on whether the derivatives are part of the banking book or part of the trading book of a bank, under IFRS all derivatives which are not designated as part of a hedging relationship are considered to be held for trading and therefore subsequently measured at fair value.
- Under IFRS the fair value of the derivatives is not subject to an adjustment for the risk of measurement uncertainties, i.e. the fair value of the derivatives recognised under IFRS is ceteris paribus higher than the fair value recognised under German GAAP.
- Under IFRS there is no regulation similar to the macro interest rate risk test in the banking book performed under German GAAP, i.e. all interest bearing derivatives not designated in hedging relationships are measured on an individual basis.

Special Regulations of German GAAP
No Equivalent Regulation under IFRS

Furthermore there are special accounting regulations for banks under German GAAP to which there is no equivalent regulation under IFRS.

- **Provision for General Banking Risks:** Banks may subsequently measure certain loans and securities at an amount which is lower than the amount determined when applying the general regulations on subsequent measurement to these assets and thus may set up hidden reserves for „general banking risks“. The hidden reserves can be released subsequently at the discretion of the bank. Neither the actual amount nor changes in the amount of the hidden reserves have to be disclosed.
- **Fund for General Banking Risks:** Banks may also form a special line item in the balance sheet being a „fund for general banking risks“ as a special provision for general banking risks and thus may set up disclosed reserves. Dotations to and releases from the fund are presented separately in the profit and loss account.
- **Cross Compensation in profit or loss account:** Income and expenses from setting up and releasing the provision for general banking risks, as well as certain items of income and expense relating to securities and credit business may be offset and presented net in one line item of the profit and loss account. No further information has to be disclosed.
- **Macro Interest Rate Risk of the Banking Book:** Interest bearing banking book assets, liabilities and derivatives – the banking book is defined based on the bank’s internal risk management processes – for example including securities, loans, deposits, long term borrowings and interest rate derivatives, are measured at cost. Gains and losses are not recognised for interest rate movements. However, banks are required to perform a test on the basis of all interest-bearing positions of the banking book to show that there is no net loss interest rate position in the banking book. If it is determined there is a net loss, a provision has to be recognised. A net gain must not be recognised.

Further questions?

Please be welcome to contact us!

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