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## REASONS FOR NOT CLAIMING § 241A GERMAN HGB (HGB) IN CONJUNCTION WITH § 242, PARAGRAPH 4 GERMAN HGB (HGB)

### Introduction and problem definition

On 29 May 2009<sup>1</sup> the largest reform of the German Accounting Principles (BilMoG) in the last 25 years was enforced.<sup>2</sup> The central concern of BilMoG is to develop the German Accounting Principles into lasting and, in comparison with the international financial reporting standards (IFRS), fully adequate accounting principles. The result of this development should be a cheaper and simpler alternative to IFRS.<sup>3</sup> Summing up, there are four main goals of BilMoG: deregulation, internationalization, preservation and harmonization.<sup>4</sup>

This paper focuses on the deregulation aspect. E.g. the legislator planned to simplify some standards concerning merchants of certain organizational size and legal form with BilMoG. Until BilMoG each merchant<sup>5</sup>, who has been doing their own accounting (§ 238, paragraph 1 HGB), had to show their inventory at the end and the beginning of each financial year (§ 240, paragraph 1, 2 HGB) and had to prepare an annual balance sheet (§ 242, paragraph 1–3 HGB). With the introduction of §§ 241a and 242, paragraph 4 HGB each merchant, who does not exceed 500.000 € sales revenues and 50.000 € annual surplus in two financial years in a row, was exempted from these regulations.

The deregulation efforts for these merchants are only suitable, if they have a real chance to resign annual financial statements. Therefore we pose the question, whether these merchants need structured information, such as annual financial statements, beside any legal requirement.

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<sup>1</sup> Act to modernize the accounting principles (BilMoG) from 29 May 2009.

<sup>2</sup> K. Petersen, C. Zwirner: *Rechnungslegung und Prüfung im Umbruch: Überblick über das neue deutsche Bilanzrecht*, 2009.

<sup>3</sup> BT-Drucksache 16/12407 (2009).

<sup>4</sup> BT-Drucksache 16/12407 (2009); H. Kessler: *Einleitung*, Freiburg 2009.

<sup>5</sup> A merchant in terms of the German HGB is somebody, who carries on a trade (§ 1 HGB), or who is considered a merchant under another legal basis in the HGB (§§ 2 HGB ff.).

## State of research

Most German authors are convinced that a lot of companies will continue financial accounting.<sup>6</sup> Even without legal requirements there will be a need for annual financial statements, e.g. for the merchants themselves or other addressees, such as banks. Among other things the banks' credit rating system is based on the companies' annual financial statements.

Nevertheless, there are also contrary opinions about the use of these new accounting principles. From previous experiences with § 141 AO Herzig<sup>7</sup> concludes, that a predominant number of companies will choose the net income method<sup>8</sup> instead of using accrual accounting and annual financial statements. The advantage of the net income method is the simple concept and practicability, which is also cost-saving. Therefore the number of merchants using accrual accounting and annual financial statements will decrease.<sup>9</sup>

English literature only discusses international accounting standards. These discussions have two priorities. On the one hand the focus of these studies is on the necessity of auditing annual financial statements from companies which are not listed on the stock exchange market.<sup>10</sup> It is not mentioned, whether an annual financial statement itself is necessary. On the other hand, there is the goal to simplify the IFRS to make them applicable for small and medium sized entities.<sup>11</sup> This refers especially to entities whose activities cross borders (see BC16).<sup>12</sup> Thus, the IFRS are not applicable for merchants in this context. Because of their company size they are only able to deal with regional markets.

We summarize that there is no empirical research about the reasons, why merchants prepare annual financial statements besides legal requirements. As a result we do exploratory research from the merchant's point of view, which will explore different reasons for and against accounting or the preparation of annual financial statements. The merchants are the only ones who experience their daily business and are able to describe which information is really needed. Our research design is explained in the following paragraphs.

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<sup>6</sup> H. Bieg, et al.: *Bilanzrechtsmodernisierungsgesetz*, Munich 2009; H. Kußmaul, S. Meyering: *Wen entlastet § 241a HGB-E?*, 2008; H.F. Gelhausen, G. Fey, G. Kämpfer: *Rechnungslegung und Prüfung nach dem Bilanzierungsmodernisierungsgesetz*, Düsseldorf 2009; C. Theile: *Der neue Jahresabschluss nach dem BilMoG*, 2009; L. Richter: *Befreiung von der handelsrechtlichen Buchführungspflicht gem. § 241a HGB*. 2009.

<sup>7</sup> N. Herzig: *Modernisierung des Bilanzrechts und Besteuerung*, 2008.

<sup>8</sup> § 4 Nr. 3 EStG.

<sup>9</sup> BT-Drucksache 16/10067 (2008).

<sup>10</sup> See also: V. Cole: *Are users of financial statements of publicly and non-publicly traded companies different or not?*, Catania, Italy 2009; J. Collis, R. Jarvis, L. Skerratt: *The demand for the audit in small companies in the UK*, 2004.

<sup>11</sup> Entered into force on 09 July 2009.

<sup>12</sup> ED-IFRS for SME (2008).

## Research design

„Qualitative research“ is a generic term for different research approaches. These can be differentiated according to their theoretical assumptions of methods for generating and interpreting data.

Based on our research objective, this report will help to get an insight into the merchant's subjective perception and experience by interviewing him.

Over the years a variety of interview techniques have been built up in literature and scientific research.<sup>13</sup> Concerning our research topic, we chose the problem-centered interview, because theoretical-scientific previous knowledge already exists before generating data.<sup>14</sup>

In explorative research the representativeness of a sample group has a minor significance. Instead of focusing on the variance of characteristics in a population, the sample's specific appearance and constitution is relevant.<sup>15</sup> We select interviewees based on the theoretical sampling.

The population includes all merchants, who apply to the new principles of § 241a in conjunction with § 242, paragraph 4 HGB. The new principles integrate both, the “Real Merchant” (§ 1 HGB) as well as the “Optional Merchant” (§ 2 HGB). “Optional Merchants” are characterized by a low economic interaction. This minimum of economic participation is the reason why we do not include “Optional Merchants” in our sampling.

Consequently we consider “Real Merchants” exclusively, since they have been in duty of accounting before the introduction of BilMoG. For “Real Merchants” business activities according to a specific way and size, which refers to the duty of accounting as well, are required. Since BilMoG has been enforced, “Real Merchants” have to decide, either to continue accounting or not.

Because the legislator does not define any quantitative measures to define “Real Merchants”, a further limitation of the entire population is mandatory. To ensure that our interviewees are consistent with the assumptions, concerning business activities in a specific way and size, our sampling uses court decisions<sup>16</sup>: With a turnover of 250.000 € a business can surely be assumed as a trading business. Hence, the entire population of all merchants according to § 1 HGB are companies, that generate a turnover between 250.000 € and 500.000 €. According to the German Federal Statistical Agency, there were 168.241 companies<sup>17</sup> which laid within this limit in 2009.

The evaluation of the interviews was supported by software programs to analyze qualitative data (QDA programs). In addition to the reduction of the total workload, QDA

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<sup>13</sup> J. Bortz, N. Döring: *Forschungsmethoden und Evaluation*, Berlin 2006; S. Lamnek: *Qualitative Sozialforschung*, Weinheim 2005.

<sup>14</sup> S. Lamnek: *Qualitative Sozialforschung*, Weinheim 2005.

<sup>15</sup> A. Witzel: *Verfahren der qualitativen Sozialforschung*. Frankfurt a.M. 1982.

<sup>16</sup> A. Baumbach, K. Hopt: *Handelsgesetzbuch*, Munich 2010.

<sup>17</sup> German Federal Statistical Agency: *Umsatzsteuerstatistik, Eckdaten 2009*.

programs maintain the traceability of results by increasing the transparency.<sup>18</sup> Nevertheless, despite the use of software support, qualitative research is dominated by subjectivity.

In our study the qualitative content analysis delivered significant indicators for evaluating the data.<sup>19</sup> The theoretical coding of the Grounded Theory fulfills this examination. The structural content analysis represents the basic model of the data analysis. The examination targets the identification of specific aspects based on previously defined criteria. This is completed by the summarizing content analysis, which aims to reduce the data material by paraphrasing, but to obtain the essential content. This method is used to classify inductive categories, which is as well a fundamental process of the Grounded Theory<sup>20</sup> that is named "Open coding". The combination of the summarized and the structured content analysis enables the deductive-inductive approach.<sup>21</sup>

In contrast to the summarized content analysis we will not paraphrase data, because paraphrasing data could lead to information losses.

In this study the interview guideline served as an orientation for a prior category system. At first we defined four categories: (1) accounting, (2) internal information, (3) external information and (4) personal background. Each top category contains narrative subcategories. E.g. we divided the top category "external information" into the subcategories banks, suppliers, customers, promotion and competition.

The following chapter presents the first results of the interviews and gives evidence by appropriate quotations. To obtain the interviewees' anonymity, each interview was associated with a serial number.

## Initial findings

We evaluated eleven interviews up till now. Further interviews are planned in February 2011. We tested the interview guideline through a test interview in order to check the structure, the adequacy of the questions and the time needed for one interview. This interview is not part of the analysis.

An additional short questionnaire (to be filled out by the interviewees themselves) should ensure that the interviewees are "Real Merchants" only, who can therefore be examined under the theory of our theoretical sampling. All interviews were conducted face to face.

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<sup>18</sup> U. Kuckartz: *Einführung in die computergestützte Analyse qualitativer Daten*, Wiesbaden 2007.

<sup>19</sup> P. Mayring: *Qualitative Inhaltsanalyse: Grundlagen und Techniken*, Weinheim 2008.

<sup>20</sup> J. M. Corbin, A.L. Strauss: *Basics of Qualitative Research: Techniques and Procedures for Developing Grounded Theory*, Los Angeles 2008.

<sup>21</sup> U. Kuckartz: *Einführung in die computergestützte Analyse qualitativer Daten*, Wiesbaden 2007; K.J. Srnka, S.T. Koeszegi: *From Words to Numbers: How to Transform Qualitative Data into Meaningful Quantitative Results*, 2007.

According to the HGB, providing information about one company is a main task of the annual financial statement.<sup>22</sup> This function is deduced from the general principles §§ 238, 264 and 297 HGB, which express that information delivery to addressees of annual financial statements is a legal requirement. The most important external addressees of an annual financial statement are banks, suppliers, customers, competitors, credit agencies as well as investors and creditors. In addition, there are also internal addressees, such as the management, who need and use data of annual financial statements for planning and controlling etc.

First interviews show, that only banks can be confirmed as external addressees of annual financial statements. Banks require annual financial statements as merchants take up loans to finance their companies. Some interviewees pointed out, that – based on data of past annual financial statements - banks determined the conditions of the loans. That is why the banks' information requirement is indicated as an essential reason for preparing annual financial statements. (The following paragraph shows examples).

*"[...] we had to go to the bank in the beginning of the year 2009 to receive a loan to support our company during spring. In order to receive the loan I had to hand in the annual financial statements of the years 2005, 2006, 2007 and for 2008 as well. I also had to hand in a prepared prediction for the years 2009 and 2010."* (Interview 6, paragraph number 104 and following).

*"[...]then the banks would say: Show us your balance sheets."* (Interview 2, paragraph number 88 and following).

The analysis of the interviews figured out one question: Are merchants, who decide to use § 241a in conjunction with § 242, paragraph 4 HGB, disadvantaged when applying for loans? Possibly there is an additional "risk charge" included in the loan's interest.

To check the answers of the merchants we will interview banks, too. This is necessary according to data triangulation and contributes to a higher internal subjectivity.

Until now, all interviews reveal that external-addressees besides banks are of no importance.

The internal use of annual financial statement data reveals a non-uniform picture. All interviewed merchants mentioned they control their company based on payments and payouts. Some merchants use annual financial statement data, too, like the annual surplus to manage tasks for the following financial year. The following paragraphs show two examples:

*"The calculation of the monthly surplus reveals my financial options for the next month. The annual financial statement shows the total volume of my sales, the amount of profit and loss. This is important for my next planning, what I have to do next year for tax allowances and appropriate investments."* (Interview 7, paragraph number 108 following).

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<sup>22</sup> T. Siegel: *Normierung der Rechnungslegung und „Bilanzrechtmodernisierung“*, Wiesbaden 2008.

*“Yes, of course. You are able to see, whether it was a good, bad or ordinary financial year. Because of the sales figures I know: Ok; I could do a lot more, I could afford another employee. This could actually be an expression of a very good tax counselor in October: You should invest your money! [ ... ], because otherwise you would reach a higher profit zone and then you have to pay a lot more taxes. Then you start buying equipment, vehicles - although it seems to be silly afterwards, because you will have your 4 to 5 years depreciation – but nevertheless you have spent money in this moment. This is always important.” (Interview 4, paragraph number 38 following).*

The examples show, that the annual surplus is of importance only to some merchants. As this data seems to be the only important financial data for them, we assume that the net income method would be of equal quality for planning purposes etc.

As a conclusion the only addressees of the merchants’ annual financial statements are banks.

Besides the findings above, a merchant seems to have other reasons to prepare an annual financial statement. The tax counselor has a major influence. Only two of the interviewed merchants were informed about § 241a in conjunction with § 242, paragraph 4 HGB by their tax counselor. Furthermore both merchants prepared an annual financial statement for information purposes. It seems that there is information asymmetry between tax counselors and merchants. With interviewing tax counselors we want to figure out why or if there really is information asymmetry between tax counselors and merchants.

Furthermore the personal interest of the merchants could be another reason for preparing annual financial statements. Two merchants mentioned that they would prepare an annual financial statement because of personal reasons even if they did not have to.

## **Outlook**

Our first results indicate, that even with the new regulation of the § 241a in conjunction with § 242, paragraph 4 HGB, only banks are addressees who demand annual financial statements. Merchants who need loans for future projects will always have to prepare an annual financial statement. Other addressees do not demand annual financial statements. Some merchants use annual financial statement data for their management although the demanded data could also be provided by the results of the net income method.

These results lead to temporary knowledge. Besides further interviews with merchants there will be minor research on the important addressees. The current state of research points out, that banks are the major addressees and lead to the assumption of an information asymmetry between tax counselors and “Real Merchants”. Further studies will be done in the course of 2011, so that the final results will be available at the beginning of 2012.

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### Summary

With the introduction of §§ 241a and 242, paragraph 4 HGB each merchant, who does not exceed 500.000 € sales revenues and 50.000 € annual surplus in two financial years in a row, was exempted from preparing inventories and annual financial statements. These deregulation efforts are only suitable, if these merchants have a real chance to avoid annual financial statements. Therefore we pose the question, whether these merchants need structured information, such as annual financial statements, beside any legal requirement. Based on our research objective, this report will help to get an insight into the merchant's subjective perception and experience by interviewing them. The first interviews showed that only banks can be confirmed as external addressees of annual financial statements. Banks require annual financial statements as merchants take up loans to finance their companies. The internal use of annual financial statement data reveals a non-uniform picture. All interviewed merchants mentioned they control their company based on payments and payouts. Only the annual surplus is of importance to some merchants. As this data seems to be the only important financial data, we assume that the net income method would be of equal quality for planning purposes.