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Press Release

GBP Monitor: More and more companies overstate their profits in financial statements

The September report of the German Business Panel (GBP) shows that financial information of companies must currently be taken with a grain of salt. It seems that companies are using their room for manoeuvre more than they used to, and that they use it, in particular, to make their profits appear higher. Since spring, the percentage of such companies has tripled and currently amounts to 10 percent. For sectors in crisis, the percentage is particularly high. One reason for this development could be the ongoing difficult economic situation: In energy-intensive sectors, the probability of default has even increased to up to 16 percent.

The economic outlook in Germany remains gloomy. The September data show that, while key business figures have improved, the probability of default has also increased. The expected probability of default has increased to 14.3 percent. In energy-intensive sectors such as the mechanical industry, the rate has increased to 16 percent and in sectors particularly affected by the coronavirus crisis event to 18.2 percent. The probability of default provides information on how likely entrepreneurs believe it is that a competitor will go out of business within the following 12 months.

Since the higher economic pressure threatens corporate goals and a company's survival, the majority of companies uses accounting policies: Almost 85 percent of the companies say that they actively steer their results. In most cases, implementing a cost-cutting strategy to reduce consumption but also to layoff employees is the first step. However, companies are increasingly using accounting measures to artificially increase their profits. This particularly applies to large corporations.

"This is not a scam or accounting fraud", explains Professor Dr. Jannis Bischof, holder of the chair of Business Administration and Accounting at the University of Mannheim and director of the GBP. "It is not surprising that companies push their profits up within the limit permitted during this dramatic energy and raw material crisis. They do this to convincingly demonstrate their creditworthiness and to calm investors", Bischof adds. In line with the

economic situation, using accounting policies is particularly popular in the trade sector (21.5 percent) and the construction business (21.3 percent).

The data also show that the share of companies which have chosen to push their profits up in their financial statements has considerably increased over the last months. In the last survey, 10.4 percent of the companies said that they used accounting policies to maximize their profits. This number is almost three times as high as in spring (approx. 3 percent in February 2022). In a good economic climate, companies tend to make their profits appear low, for example, in order to minimize tax payments. Until April 2022, the majority of companies made their profits appear as low as possible.

The complete report on company trends in September 2022 (“GBP-Monitor: Unternehmenstrends im Juni 2022”) can be found here: https://www.accounting-for-transparency.de/wp-content/uploads/2022/09/gbp_monitor_2022_09.pdf

Further information on the GBP monitoring report

The German Business Panel interviews more than 800 companies per month on the economic situation in Germany and collects data on 1) any expected changes in revenue, profit and investments, 2) economic decisions, 3) the expected default probability in the sector and 4) the satisfaction with the economic policy. Furthermore, GBP reports on particularly relevant questions once per month. **This month, the German Business Panel asked the companies in the panel if and how they use measures to manage their results and if their use of such measures has changed over time - also under the influence of the war between Russia and Ukraine.**

Background information on the German Business Panel

The GBP is the long-term survey panel of the trans-regional Collaborative Research Centre “Accounting for Transparency” (www.accounting-for-transparency.de).

The Collaborative Research Centre (CRC) “TRR 266 Accounting for Transparency” started in July 2019 and is funded by the German Research Foundation (DFG) for four years. It is the first CRC with a focus on business administration. Approx. 100 researchers from the following nine universities are involved in the CRC: Paderborn University (host university), Humboldt-Universität zu Berlin, University of Mannheim, Ludwig-Maximilians-Universität München, ESMT Berlin, Frankfurt School of Finance & Management, Goethe University Frankfurt am Main, WHU - Otto Beisheim School of Management and the Carl von Ossietzky University of Oldenburg. The researchers examine how accounting and taxation affect the transparency of companies and how regulation and firm transparency impact our economy and society. The CRC is funded with approx. 12 million euros.

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