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Accounting Regulation in Europe

Edited by
Stuart McLeay

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Stuart McLeay
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Preface

This book presents part of the research output of the European Universities Accounting Network. This research group was founded in 1993, with, as members, the accounting departments of the following universities:

Belgium: Katholieke Universiteit Leuven
Denmark: Handelshøjskolen i København
England: London School of Economics and University of Oxford
France: Conservatoire National des Arts et Métiers, Paris
Germany: J.W.Goethe Universität Frankfurt-am-Main
Greece: Athens University of Economics and Business
Ireland: University College Cork
Italy: Università degli Studi di Siena
Netherlands: Rijksuniversteit Limburg, Maastricht
Portugal: Universidade Tecnica de Lisboa and Escola de Direcçâo e Negócios
Spain: Universidad Autónoma de Madrid
Wales: University of Wales Bangor

The network was established by Professor John Flower, of the Centre for Research in European Accounting, which is attached to the European Institute for Advanced Studies in Management, Brussels. Considerable effort has gone into shaping the research contributions into a coherent whole, although differences in research approach and style remain for very good reasons. Each author, or team of authors, hosted a trainee research associate from another country in the EU, and this interchange of ideas helped to form a more encompassing approach to the study of regulation, whilst still locating the analyses within their distinctive national contexts.

The aim of this book is to explain how accounting rules are developed. In so doing, the authors provide a detailed account of how the institutional structures of accounting regulation have developed into their present form, together with a critical assessment of the visibility and effectiveness of the processes involved. The task of coordinating the various chapters for publication in this book was undertaken with considerable help from others, as acknowledged elsewhere, and with a certain degree of patience on the part of the authors as their draft chapters were edited and revised in a spirit of harmonisation if not of standardisation.

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Acknowledgements

This book is the result of the efforts of many people. Special thanks are due for the considerable assistance received during the preparation and revision of typescripts, particularly from Meryl Furlong (University of Wales Bangor), and Michelle Reed (Centre for Research in European Accounting, Brussels). We also wish to thank Gail Hughes for her careful review of style and syntax, and the helpful advice given to authors who were writing in English as a second language.

In addition, a number of researchers were employed on a training scheme associated with this project under the auspices of the European Union's Human Capital and Mobility programme (contract ERBCHRXCT). Some are co-authors of chapters in this book: Lieve Van Nuffel (Chapter 2); Evelyne Lande (Chapter 4); and Holgar Vieten (Chapter 12). The remaining research associates were Ioannis Asimakopoulos, Laury Bollen, Roberto Di Pietra, Gabi Ebbers, Giuseppe Ianniello, Araceli Mora, David Neal, Bernard Olivero, Michael Power, Simon Quinn, Ole Sørenson and Steven Young. A separate publication, *Comparative Studies in Accounting Regulation in Europe* (Leuven: Acco, 1997), presents some of the results of their cross-national research, and their working papers and published articles are referenced in the text. We acknowledge the helpful comments made by the research associates, and the constructive criticism of drafts of the various chapters in this book during meetings held throughout the course of the project.

Finally, an immeasurable debt is owed to Merete Christiansen, who had the courage and fortitude to complete Chapter 3 in the last months of her life. Although there have been one or two developments in Denmark in the intervening period, this particular chapter remains largely as it was conceived (together with a few editorial changes, some of which benefited from the useful advice given by Professor Christiansen's colleagues at the Copenhagen Business

School). As such, the chapter on Denmark provides a thorough analysis of representation on the various bodies involved in standard-setting and law-making, and reflects Professor Christiansen's aspiration to set down a detailed account of the political processes underlying accounting regulation in Denmark, not only explaining how the search for consensus is institutionalised, but also highlighting the potential for polarisation.

STUART MCLEAY

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1 Introduction

John Flower

This book is different from other books about European accounting, in that its focus is on the national systems for the regulation of financial reporting. Certainly it deals with the rules that govern the form and content of financial statements, but the emphasis is on the process for setting these rules, not on their content: that is, it deals with how the rules are set, not with what the rules are, which is the subject matter of most other books in the field.

A very wide concept of 'rule' is employed: it includes not only laws and delegated legislation (government decrees and mandatory orders), but also accounting standards, recommendations and opinions, where these are influential. For the purposes of the studies that are described in the later chapters of this book, a financial reporting rule is defined as any precept that influences the behaviour of those who prepare financial statements and, as such, covers a very wide spectrum which ranges from laws which are binding on the preparers of financial statements and which are enforced by a country's law enforcement agencies, to pronouncements of private bodies and individuals which have only a persuasive influence on the preparers of accounts. Using this approach, the later chapters of this book present a description and analysis of the national system for the regulation of the financial reporting of companies in the following eleven countries, all of whom are members of the European Union (EU): Belgium, Denmark, Germany, Greece, Spain, France, Ireland, Italy, the Netherlands, Portugal and the UK.

THE FUNCTION OF RULES

Why are Rules Necessary?

It is an observable fact that financial reporting is governed by rules which prescribe, to a greater or lesser extent, the form and content of financial statements. In analysing this phenomenon, it is natural first to consider the question: 'Why, in financial reporting, are rules necessary?' Solomons (1983) identifies a number of reasons, including the following:

Market failure

Under EU law, the financial statements of companies are made available to all who demand them, either freely or at a nominal charge. In general, the preparer bears the costs of financial reporting and the user enjoys the benefits. Since there is no effective mechanism by which those who use financial statements may compensate the preparers for the costs, there is a considerable danger of the demand for financial reporting exceeding the supply, a situation of under supply. The potential failure of the market is therefore attributable to the peculiar nature of published financial statements as a public good. If companies were allowed complete freedom, they would be unlikely to produce spontaneously the financial information required by outsiders. The preparation costs can be substantial and a company's management may prefer to withhold certain information in its possession which it feels may be used against it by other persons, including (a) shareholders who may question the managers' efficiency or integrity; (b) creditors and lenders who may decide to cease extending credit to the company; (c) workers who may decide to seek alternative employment; and (d) competing firms who may detect where the company is vulnerable to competition.

Credibility

In the absence of regulation, there is a significant danger of the public losing faith in the credibility of financial reporting by companies in general. This often occurs in financial scandals: for example, where a company fails, despite the fact that its latest financial statements, drawn up using current accounting principles, show it to be profitable and financially sound, the public will generally conclude that these accounting rules are wrong. It may also occur where there is a lack of consistency: the current accounting rules may allow such discretion to the preparers of accounts that two companies, which are fundamentally similar in all respects, may report quite different figures for total assets and profits. To be credible, there should be broad agreement among the experts reading a set of financial statements on factors such as the size of the company and its profitability.

Comparability

The information provided by a company is more valuable if it can be easily compared with information provided by other companies. Hence all companies should follow the same rules. This will not happen automatically. In the absence of an agreed set of rules, comparability would be feasible only if each company were to include with the accounts a lengthy and detailed explanation of the rules that have been followed in their preparation, leaving it up to the user to make any necessary adjustments. This procedure imposes costs not only on the preparer but also on the user, who has to read and understand explanations which will be different for every company. These costs may be avoided if a common set of rules (available to and understood by all concerned) were used by all companies.

Of the reasons presented above, comparability rests essentially on the advantages of all financial statements being based on the same rules. Credibility and market failure, however, concern the qualitative characteristics of information provided by companies, since they refer to the nature of the information that is demanded by those persons and organisations that use financial reports to make decisions. In all European countries, the legal obligation on a company is to report to its owners, but the users of its financial statements may include providers of finance, suppliers of goods and other trade creditors, workers, customers, the government and the general public.

There is little incentive for any of these users to contract individually with the company to pay more for better information to be included in the financial statements. The individual user would have to bear the cost, and others would then benefit as 'free-riders'. Moreover, it would not be feasible for the information to be supplied solely to those who pay for it, as its use in such circumstances would be an offence under 'insider-trading' laws.

There is no force that inhibits the company management from publishing only information that it considers to be in its interest. The implications have been well summarised by Burggraaff (1983), who characterizes the main thrust of rules as 'to reduce the freedom of preparers in order to satisfy some of the demands of the users'.

The Role of Government and of the Law

Since the market cannot ensure the provision of the information, both in quantity and in quality, that is demanded by important groups in society, the government, at the instigation of these groups, is obliged to intervene. This result is made all the more inevitable in that the government itself is an important user of information. Hence, governments pass laws that regulate financial reporting. Such rule-making is essentially a political process. As the rules that are laid down influence the distribution of resources between social groups, their interests may be taken into account through the normal political processes of consultation, debate, lobbying, bargaining and, in the end, voting on the enactment of laws by the legislature.

The setting of the rules of financial reporting by law has a number of advantages which have been well analysed by Bromwich (in Bromwich and Hopwood 1992) who sets out the principal benefits as:

(a) the legitimacy and social acceptance of the rules are assured, at least when they have been set by a democratically elected legislature;
(b) compliance with the rules may be enforced through society's usual procedures, the ultimate sanction being penalties imposed by the courts.

However the law, as a means of regulating financial reporting, also suffers from a number of disadvantages.

(1) In general, legislators do not give great priority to laws concerning financial reporting, with the result that such laws are often enacted after considerable delays, so that, by the time they come into force, they are already out of date. Law is not an effective way of dealing with urgent problems or with new developments in financial reporting.

(2) Financial reporting is simply too detailed for all aspects of it to be dealt with by law and most legislators are ill-informed about the technicalities of financial reporting. Hence, if the law purports to regulate financial reporting in great detail, there is a danger that its provisions will be inappropriate.

A HIERARCHY OF RULES

It is generally accepted that, because of the limitations of legislation and of legislators, it is more appropriate if laws are restricted to laying down the objectives and the more important rules and principles of financial reporting. Hence, in any regulatory system, the law is supplemented and completed by a number of other rules. The set of rules may be regarded as forming a hierarchy with law at the top. The principal elements of this hierarchy are presented in Table 1.1.

The upper elements of the hierarchy constitute law and therefore have legal authority. The rules in the lower elements of the hierarchy do not necessarily have legal authority. This does not mean that they are ignored by the preparers of financial statements.

Table 1.1 A hierarchy of rules

Rule	*Rule-making bodies*
Laws	Legislature
Delegated legislation	
Decrees	Government
Tax regulations	Tax authorities
Judgements	Courts of law
Standards	Standard-setting body
Rules of other bodies	
Professional recommendations	Professional associations
Guidelines	Industrial associations
Listing rules	Stock exchange
Interpretations	Individuals: academics, lawyers etc.

For a number of reasons, generally connected with the reputation and position of the rule-maker, companies find it appropriate to follow these rules, although they may not be under a legal obligation to do so. Nevertheless, in certain countries, rules lower down in the hierarchy may on occasions be endowed with the authority of law. For example, the courts of law many endorse such a rule by stating in a judgment that the rule represents a valid interpretation of the law (in effect, incorporating the rule into the law). The legislator may also grant to a lower-level body the authority to issue rules that are legally binding. The various elements of the hierarchy of rules are described in greater detail below.

Legislation

Law is the foundation of all regulatory systems. At the top of the hierarchy are laws enacted by the legislator. In certain countries, notably those whose legal system is based on Roman Law, these laws are incorporated into a Commercial Code which sets out in one single comprehensive document all the laws relating to business. However, even in England (which has a Common Law system), the basic rules that govern financial reporting are set out in Companies Acts which are periodically enacted by Parliament.

Delegated Legislation

Under the constitution of every EU country, whether the constitution is written or unwritten, the authority to make rules that are binding on citizens resides with the legislature. However, it is very common for laws enacted by the legislature to contain provisions that empower other government bodies, such as ministries and state agencies, to enact rules within laid-down limits. These rules are given various titles: decrees, orders, regulations, instruments etc.

Judgments of the Courts of Law

The courts of law play an important role in the regulatory system in deciding whether a particular rule should be recognised as law. Generally, the courts will accept the validity of government regulations enacted under proper delegated authority and enforce compliance with them through their judgments.

Standards

Standards are a peculiar feature of almost all systems for the regulation of financial reporting. They specify, in greater or lesser detail, how particular aspects of financial statements should be dealt with. Standards can supplement and extend the legal rules in areas where these are inadequate. Hence they may be regarded as:

(a) providing authoritative interpretations of the law where this is ambiguous or unclear;
(b) expanding the legal rules when these do not cover a point in sufficient detail;
(c) supplementing the law, by providing additional authoritative rules on matters not covered by the law.

As with delegated legislation, there is a problem of terminology. The term ‘standard’ is used only in English-speaking countries. Elsewhere various terms are used for this type of rule: *principi* (principles), *richtlijnen* (guidelines), *directrizes* (directives), *avis* (notices), and so on. There is great variety among the European countries in the status and importance of their standard-setting bodies, particularly in respect of the extent to which the body is instituted, controlled and/or recognised by the government and the degree of authority attached to the standards that it issues, for example the extent to which they are recognised by the courts as valid interpretations or extensions of the law. Within Europe, one finds examples of standard-setting bodies that, at one extreme, are clearly organs of government and whose standards are accepted by the courts as part of the law, and, at the other extreme, bodies that have an exclusively private status and whose standards have no formal legal authority (although often followed by accountants).

Rules Issued by Other Bodies

Many other bodies set rules. In general, the authority of the rules extend only to certain parties, such as members of the association in question; in respect of non-members, the rules have, at most, persuasive force. There are three types of body in this category which are important in the field of financial reporting.

Professional Associations of Auditors

In all European countries there is a legal obligation for the accounts of companies to be audited by a qualified auditor and there exist professional associations which represent those who are so qualified. Commonly these associations issue guidance to their members on the conduct of audits and, in particular, on the accounting rules that should be respected in the financial statements that they audit. Occasionally the professional associations seek to compel their members, through the threat of disciplinary measures, to require their corporate clients to follow these rules; however, this is rare. More commonly, the rules are in the form of recommendations, which the members are not strictly obliged to follow but often do, because of the prestige and moral authority of their professional body. In some European countries, there also exist separate associations of accounting experts who are not auditors but who offer accounting services or are employed as company accountants. Some of these associations also publish their own rules which may be binding on their members or merely provide guidance in applying official regulations.

Industrial Associations

These are loose associations of companies, perhaps in a specific industry or alternatively representing business interests at national level. They may issue guidance to their members on accounting matters, more frequently on management accounting, less frequently on financial reporting. There is rarely any attempt to enforce compliance. Nevertheless the industrial association's guidelines may be widely followed in matters specific to the industry because they are perceived as being technically competent and relevant to the particular problems of companies in that industry, or to business interests in general because of the role of the association at the policy-making level.

Stock Exchanges

Companies that seek to have their shares and other securities listed on a stock exchange have to agree to observe the rules of that stock exchange. These rules may contain quite detailed provisions relating to financial statements (for example, requiring the disclosure of information additional to that prescribed in the law), and they may be a very important influence on the financial reporting of the small number of companies to which they apply. However, although listed companies may be small in number, their economic importance is often considerable. Listed companies generally observe these rules because the stock exchange authorities have a very effective means of assuring compliance: they can suspend the listing of the company's shares and, as an ultimate sanction, expel the company from the exchange. In certain countries, the stock exchange authority is a government agency and its rules have the authority of delegated legislation.

Interpretations and Opinions

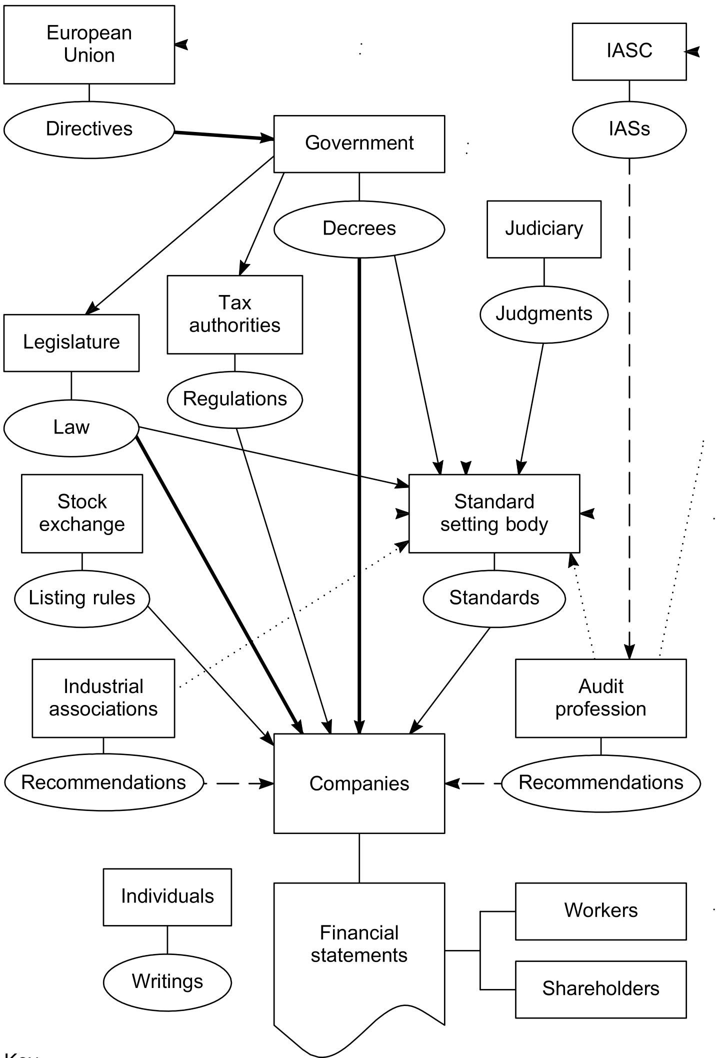
The weakest forms of rule are the interpretations and opinions of individuals, such as learned professors and distinguished lawyers, set out in books and articles. They are binding on no-one, unlike the rules of a private body which may be binding on its members. Nevertheless they may be very influential, particularly where the law is ambiguous or lacking, and these lacunae have not been filled by the issue of rules by a higher authority.

THE REGULATORY SYSTEM

In each European country the rules that govern financial reporting are made up of a mix of laws, standards, the rules of other bodies and interpretations by experts. The bodies that set these rules are also specific to the country: that is, each European country has its own system for the regulation of financial reporting. A general model which can be used to describe and analyse the system in each country, and to compare systems between countries, is presented in Figure 1.1.

The influence exercised by a rule over companies in preparing their financial statements is represented in Figure 1 by a connecting line, the strength of the influence also being indicated. In addition to the general influence of different types of rules and regulations, one rule-making body may influence another not only through its relative authority but also through active involvement in other

Figure 1.1 A general model of the regulatory system



Key
Strong influence
Moderate influence
Weak influence
Membership
IASC = International Accounting Standards Committee
IASs = International Accounting Standards

institutions' decision-making. In Figure 1.1, this kind of influence is denoted by a dotted line. For example, in Figure 1, it is assumed that the decision making board of the standard-setting body is made up of representatives of the government, employees, the audit profession, industrial associations and the stock exchange. Finally, Figure 1.1 presents a new category: external rule-makers. There are two organisations in this category: the EU and the International Accounting Standards Committee (IASC). Both are discussed in more detail later in this chapter.

FACTORS THAT SHAPE FINANCIAL REPORTING

A number of factors may explain differences in financial reporting between countries. Nobes and Parker (1995, Ch.1) identify four of these: the nature of the legal systems; the information requirements of different providers of finance; the linkage between company taxation and disclosure in published financial reports; and the degree of professionalisation. They are all elements of the regulatory system and will be now considered in detail.

The Legal System

Within Europe, England and Ireland have a legal system based on Common Law. The role of statute law (that is, law enacted by the legislator) is limited to laying down general principles. The courts interpret these principles and, over time, build up a body of case law to supplement statute law. In all the other European countries that are dealt with in this book, the legal system is based on Roman Law. The law specifies the rules in great detail, and, in principle, the role of the courts is mainly to enforce the law. In some Roman Law countries, there is a Commercial Code (enacted and amended periodically by the legislature) which is a single instrument that lays down the rules governing all aspects of economic activity including financial reporting.

It is to be expected that the distinction between Common Law countries and Roman Law countries would manifest itself in differences in the relative importance of the legislator and the courts as sources of rules. In Roman Law countries, for instance, standards may play a less important role or be absent altogether; where the law lays down the rules in great detail, there is less need for separate accounting standards.

Providers of Finance

In some European countries, equity investment through a stock exchange is more prevalent than in others, with the exchanges in Amsterdam and London being the most active as a source of finance for domestic companies. Companies that are listed on the stock exchange generally have a large number of shareholders. For these companies, the published financial statements are the principal means of communicating with their shareholders, and such companies may be motivated to make their financial statements as informative as possible in order to avoid uncertainties which would affect the cost of capital.

Where the stock exchange is less important, companies obtain more of their funds from banks and other financial institutions, and from less public sources such as family members and business contacts. Here, the financial statements will play a less important role in providing information for investors, as providers of debt finance and venture capital are generally able to obtain all the information that they need through direct contacts with the company's management. In such circumstances, there may be little motivation for companies to publish informative accounts. The government has to intervene to oblige companies to do so. In some European countries, it is even considered that 'the traditional paucity of "outsider" shareholders has meant that external financial reporting has been largely invented for the purpose of government as tax collectors and controllers of the economy' (Nobes and Parker, 1995, p. 14).

Taxation

In certain countries, there is a closer connection between the tax rules and financial reporting rules than in others: that is, the rules used to compute taxable profit and wealth are the same (either wholly or partially) as the rules that govern financial reporting. Indeed, the law may lay down the basic principle that tax should be computed on the basis of the figures presented in the financial statements. It might be expected that this would lead to taxation becoming subordinate to financial reporting. In fact the reverse is invariably the case, as governments are moved to enact financial reporting rules specifically to protect their tax revenues, with the end result that tax dominates financial reporting. This often manifests itself in the rule that the tax authorities only recognise an expense as a charge against taxable income if this expense is also reported as such in the profit and loss account. In these circumstances, the taxpayer has an incentive to charge the maximum amount permitted by the tax authorities for items such as depreciation. As governments frequently use the tax depreciation rates as a means of managing the economy, this can result in tax rules which permit companies to charge as much as 100 per cent depreciation in the year that an asset is acquired. The charge for depreciation in the financial statements rarely represents what may be considered to be a fair view of the cost of using the asset. This conflict between tax rules and accounting regulations is particularly evident in those European countries where there is no obvious separation between annual financial reporting and tax assessment.

In the UK, Ireland, the Netherlands, Spain and Denmark, there is no formal legal rule that the tax computation must be based on the figures in the financial statements. However, even in these countries, many companies will find it convenient to use the tax rules in their financial statements. This simplifies negotiations with the tax authorities and avoids the necessity of making two calculations (one for tax and one for financial reporting), an important consideration for smaller companies.

The Audit and Accountancy Professions

The importance of the audit and accountancy professions appears to vary from country to country, at least insofar as there exist associations through which the professions may exercise their influence, both over their members and on their behalf at the policy-making level. In countries where the profession is strong and well established, as it is in Britain, Ireland and the Netherlands, it is a major influence over financial reporting, both through the profession's own rules but more particularly through its influence over other rule-makers.

INTERNATIONAL INSTITUTIONS

The following chapters describe and analyse the system for the regulation of financial reporting in eleven European countries. They are based loosely on the ideas that have been presented in this chapter, and, in particular, each chapter contains a detailed analysis of the institutional structures that influence financial reporting at the level of each country. However, as shown in Figure 1.1, there are two bodies that are outside these national systems: the EU and the IASC. Since their influence extends over many countries, it is more convenient to deal with them in this chapter.

The European Union

All the countries covered in this book are member states of the EU. For more than 25 years this organisation has been active in the field of financial reporting. It aims to achieve 'harmonisation' of company accounts: that is, to reduce diversity in this field so that any remaining differences between the financial statements of companies located in different member states do not represent an impediment to the efficient operation of the common market. When the EU was founded, the following article was written into the Treaty of Rome which, in 1957, set up the European Economic Community (EEC), the forerunner of the EU:

> Article 54
> 1. . . . the Council shall draw up a general programme for the abolition of existing restrictions on freedom of establishment within the Community . . .
> 3. The Council and Commission shall carry out the duties devolving on them under the preceding provisions, in particular: . . . (g) by coordinating to the necessary extent the safeguards which, for the protection of the interests of members and others, are required by member states of companies . . . with a view to making such safeguards equivalent throughout the Community.

This is the sole reference to company accounts in the treaty and in fact the word 'accounts' is not mentioned. This article furnishes the sole legal basis for the EU's action in this field.

The EU is based on the principles of a common market within which there is a free flow of goods, services, labour and other factors of production between the member states. In this way the welfare of the population as a whole is maximised. The consumer benefits from the availability of goods and services that have been produced in the cheapest place, in the most efficient way, using the lowest-cost factors of production.

One important factor of production is capital. To achieve the most efficient use of capital, a company should be able to raise its capital in any member state (for example, where the capital is cheapest) and put it to work in any other member state (for example, where the production opportunities offer the greatest profit). However, if the rules of various member states on the form and contents of company accounts are very different, these will act as a severe restraint on the efficient operation of the common market. For example, a French investor, banker or supplier of goods or services may be reluctant to have dealings with a German company if he or she cannot understand its finances because its accounts are strange and mystifying; similarly a German company will be reluctant to raise capital in France if it has to spend resources on explaining and adapting its accounts for French investors. Hence, for the efficient operation of the capital market, a certain minimum level of harmonisation of company accounts is necessary.

However the effect of a member state's financial reporting rules is not limited to the capital market. The ultimate aim of the EU is to provide a common environment for business throughout Europe. A company that is based in one member state should not experience major difficulties in carrying on business in another member state either through a branch or through a subsidiary company. The financial reporting requirements of the various member states are a major feature of the business environment and can add considerably to the costs of operating in another member state, particularly if these requirements differ significantly from those of the member state in which the company is based. If the requirements of the two member states are inconsistent (or, even worse, contradictory), their effects can be most harmful.

In order for the common market to operate efficiently, it is necessary that the allocation of resources which results from the interaction of market forces should not be distorted by government action, (for example, by the government offering subsidies and other benefits to national companies). The same applies to restrictions and other obligations imposed by governments in such fields as workers' safety and the protection of the environment. Of course, such limitations on a company's freedom are a necessary feature of a civilised society but, in a common market, it is vitally important that they do not differ significantly between countries, otherwise one member state might be able to secure for its companies a competitive advantage over their foreign rivals.

If companies resident in one member state were to be permitted to get away with publishing uninformative accounts, they would have an unfair advantage over companies in other member states. Since, in a common market, there should be no restrictions on where companies may establish themselves, there would be a tendency for companies to set themselves up in the member state that offered the most favourable financial reporting regime. For companies not affected by the need to signal clear information to the financial markets, such a regime would be appealing as it would allow the company to minimise the costs of financial reporting. Since, in general, governments are in favour of companies establishing themselves on their territory (they provide employment and pay taxes), they would be reluctant to see companies enticed away by incentives offered by other countries. The result would be a form of auction in which governments vied with each other in offering the most favourable financial reporting regime for companies which are able to avoid the discipline of the financial market, and would provide an illustration of 'Gresham's law' of accounting: poor financial reporting drives out good financial reporting.

That such a scenario is not just a theoretical possibility is demonstrated by the experience of the USA a hundred years ago. Company law being a state and not a federal matter, certain states sought to attract companies to their territory by enacting very favourable (that is, non-restrictive) laws on company accounts. It is generally agreed that this competition was won by the state of Delaware. To this day, many important companies are resident there, despite it being one of the smallest states in the Union (Coleman, 1983).

Above, three reasons are given for why the EU should intervene in the field of company financial reporting; they may be characterised as: (a) the economic reason: to ensure the efficient operation of the common market; (b) the legal reason: to fulfil the treaty obligation to protect shareholders and others with an interest in a company's affairs; and (c) the competition reason: to prevent member states from unfairly favouring companies registered in their jurisdiction. Whereas the economic reason is useful in highlighting the benefits of the EU's actions (the greater welfare of the whole population) and the legal reason is necessary because of the need to have a valid legal basis for the EU's actions, the compelling motive behind the EU's actions in the accounting arena is competition. If the EU were to do nothing and leave the regulation of financial reporting entirely to the member states, there is some danger of a competitive downward spiral in European financial reporting.

To achieve some degree of harmonisation on any issue, the instrument that the EU has used is the directive. A directive is a special form of EU law. It is enacted by the EU's legislative organ (the Council of Ministers) and is addressed to the governments of the member states who are legally obliged to comply with its provisions. A directive specifies the objectives to be achieved and requires that each member state should enact the necessary laws and regulations to make the directive's provisions binding in its country. The result is that each member state retains its own national legal and regulatory systems, which are, however, strongly influenced by the EU's directives.

In the field of financial reporting, the EU has enacted two important directives: the Fourth Directive, which deals with the annual accounts of individual companies; and the Seventh Directive which deals with consolidated accounts. Both directives set out in remarkable detail the rules to be followed for the preparation of financial statements, particularly in relation to formats, valuation and disclosure. Some important dates relating to the two directives are presented in Table 1.2. For a directive to be effective, it has to be enacted by the member state (that is, incorporated into its laws and regulations). Not all member states have been equally expeditious in achieving this, and the legislative process has taken a very

Table 1.2 The EU's Directives

	The Fourth Directive	*The Seventh Directive*
First EU proposal	1971	1973
Directive enacted by EU	1978	1983
Directive enacted by the member states		
Belgium	1983	1990
Denmark	1981	1990
France	1983	1986
Germany	1985	1985
Greece	1986	1990
Ireland	1986	1992
Italy	1991	1991
The Netherlands	1983	1988
Portugal	1989	1991
Spain	1989	1989
UK	1981	1989

long time. In the case of the Fourth Directive, for example, 20 years elapsed between the first proposal and its enactment in Italy, the last member state to act.

Table 1.2 illustrates that in EU affairs there is often a marked disparity between the rhetoric and the reality. In formal terms, the member states are obliged to comply with EU directives; in joining the EU they have surrendered a part of their sovereignty. In reality the attitude of most member states to their obligations under EU law is much more relaxed. However, there is no doubt that the EU is a most important influence in financial reporting, although its influence has been most noticeable in certain member states and in certain fields, as the following chapters make clear. Further information on the EU's constitution and on its harmonisation programme may be found in Van Hulle (1993) and Flower (1994).

The International Accounting Standards Committee

In contrast to the EU, the IASC is a purely private organisation. It was set up in 1973 by the professional accountancy bodies of the major developed countries. By 1996 its membership had grown to include no less than 116 professional bodies from 86 countries, including virtually all the developed countries and many developing countries. However, the full committee meets only rarely. All the IASC's powers and responsibilities are delegated to its board, which in 1997 consisted of representatives of the accountancy profession of the following countries: Australia, Canada, France, Germany, India, Japan, Malaysia, Mexico, the Netherlands, the Nordic Federation, South Africa, the UK and the USA; in addition there are three co opted members from organisations that represent the financial analysts, the financial executives and industrial holding companies. The European Commission (the EU's executive organ) and the USA's Financial Accounting Standards Board (FASB) sit on the board as observers. It should be noted that four of the sixteen board members are from the EU: France, Germany, the Netherlands and the UK. In addition, Denmark, Finland and Sweden are part of the Nordic Federation which is a member of the IASC's board. Hence the European accountancy profession is in a minority but may be expected to have some influence over the board's decisions. An analysis of the membership of the IASC in relation to the EU is presented in Table 1.3.

The IASC's principal function is to issue standards, known as International Accounting Standards (IASs). Since 1973 it has issued some 30 such standards, covering all aspects of the financial statements of companies, both the individual accounts and the consolidated accounts. The members of the IASC (that is the 116 professional bodies on the full committee) have committed themselves to use their best endeavours to ensure that the IASs are implemented in their own countries by exercising their influence over companies, governments, stock exchange authorities and auditors. In reality, the IASC has no effective means of ensuring compliance. Of the four groups mentioned above, it has influence only over the auditors and, even with this group, its influence is limited. For the first 20 years of its existence, the IASC avoided the problem of compliance by making its standards very broad so that almost every conceivable accounting treatment was permitted. Nevertheless, as demonstrated in the following chapters, the IASC's influence in certain countries has been considerable. However, recently it has adopted a different strategy of making its standards

Table 1.3 The IASC and the EU

The following professional accountancy bodies from the EU countries are members of the IASC's full committee. Those EU countries indicated in bold type are members of the IASC Board. Those countries marked with (*) are on the IASC Board by virtue of being members of the Nordic Federation of Public Accountants

Belgium	IEC – Institut des Experts Comptables IRE –Institut des Réviseurs d'Entreprises
Denmark*	FRR – Foreningen af Registrerede Revisorer FSR – Foreningen af Statsautoriserede Revisorer
Germany	IdW – Institut der Wirstchaftsprüfer WPK – Wirtschaftsprüferkammer
Greece	SOE – Σώμα Ορκωτών Ελεγκτών – Institute of Certified Auditors
Spain	IACJCE – Instituto de Auditores-Censores Jurados de Cuentas de España
Finland*	KHT-yhdistys – Association of Authorised Public Auditors
France	CNCC – Compagnie Nationale des Commissaires aux Comptes OEC – Ordre des Experts Comptables
Ireland	ICPAI – Institute of Certified Public Accountants in Ireland ICAI – Institute of Chartered Accountants in Ireland
Italy	CNDC – Consiglio Nazionale dei Dottori Commercialisti CNRPC – Consiglio Nazionale dei Ragionieri e Periti Commerciali
Luxembourg	IRE – Institut des Réviseurs d'Entreprises
Netherlands	NIVRA – Nederlands Instituut van Registeraccountants
Austria	IÖW – Institut Österreichischer Wirtschalftsprüfer
Portugal	CROC – Câmara dos Revisores Oficias de Contas
Sweden*	FAR – Föreningen Auktoriserade Revisorer SRS – Svenska Revisorsamfundet
UK	ACCA – Chartered Association of Certified Accountants CIMA – Chartered Institute of Management Accountants CIPFA – Chartered Institute of Public Finance and Accountancy ICAEW – Institute of Chartered Accountants in England and Wales ICAS – Institute of Chartered Accountants of Scotland

tighter and more prescriptive. It is also seeking to increase the international acceptance of its standards through agreements that it has made recently with the European Commission and IOSCO (the body that represents the capital market authorities at international level). It is too early to judge the success of this new strategy but it seems probable that in the future the IASC will become a most important and influential player in financial reporting throughout the world. For more information on the IASC's recent activities, see Flower (1997) and Cairns (1997).

THE NATIONAL REGULATORY SYSTEMS OF EUROPEAN COUNTRIES

The following chapters present a description and analysis of the systems for the regulation of financial reporting of eleven European countries. The countries are all members of the EU, in fact they represent a major part of the fifteen countries that currently make up the EU, accounting for 94 percent of its population and 93 percent of its gross domestic product. The only member states not covered are Austria, Finland, Luxembourg and Sweden. Of these countries, the regulatory systems of Finland and Sweden have already been the subject of a detailed study (Flower, 1994).

The research uses a very wide definition of financial reporting rule. As indicated above, this may include laws, standards, stock exchange regulations, professional recommendations and even the opinions of private individuals when they are influential. This implies in turn a wide definition of 'rule-making body'. In each country, the history of financial reporting is analysed, which leads to an assessment of the importance of the factors that have influenced, and still influence, its development. They are not only the four factors that have already been identified (the legal system, taxation, finance and the audit profession) but also those that are specific to the particular country, such as geography (Ireland's proximity to the UK), inflation (Germany's harrowing experience in the 1920s) and outstanding individuals (Theodore Limperg in the Netherlands). This is followed by an analysis of the constitution and functioning of the various rule-making bodies (in both the public and the private sector). The influence of the various parties on the rule-making process is considered, by investigating institutional structures, the procedures of rule-making and the composition of decision-making committees. The chapter on Germany reports on an innovative and instructive study which measures the influence of the various interested parties (preparers, auditors and academics) on the law-making process in that country.

The great diversity in the national regulatory systems of its constituent member states poses a major problem to the EU in its efforts to harmonise financial reporting. However, there is evidence that these differences have become less significant over the past 20 years. The EU itself, through its directives, has clearly been one of the causes of this narrowing of differences; other factors have been the growth in international trade and investment, and the growing influence of the large international audit firms and of the IASC. However, there is a danger that the EU, in imposing through its directives a set of detailed rules, will achieve only a very superficial level of harmonisation if it does not also take into account the different national systems for the development and implementation of rules. Such an approach is similar to that of a physician who treats the symptoms of a disease without curing the fundamental causes. The rules that govern financial reporting on the ground in the EU are in each country the product of a complex system that reflects both the country's history and the balance of forces in its society. Without a better understanding of these systems, effective harmonisation will never be achieved. That is essentially the interest and the justification of the studies reported in this book.

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2 Belgium

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INTRODUCTION

Belgium is a country at the cross-roads of many socio-cultural traditions. In accounting, French, Dutch and German influences can be seen alongside the more recent impact of the English-speaking countries. Nevertheless, Belgium's system of accounting regulation has also been shaped by its own political institutions and legal system, as well as by the social and economic environment in which accounting by Belgian companies takes place. Indeed, the present approach to the regulation of financial reporting very much reflects the model of social coalition that has been dominant in Belgium since the end of the Second World War.

This chapter traces the evolution of the Belgian regulatory system into its present form, emphasising its unique qualities as well as its dependence on external factors together with a detailed analysis of the current institutional framework for the regulation of financial reporting in Belgium.

HISTORICAL BACKGROUND

The Flemish School of Accounting exercised a great influence on the development of commerce during the sixteenth century (ten Have, 1973). In centres such as Antwerp, Amsterdam, Middelburg and Franeker, a total of eleven Flemish authors published works on the subject of accounting. Two of these emerged as the leading scholars. The first was Jan Ympijn (Christoffels), an Antwerp merchant whose book was published in 1543. The second was Simon Stevin (van Brugghe or Bruggelinck) who, like Luca Pacioli, was well known as a mathematician.

Ympijn's book, a treatise on accounting, was translated into French in the year it was published. Four years later, in 1547, it was translated into English under the title *A Notable and very excellente woorke, expressyng and declaryng the maner and forme how to kepe a boke of acco(m)ptes or reconynges*. Fortunately, there still exists evidence of accounting practice at that time. During the last half of the sixteenth century, Christopher Plantin, a printer and publisher, settled in Antwerp and set up his well-known press. The account books of his business have been preserved and illustrate the application of the double-entry accounting system. It is remarkable that Plantin kept separate inventory accounts for raw materials and finished products, and product cost accounts charged with direct labour costs, materials, and other direct costs (Edler, 1937). He also used a type of multi-monetary accounting system, where different books were used for different currencies.

Stevin's book was published in Leiden in 1607 and was almost immediately translated into French. It was written for Prince Maurice of Orange-Nassau, who was so impressed by the merchant accounting system which Stevin described that he imposed a similar system for governmental accounting purposes (ten Have, 1973). Thus, by the beginning of the seventeenth century, the Flemish accounting school had not only made its mark on commercial practice but also on the earliest of accounting regulations, issued through Royal proclamation.

Belgium as we know it today came into being in 1830. The Napoleonic Code of Commerce, which had been introduced under the French in 1807 and then suspended for a time following independence, served as the basis for the development of Belgium's first Company Law which was enacted on 18 May 1873. The Code of Commerce stipulated matters such as the books of account to be kept and the procedures to be followed in bankruptcy. The 1873 Company Law established the Limited Company (*Naamloze Vennootschap/Société Anonyme*), and laid down the requirements in law concerning the publication of annual accounts and the duties of commissioners (*commissarissen/commissaires*) and directors.

The Importance of Belgian Holding Companies

The first holding company in Belgium dates back to December 1822 when *Société Générale des Pays-Bas pour favoriser l'Industrie Nationale* was established. The function of this holding company was to take care of the financial needs of the Southern Provinces and to assist King Willem I to balance his budget. It follows that, when Belgium became independent in 1830, a relatively powerful financing company was already in existence. Whilst its capacity was much larger than the needs of industrial development in the initial years of independence, the existence of the *Société Générale* laid the basis for financing considerable industrial growth in Belgium in the latter part of the nineteenth century.

Some time later, in the period between 1928 and 1932, a number of other holding companies were established, such as the *Société d'Electricité de la Campine* and the *Centrales Electriques des Flandres et du Brabant*, which took control of the Belgian electricity industry. Industrial holding companies were also created in other sectors, such as textiles and glass. Thus, the expansion of Belgium's industrial base was financed by a small but growing number of powerful holding companies.

This method of financing industrial development had important repercussions on the preparation of financial statements in Belgium. The holding companies had no real interest in the disclosure of information to third parties, the proportion of shares belonging to third parties other than the remaining holding companies being low and the public interest in financial information also being limited by the absence of an active capital market.

Such was the power of the Belgian holding companies, even as far back as 1934, that the Government was forced to intervene. As a result, the banking activities of the holding companies were transferred to subsidiaries under independent management (Lafferty, 1976). The Royal Decree of 9 July 1935 instituted the Banking Commission (*Bankcommissie/Commission Bancaire*) and stipulated that all banks accepting deposits from the public must eliminate their non-banking trade investments and also include bank auditors among their commissioners. Consequently, the Institute of Bank Auditors (*Instituut der Bankrevisoren/Institut des Reviseurs de Banque*) was formed, under the supervision of the Banking Commission which approved its members. This was the first step in Belgium towards official recognition of a profession with expertise in accounting matters, limited at the time to the banking sector.

Belgian company law was amended on several occasions and this process led to the 1935 Company Law. Section 9 of this law stipulated the various requirements which companies had to comply with regarding their bookkeeping and financial reporting. These requirements were minimal, concerning only the basic content of a balance sheet and income statement. The published balance sheets were often referred to as the 'visiting card form' or 'pocket size' balance sheets. Although it was officially satisfactory to report only six items on the balance sheet and 'sufficient' depreciation allowances in the profit and loss account, many Belgian limited companies did not confine themselves to those legal requirements; but this does not mean that the amount of information disclosed was sufficient to meet the needs of users of the financial statements. As in many other countries at the time, the published accounts were essentially fiscal accounts because tax benefits were received only when the relevant entries were recorded in the books.

The New Social Order in Post-War Belgium

In September 1944, a Conference on Employment brought together various interest groups in Belgian society. This was similar to a previous gathering that had taken place in 1936, but this time socialist and Catholic trade unions pressed for wider and greater participation. In fact, following the Second World War, the majority of Western nations strove to create a new social order. Ideally, society would be transformed into an economic community in which employers and employees would view each other not as opponents, but as partners. In this context, one of the most emphatic demands in Belgium was for the participation of employees in the decision-making process of the companies which employed them, by means of works councils and shared ownership.

The new post-war order was formalised in a law of 20 September 1948. New organisations were proposed at the national, industry and company levels, as shown in Table 2.1, so that employers and employees would be brought together to discuss economic and social matters. Industry Trade Boards were created at the sector

Table 2.1 Post-war industrial organisation in Belgium

Level	*Economic*	*Social*
National	Central Economic Council (*Centrale Raad voor het Bedrijfsleven/Conseil Central de l'Economie*)	National Workers' Council (*Nationale Arbeidsraad/ Conseil National du Travail*)
Industry-wide	Industrial Councils (*Bijzondere Raadgevende Commissies/Commissions Consultatives Spéciales*)	Joint Committees (*Paritaire Comités/Commissions Paritaires*)
Company	Works Councils (*Ondernemingsraden/ Conseils d'Entreprise*)	Works Councils (*Ondernemingsraden/Conseils d'Entreprise*) Health and Safety Committee (*Comité voor Veiligheid en Hygiëne/Comité de Sécurité et de Hygiène*) Trade Union Delegates (*Vakbondsafgevaardigden/ Délégués Syndicaux*)

level, composed of equal numbers of employer representatives and employee representatives. Finally, works councils (*Ondernemingsraden/Conseils d'Entreprise*) were created at the level of the individual enterprise, again on a 50:50 representational basis.

The anticipated introduction of the works councils gave rise to further pressure from the trade unions. This led to two other important provisions in the law of 20 September 1948: (a) works councils would be entitled to financial and economic information; and (b) they could appoint a *revisor* to audit the information supplied to them. Thus, from this point onwards, the Belgian trade unions expected to receive regular financial reports certified by an independent professional auditor.

The need for an audit profession had already been foreseen, as a commission had been appointed in 1946 to prepare the way for a legally-recognised national body. The first accountancy body in Belgium, the *Syndicale Kamer van Boekhouders/Chambre Syndicale des Experts Comptables*, had been formed in 1903 and, in 1942, the

German occupying authorities had made an effort to establish a state accountancy body, although this had proved to be unsuccessful and was suppressed at the end of the war. By 1950, there were many professional organisations concerned with accountancy and auditing, 20 of which agreed that, rather than integrate, they would form an association to be known as the National College of Belgian Accountants (*Nationaal College van Accountants van België/Collège National des Experts-Comptables Belges*, or NCAB/CNECB). One of the main responsibilities of the NCAB/CNECB was the training of professional accountants. Other tasks were to extend its responsibilities and to promote the official recognition of the accountancy profession. Members of the NCAB/CNECB included independent accountants and others working as employees, and were designated either '*Accountant NCAB*' or '*Expert-Comptable CNECB*'. Although it lacked legal status, the NCAB/CNECB may be considered as the first and foremost representative accountancy body in Belgium during this period. The members of the NCAB/CNECB were concerned primarily in providing accounting services to companies, often involving tax advice. They did not perform audits, the concept of an independent audit hardly existing in Belgium at that time.

The trade unions continued to press for a legally-recognised and independent audit profession and, in 1948 and 1951, bills on the supervision of companies were introduced by a highly respected member of Parliament, A. De Schrijver, but both attempts failed. In 1953, however, another bill calling for independent auditors was introduced by De Schrijver and this was enacted on 22 July 1953, creating the Institute of Auditors (*Instituut der Bedrijfsrevisoren/Institut des Reviseurs d'Entreprises*). The legislation provided for members of the Institute of Bank Auditors to become members of the Institute of Auditors and almost all of them decided to do so.

The Act of 22 July 1953 became effective only after a second piece of legislation, again introduced by De Schrijver, was passed on 1 December 1953. This required companies quoted on the Stock Exchange to appoint at least one auditor among the commissioner members of the supervisory board appointed by the General Meeting of Shareholders. According to this Act, the 'commissioner-auditor' was to be chosen from the members of the newly created Institute of Auditors. Subsequently, the law of 16 March 1954 restricted the statutory audit of organisations of public interest such as companies to the members of the Institute of Auditors. However, it took four more years for two important executive measures in the Act of 1953 to come into effect. These were the regulations surrounding the ethical code (16 March 1957) and training (24 July 1957).

The final event in this phase saw the separation of the accounting profession in Belgium into two major bodies, in 1957. These were the NCAB/CNECB and the National Association of Belgian Accountants (*Association Nationale des Comptables de Belgique/Nationale Associatie der Boekhouders van België*), the latter representing a second tier of members who did not aspire to become *experts comptables*.

Dissatisfaction and Trade Union Pressure

The creation of the Institute of Auditors in 1953 had not dissipated the general dissatisfaction with the Belgian accounting situation. Many wanted a similar kind of professional organisation, but freed from state control. Spinoy (1964), Declerck (1965), Van Bulck and Coucke (1966/7 and 1968) and Herbiet (1968) all introduced bills into Parliament in order to protect the title of accountant and to create separate institutions for accountants and auditors (Delbeke, 1982).

Nevertheless, during this period, the legal responsibilities of auditors were extended by various laws and decrees. These were the Law of 23 July 1962 which dealt with the certification of the conversion of debentures into capital; the Law of 10 June 1964 which provided for the audit of businesses receiving reimbursable funds from the public; the Law of 23 February 1967 which required investigation in the case of company restructuring; the Laws of 26 and 30 June 1967 which required investigations in the case of amendments to the company statutes, and of any non-cash capital contributions. Other legislation had to do with the audit of holding companies (Royal Decree 10 November 1967) and the audit of companies in which the state has a material interest (Royal Decree 11 November 1967).

This period also saw the creation of a number of working parties to review various aspects of accounting and auditing in Belgium. In

1964, the Geulette Commission was established to make recommendations regarding a Standard or Uniform Chart of Accounts. In 1967, the Oleffe Task Force was created to review the whole area of corporate financial disclosure. The chairman, from the Walloon Christian trade union movement, was also a representative of the Banking Commission which, in the same year as the Task Force was set up, was given the right to exercise full supervision over the information released to the public by Belgian holding companies (Royal Decree, 10 November 1967). The recommendations of the Oleffe Task Force stressed that financial reporting in Belgium should be based on the 'true and fair view' principle and that disclosure requirements should be extended. Dissatisfaction with the low level of disclosure in annual accounts continued to grow and another working group (the De Voghel Committee, named after its chairman who was a representative of the National Bank) published further recommendations in the same vein as the Oleffe Task Force.

Until this time, legislation concerning annual accounts in Belgium had remained archaic and the Belgian accountancy profession was weak both in numbers and status. The accountancy profession tended merely to follow the law rather than to seek to change it. Moreover, with the law providing little guidance, the profession did little to fill the gap and failed to develop a coherent and relevant set of accounting principles. The few Belgian groups that did publish accounts used methods which were not only profoundly different from methods used in other countries but also different from each other. The ruling principle was conservatism. Manifestations of this conservatism included the compulsory building-up of reserves from profit, and the acceptance of secret reserves and general provisions against contingencies and possible losses in value, as well as the tendency to understate stocks and work in progress and the refusal to consider any form of inflation accounting. Consequently, the concepts of 'true and fair view' and 'the going concern' were overruled by the principle of conservatism and thus were not established in Belgian accounting practice. The practice of auditing itself, despite the Institute of Auditors, remained undeveloped. Although the law required many companies to have an audit, it was remarkably vague about how the audit should be carried out. Audits were conducted by unqualified persons in a cursory and casual manner. Even when Belgian accountants were engaged as auditors, they tended to neglect the auditing and to concentrate more on providing taxation and financial advice. As a result, reports issued to express an opinion on financial statements were often of little value. Qualifications and reservations were virtually unheard of. Consequently, financial statements tended to be regarded by the public and the business world with some suspicion.

The looming crisis in Belgian accounting was to be resolved in a way that sets Belgium apart. First, revision of the legislation concerning the provision of economic and financial information to works councils provided an opportunity to extend disclosure requirements extensively. Second, Belgium harnessed its own company law reform to the decision in 1968 by the member states of the European Community to initiate negotiations over a possible directive on the annual accounts of companies.

The Economic and Social Economic Conference of 1970, which called for better information from businesses, must be considered as one of the milestones in the development of Belgian accounting regulation (Lefebvre, 1984). Working groups including representatives of employers, trade unions and government were subsequently established and these were soon embroiled in disputes, particularly over wider disclosure requirements. Eventually, when the Christian trade unions submitted a firm proposal concerning greater disclosure in annual accounts, a decision was made instead to consider the contents of the new Draft of the European Community's Fourth Directive which was issued on 1 November 1971. The Belgian Government then decided to anticipate the Community's move. It was felt that, since the proposed directive would impose radical change, it was desirable to start the process of accustoming the business world to the new requirements as early as possible.

Thus, the influence of trade unions was significant in two ways: first, in breaking down the complacent conservatism of the main political parties towards financial reporting; and, second, in persuading the government of the advantages of adopting a positive and constructive attitude towards the implementation of the Community's legislation. Although there was still much disagreement, a decree concerning financial and economic information for works councils was issued in 1973.

The Royal Decree of 27 November 1973 on Financial and Economic Information for Works Councils

In Belgium, works councils had been established in 1948 at the level of the individual firm. As noted earlier, these represented employees and employers equally, and had advisory rather than managerial or decision-making power in the firm. The decree of 1973 gave council members the right to information and the right to appeal to a *revisor* for additional comments on the accounts. Indeed, it seemed that the works councils, supported by the trade unions, were more concerned than were the shareholders that better information be disclosed by the company, a situation which was due in part to the small number of outstanding shares owned by the public who preferred the relatively risk-free investments which were made abundantly available through the frequent issues of governmental bonds and securities.

The 1973 legislation requiring financial and economic information to be reported to the works councils was an important step in the development of Belgian accounting. It attempted to ensure that employees were provided with a clear and correct picture of the economic and financial situation of the enterprise. Moreover, the information had to enable the employees to understand the firm's position within the group as a whole and in its sector of operations and local economy.

Although no detailed analysis of this decree is presented here (see Lefebvre, Lin and Van Nuffel, 1995), it is interesting to note the main thrust of its rationale. First, the emphasis is on disclosure requirements rather than on the preparation and registration of accounts, the type of information that should be disclosed being stressed rather than the procedures for processing accounting data. For instance, the decree introduced the important concept of segmental reporting, subdividing sales and earnings by product line and between foreign and domestic sales. The decree was also forward-looking, focusing on the goals to be attained and on budgetary planning and control. It is important to emphasise that the firm was not obliged to disclose this financial and economic information to parties other than the employee representatives on the works council. It should also be recalled that this piece of legislation was not scrupulously observed in practice.

THE EMERGENCE OF ACCOUNTING LEGISLATION

Financial reporting was the subject of another resolution by the Central Economic Council when, in 1972, a uniform general plan of accounts was proposed. The task was entrusted to a Committee under the guidance of the Secretary-General of the Central Economic Council, André Baeyens. When the Committee published its report, a change of government delayed action on the particular issue of the chart of accounts (see Forrester, 1980). Nevertheless, Belgium embarked on an extensive programme of legislation in the field of accounting and financial reporting. The centrepiece of this legislative programme was the law passed by the Belgian Parliament on 17 July 1975 which authorised the government to issue detailed regulations governing the annual accounts of companies (implemented in the Royal Decree of 8 October 1976) and which also established the Accounting Standards Commission, the CBN/CNC (*Commissie voor Boekhoudkundige Normen/Commission des Normes Comptables*). A part of the Banking and Finance Commission, the Accounting Standards Commission was given the brief to advise Parliament and, upon request or at its own initiative, to formulate principles of accounting by means of advice or recommendation.

The contents of a minimum standard chart of accounts were later specified in the Royal Decree of 7 March 1978. As for consolidated accounts, the law of 17 July 1975 stipulated that the Government (formally, the King) could by decree oblige companies to establish and publish consolidated accounts. The first executive measure of this provision found its way into the Royal Decree of 29 November 1977 which imposes such requirements on holding companies which, on their own or through subsidiaries, resort to raising funds from the public, or which have shareholdings worth either half their own equity or at least BEF 500 million. This decree also dealt with the non consolidated accounts of holding companies.

Subsequent accounting and financial reporting legislation for non-consolidated accounts was contained in Royal Decrees on the Annual Accounts of Companies of 12 September 1983 (amended on 5 May 1985, 6 November 1987 and 6 March 1990) and on the Minimum Standard Chart of Accounts of 12 September 1983 (amended on 6 November 1990).

With regard to group accounts, a Royal Decree of 1 September 1986 adapted that of 29 November 1977 and incorporated the experience on consolidated accounts gained in the meantime and, to some extent, the provisions of the Seventh Directive (Alexander and Archer, 1992). Finally, the Royal Decree of 6 March 1990 set out the regulation of consolidated accounts in full, affecting a much wider range of companies than did the 1977 and 1986 decrees.

THE LEGAL REFORM OF THE ACCOUNTING AND AUDITING PROFESSIONS

In 1974, the Féaux Commission was established in order to study the statutes of the accounting and auditing professions. A bill to reform auditing was introduced in the Belgian Parliament in 1983 and a law dealing with this matter was passed in 1985, which also incorporated the requirements of the Eighth Directive. The law of 21 February 1985 created the Institute of Accountants, the IDAC/IEC (*Instituut der Accountants/Institut des Experts Comptables*). This Institute regulates the work of public accountants, the titles '*accountant*' in the Dutch language and '*expert comptable*' in French having been legally restricted for use by the members of IDAC/IEC only. It may be noted in passing that this contrasts with the Dutch tradition in which the term '*accountant*' has a broad and general meaning whereas, in France, the title '*expert comptable*' is also legally protected.

Following the legal reform, many accountants, particularly those working in smaller firms, expressed their discontent with the way in which the Institute of Accountants excluded them. By combining their efforts, they brought about the establishment of an association to protect their own interests. In 1992, the Belgian Institute of Bookkeepers, the BIB/IPC (*Belgisch Instituut van Boekhouders/Institut Professionel des Comptables*) was created with more than 10 000 members.

The law of 21 February 1985 provided for the establishment of the Supreme Audit Council (*Hoge Raad voor het Bedrijfsrevisoraat/Conseil Supérieur du Revisorat d'Entreprises*). The first chairman was a professor at the Katholieke Universiteit Leuven Law School, Professor Dr F. Vanistendael, who was succeeded by his Leuven colleague, Professor Dr K. Geens. The Council would represent the broader public interest and would have to guarantee the adequate performance of statutory audits. Composed of four members nominated by the representatives of employers' organisations and trade unions (that is, the 'social partners') and three independent members who are appointed on the basis of their expertise vis-à-vis the profession by the Ministry of Economic Affairs, the Council was established with the purpose of protecting the quality of information disclosed to the public at large. It was not established to defend the interests of auditors, and the audit profession was not represented directly.

A Royal Decree of 23 June 1994 extended the responsibilities of the Supreme Audit Council to the accountancy profession, and consequently the name was changed to the Supreme Audit and Accountancy Council (*Hoge Raad voor het Bedrijfsrevisoraat en de Accountancy*). Again, as the purpose of the Supreme Audit and Accountancy Council is to protect the quality of information disclosed to the public at large, neither the audit profession nor the accountancy profession is represented on the new council. The Council makes, either voluntarily or upon request, recommendations to the government and/or to the relevant institutes on matters concerning:

(a) the organisation of the professions of auditor, accountant and bookkeeper (and perhaps eventually the as yet unregulated profession of tax adviser);
(b) the code of conduct and professional ethics of the profession;
(c) auditing and accounting standards (the Supreme Council will analyse standards and monitor them for conformity with international standards and opinion as well as with Belgian company law and accounting law).

In 1995, laws passed on April 7 and April 13 brought important changes to the Company Law of 1935. These laws originally were meant only to make small but necessary changes to existing company legislation. The final texts of the laws, however, contained a number of important changes. The Law of 13 April 1995 was instrumental in bringing about greater cooperation between accountants and auditors. Article 98 of this law mentioned that the legal framework of the accountancy profession would be adapted to the existing legal framework for auditors. On 13 June 1995, the Institute of Auditors and the Institute of Accountants signed a joint statement of intent to bring about greater cooperation.

At the end of 1995, the Supreme Audit and Accountancy Council launched a plan to establish just one professional body, consisting of the four different professional bodies presently involved: the Institute of Auditors, the Institute of Accountants, the Belgian Institute of Bookkeepers and the Fiscal Consultants. The Council sought to coordinate and facilitate cooperation between the different institutions, believing that excessive competition between them is undesirable and that cooperation concerning education and training could improve the quality of the services offered.

In response to the position taken by the Council, the Institute of Auditors and the Institute of Accountants decided to establish an Inter-Institute Coordination Committee which came into being at the beginning of 1996. The goals of this Committee include the development of regulations for the cooperation of practitioners, the coordination of the rules of conduct of both Institutes, and negotiations with the Belgian Institute of Bookkeepers in order to encourage a global, coherent and autonomous organisation for the entire accountancy and audit profession (Instituut der Bedrijfsrevisoren, 1996).

Compromise in Accounting Lawmaking: The Case of Insurance Company Regulation

An interesting example of the Belgian approach to lawmaking is the procedure which led to the Royal Decree of 17 November 1994 which set down new regulations for the annual accounts of insurance companies. Previously, accounting by insurance companies had been regulated by a special Royal Decree in November 1979, based on the general requirements for companies and dealing with valuation rules and the form of financial statements. Although the proposal for a new law came formally from the Minister of Economic Affairs, the Decree refers in its preface to the opinion of the Insurance Regulation Office which had been sought by the legislator. This is significant since the Insurance Regulation Office has two main functions, the first being the prudential supervision of insurance companies and allied institutions and the second being to review consumer complaints. Its relationship with the insurance industry is therefore complex.

The Insurance Regulation Office prepared the draft law by incorporating a part of the 1979 legislation and a part of another Royal decree (23 September 1992) which deals with annual reports of credit institutions as well as the provisions of a European Directive of 19 December 1991. The insurance companies themselves reacted against the draft, since they found contradictions in the legal text and were not prepared to take on the extensive publication requirements proposed. In order to reach a compromise, a new working group was established within the Insurance Regulation Office with the task of writing a new draft text. Taking the different points of view into account, the text of the new decree seemingly satisfied the various interest groups on this issue. The new decree was finalised without further criticism.

This particular case of compromise in accounting law-making is an insightful illustration of the current system of accounting regulation at work in Belgium. A more detailed analysis of the institutions involved in the Belgian system of financial reporting regulation is given in the following section.

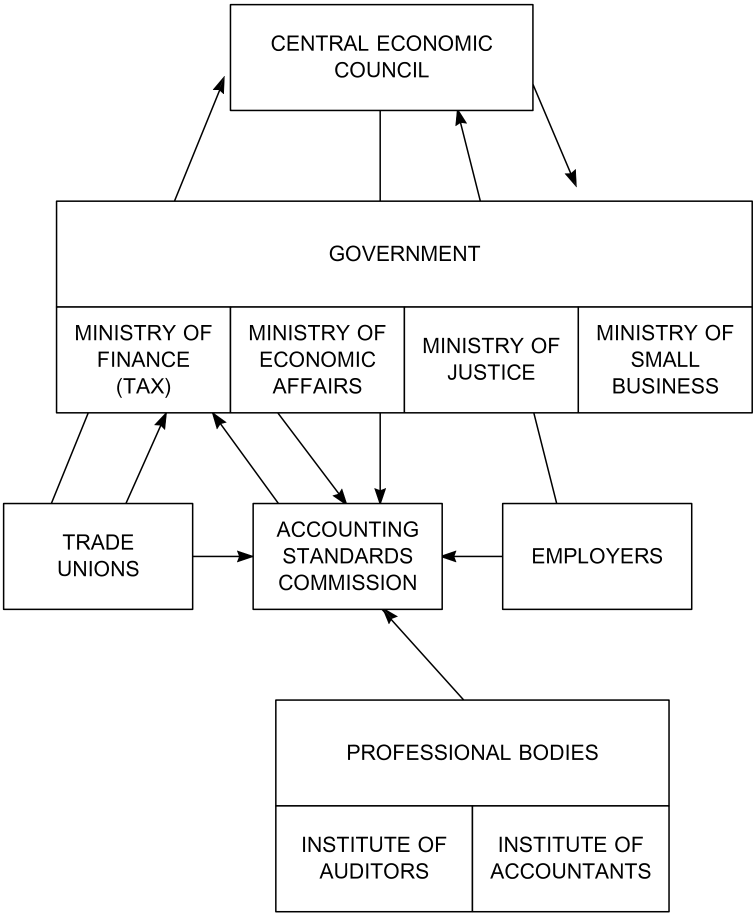
THE CURRENT SYSTEM OF FINANCIAL REPORTING REGULATION

The diagram in Figure 2.1 illustrates the role of the different institutions and organisations that play an important part in financial reporting regulation in Belgium. The contribution of these different institutions and organisations is discussed in detail below.

The Government

Accounting practice in Belgium is dominated by the law. Indeed, the law is the sole source of binding regulations governing the maintenance of accounting records and the preparation of financial statements by industrial and commercial companies. In the last

Figure 2.1 The institutional structure of accounting regulation in Belgium



20 years, the commanding role of the law has been greatly strengthened through the enactment of a mass of detailed legislation, often by decree. These regulations contain numerous requirements including valuation rules for specific items and prescribed formats not only for the balance sheet and the profit and loss account, but also for the notes to the accounts.

Legislation relating to accounting passes through Parliament in the form of bills which are put forward either by active members of Parliament or by members of the government (Ministers of Finance, Economic Affairs, Justice and Small Business). However, most of the detailed Belgian regulations on accounting are contained in decrees which do not pass through Parliament itself.

The Central Economic Council

The Central Economic Council gives advice and presents policy recommendations on economic issues to both Government and Parliament, either upon request or voluntarily. An important characteristic of the Central Economic Council is that it acts in an advisory capacity only, with responsibility for decision-making resting with the legislature and the executive. The reason for establishing the Central Economic Council was to actively involve various stakeholders in the preparation of social-economic policy.

The advisory role of the Central Economic Council is observable in the formulation of accounting law. For example, in the Report to the Crown on the Royal Decree of 8 October 1976 concerned with the revaluation of assets, amongst other things, the advice of the Central Economic Council of June 1972 is mentioned as an important element underlying the position taken in the legal text. Similarly, when the provisions for foreign currency translation in consolidated accounts were set out in the Royal Decree of 6 March 1990, the Report to the Crown again explained that the legal text takes into account the proposals formulated on the advice of the Central Economic Council, noting that it represented the unanimous point of view of the employers' and employees' organisations (Van Hulle, 1993). Thus, the Central Economic Council plays an important role in the due process of law-making in Belgium.

The Central Economic Council is composed of equal numbers of employer and employee representatives. Each constituency can appoint 22 working and 22 deputy members, and 12 other members are coopted. Representation on the Council is summarised in Table 2.2. The 12 coopted members provide the Central Economic Council with information concerning technical and scientific aspects of matters under discussion, and may also ensure that private interests are safeguarded.

Table 2.2 Representation on the Belgian Central Economic Council

	Seats
Employers	
Organisations representing industry, banks and insurance companies, assigned by the Federation of Belgian Enterprises	9
Nominations by the main organisations representing the agricultural sector	5
Representatives of the commercial sector, appointed by common agreement between the Federation of Belgian Companies and the Federation of the Chambers of Commerce	4
Small businesses, appointed by the High Council of Small Businesses	4
	22
Employees	
Trade unions:	
Belgian General Federation of Labour	8
Confederation of Christian Trade Unions	8
General Federation of Liberal Unions in Belgium	1
Co-operative societies:	
Belgian General Federation of Labour	3
Confederation of Christian Trade Unions	2
	22
Co-opted members	
Scientific and technical expertise	12
	56

All members of the Central Economic Council are appointed by the Crown for a period of four years after which their mandate can be renewed. The president of the Central Economic Council is chosen by the Government, on advice of the Council, and appointed by the Crown for a period of six years. The president is an independent person, and is not connected with any of the member organisations. The President is assisted by four vice-presidents, two appointed by the employers and two by the employees.

Authority is vested in the Plenary Meeting which delegates to an administrative committee consisting of 12 members of the Council (six for the employers and six for the employees). The Administrative Committee oversees the activities of the Central Economic Council; that is, forming the agenda, giving priority to the various reports, organising the preparation of working documents. The Plenary Meeting has the final power of decision on, first, the advice or policy recommendations provided upon request of a minister or a legislative chamber or voluntarily provided, and second, on the administrative and personnel matters of the Central Economic Council. The plenary meetings are not public.

Specialised commissions and working groups are composed of members of the Central Economic Council, experts from organisations represented in the Central Economic Council and experts from other prominent institutions, such as universities, the National Bank of Belgium and international institutions invited by the president of the Central Economic Council. The commissions, which are assisted by the Secretariat of the Central Economic Council, monitor areas of concern such as international relations, competition policies, the business outlook and information provided by companies.

The Accounting Standards Commission

The Accounting Standards Commission, the CBN/CNC, was created by the accounting law of 1975. Article 14 of that law sets out the responsibilities of the Accounting Standards Commission as, first, to bring forward proposals to the government and Parliament as required or on its own initiative and, second, to formulate principles of proper accounting by way of opinions or recommendations.

Article 15 further empowers the Accounting Standards Commission to advise the Minister when companies apply for exemption from particular requirements of accounting law. In specific circumstances and upon the considered opinion of the Accounting Standards Commission, the Minister of Economic Affairs may authorise departures from the accounting regulations set out in the accounting law and the related decrees. In the case of small and medium sized companies, this power is exercised by the Minister of Small Business.

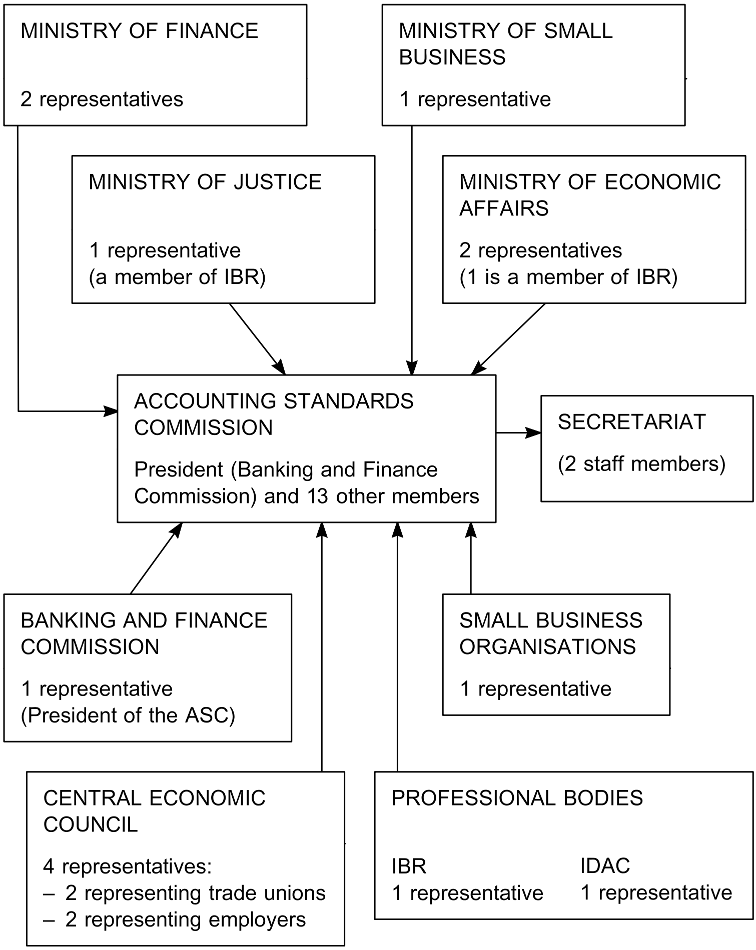
The Accounting Standards Commission consists of 14 members, each appointed for a period of six years, with the possibility of reappointment. Members are appointed by the Crown according to the following rules:

(a) two nominated on the recommendation of the Minister of Finance from among the senior officials in the tax administration, a strong tax influence over financial reporting thus being secured;
(b) one of two candidates put forward by the Banking and Finance Commission, from among the members of the Commission;
(c) one of two candidates proposed by the Institute of Auditors from its members;
(d) one of two candidates proposed by the Institute of Accountants from its members;
(e) one of two candidates put forward by organisations representing small business organisations, on the recommendation of the Minister of Small Business;
(f) eight are nominated on the strength of their special experience in accounting, four of whom are selected from a list of eight candidates submitted by the Central Economic Council, two nominated by the Minister of Economic Affairs, one by the Minister of Justice, and one by the Minister of Small Business (these members represent employers and employees, the universities and the accounting profession).

Members of the Accounting Standards Commission generally have a legal background. The president is nominated by the Crown from among the members of the Accounting Standards Commission for a renewable period of six years, on the recommendation of the Minister of Economic Affairs, the Minister of Finance, the Minister of Justice and the Minister of Small Business.

The Commission is composed of at least one representative from each of the main interest groups (government, business, trade unions). As discussed above and as shown in Figure 2.2, the composition of the Accounting Standards Commission reflects

Figure 2.2 Structure and composition of the Belgian Accounting Standards Commission



ASC = Accounting Standards Commission
IBR = Instituut der Bedrijfsrevisoren

the Belgian approach to, among other things, social policy formulation. It is based on mutual agreement between the different interest groups represented on the Commission's board, and reflects the coalition model of political behaviour, with representation of the points of view of constituent groups.

The influence of the government is guaranteed by the composition of the Commission for Accounting Standards itself. Four Ministries all have appointed members on the board. Therefore they can have a significant impact on the deliberations over accounting standardisation in Belgium. The government has the final responsibility for the provision of legislative authority.

By March 1995, the commission had published 34 bulletins dealing with general accounting problems and the application of new accounting legislation. Its pronouncements and recommendations tend to be strong on detail but weaker on certain fundamental aspects of accounting. For instance, to date, the Commission has offered no advice on fundamental issues such as inflation accounting or cash flow statements.

The Professional Bodies

The professional organisation of Belgian accountancy consists of three bodies representing auditors, accountants and professional bookkeepers. The organisational structure of these bodies is described briefly below.

The Institute of Auditors

The Institute of Auditors, or IBR/IRE (*Instituut der Bedrijfsrevisoren/Institut des Reviseurs d'Entreprises*), was established by law on 22 July 1953 as a public institution. All public auditors in Belgium are regulated by the IBR/IRE. At the end of 1995, there were 923 members in public practice: 586 in the Dutch-language section, 337 in the French-language section.

The organisational body of the IBR/IRE is the Council, consisting of 12 public auditors, (with a president and a vice-president), appointed at the general meeting of the Institute. The Council has set up a number of specialised committees, the first of which is the Supervisory Board (*Commissie van Toezicht*) which supervises the general activities of the auditing profession and ensures a high standard of auditing. The Supervisory Board is subdivided into subcommittees concerned with professional conduct (*Subcommissie van Toezicht op de Beroepsuitoefening*) and inter-professional 'peer' review (*Subcommissie Confraternele Controle*). Other subcommittees deal with disciplinary matters, appeals, traineeships, international relations and interinstitute coordination. In addition, a further subcommittee of the IBR/IRE is responsible for the formulation of auditing standards.

The IBR/IRE is a full member of the International Federation of Accountants (IFAC) and therefore is represented on the IASC, and is also a member of the *Fédération des Experts Comptables Européens* (FEE).

The Institute of Accountants

The Institute of Accountants, or IDAC/IEC, (was established by law on 21 February 1985. By April 1996 it had 6313 members (3632 in the Dutch-language section, and 2681 in the French-language section) who had the legal right to use the title '*accountant*' or '*expert comptable*'. The law of 21 February 1985 defined the activities of the members of the Institute of Accountants to include the provision of expertise in the analysis of accounting procedures and the functioning of a company from the point of view of solvency, profitability and risk, bookkeeping on behalf of third parties and the provision of a tax advisory service.

The Institute of Accountants is divided into two sections roughly equal in size: accountants who offer their professional services to the general public and those who are employed as company accountants. The IDAC/IEC is organised in a similar way to the Institute of Auditors. The Council consists of a President, a Vice-President, six Dutch-language members and six French-language members. Meetings of the Council, which are called by the president, occur at least eight times per year. The Institute's Executive Committee consists of the President, the Vice President and two administrators. Its Legal Service defends members in court cases related to the monopoly rights of the accountant and imposes penalties or sanctions in cases where the rules of conduct are breached.

The IDAC/IEC is a member of the IFAC, and, is therefore, represented on the IASC.

The Institute of Bookkeepers

Given the exclusion of many accountants from the two Institutes described above, as mentioned earlier, a petition for the establishment of a separate association was addressed to the Minister of Small Businesses by the *Nationale Associatie der Boekhouders van België* (Belgisch Staatsblad, 5 August 1987). The Belgian Institute of Bookkeepers, the BIB/IPC, was created by the Royal Decree of 19 May 1992. Initial members included more than 10 000 practitioners who held the title of '*erkend boekhouder*' in Flemish or '*comptable agréé*' in French. Any accountant who is not a member or trainee of IBR/IRE or IDAC/IEC is obliged to be member of this new institute.

CONCLUDING REMARKS

Although regulation in Belgium is generally based upon the coalition model, in which decisions are taken by mutual agreement of the interested parties, the various professional bodies with an interest in accountancy and auditing (IBR/IRE, IDAC/IEC and BIB/IPC) have had little influence. In recent years, however, due to the increasing numbers of professional accountants and their international exposure (IASC, OECD, UNCTAD, ISAR), the influence of the Institutes on the setting of new standards has become more apparent. The representatives of the IBR/IRE and IDAC/IEC on the Accounting Standards Commission have played a part in this respect. Nevertheless, it is notable that the representation of the professional bodies on the Accounting Standards Commission is minimal. Even though the representative from the Ministry of Justice is also a member of the professional auditing body, as is one of the representatives of the Ministry of Economic Affairs, this still leaves the accounting and auditing institutes (organisations which are relatively sizeable and represent a formidable technical expertise in the area of accounting) with little say on the Accounting Standards Commission.

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3 Denmark

Merete Christiansen

INTRODUCTION

In Denmark, the introduction of new legislation on accounting has split Parliament along party lines on a number of occasions, from the earliest bills requiring companies to make their accounts public to the more recent attempts to remove the privileges enjoyed by companies exempted from the preparation of consolidated accounts. Traditionally, the outcome was that Denmark saw relatively little government intervention in business, and corporate accountability remained at a low level for many years. More recently, however, there have been a number of major changes in the regulation of Danish financial reporting, many of which have been greatly influenced by developments at the international level.

The process of change started in the late 1970s when the Danish auditing profession adopted IAS as a surrogate for national standards. These were translated into Danish by the Institute of State-Authorised Public Accountants (*Foreningen af Statsautoriserede Revisorer*, or FSR) and given a Danish preface with recommendations concerning their application under local conditions. At the time, the use of IASs by companies was voluntary, but accounting regulation through statute soon followed and, in 1981, a new Financial Statements Act (*Årsregnskabsloven*) containing detailed rules on financial disclosure and accounting methods was adopted in order to implement the Fourth European Directive.

This combination of private and public regulation has continued to the present day in Denmark. In 1986, the auditing profession decided to publish its own Danish Accounting Standards (*Danske Regnskabsvejledninger*), the nine standards issued to date generally being compatible with IASs and compulsory for all Danish publicly-listed companies. In 1990, further legislation was introduced to implement the Seventh European Directive, and in this case a ministerial Financial Statements Order (*Årsregnskabsbekendtgørel-*

sen) was issued specifying financial disclosure requirements in greater detail than before and dealing with some of the technicalities of group accounting. More recent developments have included the creation by the auditing profession of an Accounting Panel (*Regnskabspanelet*) to give greater involvement in standard-setting to other parties with an interest in financial accounts, and the lawmaking process has also been reorganised to enable representation on an Accounting Council (*Regnskabsrådet*).

The high visibility of international influences in Denmark is not surprising. Its history is that of a country located at the centre of trade in northern Europe, and Denmark has long had an importance far in excess of its size. Denmark commands the entrance to the Baltic, borders Germany to the south and is linked by language and culture to the Nordic countries. Furthermore, Denmark counts the UK and the USA amongst its main trading partners. These international relationships can be seen in the evolution of Danish business regulation. Initially, Germany was the predominant influence, and then there was a movement to harmonise commercial law in the Nordic countries. The influence of the UK and the USA can also be seen in the nature of the accounting rules that now exist. Indeed, the legal system in Denmark has much in common with British legal tradition, rather than with the codified law of continental Europe.

International accounting practices have spread easily into Denmark. The country is home to a number of leading multinational companies which are exposed directly to accounting developments elsewhere, and many foreign companies (mainly from Sweden, the UK, USA, Germany, the Netherlands and Norway) have acquired Danish businesses in recent years. As elsewhere in Europe, the influence of the USA has been particularly important in the internationalisation of accounting in Denmark. The American presence started with the post-war Marshall Economic Aid programme and was followed by the establishment in Europe of subsidiaries of US companies and the growth of US-based audit firms. Indeed, it seems as though the accounting standards promulgated in the USA by the FASB, which were by far the most detailed accounting rules available at the time, were as easily assimilated into business practice in Denmark as were American movies and television programmes into the general culture and language.

However, it is worth noting that the vast majority of Danish companies have not had any direct experience of business regulation in other countries. Most Danish businesses are small, with 94 per cent having fewer than 20 employees and 5 per cent having between 20 and 100. Only 1 per cent of companies (3800 in 1993) have more than 100 employees. In fact, about 70 per cent of businesses are sole proprietorships. Of the remainder, 17 per cent are limited companies of which only 6 per cent are public companies. The predominance of small companies has created a certain secrecy in many aspects of Danish business life, as small firms tend to avoid publicity about their structure and performance since this may be to the advantage of competitors and others. In Denmark, it is possible that this conservative attitude is prevalent amongst larger firms as well because the lack of natural resources in Denmark has placed particular emphasis on research-based activities which leads in turn to more conservative attitudes towards disclosure. Also, many of the larger Danish firms are active in international commerce and are reluctant to reveal information that will help their competitors in other countries.

Thus, Danish accounting regulation has evolved out of a process of conflict between the forces calling for more financial information and greater public accountability and those wishing to avoid the costs of increased disclosure and the publicity which it entails. The lobbying of the A.P. Møller-group is interesting in this context. The group is one of the largest in Denmark, with two group companies listed on the Stock Exchange. It operates in the shipping industry which is highly competitive and has a long tradition of secrecy. The economic and political power of the group is such that its pressure to prevent more business regulation has even led to sections of company law being known as the 'Lex A.P. Møller' (see *Børsens Nyhedsmagasin*, No. 10, 27 May 1994).

However, in Denmark it would seem that the public attitude towards company privacy has hardened in recent times. The number of bankruptcies and financial scandals during a recent period of economic crisis, and the increasing interest in personal investment, have both turned the attention of the news media towards the coverage of business news. Newspapers and broadcasters are increasingly aware of the need to employ journalists whose professional skills match the skills of the managers and the auditors whose activities they report. The news media has been important in gradually setting up the necessary preconditions that have influenced changes in the rule-making system regarding accounting regulation.

THE HISTORY OF ACCOUNTING RULE-MAKING IN DENMARK

The oldest limited companies in Denmark date back to the seventeenth century. Two hundred years later, at the end of the nineteenth century, there were about 1000 limited companies, but by 1910 the number had increased to 2500. There was no requirement to publish accounts at this time, and there was considerable flexibility in the choice of accounting principles by those companies which presented their annual accounts voluntarily. The only regulations existing at the beginning of the twentieth century were contained in a Bookkeeping Order of 1832 which required those engaged in business to maintain records and to have these authorised by public officials, and the Firms Act (*Firmaloven*) of 1862 concerning the registration of business firms (see Christiansen, 1995a). The Firms Act had been revised in 1889 in the first of a number of harmonisation programmes in Scandinavia, and the new law set down conditions for registration of limited companies but without requiring public accountability. However, the rapid growth of the corporate sector along with abuses of limited liability and other financial scandals led to demands for stricter legal regulation of limited companies (including financial disclosure).

In 1901, a Commission under the Trade Ministry put forward a proposal for what was intended to be the first Danish Limited Companies Act (*Udkast til Lov om Aktieselskaber m.m. med tilhørende motiver*). The main aim of the Commission was to protect shareholders against the fraudulent promotion of limited companies and to protect creditors by imposing a minimum share capital requirement. The proposal was influenced by the newly-adopted Companies Act in Sweden and was linked to the plans to set up a common Commercial Code in Scandinavia. However, objections in Parliament prevented the adoption of the proposal.

Not long afterwards, one of the most spectacular scandals in financial history took place. A crisis in the banking and building construction sectors was the starting point and, on 8 September 1908, the Danish Minister of Justice (P.A. Alberti, who was also chairman of a savings bank *Den Sjællandske Bondestands Sparekasse*) gave himself up to the authorities, admitting to fraud and deception on an unprecedented scale.

Alberti, who was imprisoned for eight years, had been one of the leading opponents of the regulation of limited companies. Ironically, his case led to the establishment of another Companies Act Commission which put forward new proposals in 1911 for a Limited Companies Act, a Cooperatives Act and a Limited Partnerships Act (*Udkast til Love om Aktieselskaber, Kommanditaktieselskaber samt Andelsforeninger med tilhørende motiver og bilag*). Moreover, two other laws were approved in the wake of this scandal: the first State-Authorised Public Accountants Act in 1909 (*Lov om Statsautoriserede revisorer*) and the first Bookkeeping Act in 1912 (*Bogføringsloven*). Under the latter, most businesses were obliged to keep books of accounts relating to their financial affairs, the only important exceptions being farmers and craftsmen.

In spite of the initial momentum from the Alberti case, the Company Law proposals met renewed political resistance which, this time, took the form of claims that the regulations were far too detailed and were inconsistent with free enterprise. Those participating in the debate were mainly business people, lawyers and economists, and the discussion mirrored the political issues of the time: a liberal anti-regulatory ideology on the one hand and a socially-oriented regulatory approach on the other (Dübeck, 1991). Opposition to regulation was concentrated in the financial sector and the legal profession, and the shipping industry was also set firmly against company regulation.

During the period from 1910 to 1917, six proposals were put before Parliament before the final adoption of the Limited Companies Act (*Lov om Aktieselskaber*) of 1917. The political compromises entered into during its passage through Parliament led to a greatly watered-down law. In fact, one member of Parliament, Professor L.V. Birch (1871–1933), referred to the final draft as ‘a shaved poodle’ compared to the initial Commission report of 1901.

Although the 1917 Act was influenced by the German Handelsgesetzbuch of 1897 and the newly-adopted legislation in Norway and Sweden, the accounting sections of the legal text were framed in accordance with English law, with a general clause providing outline guidance on the preparation of accounts. The law included only two sections regarding financial reporting, but it applied to all limited companies. The law stated that all limited companies had to prepare an income statement and a balance sheet, but there were no prescriptions as to the form or content of the accounts other than that they should show 'the true position of the company in accordance with the best estimates of the management' (*selskabets sande status efter bestyrelsens bedste skøn*). These financial statements had to be audited, and companies were also obliged to submit a copy of their audited accounts to the public registry (*Aktieselskabsregisteret*), later known as the Danish Commerce and Companies Agency (*Erhvervs- og Selskabsstyrelsen*). The only exception as regards publication was for family-owned companies which were defined as companies with ten or fewer shareholders.

The Limited Companies Act of 1917 proved to be weak and ineffective and, during the 1920s, several attempts were made to introduce a more rigorous version. Eventually, a new Limited Companies Act was adopted in 1930. Although some specific rules concerning accounting for goodwill and formation costs were introduced, the accounting requirements were again mainly embodied in general prescriptions, this time in three sections. The Act required that a balance sheet and income statement should be published, but without specifying items or format, and also indicated that the financial statements should be prepared in accordance with 'orderly and prudent business practice' (*ordentlig og forsigtig forretningsbrug*). Although the obligation to be prudent generally reinforced conservatism in accounting, the new law also allowed for asset revaluation where a permanent increase in value had taken place. Moreover, companies were required to give information on the publicly-assessed value of land and buildings. In fact, in Denmark, the regular assessment of the value of property dates back to the 1840s when the Land Registry (*Matriklen*) was established, and public assessment for the purposes of wealth taxation had therefore already provided the motivation for companies to consider revaluing assets in their annual accounts (Torp, 1919). It is worth noting that asset revaluation in company accounts has remained commonplace in Denmark to the present day.

The Act of 1930 remained in force for over 40 years during which time there were no major changes in accounting legislation, although there was a move in 1934 for the Nordic countries to harmonise company law which included a requirement for group accounting in the form of a statement based on the balance sheets of subsidiaries. In fact, Denmark, Finland, Norway and Sweden agreed in 1942 on a proposal for a new Companies Act, but this was not implemented because of the Second World War.

An interesting contribution to rule-making during the pre-war years was made by the Committee for Recommendations (*Responsumudvalget*), set up by the FSR in 1925 to issue recommendations relating to 'good practice' in auditing and accounting, and to resolve conflict over the audit fee. The Committee still exists and has 10 members who are elected from the membership of FSR. Usually, a subcommittee of three will write a report on the basis of which the Committee makes its decision. The Committee has issued more than 1000 opinions since 1925. Generally the issues have related to specific circumstances, but when they dealt with 'good accounting practice' the pronouncements were an effective part of the rulemaking system in the absence of other accounting regulations.

Although there was almost no accounting regulation in law, the basis on which financial statements were drawn up was influenced nevertheless by other factors. Some of these changes in accounting were brought about by the implementation of new tax laws, and the tax authorities became one of the major constituents in the process of formulating accounting rules. Indeed, for many years from 1917 onwards, companies mainly used the tax rules for the valuation of inventories and fixed assets. Tax law required that the same inventory value should be used in both the tax statement and the annual accounts. As regards fixed assets, the position taken by the tax authorities caused serious understatement by not accepting accelerated tax depreciation charges in the tax statement unless they were also made in the financial accounts.

After the war, there continued to be a close relationship between tax rules and accounting rules, and the problems arising from this became more obvious when new tax rules were introduced in the 1950s in which the orientation towards fiscal objectives conflicted more openly with the measurement of a company's income for other purposes. Eventually, the auditing profession recommended that companies should ignore tax rules in the financial statements, but was divided over how to reflect this in the accounts themselves. Some recommended the USA's method of accounting for deferred taxation, while others preferred the 'Nordic combination model' used in Sweden and Norway. Generally, however, the separation between the taxation and accounting concepts of profit was not achieved until the implementation of the Fourth Directive.

Another significant change, which began to make itself felt in the 1950s was the move by Danish companies from absorption costing to marginal costing as the dominant principle for inventory valuation and profit calculation. The driving force behind this development was the late Professor Palle Hansen of the Copenhagen Business School whose principle of marginal costing in financial accounts required the separation of variable and fixed costs, resulting in the disclosure of the contribution margin as a subtotal and the valuation of inventories of semi-finished and finished goods at variable costs. Danish cost accounting had been influenced by Erich Schneider, a German accounting professor who came to Denmark during the Second World War and influenced Danish thinking with books on capital theory and accounting. Palle Hansen refined this theoretical approach, and it is interesting to note that, at a later stage, Danish negotiators managed to get the marginal costing principle included in the Fourth European Directive (Article 35.3), which allowed the continued use of this principle in Denmark. However, the issue has now turned full circle as a result of international pressures and Danish Accounting Standard No. 8 now recommends a return to the use of absorption costing.

In 1957, the Danish parliament appointed a Commission to draft a new Limited Companies Act. The Commission published its draft (*Betænkning om Revision af Aktieselskabslovgivningen*) seven years later in 1964, but again the proposals were not implemented because about that time the Nordic countries decided to continue their efforts at harmonising company law. Amongst other things, the report set out for the first time definitions of a group for the purposes of consolidation. A new Nordic proposal (*Betænkning om en fællesnordisk aktieselskabslovgivning*) was put forward in 1969, but in the same year Denmark became a member of the EEC. In 1973, the Limited Companies Act was replaced by two new Acts, the Private Limited Companies Act (*Anpartsselskabsloven*) and the Public Limited Companies Act (*Aktieselskabsloven*), which implemented part of the joint Nordic proposal. The thirteen sections concerning accounting regulation were in some ways a codification of existing accounting practices, and the general clause on 'orderly and prudent business practice' was reformulated as 'good accounting practice' (*god regnskabsskik*), the term used in all of the Nordic countries. The most important changes were that notes to the accounts and a directors' report were required, as was a consolidated balance sheet from a group with a Danish public limited liability company as its parent. Whilst small private limited companies were exempted from many of these new requirements, the privilege of non-disclosure was withdrawn from family-owned companies.

By this time, there were three types of auditor practising in Denmark: state-authorised, registered and unqualified. The second tier had been created through the Registered Public Accountants Act (*Lov om Registrerede Revisorer*) of 1970, and the Institute of Registered Public Accountants (*Foreningen af Registrerede Revisorer*, or FRR) had been established. In drafting the Public Limited Companies Act of 1973, it was decided that at least one of the auditors of a public limited company should be either state-authorised or registered. However, for private limited companies, the new law continued to allow the audit to be performed by an unqualified auditor, but this privilege was also to disappear within a few years as a result of the European Community's harmonisation programme.

As the first member state to do so, Denmark implemented the Fourth European Directive in 1981. The overruling concept of 'good accounting practice' was replaced by a 'true and a fair view' (*retvisende billede*). Accounting regulation was removed from the Companies Acts and incorporated into a new Financial Statements Act which contained 68 sections. Thus, the implementation of the Directive increased considerably the degree of legal accounting regulation in Denmark (see Christiansen and Elling, 1993) and its separation from the rest of commercial law further stressed this aspect.

Until the 1980s, the Copenhagen Stock Exchange had not been very active as a rule-making body in accounting regulation. However, in 1983, a Ministerial Order (No. 526 of 10 November, 1983) radically changed the conditions for obtaining public quotation of securities on the Stock Exchange. Together with a revised Ministerial Order (No. 813 of 13 November, 1986), this led to new disclosure requirements for quoted companies, including interim accounts. This initiative may be seen as the first reaction to the growing number of bankruptcies in Denmark, but was also related to the implementation of the European Directive on Stock Exchanges which brought an end to the stockbroking monopoly and which opened up the exchange to large banks.

When the Seventh European Directive was implemented in 1990 (as an amendment to the Financial Statements Act), the government wished to avoid bringing the technicalities of group accounting before Parliament and this led to a change in the regulatory framework. The majority of the disclosure rules and almost all of the measurement rules relating to group accounting were separated from the Financial Statements Act and incorporated in a special Financial Statements Order published by the Ministry of Industry through the Danish Commerce and Companies Agency. A comparison between the regulation of a single company and that of groups reveals a change in the tactics of accounting regulation. For groups, nearly all accounting rules are to be found in the Ministerial Order. For individual companies on the other hand, only the rules regarding disclosure and sanctions are covered by the Financial Statements Order, whereas basic accounting principles and valuation principles are to be found in the Financial Statements Act.

Even after the implementation of the Fourth and Seventh Directives, Danish accounting regulation has remained fairly discretionary. For instance, the number of options implemented under the Directives exceeded 50 per cent of the available options, still leaving room for the auditing profession to influence accounting practice. During the 1980s, the degree of discretion in Danish accounting law became more evident. The growing importance of the stock market emphasised the need for comparability across companies as did growing internationalisation. Furthermore, the collapse of certain large Danish companies revealed a degree of creative accounting. The shortcomings of the accounting regulations generated a number of criticisms of accounting practice, particularly when it became clear that several publicly-listed companies had not complied with the law and when there was a wider realisation that the discretion available under the current disclosure rules and measurement methods meant that profit, assets and liabilities could be measured differently by identical companies.

This situation led to pressure for change in the regulatory environment. The IASs published in Danish with recommendations for local application lacked sufficient disciplining power, and the FSR was forced to consider national accounting standards. Thus, under pressure from the government, the auditing profession began to publish Danish Accounting Standards in 1988, and these standards have become binding upon quoted companies. The objectives of Danish Accounting Standards were summarised by the Institute of State-Authorised Public Accountants as:

(i) to adopt and publish, in the public interest, Accounting Standards which must be followed in the preparation of publicly-available annual financial statements; and
(ii) to contribute to greater uniformity in accounting practice and to a continued improvement in the standard of Danish financial statements concurrent with developments in the accounting area both nationally and internationally.

Initially, Danish Accounting Standards were prepared by the Institute of State-Authorised Public Accountants through its Accounting Technical Committee (*Regnskabsteknisk udvalg*). Suppliers and users of financial information were given the opportunity to comment on exposure drafts, but final approval was reserved for the professional association at its annual general meeting. However, not long after these changes in self-regulation took place, the collapse of the Nordic Feather Group brought the issue of corporate accountability back into the headlines. The largest economic scandal in the modern economic history of Denmark, it has had serious economic consequences, both nationally and internationally. With respect to accounting, the criticism following in the wake of the scandal has focused on the need to reduce the existing discretion in disclosure and measurement rules and to place accounting users in a more central position in the regulation process (Elling, 1994). In 1992, the auditing profession acted by establishing a new approach to standard setting, with the FSR creating the Accounting Panel (*Regnskabspanelet*). This body is representative of the users, preparers and auditors of accounts, and its function is to comment on all proposed accounting standards. Although these are issued formally by the FSR, it is accepted that all Danish Accounting Standards must have the prior approval of the Accounting Panel.

The following year, in 1993, the Commerce and Companies Agency commissioned a survey of financial statements filed by limited companies. The aim of this survey was to establish the extent to which limited companies had complied with the Bookkeeping Act, the Limited Companies Acts and the Financial Statements Act and related orders. The results were astounding. It was found that 94 per cent of the companies involved did not comply with the law and that one third of the companies did not file their annual financial statements within the time limits prescribed by the law. Non-compliance related to many areas including the format of the income statement and the balance sheet, the lack of mandatory notes and statements of accounting policy, the absence of group accounts and inadequate disclosure in directors' reports.

As a direct result, an amendment to the Financial Statements Act (Law No. 122 of 18 February 1994, *Undersøgelse af årsregnskaber*) was passed in Parliament, and the Commerce and Companies Agency was given responsibility to review annual financial reports for obvious non-compliance with the above-mentioned laws. The Ministry of Industry already had the responsibility under the Financial Statements Act of administering the filing of annual accounts pursuant to the Act, a task which it had delegated for many years to the Commerce and Companies Agency. However, from being a purely administrative organisation under the 1983–93 conservative and liberal government, under the subsequent social democratic government the Agency was granted the power and resources to review compliance with the law. Companies may now be required to submit additional information, and directors and auditors may be fined in the case of non-compliance, under the sanction of legal proceedings. Previously, publicly-listed companies had to file their annual financial statements immediately after the general meeting and not later than six months after the balance sheet date, a deadline which has been changed to five months (top management and the directors will automatically be fined if the deadline is missed).

The 1994 amendment also gave the Commerce and Companies Agency authority to set up the Accounting Council (*Regnskabsrådet*) which, according to the preamble to the parliamentary bill, would advise the Minister of Business and Industry of changes to existing accounting legislation, interpret existing accounting regulation and publish related guidelines. The establishment of the Accounting Council may be viewed as the setting up of a state-controlled regulatory agency to counter the power of the auditing profession in terms of its self-regulation. In some respects, it may be the beginning of the end of self-regulation in Denmark.

CONSULTATION IN THE PRESENT RULE-MAKING SYSTEM

Below, the components of the present rule-making system are considered in greater detail, with particular emphasis on the consultative process that has emerged in Denmark.

The Legislative System

In Denmark, a new law is discussed in Parliament (*Folketinget*) three times before it is adopted. The first discussion deals with the principal aspects of the proposal which is then passed to the relevant Parliamentary committee which, in the case of accounting regulation, is the Business Committee (*Erhvervsudvalget*). These committees consider the more technical aspects of a proposal as well as its political consequences, and may ask for clarification. Organisations outside Parliament can request a meeting with the committee and may try to influence its final report. Based on this report, the second discussion takes place in Parliament and the third and final discussion may follow immediately or the Bill may

Table 3.1 The legislative process governing the implementation of the Seventh European Directive in Denmark

Date	*Action*
Before January 1990	The Ministry for Business and Industry prepares a first draft of the proposal. The first draft of the proposal is discussed by the Company Law Panel. Based on comments from the Company Law Panel, the Ministry for Business and Industry finalises the proposal
17 and 24 January 1990	The Minister for Business presents Law Proposal No. 130 together with a written introduction. The debate in Parliament focuses on the possibility that small companies be exempted from consolidation and on the new definition of large companies (groups) which will increase the number that may avoid the preparation of a directors' report to about 80% of all limited companies and which will exempt 60–75% of all Danish groups from presenting consolidated accounts. The debate is divided along the main party lines, the conservative government being supported by the liberals and social liberals, with the social democrats and socialists in opposition
26 April 1990	Parliament receives a written report from the Business Committee. The Committee has dealt with the proposal, and sent questions to the Ministry for Business and Industry which have been answered by letter. Furthermore, the Danish Shipowners' Association, the FSR and the Confederation of Danish Industry have given comments to the Committee. There is a minority proposal from the social democrats for a broader definition of the group and that small groups should not be exempt from presenting group accounts
4 May 1990	Second discussion in Parliament
8 May 1990	Further report from the Business Committee
10 May 1990	Third and final discussion. The proposal is adopted by 60 votes (conservatives, liberals, social liberals, Christians and progress party) against 52 (social democrats and socialists)

be returned to the committee to consider new aspects. Parliamentary debate on accounting issues has tended to be relatively short, with only a limited number of questions to the minister.

To illustrate the procedure, Table 3.1 shows the parliamentary process relating to the Seventh European Directive. The debate over this Bill focused on the special treatment to be afforded to smaller companies and was divided along party lines, with the left pressing for definitions of large and small which would oblige most groups, including smaller groups, to prepare consolidated accounts. The conservatives and liberals eventually achieved a slim majority over the social democrats and socialists, and Parliament therefore approved a law where reporting obligations were the minimum permitted under the Seventh Directive.

Naturally, the political process of law-making extends beyond Parliament. Before a proposal for a new law is presented, the relevant Ministry often consults with interested parties to achieve some form of consensus on the new law. With regard to commercial law, the Company Law Panel of the Ministry for Business and Industry (*Erhvervsministeriets Selskabsretspanel*) advises the minister during the political process. Representation on this panel includes industrialists, financiers, retailers and representatives of the labour movement, the legal and auditing professions, as well as others. The full list of parties involved in the process of formulating company laws through the workings of the Company Law Panel is given below.

The Danish Shipowners' Association (*Danmarks Rederiforening*)
The Confederation of Danish Industry (*Dansk Industri*)
The Danish Bankers' Association (*Finansrådet*)
The Danish Insurance Association (*Assurandør-Societetet*)
The Joint Council of Retail Trade (*Butikshandelens Fællesråd*)
The Chamber of Commerce (*Det Danske Handelskammer*)
The Danish Confederation of Small and Medium-sized Enterprises (*Håndværksrådet*)
The Federation of Danish Cooperatives (*De Danske Andelsselskaber*)
The Economic Council of the Labour Movement (*Arbejderbevægelsens Erhvervsråd*)
The Danish Bar and Law Society (*Advokatrådet*)

The Institute of State-Authorised Public Accountants (*Foreningen af Statsautoriserede Revisorer*)
The Ministry of Business and Industry (*Erhvervsministeriet*)
The Commerce and Companies Agency (*Erhvervs- og Selskabsstyrelsen*)

Normally, company law contains relatively broad rulings, and the Ministry for Business and Industry is often empowered to lay down more precise rules. Ministerial Orders may be issued, such as the Financial Statements Order relating to the format of Annual Financial Statements and Consolidated Accounts and the Preparation of Group Accounts.

A new development is the delegation of authority by the Commerce and Companies Agency to the newly-created Accounting Council which provides a forum for representatives of those specifically interested in accounting regulation. The creation of the Accounting Council can be seen as a consequence of having separated accounting law from the Limited Companies Act. It decreases the influence of the relatively powerful Company Law Panel and provides greater control by the Ministry for Business and Industry over company law relative to that exercised by the Ministry of Finance and the Ministry of Justice. The representatives on the Accounting Council are listed below.

The Confederation of Danish Industry (*Dansk Industri*), the Danish Employers' Confederation (*Dansk Arbejdsgiverforening*), the Danish Shipowners' Association (*Danmarks Rederiforening*), the Danish Confederation of Small and Medium-sized Enterprises (*Håndværksrådet*) and the Danish Contractors' Association (*Entreprenørforeningen*)
Danish Commerce & Services (*Dansk Handel & Service*) and the Chamber of Commerce (*Det Danske Handelskammer*)
The Danish Bankers' Association (*Finansrådet*), the Council of Danish Mortgage Credit Association (*Realkreditrådet*) and the Danish Insurance Association (*Assurandør Societetet*)
The Federation of Danish Cooperatives (*De Danske Andelsselskaber*)
The Danish Society of Financial Analysts (*Den Danske Finansanalytiker Forening*)

The Council for Labour Market Pension Schemes (*Arbejdsmarkedets Pensionsråd*), the Association of Company Pension Funds (*Foreningen af Firmapensionskasser*), the Danish Labour Market Supplementary Pension (*Arbejdsmarkedets Tillægspension*), the Employees Capital Pension Fund (*Lønmodtagernes Dyrtidsfond*) and LMP-Cooperation (*LMP-Samarbejdet*)
The Economic Council of the Labour Movement (*Arbejderbevægelsens Erhvervsråd*) and the Danish Confederation of Trade Unions (*Landsorganisationen i Danmark*)
The Danish Bar and Law Society (*Advokatrådet*)
The Institute of State-Authorised Public Accountants (*Foreningen af Statsautoriserede Revisorer*)
The Institute of Registered Public Accountants (*Foreningen af Registrerede Revsorer*)
Copenhagen Business School (*Handelshøjskolen i København*)
The Ministry of Business and Industry (*Erhvervsministeriet*)
The Commerce and Companies Agency (*Erhvervs- og Selskabsstyrelsen*)

Self-Regulation by the Auditing Profession

In Denmark, accounting standards issued by the FSR are recommended for all limited companies above a certain size, and are obligatory for all quoted companies. Each published standard has the following structure:

(a) an introduction including the scope of the subject and description of any legal provisions relating to the subject;
(b) an explanatory text which expands upon the accounting issues
(c) sections containing the standard;
(d) comparison with IASs;
(e) examples, if any;
(f) an effective date which will be as close to the publication date as possible.

Initially, the choice of the subject matter of Danish Accounting Standards, and research and preparation of the standards, were undertaken by the FSR's Accounting Technical Committee. As mentioned earlier, the exposure drafts went through a process of consultation and the first Danish Accounting Standards were adopted at the general meeting of the FSR. Eight accounting standards were published under this regime (Christiansen, 1995b). However, following the introduction of a new structure in 1992, the Accounting Technical Committee now prepares a first draft and, after review by the Accounting Panel, a public hearing is held. Following revision, a further public hearing considers a second draft, and the final draft is again reviewed by the Accounting Panel. The membership of the FSR's Accounting Panel is given below.

The Danish Shipowners' Association (*Danmarks Rederiforening*)
Confederation of Danish Industry (*Dansk Industri*)
Danish Bankers' Association (*Finansrådet*)
Danish Securities Dealer Association (*Foreningen af Danske Børsmæglerselskaber*)
Danish Labour Market Supplementary Pension (*Arbejdsmarkedets Tillægspension*) and Employees' Capital Pension Fund (*Lønmodtagernes Dyrtidsfond*)
Danish Insurance Association (*Assurandør-Societetet*), The Council for Labour Market Pension Schemes (*Arbejdsmarkedets Pensionsråd*) and the Association of Company Pension Funds (*Foreningen af Firmapensionskasser*)
The Danish Institute of Registered Public Accountants (*Foreningen af Registrerede Revisorer*)

The composition illustrates a principle of balance often found in Danish policy making, with three members representing the preparers, three members representing the users and the two professional accounting bodies placed in between. The FSR retains the chairmanship, and the profession may also appoint an academic adviser to the panel. The search for consensus was stressed in the new preface to Danish Accounting Standards which was rewritten when the new structure came into being, as follows: 'In developing new standards, a balanced approach should be taken towards the interests of both the preparers of accounts and the users. Consideration should also be taken of the different nature of preparers and of users.'

At the time of writing, one Danish Accounting Standard (No. 9 on Foreign Currency Translation) has been adopted following the change in the regulatory procedure. As mentioned earlier, Danish Accounting Standards are generally very close to IASs, although this is not always so. According to Standard No. 7 on Research and Development, Danish companies do not have to publish the amount of the research and development costs. In that respect, the Danish standard is more flexible than the corresponding international standard, which again is attributable to representations concerning the small size of Danish companies, their economic visibility and their lack of competitive strength combined with Danish industry's aversion to accounting regulation. Indeed, the current preface to Danish Accounting Standards is explicit in this respect when it is stated that: 'Danish annual accounts will be prepared at the appropriate international level, but taking into consideration the possible detrimental effects on the international competitiveness of Danish companies.' In some ways, it would seem that the politics of accounting have changed little between the beginning and the end of the twentieth century.

The Role of the Copenhagen Stock Exchange

The Copenhagen Stock Exchange does not participate in the Accounting Panel or in the Accounting Council. Indeed, the Copenhagen exchange today plays a less important role in market regulation than many other stock exchanges. However, as indicated earlier, the exchange is empowered by law to issue disclosure requirements for publicly-listed companies, and in this respect must be seen as a part of the accounting rule-making system.

The Copenhagen Stock Exchange is governed by a board of directors appointed for a three year period by the Minister of Business and Industry. Apart from the chairman, the board members are appointed on the recommendation of various interested parties, as shown below.

The Stock Exchange Chairman

Confederation of Danish Industry (*Dansk Industri*), Danish Shipowners' Association (*Danmarks Rederiforening*) and Chamber of Commerce (*Det Danske Handelskammer*)

Danish Bankers' Association (*Finansrådet*)
The Council of the Danish Mortgage Credit Association (*Realkreditrådet*)
Labour Market Supplementary Pension Fund (*Arbejdsmarkedets Tillægspension*) and the Employees' Capital Pension Fund (*Lønmodtagernes Dyrtidsfond*)
Danish Insurance Association (*Assurandør-Societetet*), the Association of Company Pensions Funds (*Foreningen af Firmapensionskasser*) and the Danish Mutual Funds Joint Committee (*Danske Investeringsforeningers Fællesrepræsentation*)
Danish Securities Dealer Association (*Foreningen af Danske Børsmæglerselskaber*)
Danish National Bank (*Danmarks Nationalbank*)
The employees of Copenhagen Stock Exchange

It has to be said that there appears to be a certain lack of resoluteness in its approach to incorporating the views of the users of annual reports. This was demonstrated when the requirements concerning the interim six monthly reports were revised when the proposals of an outside group involving six pension funds and an audit firm for more informative financial statements met with little success (see '*Klar besked – En gruppe institutionelle investorers forslag til, hvordan specielt børsnoterede selskaber kan forbedre deres regnskaber og informationspolitik*', *Jurist- og Økonomforbundets Forlag*, 1991).

CONSENSUS OR POLARISATION IN ACCOUNTING RULE-MAKING?

As mentioned, the principle of consensus is relatively important to the Danish political process. Interestingly, if the various means of due process in accounting regulation are compared, a certain pattern emerges concerning the parties involved. Table 3.2 shows that four organisations are represented in all of the consultative and/or executive boards which have a bearing on accounting rule-making. These are the Confederation of Danish Industry, the Danish Shipowners' Association, the Danish Bankers' Association and the Danish Insurance Association. The Danish Shipowners' Association, which is oddly prominent, represents an industry with

Table 3.2 The participation of various interested parties in the Danish rule-making process

Organisations representing interest groups	*FSR Accounting Panel*	*Accounting Council*	*Company Law Panel*	*Copenhagen Stock Exchange*
Danish Employers' Confederation		×		
Confederation of Danish Industry	×	×	×	×
Danish Shipowners' Association	×	×	×	×
Danish Contractors' Association		×		
Danish Confederation of Small and Medium-sized Enterprises		×	×	
Danish Bankers' Association	×	×	×	×
Danish Insurance Association	×	×	×	×
Joint Council of Retail Trade			×	
Danish Commerce & Services		×		
Federation of Danish Cooperatives		×	×	
Chamber of Commerce		×	×	×
Danish Securities Dealer Association	×			×
Danish Mutual Funds Joint Committee				×
Danish Labour Market Supplementary Pension	×	×		×
Employees Capital Pension Fund	×	×		×
Council for Labour Market Pension Schemes	×	×		
LMP-Cooperation		×		
Danish Confederation of Trade Unions		×		
Economic Council of the Labour Movement		×	×	
Association of Company Pension Funds	×	×		×
Council of Danish Mortgage Credit Association		×		×
Danish Bar and Law Society		×	×	
Danish Institute of State-Authorised Public Accountants	×	×	×	
Danish Institute of Registered Public Accountants	×	×		
Danish National Bank				×
Business Schools/Universities		×		
Danish Society of Financial Analysts		×		

a long tradition of secrecy and has been one of the most active in keeping accounting regulation to a minimum.

Political polarisation, rather than consensus, has already been seen in the political process of accounting regulation when minimal disclosure in the interim financial statements of publicly listed companies was decided upon. Indeed, the Confederation of Danish Industry and the Danish Shipowners' Association have been in open disagreement with the institutional investors who have demanded more influence.

In a different context, the OECD commented on science policy and education policy in Denmark by suggesting a tendency to 'polarise opinion instead of trying to obtain consensus' (see *Ugebrevet Mandag Morgen*, No. 39, 7 November 1994). The key question is whether this kind of criticism is also relevant in the case of accounting regulation, and whether it makes any difference if accounting regulation is based on private sector standard-setting or on regulatory initiatives dominated by the state.

CONCLUSIONS

An overview of existing company accounting rules in Denmark is provided below.

Laws, Ministerial Orders and Guidelines
- The Bookkeeping Act
- Ministerial Order on Accounting: Financial Statements and Maintenance of Accounting Records of Commercial Undertakings
- Ministerial Guideline concerning Bookkeeping
- The Financial Statements Act
- Ministerial Order relating to the Format of Annual Accounts and Group Accounts and the Preparation of Group Accounts
- Ministerial Guideline concerning Group Accounts

Accounting Standards and Recommendations
- Danish Accounting Standards:
  - No. 1 Objective and Contents of the Annual Accounts
  - No. 2 Disclosure of Accounting Policies

No. 3 Changes in Accounting Policies and Accounting Estimates
No. 4 Contingent Liabilities and Events occurring after the Balance Sheet Date
No. 5 Extraordinary Items
No. 6 Long-term Contracts
No. 7 Research and Development
No. 8 Inventories
No. 9 Foreign Currency Translation
(These standards are mandatory for publicly-listed companies)

Information Obligations for Issuers of Listed Securities
(These obligations are mandatory for publicly-listed companies)

International Accounting Standards
(Generally, these are recommended by the auditing profession)

Opinions issued by the Institute of State-Authorised Public Accountants (FSR)

Other sources

'*Revision & Regnskabsvæsen*' (*Auditing & Accounting*, the professional journal of the FSR)

'*Revisorbladet*' (*The Auditor's Journal*, the professional journal of the FRR)

Olaf Hasselager and Aksel Runge Johansen: *Årsregnskaber – Kommentarer til regnskabslovgivningen* (København: G.E.C. Gad, 1992: the standard commentary on Danish accounting regulation.)

This overview, and the preceeding discussion of the development of accounting regulation in Denmark, suggest that the present accounting rules have evolved as follows.

1. As a result of the legislative process, either by Act of Parliament or by Ministerial Order, and in some cases by empowering agencies to issue legally-binding rules. Recently, Danish law has become more active in establishing new accounting rules in contrast to the previous approach of merely enshrining in statute those practices which were already generally adhered to.

2. By means of standard-setting in the private sector, where rules are established in areas not dealt with by law, such as the translation of foreign currencies, or where the treatment in the law is only at a general level, such as the valuation of stocks.
3. Through consensus in practice and authoritative commentaries. In some cases, the situation is characterised by flexibility and freedom of choice, as with asset revaluations and the treatment of goodwill. In other cases, a rule emerges or is imported . The use of the equity-method as the rule in practice some ten years before it became part of legal regulation exemplifies this aspect of rule-construction, with proponents (Andersen, 1977) and opponents (Rossau, 1979) debating the matter in professional journals leading finally to support for the method by an official at the Danish Commerce and Companies Agency (Hasselager, 1979).

Denmark has seen a gradual development from self-regulation towards a greater reliance on legislation, with professional standard-setting taking a subsidiary role in the process, much of which has been driven by pressure for international harmonisation and public accountability in the wake of financial scandals. Two political ideologies are present in this compromise, with both conservative views and social-protectionist views characterising the ongoing debate. The conflict between these two ideologies goes back to the preparation of the first Companies Act around the beginning of the century. In Parliament, the conservative ideology is mainly represented by the conservatives and the liberals whereas the protectionist ideology is mainly represented by social democrats and socialists. In the process of accounting rule-making, the conservative view is mainly sustained by Danish industry, especially the Danish Shipowners' Association, and the need for accountability is supported in some ways by the users of accounting information, such as pension funds, although it is worth remembering that some of the actors in this debate find themselves in conflicting situations from time to time.

Indeed, the auditing profession has been in just that position, between two opposing forces. As long as accounting regulation remained exclusively a tool in the hands of the auditing profession, accounting rule-making was caught in a dilemma concerning auditors' self interests. On the one hand, the need to be on good terms with the client who pays the fee lends support to the more cosy attitudes of free enterprise and, on the other hand, the need for detachment in the face of financial malpractices, corporate failures, and so on, calls for statutory definition in order that the auditor can maintain a position of independence with regard to a client's affairs.

A final point concerns the relationship between legislation and private sector standard-setting. The standard-setting process is normally considered to be faster than parliamentary law-making, and professional self-regulation may be seen as an optimal means of keeping up with new problems. At the moment, however, Denmark seems to be caught in something of a trap. Private sector standard-setting was the driving force through which accounting discretion was reduced, but Danish membership of the EU, and the implementation of European accounting directives by law, has led to a new situation in which it must be asked whether it possible to combine accounting legislation with private sector self-regulation by means of standards?

Two issues have emerged in this respect. First, the notion that professional standards are subject to the law, and may attempt to explain or supplement it, tends to place standards in a subordinate role. The preface to Danish Accounting Standards points in this direction:

> Danish Accounting Standards are prepared on the basis of the Financial Statements Act and will in this way constitute an explanation and supplement to the individual provisions of the Act . . . In particular, the Standards cover accounting areas which are not regulated (or not regulated in detail) by the Financial Statements Act and areas where there is a possibility of choice which has a material influence on financial reporting.

Second, any attempt by the professional standard-setters to cover areas which are not regulated leads to the question as to whether other benchmarks are excessive in the context of the law. Danish Accounting Standards now emphasise that the standards issued by the IASC are assessed in the context of Danish law: 'The standards are prepared within the framework of the Financial Statements Act taking into consideration existing International Accounting Standards.'

In December 1992, these two issues came to the forefront when Parliament rejected a proposal concerning the information in directors' reports. The proposal suggested 'a future oriented feasibility analysis, which stresses favourable and unfavourable trends, and illustrates how these may influence the company's liquidity and profitability and the shareholders' equity'. At the same time, the FSR published an exposure draft of an Accounting Standard concerning the form and content of the directors' report which went at least as far as the unsuccessful Parliamentary proposal. Opponents argued that the auditing profession's exposure draft went further than the corresponding regulation in other countries, and set international standards as an upper limit for Denmark, with a possible detrimental effect on companies and their competiveness (Nielsen, 1993, Stenbjerre, 1994).

If accounting standards have to be subordinated to law, almost all initiatives by the Accounting Panel may be subject to criticism for attempting to go beyond the law, a criticism which is facilitated by the flexibility of Danish law. Consequently, it may be difficult to sustain the view that standards are a more dynamic means of accounting regulation as private sector standard-setting may ultimately enter a state of paralysis. Furthermore, it is not clear that there will be any great advantage to private sector standard-setting over and above the detailed rule-making permitted by ministerial orders which have the backing of law.

Appendix: The Development of Danish Accounting Regulation

Year	*Event*
1901	First proposal for a Limited Companies Act
1909	First Act on State-Authorised Public Accountants
1912	The first Bookkeeping Act
1917	The First Limited Companies Act
1930	The Limited Companies Act is revised
1959	The Bookkeeping Act is revised. A Ministerial Order on Accounting, Financial Statements and Maintenance of Accounting Records of Commercial Undertakings

1971 First Act on Public Registered Accountants
1973 The Limited Companies Act is split into two new acts, both based on proposals for a Nordic Company Law:
The Public Limited Companies Act
The Private Limited Companies Act
1978 The Institute of State-Authorised Public Accountants publishes International Accounting Standards in Danish
1981 The Financial Statements Act is adopted, implementing the Fourth Directive, and sections in company law dealing with the annual accounts of limited companies are separated from the two Limited Companies Acts
1987 Copenhagen Stock Exchange issues the 'Information Obligations For Issuers of Listed Securities' in which it is stated that the financial statements of publicly-listed companies must be in accordance with the highest level of accounting standard in the industry in which the company operates
1988 The Financial Statements Act is revised: the section on auditing is transferred from the Limited Companies Acts to the Financial Statements Act. The first Danish Accounting Standard is published by the Institute of State-Authorised Public Accountants. The Eighth Directive is implemented
1989 The Stock Exchange's 'Information Obligations For Issuers of Listed Securities' is revised
1990 The Ministerial Order on Accounting, Financial Statements and Maintenance of Accounting Records of Commercial Undertakings (the Bookkeeping Order) is revised. A Ministerial Guideline concerning Bookkeeping is issued
1991 The Financial Statements Act is revised, implementing the Seventh Directive. A Ministerial Order relating to the Format of Annual Accounts and Group Accounts is adopted. A Ministerial Guideline concerning Group Accounts is issued
1991 The Public Limited Companies Act is revised. The limit for disclosure concerning important shareholders is decreased from shareholders owning 10% of the share capital to shareholders owning 5% of the share capital
1991 The Financial Statements Act is revised:
If a company changes its financial year, no financial period may exceed 12 months
If a company changes its accounting policy, the accumulated change must be transferred directly to equity and the comparative figures must be adjusted accordingly
An outgoing auditor of a publicly-listed company must immediately inform the Copenhagen Stock Exchange, and must inform the newly-elected auditor of the reason for not continuing as auditor

1991 Revisions to Financial Statements Act (*cont.*)
The auditor must attend the general meeting of publicly-listed companies and answer questions relating to the annual accounts which are signed by him/her
The auditor must ensure that the board of directors follows the legislation laid down in the Limited Companies Acts and the Financial Statements Act
The financial report must be filed with the Danish Commerce and Companies Agency within five months of the end of the financial year

1991 The Stock Exchange's 'Information Obligations For Issuers of Listed Securities' is revised:
A publicly-listed company must follow Danish Accounting Standards
Information must be given in the annual financial report if all group companies are not audited by at least one of the auditors of the parent company, their international affiliations or a reputable international audit firm
The time limit for publishing the semi annual and annual reports is shortened

1992 The Financial Statements Act is revised:
Partnerships and limited partnerships must follow the Act if all the partners or limited partners are companies covered by the law
The Danish Commerce and Companies Agency may request such information as is necessary to determine whether the Act, provisions laid down pursuant to the Act and the Company's Articles of Association have been complied with

1992 The Public Limited Companies Act is revised:
Information must be given at the annual general meeting and in the annual financial report concerning the position of the members of the board of directors in other public limited companies

1994 The Financial Statements Act is revised.
The Danish Commerce and Companies Agency must carry out statistical tests to examine whether companies follow the Act and the provisions laid down pursuant to the Act
An Accounting Council is established as an advisory forum of the Ministry of Business and Industry
Information concerning the audit fee must be disclosed in the financial report for large companies

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4 France

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INTRODUCTION

In France, financial reporting as we know it today emerged from a programme of standardisation during the 1940s and 1950s, from the development of securities markets in the 1960s and 1970s and, finally, from a process of legal harmonisation during the 1980s.

Prior to the 1940s, public accountability had been limited to two areas. The first was the presentation of an annual financial report by directors to the annual general meeting of incorporated companies which had been required under the companies law since 1867. The second was the filing of annual accounts by companies at the commercial registry which began in 1919. Two developments then had considerable impact on the emergence of modern financial reporting: the establishment of the profession of statutory auditor in 1935 and the growth of accounting standardisation which took place in the years after 1947. Each of these milestones in the development of modern financial reporting in France resulted from legislation initiated by the government and it can thus be concluded that successive French governments have been instrumental in the process of development (see Scheid and Walton, 1992).

Until the adoption into French law of the Fourth European Directive on 30 April 1983, however, there was no statutory legislation for accounting. It should be noted that French law is based on statutes rather than cases, the obligations of the individual being stipulated in laws, in other legal texts (such as decrees promulgated by the state) and in contracts. Although a national accounting code 'the *Plan Comptable Général*, or PCG,' had existed since 1947, this code was never compulsory in its own right but only in the context of determining acceptable accounting treatments for tax purposes.

When the PCG was introduced in 1947, the French government created an organisation to take responsibility for accounting standardisation, with representatives from a wide range of organisations interested in accounting. The *Conseil National de la Comptabilit*é, which is attached to the Ministry of Finance, still formulates policy on accounting issues, although the whole structure of accounting regulation in France is in the process of changing (as explained in greater detail below).

ACCOUNTING STANDARDISATION IN FRANCE

The history of accounting regulation in France can be divided into three main periods. In the first period, prior to 1947, there were no arrangements for standardisation of accounting. During the second period, from 1947 to 1983, standardisation was undertaken by means of a national accounting code, the PCG. The 1983 law implementing the Fourth Directive marked the beginning of the third period which extends to the present day and is characterised by extensive standardisation of accounting practices in which the PCG no longer plays a dominant role. The main pieces of legislation in France leading up to the current position are listed below.

Acts of Parliament (Laws and Edicts)

Edict of 19 September 1945	Establishment of the *Ordre des Experts Comptables* (OEC)
Law of 27 July 1966	Companies Act (*Loi sur les sociétés*)
Edict of 28 September 1967	Establishment of the *Commission des Opérations de Bourse* (COB)
Law of 30 April 1983	Transposition of the 4th Directive (incorporated into the Commercial Code Articles 8 to 17)
Law of 1 March 1984	Extension of the 1983 law to all enterprises
Law of 3 January 1985	Transposition of the 7th Directive (incorporated into the Company Law of 27 July 1966)
Law of 6 April 1998	Establishment of the *Comité de Réglementation Comptable* (CRC)

Government decrees	
16 January 1947	Establishment of the *Conseil Supérieur de la Comptabilité* (CSC)
31 March 1950	Composition of CSC membership is modified
7 February 1957	The *Conseil National de la Comptabilité* (CNC) replaces the CSC
28 October 1965	Computation of taxable income in accordance with the PCG
13 April 1962	Adaptation of the PCG to particular sectors
12 August 1969	Establishment of the *Compagnie National des Commissaires aux Comptes* (CNCC)
29 November 1983	Detailed application of Act of 30 April 1983
1 March 1985	Application of Act of 1 March 1984
17 February 1986	Detailed application of Act of 3 January 1985
26 August 1996	Reform of the CNC
Ministerial orders	
Order of 18 September 1947	*Plan comptable général* 1947
Order of 11 May 1957	*Plan comptable général* 1957
Order of 29 November 1971	Composition of CNC membership is modified
Order of 27 April 1982	*Plan comptable général* 1982
Order of 9 December 1986	Inclusion of consolidated accounting in the PCG

THE PERIOD OF NON-STANDARDISED ACCOUNTING

Whilst the 1947 PCG initiated the standardisation of accounting practices in France, the practice of bookkeeping had begun many centuries earlier. In 1673, during the reign of Louis XIV, the government issued an edict requiring all French traders who were engaged in commerce to keep books of accounts, specifically a journal of original entries which recorded all transactions by date, an inventory of all possessions to be completed every two years, and a book of letters received and copies of letters sent out. This edict, the *Ordonnance de Colbert* (named after the Finance Minister at the time: see Miller, 1990; Mikol, 1995), was the first regulation to impose a form of accountability, as it required traders to register their books of account with a designated civil authority.

The codification of French law following the revolution led to the creation of both a Civil Code and a Commercial Code. The *Code de Commerce* of 1807 repeated the obligation to keep accounts and to take stock, this time on an annual basis. Later, in 1867, new legislation opened the way for the incorporation of companies and included requirements for the annual shareholders' meeting to approve audited accounts prepared each year by the Board of Directors. At that time, the function of the auditor was not defined and anybody could take on the role. Indeed, until the twentieth century, financial reporting was perfunctory, the profit and loss account not even divulging costs and revenues. The distribution of a fictitious profit was only a punishable offence when it resulted in a reduction of paid-up capital. As long as there were reserves, an enterprise could distribute a dividend.

A significant change occurred when, in 1919, the accounts of companies (SA and SARL) had to be filed each year in the Commercial Registry. The real accounting revolution, however, began in France with the passing of the law that created income tax. This law came into force in 1920, having been enacted in 1917. In the absence of generally accepted accounting principles, the portion of company profit on which the tax was to be calculated was determined by the tax law. Tax law evolved very slowly, however. In the beginning, tax did not apply to all of a company's profit but only to the amount of profit actually distributed. It took more than 20 years to arrive at a firmer definition of taxable income when, in 1941, Article 39 of the newly published *Code Général des Impôts* stated that taxable income would be based on the change in net worth over the relevant period. As there was no other means of computing income, the fiscal definition was also used for accounting purposes until the appearance in 1947 of the general accounting plan, the PCG, corporate tax being introduced one year later in 1948.

In the meantime, in 1935, the *Commissariat aux Comptes* was legally defined and charged with the obligation to report to the police any cases of fraud which might come to light. At that time, as the only statutory auditors, the *Commissaires aux Comptes* were organised as assistants to the Courts of Justice on a regional basis. Accountants in public practice mainly provided services with respect to the preparation of accounts and tax returns. An examination for all accountants in public practice had been introduced in 1927, and the need then arose to establish an organisation to regulate the entry qualifications into the profession, in a similar way to other professional bodies representing lawyers, doctors or architects. Previously, many had described themselves as professional accountants without any technical qualifications. The *Ordre des Experts Comptables*, a professional organisation of certified public accountants whose function was to give members the exclusive right to provide accounting services to the public, was finally created in 1945 following an earlier attempt in 1942 to establish it under a different structure.

The Era of the PCG

During the Second World War, a proposed national accounting code was issued by the *Commission du Plan Comptable* which was established for the purpose in 1941 (Standish, 1990; Richard, 1995). The code first appeared in the official journal in 1942, and was published separately in 1943 through the *Commission Interministérielle*. This code was modelled on the German accounting code of 1937, the so-called Goering Plan. However, it was never applied in France.

In 1946, the government appointed a *Commission de Normalisation des Comptabilités* to formulate a new national accounting code, and the PCG was issued in 1947. At the same time, responsibilty for its implementation and its subsequent development was vested in a new body, the *Conseil Supérieur de la Comptabilité* (CSC).

Although it was intended as an instrument of government economic policy (Miller, 1986), the PCG consisted of little more than a numbered list of required accounts and was not accompanied by explanations of accounting principles or of applications to complex cases. It did, however, contain a precise description of the balance sheet and the profit and loss account. The 1947 version differed from the 1943 proposal in two respects. First, the accounts were grouped in nine classes. This differed from the structure of the 1943 plan, which resembled that of the 1926 Schmalenbach system. Second, the accounts concerning product costs were optional and these were separated from the expense and revenue accounts which were presented according to nature or type (*par nature*) and not according to purpose or function (*par fonction*). The 1947 PCG, although optional, was progressively implemented by French companies, and its proliferation became the sole object of accounting teaching programmes. It was revised in 1957. However, it was not until 1965 that the tax system stipulated that companies adhere to the PCG when compiling annual tax returns, even though the lack of detail in the plan presented problems in determining the figures to be reported.

From 1965 onwards, therefore, the CNC issued opinions to supplement the 1947 PCG. In the same year, the OEC also began to issue recommendations on the question of standardised accounting, the first of which concerned provisions for contingencies. In 1966, when company law was completely revised, the new law contained two major provisions in relation to accounting.

1. A legal definition of income (after depreciation and provisions) which, although not explained in detail or essentially different from that of the PCG, had the advantage of clarifying an essential accounting concept in law. Under French law, the tax definition of income still remains a great deal more precise.
2. A definition of the function of the auditor who must certify the *regularité* and *sincerité* of annual accounts, based on an ongoing examination of the accounts and their adherence to other legal requirements.

Although the law made some headway with regard to the role of the auditor (it specified a term of appointment of six years, for example), it did not entrust the audit function to the care of certified public accountants. Instead, a national institute of statutory auditors was established for this purpose by decree in 1969. This institute was the CNCC, to which certified public accountants (as well as those who were previously practising as auditors) could belong. Since its creation in 1969, the CNCC has developed a comprehensive set of auditing standards which are closely modelled on those in the USA (see CNCC, 1995).

The 1960s also saw the development of the securities markets and the appearance of detailed financial information on large listed companies. The Stock Exchange Commission (COB) was created in 1967, modelled on the SEC in the USA. The COB was responsible for monitoring financial markets and information concerning the securities traded. From the outset, the COB began to take a position on accounting standardisation, particularly through its representation on the CNC.

The PCG was scheduled for revision in 1971 but, although a new version was approved by the CNC in 1975, it was held up by discussions on the Fourth European Directive. Finally, an entirely new PCG in keeping with the Directive was issued in 1982 and implemented on 1 January 1984. A law reproducing the essentials of the Directive was adopted on 30 April 1983, for implementation on 1 January 1984.

The publication of the 1983 law marked a change in the nature of accounting standardisation in France. A matter which had previously been optional now became obligatory. It should be noted, however, that the PCG had been adhered to by almost all enterprises and other entities, especially those in the public sector, despite its optional status. The 1947 and 1957 versions of the PCG had a surprising influence, even though the initial objective that it should be an instrument of government economic policy was never achieved in full.

The Era of Accounting Law

The law of 30 April 1983 ushered in a new era of accounting standardisation in the sense that, as mentioned above, standardisation now became mandatory from a legal point of view. This new status was subsequently reinforced by numerous other laws and decrees:

(a) a decree (29 November 1983) which included the detailed regulations arising from the Fourth Directive;
(b) a further law (1 March 1984) and decree (1 March 1985) which extended the application of the 1983 legislation to all civil and public enterprises, subject to certain threshold criteria;
(c) a third law (3 January 1985) and decree (17 February 1986) which concerned consolidated accounts and which incorporated the Seventh European Directive.

The enactment of this legislation has resulted in the fact that the 1982 PCG is no longer in the forefront of French accounting standardisation. Accounting laws and decrees no longer make cross reference to the PCG and its reputation is diminishing. Because it is not (and never was) mandatory, and as it has not been updated since 1982, the PCG now plays only a minor role in accounting standardisations.

It may be thought that this legal standardisation of accounting would also have spelled the death of the CNC and its standardising role. However, the role of the CNC has been maintained, probably because it provides the forum for a dialogue on accounting issues. The development of a law, or even a decree, is a protracted process because of the formal procedures which must be carried out and approval required (Kerviler and Standish, 1992). The CNC, on the other hand, brings together experts who know one another and who can, in a short time and with a minimum of formality, arrive at considered positions on technical issues which are not sufficiently weighty for legislative attention. It can happen, however, that particular CNC projects are paralysed by the divergent opinions of its members.

In 1989, the French Stock Exchange Commission greatly increased its powers to take on the monitoring of financial markets and related information, and the COB now issues regulations, carries out investigations and imposes fines. To date, however, it has intervened little in accounting matters, which have remained the preserve of the CNC. In 1995, however, the French Government introduced a project to reform the CNC, which would remain as a consultative and research body with a new organisation (the *Comité de Réglementation Comptable*, or CRC) being set up with only ten members to make decisions on accounting standardisation with legal power of enforcement (Gélard, 1997). The reform of the CNC was effected by a decree dated 26 August 1996, the law creating the CRC passing through Parliament on 6 April 1998 with the CNC now playing a supportive role.

THE RULE-MAKING BODIES

Only a limited number of organisations are involved frequently in accounting standardisation, whilst others contribute intermittently, as is the case when the specific needs of particular industries are taken into account. In general, any CNC committees that have been formed for this purpose have been dissolved after the adaptation of the PCG to the special circumstances involved. Government ministries also contribute occasionally when, in formulating a law or decree, clauses on accounting are to be included. This can occur in many different circumstances as, for instance, when the law of 6 February 1992 on the territorial administration of the Republic required town municipalities of more than 3500 inhabitants to issue consolidated accounts. It is also worth noting that certain sectors in France possess separate legal authority to develop and impose specific accounting standards appropriate to their own circumstances, the most prominent examples relating to the bank regulator and the insurance regulator. However, with regard to the broad range of financial reporting issues, the main institutions involved in the rule making process are the CNC and CRC, the commission governing the operations of the French stock exchange and the representative associations of certified public accountants and auditors (see Scheid and Standish, 1989).

The *Conseil National de la Comptabilité*

Since 1947, the CNC and its predecessor the CSC have been the bodies officially responsible for accounting standardisation in France. As indicated above, its role was modified by the emergence of accounting law in 1983, and again in 1995 with the creation of the CRC.

The CNC operates under the auspices of the Finance Ministry. Its authority, power, structure and procedures were determined by a government decree of 7 February 1957, which has been amended since on a number of occasions. The last amendment was on 26 August 1996 which modified the composition and the responsibilities of the CNC. The recent changes have been substantial, reducing the membership of its governing board from 103 to 58. The president of the CNC is now a full-time civil servant, the first holder of this position under the new arrangements being Georges Barthes, a former president of the IASC.

The Scope of Activities of the CNC

The CNC has concerned itself with more than merely accounting standardisation. The 1957 decree set down two main tasks. The first was to coordinate and synthesise accounting research, including its practical application. It was thus anticipated that the CNC would lead the way in accounting education through collecting and circulating relevant information and research findings. The CNC was also to play an advisory role by means of prior rulings on – and subsequent interpretations of – all regulations or recommendations of an accounting nature, whether proposed by government or public agencies. The second main task of the CNC was to propose measures concerning the rational operation of accounts, either in the interest of companies or with a view to establishing national statistics or economic budgets and national accounts.

In reality, the CNC has not entirely succeeded in coordinating research and taking the lead in educational and technical activities. Nonetheless, it has been consulted prior to the issuing of any legal text on accounting matters and it has influenced accounting through the PCG and adaptations of the PCG for particular industries as well as by means of its interpretations and recommendations. In accordance with the 1957 decree, however, the CNC has never had direct authority in the matter of accounting standardisation, and none of its interpretations or recommendations are mandatory. Accounting initiatives have always begun as proposals to the supervising Ministry (the Finance Ministry), and the various PCGs have only been issued following approval by the Ministry. Nevertheless, responses by the CNC to questions posed by companies or by practising accountants have generally been issued without the approval of the Finance Ministry. For many years, the CNC issued its opinions without specifying the criteria for assessment. However, more recently the CNC has tended to accompany its opinions with explanatory reports. In this manner, the CNC has made proposals on a wide range of accounting subjects, possibly exceeding the usual scope of accounting standardisation, including national accounts and accounting in the public sector.

To summarise, the CNC has never had full authority to impose standardisation of accounting, although it has long been the required channel through which any accounting proposal of an official nature must be routed. In effect, the changes in 1998 vest legal power to standardise accounting in the new *Comité de Réglementation Comptable*, leaving the CNC with the task of detailed analysis of the issues involved.

The Structure of the CNC

The members of the CNC are appointed for fixed terms and assisted by a permanent staff of technical experts. The organisations represented on the Council cover a broad range of different interests in accounting whilst other members include key figures appointed by the Ministry of Finance because of their accounting expertise and experience.

Initially, in 1947, there were 22 members of the then CSC. Just over half of them were civil servants from various ministries (see Standish, 1997), the remainder being specialists in accounting matters, including the President of the OEC. By 1957, when the CSC became the CNC, the membership had increased considerably from 22 to 66, the composition of the Council having been modified first in 1950 then again in 1957 to include representatives from numerous organisations such as trade unions, employers' associations and associations of accountants who worked within companies. In total, there were now more accounting specialists than civil servants representing ministries. However, the Finance Ministry still dominated the CNC as it appointed the President, three out of four Vice-Presidents, and the Secretary-General, as well as six other key figures and five civil servants. All members were appointed for a three year period which was renewable indefinitely.

From the beginning, the CNC was thus characterised first by its desire to ensure the participation in accounting standardisation of many organisations which would represent varied interests but in which practising accountants were a minority and, second, by tight state control through its appointment of principal members and through the involvement of numerous ministries. The make-up of the CNC was further modified in 1971 and 1992, and on each occasion its membership was extended. By 1992, there were 103 members (53 were appointed by the Finance Ministry, and there were 50 representatives from 43 prescribed organisations who sat permanently). However, the two main features of the CNC remained unchanged: that is, representation from a wide cross-section of organisations and control by the government.

In 1996, a decree once more changed the composition of the CNC allowing, as it did, the Minister for Finance (Jean Arthuis, a practising *expert comptable*) to reduce the membership to 58 and to appoint the former president of the IASC as its new president. The new membership has broadened the representation by non-governmental participants, although accountants remain in a minority. The membership of the CNC, along with that proposed for the CRC and its urgent issues committee, is detailed in Table 4.1.

As it was felt that the large assembly of CNC members would not itself be able to formulate accounting standards, a 1952 ruling made provision for the establishment of five specialised sections. These were for (a) general accounting principles, (b) financial accounting, (c) management accounting, (d) accounting in specific industries and (e) public sector accounting. Each member of the CNC took part in the deliberations of one of these sections which could call upon non-member experts to participate in the process of accounting standardisation.

A 1981 amendment to the Rules and Regulations permitted the CNC President to set up working groups which could include external key figures. Some of these working groups have remained operative over a long period of time and have effectively become permanent committees. In 1992, for example, there were standing committees dealing with franchises, consolidation, new financial instruments, small and medium-sized companies and intangible investments. Also in 1981, the CNC president was instructed to form the Collége, a group of 35 CNC members who were granted the same powers as the general assembly of CNC members, because it was felt that a smaller group would find it easier to conduct meetings.

Table 4.1 Membership of the French accounting regulation committees (CNC, CRC and CU)

	Conseil National de la Comptabilité (CNC)	*Comité de Réglementation Comptable (CRC)*	*Comité d'Urgence (CU)*
CNC President	1	1	1
Ministry of Economy	2	1 (Pres.)	1
Ministry of Justice	1	1 (Vice-Pres.)	1
Ministry of Finance/Budget	3	1	2
Civil court (*Conseil d'Etat*)		1	
Criminal court (*Cour de Cassation*)		1	
Stock exchange commission (COB)	1	1	1
National Statistical Bureau (INSEE)	1		
National Audit Office (*Cour des Comptes*)	1		
Statutory Commissions	3		
Accounting profession (OEC)	5	1	1
Audit profession (CNCC)	5	1	1
Other professional bodies	2		
Enterprise and employer representatives	23	3	3
Trade union representatives	5		
Independent experts on accounting	5		
Total	58	12	11

Note: Membership of the CRC and CU is determined by a decree of 26 August 1996 and a law of 6 April 1998.

Since 1992, a new set of Rules and Regulations has facilitated a restructuring of the CNC membership. The number of Council members has not been reduced but there are now three rather than five sections which deal with (a) accounting principles and international relations, (b) companies and (c) non-commercial activities. These three sections can formulate opinion on the basis of general agreement within the particular section. The College was abolished as from 1 February 1993.

The total work programme of the CNC is complex and necessitates coordination. Thus, the 1957 Rules and Regulations made provision for a Committee or Bureau (comprising the President, Vice-Presidents, the Secretary-General who heads the permanent staff and a number of *rapporteurs*) which was to direct the activities of the CNC and prepare and coordinate the work of the sections and working groups. The Bureau could also take decisions in an emergency. In addition, provision was made for a Secretariat responsible for the CNC administration and the drafting of recommendations. The Secretariat included permanent technical experts.

The role of the secretariat was strengthened by a ministerial order dated 21 September 1993, its official tasks being to centralise documentation submitted to CNC, to undertake the preparation of discussion documents and to produce reports and opinions of the CNC, as well as to monitor the follow-through.

The CNC's Approach to Rule-Making

It has been seen that the working methods of the CNC are complex and varied. The CNC must be consulted in respect to all official legal texts of an accounting nature, including laws, decrees and regulations, and can be freely consulted by any enterprise or person on any question concerning accounting policy. It follows that there are two main categories of operation: (a) initiatives taken by the CNC, which lead to proposals from the CNC; and (b) responses to questions directed to the CNC, which call for consultation. The latter occupy much of the time of the permanent technical experts and likewise take up a significant amount of time of the commissions and sections and of the general assembly.

There are many occasions when consultation is compulsory and the urgency that is usually required often disrupts the working programme of the CNC. They concern two kinds of official legal text, on which a CNC opinion is mandatory. The first type comprises those which are not essentially accounting in nature but which touch upon accounting concepts, from laws to enable the creation of trusts to laws relating to local government administration. The other type of legal text deals directly with accounting issues, there being many public and private organisations which seek rulings from the CNC on adaptations of the PCG appropriate to their specific circumstances. These organisations formulate their own accounting codes which are then examined by the CNC. This is an extensive task, some examples among the many being waterways, agricultural enterprises, funeral directors, solicitors and even the City of Science and Industry in Paris.

It should to be noted that the CNC sometimes participates directly in formulating particular accounting principles or specific codification the early phases of development. Permanent technical experts, who are occasionally members of CNC, participate in working groups which are external to CNC and part of the organisations concerned. The final form of the CNC verdict takes the form of an opinion not a ruling. It should be said that only on rare occasions are these not implemented by the ministry responsible for the activity in question.

In addition to the above, any person or organisation may question the CNC on accounting issues either orally or in writing. Often, the solution is simple and a response is given directly by the permanent staff. Less frequently, the response requires the formulation of a new policy and, in this case, the question is put on the agenda of a section or a working group. The CNC finally takes a position by means of an opinion or interpretation. One example of this concerns the OEC, who are members of the IASC. The OEC sought guidance on the extent of conformity of French accounting standardisation with IASs. On the initiative of its former President, the CNC instructed the 'Accounting Principles and International Relations' section to issue statements identifying similarities and differences.

Up to the time of writing, the official CNC releases have consisted of the PCG (the 1982 version was completed in 1986, with a methodological note on consolidation which took into account the 1985 Act integrating the seventh Directive into French Law), its adaptation to various industries as well as CNC opinions (*avis*) issued on various topics (26 since 1982) and CNC recommendations in discussion papers (*études*) on various matters of concern (29 since 1982). All of these were published in the quarterly bulletin of the CNC, the *Bulletin Trimestriel du Conseil Nationale de la Comptabilité*.

The *Commission des Opérations de Bourse*

As discussed in the introduction, the COB has been assigned the general task of protecting savings and of monitoring the information provided by issuers of securities to the public. These include companies with shares and bonds listed on the stock exchange and companies which sell shares, bonds or other securities. In the former case, the COB reviews selective or periodic information which has been circulated by listed companies, including accounting information. In the latter case, the COB approves the distribution prospectus containing financial and accounting information.

The authority of the COB over any issuer of securities to the public is extensive as it has the power not only to regulate the operation of securities markets but also, by making spot investigations of financial accounts, may either compel a company to provide the prescribed information or impose fines on companies which breach the rules. The authority of the COB applies to the accounts of listed companies, including the consolidated and individual company annual accounts, as well as accounting information issued on an interim basis or on the occasion of certain events (such as new equity issues and the acquisition of a controlling interest in a company).

Since its creation in 1967, the COB has issued numerous accounting recommendations relating to the accounts of listed companies. These recommendations are not obligatory but have frequently been adhered to, as in the case of goodwill amortisation. Even though the COB now has the authority to make its own regulations and to impose them, it has not promulgated specific accounting rules for listed companies. The main reason for the apparent non-participation of the COB in accounting standardisation is that it is anyway involved in the workings of the CNC, which it greatly influences on accounting issues relevant to listed companies. It is possible that, in the future, the COB may wish to create its own set of accounting regulations applying only to quoted companies. To date, however, under French law, there are no specific accounting obligations for listed companies only. Requirements relating to annual accounts do not mention supplementary information which must be provided by these companies. Consolidated accounts must be drawn up by listed companies if they exclusively control or have a dominant influence on other companies but they must also be drawn up by unlisted companies if the group exceeds certain threshold crieria.

Like all *Sociétés Anonymes*, listed companies are obliged to file their annual accounts at the commercial registry where they are open to general consultation. The only specific obligation for listed companies is the publication of accounts (both individual and consolidated) in the official *Bulletin des Annonces Légales Obligatoires*, commonly known as BALO. This must be no later than four months following the end of the financial year and at least a fortnight before the annual shareholders' meeting. If accounts published in this way are approved by the general meeting, a note must appear in BALO at the latest a fortnight following the meeting. If not, new accounts must be published taking into consideration the amendments agreed upon at the annual general meeting.

The various statements released by the COB are published in its monthly review, the *Bulletin Mensuel de la Commission des Opérations de Bourse*. These include *Arrêtés* which are mandatory once approved by the Ministry of Finance, other rulings (*Instructions*) which contain details relating to decrees and are also mandatory, and *Recommandations* which are non-binding interpretations relating to specific points.

The *Ordre des Experts Comptables*

Unlike the stock exchange supervisory body, the OEC has no authority in the matter of accounting standardisation, even over its own members, French certified public accountants. At best, its stance on the subject reinforces established accounting principles. As the OEC is involved in the CNC, it should not need to have its own separate set of statements on accounting issues. However, the OEC has been issuing its own *Recommandations* since it set up a special committee in 1965 to advise its own members, having failed in its various requests to the CNC to take a position on several points not dealt with in the PCG. The first of these statements concerned contingencies and provisions and was issued in October

1965. Because of the quality of their analysis, the recommendations by the OEC have been influential in the development of positions taken by the CNC; for example, number 11, which deals with losses on long-term contracts, predetermines the content of CNC *Avis* 17.

The recommendations issued by the OEC usually concern issues of general significance such as changes in accounting methods, business combination, and contingencies, whereas the CNC *Avis* often concern specific aspects of accounting such as accounting for tax concessions, reusable packaging, and so on. Furthermore, OEC recommendations closely follow IASs as the OEC is a member of the IASC whereas the CNC is not. These recommendations are therefore a vehicle for importing international standards into French accounting practice.

Statements by the OEC are published under two headings: either (a) accounting principles (*principes comptables*) or (b) professional conduct between members and clients (*pratiques professionelles*). At the time of writing, there are 31 statements on accounting principles.

The *Compagnie Nationale des Commissaires aux Comptes*

The CNC was set up in August 1969. Membership is similar to that of the OEC, since the conditions of enrolment are indentical. Throughout its existence, the CNCC has deferred to the OEC when it has pronounced on matters of accounting policy. However, it does participate indirectly in accounting standardisation in four different ways. First, the CNCC has a number of members on the CNC. Second, the CNCC has set up an accounting study group (*Commission des Études Comptables*) which meets monthly in order to resolve accounting problems encountered by auditors. The speed and quality of responses make it a respected source of accounting knowhow, especially as these responses are issued in its quarterly bulletin (*Bulletin Trimestriel de la Compagnie Nationale des Commissaires aux Comptes*) and therefore have a wide audience. There is, therefore, a tacit agreement that the OEC entrusts the CNCC with the task of selectively interpreting and resolving any outstanding accounting matters for the overall profession. Third, the CNCC also issues audit guidebooks for various industry sectors in which accounting issues are dealt with indirectly. Finally, CNCC is also a member of the IASC, as is the OEC, and consequently helps to secure the application of IASs in France.

CONCLUSIONS

Accounting regulation has a long and complex history in France. Indeed, the complexity of the regulations themselves is reflected in the importance given to the annual publication *Memento Pratique Comptable* (Francis Lefebvre, 1997), a widely used commentary on accounting methods, both binding and non-binding. The relative status of various rules and regulations is not self-evident. At the present time, however, changes in the institutional structure are intended to give greater authority and more explicit legal power to the *Conseil National de la Comptabilité* through the new executive board, *Comité de Réglementation Comptable*.

Appendix: Chronological Table of Accounting Regulation

Date	*Event*	*Comments*
1867	Creation of the *Société Anonyme*	For the first time in France, annual financial reporting to shareholders is required with a report by an auditor
1919	Establishment of the *Registre de Commerce*	Annual report and financial statements of limited companies have to be made public through the Commercial Registry
1935	Statutory audit of the limited company	The statutory auditor (*Commissaire aux Comptes*) becomes a regulated profession and duties are fixed by law

Date	*Event*	*Comments*
1941	Establishment of the *Commission du Plan Comptable*	The national accounting code prepared for the Vichy government was not implemented in France
1947	Creation of the *Conseil Supérieur de la Comptabilité*	The CSC (later CNC) is the first official accounting standardisation body
1947	Publication of the first *Plan Comptable Général*	The 1947 PCG is mainly a coded chart of accounts
1957	Publication of the second *Plan Comptable Général*	The 1957 PCG updates the 1947 version
1965	Requirement on all taxable enterprises to complete standard assessment form	Tax return of any enterprise has to conform to the PCG 1957
1966	Enactment of company law (*loi sur les sociétés*)	The statutory auditor must certify the 'regularity and sincerity' of company annual accounts
1969	Creation of the *Compagnie Nationale des Commissaires aux Comptes*	All statutory auditors must belong to the CNCC, most being *experts comptables*
1975	The CNC adopts a new version of the PCG 1957	This version of the PCG was never published due to the debate concerning the Fourth European Directive.
1982	Publication of the third *Plan Comptable Général*	The 1982 PCG differs considerably from previous versions and conforms to the Fourth Directive
1983	Enactment of an accounting law followed by a decree providing details	Transposition of the Fourth European Directive into law. The accounts must show a true and fair view (*image fidèle*)
1985	Enactment of a law on consolidated accounts	Transposition of the 7th European Directive of 1983. All holding companies must publish group accounts
1997	Creation of the *Comité de Réglementation Comptable* (in progress)	The CRC will issue binding accounting standards

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5 Germany

Dieter Ordelheide

INTRODUCTION

The character of German accounting regulation has been predominantly legalistic since commercial law came into being with the unification of Germany in the second half of the nineteenth century. Until 1998 the rules of financial accounting were governed by the commercial code and, accordingly, had to be approved by Parliament. Thus, the traditional German model of accounting regulation differed significantly from countries where standards are approved by a private body or by government departments, or by some arrangement of governmental and private agencies which work together to develop and approve accounting rules. In May 1998, however, ammendments to the German Commercial Code (*Handelsgesetzbuch*, HGB) embedded the legal pre-requirements for the establishment of a standard setting institution. Since then the German Accounting Standards Board (*Deutscher Standardisierungsrat*, DSR) has been founded, although the consequences for German accounting practice are not expected before 1999.

As the German system is still influenced by its legalistic tradition, we begin by considering the way in which German accounting law was developed. To do so, it is necessary to look not only at its historical evolution but also at the way in which such law is prepared and then implemented. Indeed, it is a long way from legal theory to practice and, in order to implement laws in Germany, more private activity is involved than might be assumed from a system which is characterised as 'legalistic'. In fact, accounting regulation in Germany can be seen as a hierarchy of rules from legislation to firm-specific policies, with public as well as private agencies working together to transform abstract legal norms into accounting practice. In considering the way in which accounting law is prepared in Germany, this chapter will also describe the underlying interests which influence the development of legal accounting rules by identifying the various interest groups and evaluating their success in the political lobbying process.

Compared internationally, it is obvious that there is much greater similarity than is usually recognised between Germany's so-called legalistic system and the non-legalistic approaches to accounting regulation seen elsewhere, contradicting the false distinction which is drawn from merely observing that there are differences in the level at which the formal approval of accounting rules takes place. In particular, the relative importance of the interest groups which influence the whole process seems to be much the same, although their expression of power takes place through diverse national organisational patterns.

THE HISTORICAL DEVELOPMENT OF FINANCIAL ACCOUNTING LAW IN GERMANY

The first General German Commercial Code of 1861 (*Allgemeines deutsches Handelsgesetzbuch*, or ADHGB) included sections on accounting and was brought about as part of the process of political integration of the German states, which resulted in a unified Germany in 1871. Before that time, there had been a number of attempts in the independent German states to establish a commercial code, but these attempts had failed (Koch, 1863).

According to the ADHGB 1861, every business in Germany was obliged to provide an annual inventory and balance sheet (Article 29) in accordance with the bookkeeping rules laid down in the code. Article 31 included a rudimentary valuation rule, which was oriented towards the current market price. Further regulation, however, was left to contractual arrangements between the owners (Article 209, No. 6).

In 1870, the first German Stock Corporation Law was integrated into ADHGB Articles 179–249a. Two additional valuation rules for listed securities and for expenditure on organisation and administration were set down in law. Further regulations, including the obligation to build up capital reserves and revenue reserves, were again left to company statutes (Article 209, No. 1, Article 239a, No. 3).

Since its establishment, German accounting legislation has been the object of several reforms, as discussed by Barth (1953), Schröer (1993) and Schneider (1995). The period 1884–1897 was a learning phase, during which some fundamental changes occurred in a comparatively short period of time. These were initiated by the Stock Corporation Act of 1884, an Act which was the result of a spate of bankruptcies caused by excessive dividend distributions based on overvaluation.

Therefore, the new Act set down the foundations of a valuation system based on prudence, in which capital maintenance became mandatory. Numerous legal provisions were established: the historical cost principle for all assets; depreciation of fixed assets; prohibition of the capitalisation of organisation and administration expenses; the disclosure of equity and profits and losses as well as obligatory retained earnings; and the creation of capital reserves for the premium arising on the issue of shares. It became obligatory to publish accounts, and failure to do so (or not to provide to the general assembly a true picture of the state of a company's affairs) would result in sanctions against the management and the supervisory board. However, further regulations, especially concerning auditing procedures, were still left to company statutes.

In 1892, the limited liability company (*Gesellschaft mit beschränkter Haftung*, or GmbH) was established. Some of the obligatory rules of the Stock Corporation Act were taken over but the historical cost principle was restricted to fixed assets.

The final piece of legislation at this time was the Commercial Code (*Handelsgesetzbuch*, or HGB) of 1897 which drew up regulations for non-corporations, obliging them to follow principles of proper bookkeeping (*Grundsätze ordnungsmäßiger Buchführung*, or GoB) and to provide an annual inventory and balance sheet. The maximum accounting period was to be no longer than twelve months, and the accounts were to be in the national currency only (*Reichswährung*). Assets or liabilities were to be valued at the rate attributable on the date of the accounts and it was mandatory to include doubtful receivables.

Partly as a result of the reforms described above, a period of relative socio-economic equilibrium lasted almost 40 years until the 1930s. Once again, however, the failure of a number of large stock corporations signalled the need for further reform. This led to major reform in the Stock Corporations Act (*Aktiengesetz*, or AktG) which was enacted in 1937, although it had been preceded in 1931 by an emergency decree (the so-called *Aktienrechtsnotverordnung*) under the old Stock Corporations Law. The new rules included the following: a general norm for the preparation of balance sheets and profit and loss accounts; an option to apply either the cost or the attributable value principle for fixed assets, whichever was lower; a definition of production costs; a separate special lower of cost or market principle for securities; the historical cost principle also for current assets; and an obligatory lower of cost or market value principle for current assets. The capitalisation of formation expenses, of costs of raising capital and of self-created goodwill was prohibited but there was the option to capitalise acquired goodwill and this had to be depreciated. Bonds had to be valued at their redemption value. It became possible to capitalise the difference between the amount received and the redemption value as deferred income and to depreciate it on a timely basis. Subscribed capital had to be included at its nominal value.

The 1937 AktG also set down the basic format for the balance sheet and for the profit and loss account. Profits and losses for the year had to be disclosed separately from profits and losses carried forward. There was mandatory disclosure of additions and disposals of fixed assets and participations, and special disclosure rules were included for receivables, liabilities, reserves, provisions and own shares. Guarantees also had to be disclosed. The German government was authorised to prescribe, without parliamentary approval, other formats for the balance sheet and for the profit and loss account, as well as to prescribe special rules both for the individual accounts of companies belonging to a group and for the group accounts. The general meeting was to approve the accounts and to decide on the distribution of profits and the discharge of the managing board and the supervisory board. A deadline for the presentation of accounts to the supervisory board and to the general assembly by the managing board was introduced.

For the first time, the mandatory audit of financial statements was established. In addition, an obligatory management report was introduced with the specific requirement to disclose any changes from the previous year, such as relationships to dependent and group companies, shares acquired by the owners on behalf of the company, their own shares in the company, the transfer of ownership rights to a company or a group of companies, and *jouissance* shares. Furthermore they had to disclose guarantees not mentioned in the balance sheet, the overall income of the members of the managing and supervisory boards, any cartels or similar agreements and important events which occurred after the date of the balance sheet.

The next extensive reform of accounting law took place in 1965, having been preceded in 1959 by a minor change dealing only with the format of accounts. The AktG of 1965 altered the rights of determination and distribution of profits, set down new formats for the balance sheet and the profit and loss account and for the first time established the obligation to prepare, audit and publish group accounts as well as the individual accounts of all the companies belonging to a group.

The new direction of regulation was described in German as *gläserne aber verschlossene Taschen*, where the contents of a company's 'pockets' may have become more visible but nevertheless remained inaccessible. This was achieved by specifying the lower of cost or market principle and by restricting the possibilities to build up provisions while also granting the managing board the right to allocate 50 per cent of the annual profit to retained earnings.

The regulation of group accounts was not established as an independent piece of legislation. As in the case of the law dealing with individual companies, where accounting regulations form part of a law on corporate governance, a further law on the governance of groups was established of which the regulations pertaining to group accounts were an integral element.

All the reforms after the HGB of 1897 concentrated on the stock corporation and, to some extent, on the limited liability company. But for sole proprietors and commercial partnerships the legal basis was still the HGB of 1897. It was not until 1969 that the stock corporation law was extended to large companies of other legal forms with the Disclosure Act (*Publizitätsgesetz*, or PublG). The background to this legislation was again the failure of large companies, but this time the failures were large groups led by commercial partnerships.

In 1985, harmonisation with European accounting and auditing directives took place in Germany with the *Bilanzrichtliniengesetz* (BiRiLiG) which transformed EU directives into German law. Many new rules were established, especially concerning group accounts and the notes to the accounts.

In order to make it easier for German companies to raise capital in international capital markets, new legislation (the *Kapitalaufnahmeerleichterungsgesetz*, or KAEG) was enacted in 1998. Under this law, German listed stock corporations have the choice of applying internationally accepted accounting rules (especially IAS and US-GAAP) in their group accounts. This option is available until 31 December 2004, the German Standards Committee being mandated to adapt German accounting principles to international accounting practice by this date.

Over the years, the time interval between the major reforms of accounting law has become shorter (1884, 1937, 1965, 1985, 1998) and the complexity of regulation has undoubtedly increased. In nearly every area, the process of legal revision has resulted in more extensive and more detailed regulation. In addition to the steady movement towards greater regulatory complexity, there have also been shifts in the direction of regulation. As far back as the stock corporation reform of 1884, there was a clear tendency to prevent unrealised profits from being distributed and, furthermore, to legislate against the concealment of profits by building hidden reserves. The possibility of building up hidden reserves was substantially reduced in the 1965 reform which limited downwards revaluation. Now, for the first time, there is a law that is even less prudent, given that internationally accepted accounting standards may be allowed for group accounts.

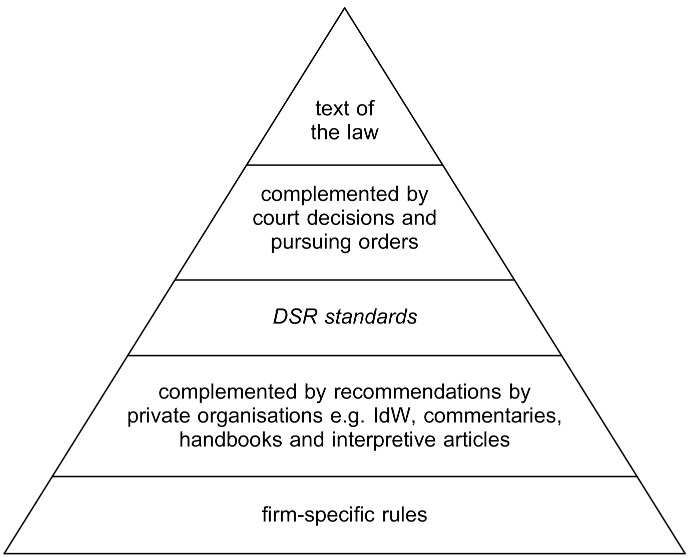
In conclusion, it can be said that over the years the most far-reaching reforms to German accounting regulation either came about in reaction to experiences which were assumed to be caused by, amongst other things, insufficient regulation in the area of accounting and corporate governance (1884, 1931/1937 and 1969) or else were the result of political or economic integration (1861, 1985, 1998).

THE PRESENT SYSTEM OF REGULATION OF FINANCIAL REPORTING IN GERMANY: INTERACTION BETWEEN PUBLIC AND PRIVATE INSTITUTIONS

A Hierarchical System

Although the letter of the law does not always determine accounting practice directly, it exercises a strong influence over the preparation of accounts by German companies. It is nonetheless still a long way from the legal provisions to the accounts of individual preparers. The German system of accounting regulation is hierarchical and may be looked upon as a pyramid which has the legal text at its apex (see Figure 5.1), moving down through a number of different authoritative sources: the associated legal orders and judgments by the highest courts; the standards of the German Accounting Standards Board (DSR); the related recommendations of the German Institute of Company Auditors (*Institut der*

Figure 5.1 The pyramid structure underlying the system of accounting regulations in Germany



Wirtschaftsprüfer – IdW) as well as the opinions of other authoritative institutions; legal commentaries and accounting handbooks; and, finally, the specific policies applied in practice by the preparers of accounts at the bottom of the hierarchy.

The first characteristic of Germany's pyramid structure of financial reporting rules is that the rules become more detailed and concrete as we descend through the levels of the hierarchy, with incomplete and unclear rules established at one level being further elaborated at one or other of the following levels.

A second feature of the hierarchy may be seen in the fact that the rules from the second level downwards derive their authority from the commercial code and may be described as 'interpretations' or 'elaborations' of the law. The rules at the second level still have legal authority: in other words, the institutions which formulate these rules are authorised by law to make binding statements. With the exception of the standards to be published by the DSR (see p. 111), the rules issued at subsequent levels have expert authority only.

A third element is responsiveness to change, which diminishes at the upper levels. If new accounting issues arise (such as lease accounting some time ago, or accounting for financial instruments as at present) or if a change in established rules is strongly advocated, then firm-specific solutions have to be found immediately. In such cases, a discussion between accounting experts normally takes place with the aim of reaching accounting solutions which are consistent with the legal framework and which are to be operationalised in a comparatively short period of time. In the case of a conflict between a preparer and some outside party (normally the tax authorities or sometimes also shareholders), this may be settled by a judgment handed down by one of the respective courts. These conventions and court judgments, if well established, may eventually be integrated into the law, but this is normally a very costly process and therefore seldom happens.

Table 5.1 gives an indication of the level of discussion surrounding financial accounting matters in Germany, and how the scope of the interpretations in law compares with the interpretations published in a variety of discussion documents. The table includes: articles and recommendations published in relevant German journals, books on financial accounting matters, court judgments, mainly by the tax courts, and rulings issued by the tax authorities.

Table 5.1 The extent of financial accounting discussion in Germany (number of articles, books and court rulings per topic, 1990–93)

Areas of Financial Accounting	*Articles*	*Books*	*Court rulings*	*Total*
1. Bookkeeping and Inventory	(24)	(28)	(4)	(56)
Bookkeeping	15	24	4	43
Charts of accounts	0	1	0	1
Inventory	9	3	0	12
2. Individual Accounts	(676)	(302)	(392)	(1370)
Literature relating to a large number of subject areas	10	112	0	122
Objectives of accounts and of the management report	2	4	0	6
Preparation and acceptance of the accounts	4	1	2	7
Principles of proper documentation	10	2	1	13
Relation between commercial and tax balance sheet	30	6	3	39
Principles of capitalisation and heading into deficit	35	12	21	68
Classification	5	0	3	8
General valuation principles	14	6	10	30
Historical costs/production cost	23	0	46	69
Lower current values	12	1	22	35
Special valuation principles for assets and liabilities	4	1	1	6
Intangible fixed assets	39	10	26	75
Fixed assets	12	8	31	51
Financial assets	50	6	11	67
Inventory	23	2	6	31
Claims receivable and other assets	15	9	14	38
Current financial securities/Liquid funds	4	0	1	5
Prepaid expenses	7	0	8	15
Equity	29	13	14	56
Special items with accrual character	10	1	15	26
Accruals	127	20	88	235
Liabilities	14	9	13	36
Deferred taxes	4	4	0	8
Contingencies	0	1	0	1
'Total cost' and 'Cost of sales' accounting format	11	2	5	18
Other operating expenses	1	0	2	3
Financial gains and expenses	2	0	2	4
Taxes	4	1	2	7

Table 5.1 (cont.)

Areas of Financial Accounting	*Articles*	*Books*	*Court rulings*	*Total*
Cost of sales accounting format and gains up to other expenses	3	0	0	3
Disposition of retained earnings	3	0	1	4
Notes to the finanical statement	8	1	0	9
Management report	8	6	0	14
Auditing and disclosure	32	27	6	65
Realisation of profits in long-term manufacturing operations	2	2	0	4
Leasing	9	1	8	18
Subsidies	4	0	7	11
Options and futures	13	13	3	29
Interim reports	3	3	0	6
DM-opening balance sheet for east German companies	64	14	17	94
Supplementary and special balance sheet	11	1	3	15
EU accounting law	10	1	0	11
Finanical reporting of banks	5	2	0	7
Financial reporting of insurance companies	0	1	0	1
3. Group accounts	(63)	(78)	(6)	(147)
General literature	15	53	0	68
Basics and principles of the group account	4	0	1	5
Preparation obligations and consolidation circle	9	2	2	13
Adaptation of the individual account/ foreign currency translation	15	7	3	25
Full consolidation	13	6	0	19
Quotal consolidation/equity method	3	5	0	8
Notes and management report	2	2	0	4
Auditing and disclosure	2	3	0	5
4. Legal Sanctions	(17)	(14)	(6)	(37)
Rules of the Commercial Law concerning violations of accounting provisions	10	8	6	24
Rules of the German Penal Code concerning violations of accounting provisions	5	4	0	9
Rules of Tax Law concerning violations of accounting provisions	2	2	0	4

Legislation

The authority of the German regulatory system of financial reporting, as set down by the legislator, is found in the Third Book of the Commercial Code (HGB §§238–342a: see Brooks and Mertin, 1993). This contains provisions for bookkeeping and accounting which apply to all businesses (§§238–63), plus additional provisions for individual accounts (Ballwieser, 1995) and group accounts (Ordelheide, 1995). Which provisions apply depends on:

(a) the legal form of the business (for corporations, see §§264–335 and for registered cooperatives, see §§336–9);
(b) the sector of activity (for banks, see §340–0o and for insurance companies, see §341–1o);
(c) the size of the company (large non-corporations are dealt with separately in the *Publizitätsgesetz*).

The regulations are stricter for corporations and large non-corporations. Except in the well-publicised case of non-disclosure by medium-sized and small corporations, which led the European Commission to arraign the German government for insufficient enforcement, the law is usually followed. The annual statistics published by the German Chamber of Auditors (*Wirtschaftsprüferkammer*) provide evidence that this is the case for large and medium-sized companies as there are comparatively few qualifications made in the audit opinions.

Court Decisions and Other Rulings

In practice, the application of accounting rules requires the interpretation of the abstract terms that are used in their formulation. In Germany, authoritative and binding interpretations of accounting law are given by the courts, especially the highest courts. If commercial accounting law is relevant in lawsuits, the final authority is the Federal Supreme Court (*Bundesgerichtshof*, or BGH). However, that court rarely passes important judgments in accounting matters. The tax courts are considerably more important, of which the highest court is the Federal Fiscal Court (*Bundesfinanzhof*, or BFH). The importance of the tax courts in financial accounting matters arises because the principles of proper bookkeeping (GoB) are part of both the financial accounting and the tax accounting system. According to §5(1) of the Income Tax Law (*Einkommensteuergesetz*, or EStG), taxable profit must be determined according to the principles of proper bookkeeping as set down in the HGB, unless the latter conflicts with specific taxation rules. Hence, the decisions of the tax courts when interpreting the GoB are of considerable importance for financial reporting.

Income tax law and the decisions of the tax courts provide the basis for pursuing orders (*Einkommensteuerdurchführungsverordnungen*, EStDV). These set down legal interpretations of the GoB as well as interpretations of special tax legislation which, although not falling under the GoB, is nonetheless of practical importance for the financial accounts. According to the HGB (§ 254), non-corporations have the option of preparing their financial accounts in accordance with special tax law instead of following the financial accounting rules. This is particularly beneficial for small businesses which can prepare one set of financial statements only and use it for both tax and financial accounting purposes. Corporations are also allowed to use these tax-specific rules for financial reporting, but only if they would otherwise have tax disadvantages – the so-called 'reverse authoritative principle' (*Umgekehrtes Maßgeblichkeitsprinzip*) which is discussed in greater detail by Haller (1992) and Ballwieser (1990, 1995).

Thus, not only are the interpretations of the GoB important in the production of financial statements, but also account must be taken of any tax-specific regulations. In this context, the Ministry of Finance rulings on income tax law (*Einkommensteuerrichtlinien*) are also of practical importance. Although not legally binding with regard to the tax accounts of companies, a company which does not adhere to them is often obliged to enter into a lawsuit against the tax authorities.

As income tax is based on the profits shown in individual financial accounts, at first glance the tax rules seem to have no relevance to group accounts. But, according to the HGB (§300 and §308), the recognition of assets and liabilities and their valuation in group accounts must follow those rules which are relevant to the parent company's individual accounts. It thus follows that the interpretations of the GoB by the BFH are normally relevant in group accounts as well. However, if tax rules are not applied in the group accounts because they conflict with the rules of financial accounting, there is no tax disadvantage in this case as tax assessment is restricted to individual companies (no reverse authoritative principle). On the other hand, if the tax rules are applied in the group accounts, additional information has to be given in the notes which makes it possible to reconcile the group accounts with those which would have been produced in accordance with the commercial code only.

Standards of the German Accounting Standards Board (*Deutscher Standardisierungsrat*, DSR)

In 1998, the German Accounting Standards Board was founded, modelled after the FASB. The committee is staffed with seven independent experts with a background in auditing, financial analysis, academia and industry, mandated with the legal task (HGB § 342) to develop accounting standards applicable to group accounts. This will be brought into effect by means of a due process with the participation of the interested public. Once published by the Ministry of Justice, the standards will be conjectured to have the standing of principles of proper bookkeeping for group accounts (GoB). They will hence be on a level above the rules and regulations issued by other private organisations.

Recommendations of the IdW and of other Institutions, Commentaries, Handbooks and Interpretative Articles

In Germany, certain professional organisations also make recommendations, especially the relevant committees of the IdW. But they do not compete with the law. Their interpretations, which are listed in Ordelheide and Pfaff (1994), are unauthorised interpretations but are nevertheless of practical importance. They are, however, not binding in a legal or contractual sense.

The statements of other institutions also influence practice, especially those of the respective working parties of the Schmalenbach Society for Business Economics (*Schmalenbachgesellschaft für*

Betriebswirtschaft), summarised in Busse von Colbe, Müller and Reinhard (1989), Busse von Colbe, and Reinhard (1989) and Busse von Colbe *et al.* (1996).

There is in Germany a wide-ranging, detailed and active public discussion on a great number of the issues surrounding financial reporting (see Table 5.1). Lawyers, judges, auditors, accounting academics and other experts from the business and public sectors contribute to this debate and offer interpretations of accounting law with respect to the numerous accounting problems which can arise.

The entire system of accounting rules is put together in voluminous law commentaries such as Adler, Düring and Schmaltz (1995), Budde *et al.* (1995), Küting and Weber (1989, 1995) and also in financial accounting handbooks (Castan *et al.*, 1987; see also Wysocki and Schulze-Osterloh, 1994). Indeed, if we look at the whole pyramid of German accounting rules, and not only at the provisions in law, we find a degree of detail in the regulatory system which is similar to US-GAAP.

Firm-Specific Rules

Companies develop their own accounting policies on the basis of the laws, authoritative rulings and recommendations discussed above. Large companies usually distribute accounting manuals to subsidiaries and other subunits in order to reduce the accountant's discretionary input and thus standardise the information needed to manage the firm and also to aid consolidation. For small companies, developing firm-specific rules is often regarded as being too costly. Consequently, there is substantial outsourcing, the largest organization being DATEV which prepares the business accounts for more than 2 million small enterprises and sole traders.

International Influence

German accounting law is based on the European Company Law Directives, the provisions of which have been integrated into the national accounting systems of the member states. As such, the Directives have been the final authoritative legal basis for German accounting law.

The Directives exercise a further influence because the interpretation of accounting law has to be in accordance with the Directives, as explained in greater detail by van Hulle and van der Tas (1995) and Ordelheide (1996). Furthermore, the highest German courts can pass lawsuits to the European Court of Justice, which then exercises its influence based on its own interpretation of the Directives. For instance, in 1994, a case concerning the realisation principle was passed by the Federal Supreme Court to the European Court of Justice. The first of its kind, the case was finalised in 1996.

At the present time, some of the larger German companies wish to draw up their group accounts in accordance with IAS or US-GAAP instead of German law, a development which took place several years ago in France (Richard, 1995), Sweden (Rundfeldt, 1995) and Switzerland (Bertschinger, 1995). The companies concerned succeeded in their attempts to convince the government to make allowances for such a fundamental change in German accounting regulation. Accounts based on rules other than those prescribed in Germany would be allowed only for the international group accounts of listed companies. The individual accounts of the parent and of German subsidiaries (that is, the accounts on which taxation is based) would still have to be prepared in accordance with German law. Furthermore, the international group accounts must be in line with the EU Accounting Directives.

THE POLITICS OF FINANCIAL REPORTING REGULATION IN GERMANY

The final topic in this chapter addresses the following question: 'Who directs the results of the regulatory process of accounting in Germany and to what extent do they do so?' Legal reform is by far the most important political activity as it exercises considerable power over the whole process. In the subsequent levels of the regulatory pyramid, group interests are pursued to a lesser extent, the experts involved normally following their professional ethos whilst also respecting the wording and the spirit of the law. Moreover, non-compliance is seldom a problem, and the interests of affected parties will already have been taken care of in the law (e.g. by providing a choice between alternative accounting methods). In order to analyse the politics of accounting regulation, we therefore concentrate on the activities which take place at the top of the 'regulation pyramid', that is, the lobbying of law-makers. Unlike many other published studies in this area, our concern is not with the lobbying in the context of accounting standard-setting, through either governmental or private agencies, but with lobbying for accounting rules which are set by Parliament.

In the USA, the UK and Australia, where prior analysis of the lobbying process has mainly been concerned with accounting standard-setting, there have been numerous studies which concentrate on specific issues: for instance, Hope and Briggs (1982) on deferred taxation; Hope and Gray (1982) and Robson (1993) on research and development; Kelly (1985) on foreign currency translation; Power (1992) and Napier and Power (1992) on intangibles, especially brand names; Nobes (1992) and Bryer (1995) on goodwill; Kenny and Larson (1993) on joint ventures; Klumpes (1994) on pension funds; Zeff (1997) on costs of stock options; and van Lent (1996) on financial conglomerates. Some insight into the dynamics of lobbying is given in the studies of Francis (1987) and Ndubizu *et al.* (1993) on lobbying against the FASB's Preliminary Views and the Exposure Draft on Pension Accounting. Deakin (1989) concentrates on a special private interest group: the managers of the gas and oil industry. In contrast to much of the above, Tandy and Wilburn (1992) provide more representative results of the wider process of accounting change which would be more comparable with the German situation of legal reform.

In their review of lobbying activity in accounting, Walker and Robinson (1993, 1994) stress the importance of the political process which precedes the development of standards. Indeed, they would claim that political power expresses itself mainly in setting the agenda, and it would also be possible to go even further back to include the nomination of the members of a standard-setting body, the decisions taken with regard to its financing, and so on. However, the following discussion of lobbying activity in Germany concentrates on the most significant legal reform of recent years: the implementation of the Fourth European Directive through the (BiRiLiG), the agenda being set in advance by the Directive itself.

As in the case of Tandy and Wilburn's analysis of lobbying for the first hundred SFAS in the USA, the transformation of the

Fourth Directive into national law also involves a large number of accounting issues, as shown in the Appendix. The process, which started in 1978 with the Fourth Directive and, in Germany, resulted in the 1985 BiRiLiG, was long and controversial. Initially, two drafts of the new law were developed by legal experts in the Ministry of Justice in February 1980 and May 1981. Two further drafts were prepared in 1982 and 1983 at government level, there being a parliamentary coalition of Social Democrats and Liberals at that time. Soon after, however, a new coalition of Christian Democrats and the Liberals took power. A completely revised draft was published in March 1985. After two hearings and further revision, the final draft was published in October 1985. It was later combined with the proposals to implement the Seventh Directive in November 1985. That draft was then accepted as law by the German Parliament in December 1985, without substantial change.

At an early stage in this process, Federmann (1980) analysed the memoranda prepared by five German interest groups prior to the first draft of the law implementing the Directive. Now, with the benefit of hindsight, we can also consider the reactions of interested parties to the successive legal drafts. In fact, unlike Tandy and Wilburn (1992) and Federmann (1980), this allows us to assess not only the input to the lobbying process (the lobbying groups, the degree of their lobbying activities, the accounting issues involved and the solutions proposed) but also the success of each of interest group in influencing the law.

When a new law is drafted in Germany, the Ministry of Justice invites those who are presumed to have an interest to submit statements whilst others are free to comment. Those interest groups which have prepared a statement on the proposed law are invited to attend the final hearings. Thus, the invitation list for these hearings identifies those who have lobbied to influence the law (see Table 5.2). The degree of their activity can be measured by the number of statements they have made during the whole process and the number of accounting issues they have raised. Five organisations can be identified as the most active, although it is worth noting that the Institute of Auditors and the Chamber of Auditors usually act jointly. Detailed analysis has shown that comments were received on 167 specific issues concerning aspects of accounting method and financial disclosure, in addition to four proposals of a general nature.

Table 5.2 Interest groups invited to comment on German accounting law reform

Group	*Invited to hearings*	*Active group*	*Very active group*
Combined German Business Associations (SPVdW)			×
The Association for Finance and Management (GEFIU)			×
Association of Independent Businesses	×	×	
Federation of German Industries	×		
Association of German Industry and Commerce	×		
Federation of German Wholesale and Foreign Trade	×		
Federal Confederation of German Employers' Association	×		
German Chamber of Industry and Commerce	×		
Central Agency of Limited Liability Companies	×	×	
Central Association for Non-profit Residental Building	×		
Study Group for Employee Pension Schemes		×	
Study Group for Economic Administration		×	
Association of Municipal Companies		×	
Association of German Utilities		×	
Association of German Skilled Crafts		×	
Federation of German Banks	×		
Federation of German Peoples' Banks and Rural Credit Cooperatives	×		
Association of German Cooperatives and Rural Credit Cooperatives	×		
German Asscociation of Rural Credit Cooperatives	×		

Group	*Invited to hearings*	*Active group*	*Very active group*
German Savings Banks and Giro Association	×		
German Insurance Industries Association	×		
German Association for Investor Protection	×	×	
Federation of Non-profit Companies	×		
Committee of German Cooperatives Association		×	
Central Loans Committee		×	
Federal Chamber of Lawyers	×		
German Association of Lawyers	×	×	
Federal Chamber of Public Notary	×	×	
Chamber of Auditors (WPK)	×		×
Institute of German Auditors (IdW)	×		×
Federation of Qualified Accountants		×	
Federal Chamber of Tax Consultants	×	×	
Federation of German Tax Consultants	×	×	
German Association of Tax Accountants	×		
German Federation of Unions		×	
German Union of Employees	×	×	
German Trade Union Federation	×		
Institute of Social and Economic Studies of the German Trade Union Federation	×		
Accounting Commission of the German Association of University Teachers in Business Economics (KRW)	×		×

Lobbying via Associations

Compared with other countries, it is noteworthy that in Germany those affected by accounting law organise themselves into associations which lobby on behalf of their members. There is no evidence of substantial individual activity such as that revealed by Tandy and Wilburn for the USA where comments on proposed standards from individuals and individual companies dominate. In Germany, even academic experts act through an association.

The statement made by each association representing an interest group normally contains only one proposal on each accounting issue. Thus, one role of the associations is to combine the preferences of their individual members, which presumably are not all identical, into a single representative proposal. From an economic perspective, such a lobbying process should dominate as a superior institutional alternative if, for a substantially large number of individuals, the cost of lobbying jointly is not outweighed by the cost of accepting a solution other than the individual's preference (Buchanan and Tullock, 1965). If the interests of individuals and the costs of lobbying were similar in Germany and elsewhere, one could expect the organisational structure of lobbying behaviour to be similar. That, however, is not the case, but having no solid information on the distribution of individual interests or on the costs involved, this line of economic reasoning is not pursued here.

Differences in lobbying behaviour may also be explained by cultural differences. Membership of associations is not restricted to political and business activities, but is common in private life too. Membership of a number of different organisations is the usual German habit (club mania) and organisations are widespread in social life. A high degree of collectivism seems to be a cultural characteristic of Germany relative to other industrialised countries (Hofstede, 1980). Lobbying for a single solution thus satisfies the need of the group to express itself as a group. It requires some form of debate within the group, and the expression of the common interest. If we apply the same reasoning to the USA, for example, we find that individual action is regarded as being a basic element of American culture (Hofstede ranks the USA highest in individualism: see also Bryce, 1910, pp. 281–2; Beard and Beard, 1949, pp. 761–2; Bell, 1960, p. 30; but also Holson, 1965, p. 16).

The groups which have played an active role in the development of German accounting legislation by commenting on several legal drafts and on a large number of accounting issues are described below.

1. The Combined German Business Associations (*Spitzenverbände der deutschen Wirtschaft*, or SpVdW) is an umbrella organisation of associations, each of which represents a certain group of businesses. Support from the member organisations of the SPVdW depends on the project in question. In this particular case, those most actively involved were the Federation of German Industries (*Bundesverband der deutschen Industrie*), the Association of German Industry and Commerce (*Deutscher Industrie- und Handelstag*) and the Federation of German Wholesale and Foreign Trade and the Federation of German Banks (*Bundesverband deutscher Banken*).
2. The *Gesellschaft für Finanzwirtschaft in der Unternehmensführung e.V.* (GEFIU) is a private organisation consisting of senior managers specialising in finance and accounting. With regard to the transformation of the Fourth and Seventh Directives, a special working group was established in which representatives of large German corporations with the necessary expertise developed the association's position papers.
3. The response of the audit profession was prepared on each occasion by the IdW, supported by the *Wirtschaftsprüferkammer* (WPK). The IdW is a professional organisation with voluntary membership, but most German auditors are members. The WPK is a public body under the supervision of the Federal Minister for Economic Affairs.
4. University professors of business economics with a special interest in accounting were represented through their own professional body by its Accounting Commission, the *Kommission Rechnungswesen* (KRW). A working party with voluntary membership was set up to develop the recommendations which were then presented as an official submission on behalf of the Business Economics Association.

A full list of the statements made by each of these organisations in response to the successive legal drafts is given below.

1. **Statements following the publication of the 4th European Company Law Directive and before the first draft of the German law**

GEFIU (1978), Hauptthesen zur Übernahme der 4. EG-Richtlinie in das deutsche Aktiengesetz, *Der Betrieb*, 1464–6.
GEFIU (1979), Vorschlag zur Umsetzung der 4. EG-Richtlinie in deutsches Aktienrecht, *Der Betrieb*, Beilage 3, 1–8.
IdW (1979), Zur Transformation der 4. EG-(Bilanz-)Richtlinie in nationales Recht, *Der Betrieb*, 1237–42 and 1296–300.
KRW (1978), Reformvorschläge zur handelsrechtlichen Rechnungslegung, *Die Betriebswirtschaft,* 453–5.
KRW (1979), Reformvorschläge zur handelsrechtlichen Rechnungslegung, *Die Betriebswirtschaft*, 1–70.
SPVdW (1979), Zur Durchführung der 4. EG-(Bilanz-)Richtlinie, *Der Betrieb*, 1093–7.

2. **Statements following the release of the pre-draft of the law by the Ministry of Justice** – Bundesminister der Justiz: Erster Vorentwurf eines Gesetzes zur Durchführung der Vierten Richtlinie des Rates der Europäischen Gemeinschaften zur Koordinierung des Gesellschaftsrechts von 1980 (mit Begründung), Az. 9522/1–3–1a SH3.

GEFIU (1980), Stellungnahme zum Vorentwurf eines Gesetzes zur Durchführung der 4. EG-(Bilanz-) Richtlinie zur Koordinierung des Gesellschaftsrechts (Bilanzrichtlinie-Gesetz) von 1980, *Der Betrieb*, Beilage 12, 1–12.
IdW/WPK (1980), Gemeinsame Stellungnahme der Wirtschaftsprüferkammer und des Instituts der Wirtschaftsprüfer zum Vorentwurf eines Bilanzrichtlinie-Gesetzes, *Die Wirtschaftsprüfung*, 501–23.
KRW (1980), Stellungnahme zum Vorentwurf eines Bilanzrichtlinie-Gesetzes vom 5.2.1980, *Die Betriebswirtschaft*, 589–97.
SPVdW (1980), Erste Stellungnahme zum Vorentwurf eines Bilanzrichtlinie-Gesetzes, *Betriebsberater*, Beilage zu Heft 28, 1–12.

3. Statements following the publication of the draft law by the Ministry of Justice – Bundesminister der Justiz: Entwurf eines Gesetzes zur Durchführung der Vierten Richtlinie des Rates der Europäischen Gemeinschaften zur Koordinierung des Gesellschaftsrechts (Bilanzrichtlinie-Gesetz) vom 18.5.1981, Az. 3507/8–30784/81.

IdW/WPK (1981), Gemeinsame Stellungnahme der Wirtschaftsprüferkammer und des Instituts der Wirtschaftsprüfer zum Entwurf eines Bilanzrichtlinie-Gesetzes, *Die Wirtschaftsprüfung*, 609–621.

SPVdW (1981), Stellungnahme zum Entwurf eines Bilanzrichtlinie-Gesetzes – Stand 18.5.1981/30.6.1981, *Der Betrieb*, 2448–62.

4. Statements following the issue of the draft law by the government – Regierungsentwurf eines Gesetzes zur Durchführung der Vierten Richtlinie des Rates der Europäischen Gemeinschaften zur Koordinierung des Gesellschaftsrechts (Bilanzrichtlinie-Gesetz) vom 10.2.1982, BR-Drucksache 61/82 vom 19.3.1982 (BT-Drucksache 9/1878 vom 27.7.1982).

KRW (1983), Stellungnahme zum Regierungsentwurf eines Bilanzrichtlinie-Gesetzes, *Die Betriebswirtschaft*, 5–15.

SPVdW (1982), Stellungnahme zum Regierungsentwurf eines Bilanzrichtlinie-Gesetzes, Maschinenschrift (vom 12.10.1982), S. 1–47.

5. Statements following the second draft of the law – Regierungsentwurf eines Gesetzes zur Durchführung der Vierten Richtlinie des Rates der Europäischen Gemeinschaften zur Koordinierung des Gesellschaftsrechts (Bilanzrichtlinie-Gesetz) vom 3.6.1983, BR-Drucksache 257/83, BT-Drucksache 10/317 vom 26.8.1983.

IdW (1984), Stellungnahme zum Regierungsentwurf eines Bilanzrichtlinie-Gesetzes, *Die Wirtschaftsprüfung*, 125–140.

SPVdW (1984), Stellungnahme der Spitzenverbände zum Bilanzrichtlinie-Gesetz, *Der Betrieb*, Beilage 7, 1–12.

6. Statements following the Parliamentary Commission established following a change of government to modify the legal objectives of the accounting law – Unterausschuß 'Bilanzrichtlinie-Gesetz': Entwurf einer geänderten Konzeption von Vorschriften des Bilanzrichtlinie-Gesetzes vom 29.3.1985, in: Stenographisches Protokoll über die 17. Sitzung des Unterausschusses Bilanzrichtlinie-Gesetz vom 9.5.1985, Anlage 2, 1–53.

GEFIU (1985), Stellungnahme zum Entwurf einer geänderten Konzeption von Vorschriften des Bilanzrichtlinie-Gesetzes vom 29.3.1985, in: Stenographisches Protokoll, Anlage 1, 101–20.

IdW/WPK (1985), Gemeinsame Stellungnahme zur geänderten Konzeption des Bilanzrichtlinie-Gesetzes, *Die Wirtschaftsprüfung*, 349–53.

KRW (1985) Stellungnahme zum Neuentwurf eines Bilanzrichtlinie-Gesetzes vom 15.5.1985, Stenographisches Protokoll, Anlage 1, 136–52.

SPVdW (1985), Entwurf einer geänderten Konzeption von Vorschriften des Bilanzrichtlinie-Gesetzes (BT-Drucksache 10/317), soweit sie im dritten Buch des HGB enthalten sind, Stenographisches Protokoll, Anlage 1, 57–87.

7. Statements following the revised draft law – Entwurf eines Gesetzes zur Durchführung der Vierten Richtlinie des Rates der Europäischen Gemeinschaften zur Koordinierung des Gesellschaftsrechts (Bilanzrichtlinie-Gesetz) vom 1.8.1985, in: Stenographisches Protokoll über die 18./19. Sitzung des Unterausschusses Bilanzrichtlinie-Gesetz, vom 23./24.9.1985, Anlage 2, S. 1–121.

GEFIU (1985), Stellungnahme zum Entwurf eines Gesetzes zur Durchführung der 4., 7. und 8. EG-Richtlinie zur Koordinierung des Gesellschaftsrechts vom 1.8.1985, in: Stenographisches Protokoll, 134–55.

IdW/WPK (1985), Gemeinsame Stellungnahme zum Entwurf eines Bilanzrichtlinie-Gesetzes, *Die Wirtschaftsprüfung*, 537–53.

KRW (1986), Stellungnahme zur Umsetzung der 4. und 7. EG-Richtlinie (Bilanzrichtlinie-Gesetz) vom 17.9.1985, *Die Betriebswirtschaft*, 85.

8. Statements following the parliamentary debate and the enactment of the law – Entwurf eines Gesetzes zur Durchführung der Vierten Richtlinie des Rates der Europäischen Gemeinschaften zur Koordinierung des Gesellschaftsrechts (Bilanzrichtlinie-Gesetz) vom 18.11.1985, BT-Drucksache 10/4268 & Gesetz zur Durchführung der Vierten Richtlinie des Rates der Europäischen Gemeinschaften zur Koordinierung des Gesellschaftsrechts (Bilanzrichtlinie-Gesetz) vom 19.12.1985, BGBl. I, 1985, 2355ff.

GEFIU (1986), Thesen zu ausgewählten Problemen bei der Anwendung des Bilanzrichtlinien-Gesetzes, *Der Betrieb*, 1985–8 & 2553–6.

As elsewhere, the preparers of accounts and the auditors are among the most active groups. This phenomenon can be explained by economic reasoning (Ordelheide, 1997) as, compared to most other groups, preparers and auditors have a greater interest in the outcome as well as more resources to act on, both in terms of knowledge and funding. This is also true of the main users of accounts – the German banks – but they are not among the most active groups in Germany. The banks are both preparers and users, and their membership of the Combined Business Associations through the BDI tends to restrict their activity to lobbying as preparers. The associations of bankers made no statements during the legal reform process and they did not participate in any of the hearings. There was no evidence of silent lobbying either. This limited extent of lobbying by German banks can be explained by the fact that, in Germany, the banks have greater access to private information on companies which thus reduces their interest in public information.

The *Schutzvereinigung für Wertpapierbesitz*, a private organisation which acts in the interests of the shareholders of stock corporations, commented only twice (including once at the final hearings). One explanation for the relatively inactive lobbying of shareholders' associations may be the fact that, in addition to large listed corporations, the Fourth Directive addresses small and medium-sized corporations which are usually management-owned. Thus, the interests of both management and shareholders coincide. Furthermore, private shareholding in listed companies is less important in Germany than in the USA or the UK.

An analysis of the lobbying recommendations reveals that the KRW, the organisation representing accounting academics, supported the users' position (less discretion and more information) and the shareholders' viewpoint was consequently put forward. It is worth noting that German academics were particularly active in the lobbying process, comparable in extent to that of US academia, as reported in the Tandy and Wilburn study. The involvement of German professors in the process of accounting law reform has a long tradition, but previously in the form of individual comments only. In fact, on this occasion, a substantial number of professors did not participate in the development of the recommendations which indicates that the joint activity this time might well have been the result of special circumstances. Compared to other groups, academics have no personal financial interest and their active lobbying cannot be explained directly by economic reasoning. However, the fact that academics are active and successful in the lobbying process adds to their reputation which may be used to advantage in other situations. It seems that academics consider themselves as guardians of the accounting system, concerned not only about its effectiveness but also with the achievement of objectives agreed upon in society.

Conflict and Compromise in the Writing of Accounting Law

Apart from the many areas of accounting method and disclosure dealt with in this legislative programme, four general issues were also raised at the time which led to disagreement between the various interest groups. These were a proposal to integrate all accounting rules into a central accounting law, the possibility of applying the new rules to the GmbH & Co. KG, the implementation of the 'true and fair view' principle into German commercial law and the foundation of a German Accounting Standards Board. A detailed description of the manner in which each of these issues was eventually treated in law highlights the political nature of accounting regulation. In each case, the solution preferred by industry became law, in spite of alternative proposals. The auditors, if participating at all, supported the position of industry.

Consolidating the Law on Accounting

Before the BiRiLiG, accounting law was contained either in the HGB which was relevant to all businesses or in separate acts by way of rules appropriate to special forms of business, especially to stock corporations in the AktG 1965. Specific valuation criteria, financial disclosure formats and group accounts were regulated by the AktG 1965 and its introductory law. In this regard, the KRW (1979, p.5) proposed the consolidation of the legislation not only to reduce the number of laws and sections of laws and to achieve greater clarity, but also because the more rigid provisions of the AktG 1965 relevant to stock corporations appeared in the meantime to have been generally accepted in practice as principles of proper book-keeping (GoB) appropriate to all enterprises. These proposals were opposed by the SPVdW (1979) and GEFIU (1980), who argued that different legal forms should be governed by different accounting requirements and that this could best be achieved by maintaining the present structure of separate legislation. The SPVdW also opposed the view that the specific rules of the AktG had become generally applicable to all forms of business.

The Ministry of Justice compromised not by establishing a separate accounting act but by adding a Third Book to the commercial code (HGB). In subsequent drafts, more and more provisions were added to the Third Book. Up to 1983, these were formulated independently for each legal form, but it was then proposed that exemptions would be integrated into those specific provisions which required different application in the case of non-corporations. The draft law was again opposed by the SPVdW (1984, p.3), arguing that there was a risk that the rules for corporations would then become relevant for non-corporations too.

This process of conflict and compromise led to the present structure of the BiRiLiG, in which there is a general section relevant to all businesses (HGB §§238–263) and a special section for corporations only (HGB §§264–335). Indeed, the solution was agreed upon at a public hearing by the SPVdW and GEFIU (Protokoll 1985, pp. 2–16). The IdW (1985, p.349) did not participate in this discussion to any great extent but finally gave its agreement as well.

Regulating Commercial Partnerships

Following the spirit of the Fourth Directive, commercial partnerships in which the unlimited partner is a limited liability company (GmbH&Co. KG) were treated like corporations in all drafts of the law until the draft prepared by the government in 1982 (Regierungsentwurf 1982). This came about against the wishes of the Liberal Party ministers in the Social-Liberal coalition (Tenhof 1985, p. 93). Those in favour of the original position argued that, for reasons of creditor protection, the GmbH&Co. KG should be treated like a limited liability corporation, especially because of the number of these which appeared in the insolvency statistics (BR-Drs. 61/82, 1982, pp. 63–4). The counterarguments put forward by Tenhof (1985) were used by the SPVdW (1981, 2449–50) to oppose this viewpoint and to favour the perceived interests of the middle range businesses (*Mittelstand*). In the public hearing of May 1985, GEFIU (1985, p. 111) supported the SPVdW's point of view whilst the academics (1985, p. 104) opposed it and the IdW made no concrete recommendation. In the final version of the law, the recommendation of the SPVdW was adopted.

The 'true and fair view' principle

Here again the propositions of the KRW on the one hand and those of the SPVdW and the GEFIU on the other were in conflict. The KRW (1979, p. 11) supported the unrestricted codification of the true and fair view principle in order to strengthen the orientation of the law in the direction of ensuring the publication by companies of information that would be useful. Under the KRW proposal, the interests of creditors would be protected by obliging companies to pass unrealised profits disclosed under the true and fair principle to an undistributable reserve. Once again, however, the more restrictive proposals of the SPVdW (1979, p. 1094) and GEFIU (1979, p. 2) were to succeed, with the IdW (1979, p. 1237) arguing a similar case. A moderating factor in this conflict of interests was the use of the notes to the accounts as an instrument to mediate between the two positions, for instance by requiring additional information in the notes in cases where the balance sheet and profit and loss account do not give a true and fair view. For more information on the true and fair principle in Germany, the reader may wish to consult Busse von Colbe (1984), Alexander (1993, 1996) and Ordelheide (1993, 1996).

The Creation of a German Accounting Standards Board

Another change proposed by the KRW (1979, p. 6) concerned the creation of a German Accounting Standards Board whose recommendations should be given an authoritative basis by transforming them into enforceable orders of the legislator. This proposition was included as an option in the first predrafts of the new act. In the second draft, the opposing arguments put forward by the SPVdW (1979, p. 1095), certain influential auditors and accountants (such as Schulze, 1979, p. 44) were accepted and the option was removed from the draft law.

Issues of Accounting Method and Financial Disclosure: the Propositions of the Main Lobbying Groups and their Outcomes

As mentioned earlier, there were altogether 167 separate issues concerning accounting method and disclosure for which recommendations were made (see the Appendix). Among them there were significant issues, such as the decision on whether the capitalisation of pension provisions should be made compulsory, as well as many other issues of lesser importance, such as whether rights should be shown under tangible assets.

The success of a particular group in the lobbying process can be measured by comparing the proposals made by that group with the legislative outcome. The complexity of this process can be simplified by comparing the first statement issued by an interest group with respect to each accounting problem with the final result, leaving the intervening process of compromise aside at this stage. The complexity of the lobbying process can be further reduced by grouping the two industry associations into one, as they did not produce conflicting statements and presumably coordinated the development of their responses to the legal drafts.

In the Appendix, the eventual position in law is given for each of the accounting issues raised by the lobbying groups, along with an indication of the lobbying positions, that is, no comment (0), success (1) or failure (2). It is on the basis of such information that we are able to obtain an *a posteriori* measurement of power in the regulatory process.

In 64 per cent of cases (107 out of 167), one or other of the lobbying groups' proposals were ratified in law, whilst the legislature adopted an approach in opposition to the lobbyists' proposals in 36 per cent of cases. Table 5.3 gives further insight into the relative success of the different interest groups. In the first column, the possible combinations of agreement and disagreement between the three groups is listed. The second column gives the number of suggestions made, and the number of successes and failures are given in the third and fourth columns respectively.

Table 5.3 Lobbying activity and the success of pressure groups in the implementation of the Fourth Directive in Germany

Suggestions by lobbyists	*Number of of cases*	*Number of successes*		*Number of failures*
i , a , p	9	7		2
i , $a \leftrightarrow p$	9	i , $a = 8$	$p = 1$	0
i , $p \leftrightarrow a$	1	i , $p = 1$		0
a , $p \leftrightarrow i$	11	a , $p = 3$	$i = 8$	0
$i \leftrightarrow a \leftrightarrow p$	0	–		–
i , a	14	10		4
$i \leftrightarrow a$	4	$i = 3$	$a = 1$	0
i , p	5	5		0
$i \leftrightarrow p$	16	$i = 10$	$p = 6$	0
a , p	5	3		2
$a \leftrightarrow p$	0	–		–
i	44	23		21
a	23	11		12
p	26	7		19
	167	107		60

i industry associations
a auditor institutes
p university professors
, identical or very similar suggestions
$\leftrightarrow$ conflicting suggestions

For example, similar suggestions were made by industry, auditors and professors (i, a, p) in nine cases, and this coalition succeeded seven times. On the other hand, there were nine issues on which industry lobbied in the same way as the auditors whilst the university professors made a dissimilar proposal (i, $a \leftrightarrow p$), the coalition of industry and auditors being successful in eight of those cases. On 15 issues, lobbying on behalf of industry was in conflict with the view expressed by the professors whilst the auditors remained silent ($i \leftrightarrow p$), industry succeeding in ten of these cases and the professors in five. When industry made the only proposal (that is, there was no comment from either the auditors or professors), there were 23 successes out of 44 proposals.

Assuming that political success depends on the political effort of the interest groups and increases with the number of interest groups engaged in lobbying for a similar outcome, then it must hold that for all proposals for which there are no alternatives, the political influence is smallest if it is supported by one interest group only. Political success would increase if another interest group were to join in. If all interest groups are in support of one proposal, political success is expected to be at its maximum.

In 75 per cent of cases, there were no conflicting suggestions. Proposals by only one interest group were successful in 44 per cent of cases (41 out of 93), where the success ratio was larger for industry with 52 per cent (23 out of 44) than for auditors with 48 per cent (11 out of 23). For academics, the success ratio was only 27 per cent (7 out of 26). However, in the case where there is agreement between two parties, the success ratio increases for industry to 79 per cent (15 out of 19), for auditors to 68 per cent (13 out of 19) and for academics to 80 per cent (8 out of 10), and for all coalitions of two groups together to 75 per cent (18 out of 24). The success ratio is 78 per cent (7 out of 9) when all three groups supported the proposals.

Political conflict exists if the interested parties support opposing proposals. This happened with respect to 25 per cent (41 out of 167) of the issues. Political conflict did not strengthen the position of the law-maker, however, in the sense that it might have led to provisions in law that had not been suggested by any of the lobbyists. Rather, in all 41 cases of conflict, the eventual law had been supported by at least one of the groups.

Conflict between industry and the academic lobbyists occurred in 88 per cent of the cases where there was disagreement (36 out of 41), with support on 20 of these issues from the auditors being spread almost equally between the two (industry 9, academics 11). Those cases in which the audit profession came out against industry and/or university professors were relatively rare (five cases), especially if compared to the opposition of academics to industry and/or auditors (25 cases) and the opposition of industry to auditors and/or professors (31 cases).

It is clear from the above that the industry associations – that is, the preparers of accounts – were especially successful. In 73 per cent (30 out of 41) of the conflicts with one or both of the other groups in opposition, industry was still successful. The comparable success rate for the auditors was 48 per cent (12 out of 25) and for the academics it was only 30 per cent (11 out of 37). The relatively high success rate of the auditors resulted from their coalition with industry, with 67 per cent (8 out of 12) of such proposals becoming law, whereas the university professors of accounting were mainly successful when they opposed industry: that is, 91 per cent (10 out of 11) of the academic lobbying group's successes were against industry. Finally, coalitions involving industry and opposed by either the auditors or the academics had a 90 per cent success rate (9 out of 10), whereas coalitions against industry had only a 27 per cent success rate (3 out of 11). (Further details, including statistical significance tests, are given in McLeay, Ordelheide and Young, 1999.)

To conclude, the process of formulating accounting regulation in Germany can be summarised as follows:

(a) the development of accounting rules in the kind of legalistic system found in Germany is mainly carried out by experts acting on behalf of interest groups in society;
(b) consensus among those groups which lobby the law-makers in Germany is substantially more important than conflict between them (opposition between academia and industry being the main source of conflict);
(c) when there is disagreement, industry tends to be the most powerful group;

(d) as the degree of consensus between the experts representing different interest groups increases, the success rate of the proposal to modify the legislation also increases and the dominant influence exerted by industry becomes less important.

Appendix: Propositions by lobbying groups and specific provisions in the BiRiLiG

Specific regulations included in the Bilanzrichtlinie-Gesetz	*Lobbying groups*		
	Academics	*Auditors*	*Preparers*
	0 = no comment is made by pressure group 1 = proposal succeeds in becoming law 2 = proposal fails to become law		
1. Recognition			
1.1 Fixed assets and intangibles			
a) No explicit regulation for leased assets	2	0	0
b) Prohibition of capitalisation of self produced intangible fixed assets	1	1	1
c) Mandatory capitalisation of acquired intangible fixed assets	1	0	2
d) Definition of intangible fixed assets restricted to that in AktG §151	0	0	1
e) Optional capitalisation of acquired goodwill	1	1	1
f) No restriction on profit distributions if acquired goodwill is capitalised	2	0	0
g) Capitalisation of start-up and expansion expenses restricted to corporations	0	1	0
h) Capitalisation of expansion expenses as an accounting convenience	2	2	1
i) Restriction on profit distributions if start-up and expansion expenses are capitalised	1	0	1
j) No prohibition to capitalise self-produced intangible current assets	0	2	0

Specific regulations included in the Bilanzrichtlinie-Gesetz	*Lobbying groups*		
	Academics	*Auditors*	*Preparers*
k) Membership in a registered cooperative should not be capitalised as a participation	0	0	1
l) Membership in a commercial partnership which fulfils the prerequisites of HGB 271 No. 1 has to be capitalised as a participation	0	0	2
m) No regulation on how to deal with the disposal of goodwill	0	2	0
1.2 Pre-paid expenses and deferred income			
a) Only transitory pre-paid expenses to be included under pre-paid expenses	1	1	1
b) Optional capitalisation of loan redemption premiums	2	0	1
c) Optional capitalisation of special taxes (customs and consumption tax and turnover taxes on payments on account)	0	2	2
1.3 Equity			
a) No explicit definition of subscribed capital for special partnerships	2	2	0
b) Explicit regulation for the building and release of retained earnings for limited liability companies	1	0	0
c) No explicit order for the release of reserves	2	0	0
d) 'Reserve for the acquisition of own shares' is mandatory for limited liability companies	1	0	2
e) No regulation for the release of 'acquisition of own shares reserve'	0	2	0
f) No requirement to disclose reductions in 'acquisition of own shares reserve'	2	0	0
1.4 Entity			
a) No recognition of the assets of partners with unlimited liability in the partnership accounts	1	1	0

Specific regulations included in the Bilanzrichtlinie-Gesetz	*Lobbying groups*		
	Academics	*Auditors*	*Preparers*
1.5 Liabilities and provisions			
a) Equity substituting loans must be shown as liabilities	0	1	1
b) Loans which must not be settled in case of bankruptcy or conciliation should not be recognised as capital reserve	0	1	0
c) Mandatory provision for pension liabilities	1	1	2
d) Mandatory provision for guarantees with no contractual obligation	1	1	0
e) Mandatory provision for repairs and maintenance expenses postponed up to 3 months after the balance sheet date	1	0	1
f) Optional provision for repairs and maintenance expenses postponed between 4 and 12 months after the balance sheet date	2	0	1
g) Provisions for repairs and maintenance expenses to cover all repairs (as opposed to major repairs only)	0	1	1
h) Mandatory provision for land reclamation expenses	1	0	1
i) Prohibition of further provisions extends to non-corporations (as well as to corporations)	1	2	2
j) Provisions according to HGB § 249 No. 2 for expenses may be set up if the expenses are likely or proved at the balance sheet date	0	0	1
k) Limitation of provisions to the purposes listed in HGB 249 for all legal forms and businessmen	0	0	2
l) Public-legal provisions are not explicitly mentioned in HGB § 249	0	0	2
m) No provisions for fictitious taxes in order to make accounts of sole traders and partnerships comparable with corporate accounts	0	0	2

Specific regulations included in the Bilanzrichtlinie-Gesetz	Lobbying groups		
	Academics	*Auditors*	*Preparers*
1.6 Effects of the tax code			
a) Mandatory recognition of deferred tax liabilities	1	1	2
b) Optional capitalisation of deferred tax assets	2	2	2
c) Restrictions on distributions in the case of deferred tax assets	1	0	0
d) No restrictions on the netting-off of deferred tax assets and liabilities	0	2	1
e) Optional disclosure of tax-based depreciation under 'special item with a reserve component'	0	1	1
f) Optional disclosure of taxfree reserves under 'special item with a reserve component'	0	0	1
g) New accounting rule for deferred tax assets and liabilities	0	2	0
1.7 Contingent liabilities			
a) All businessmen must show also warranties under contingent liabilities	0	1	0
b) Off-balance sheet disclosure of contingent liabilities obligatory for all companies	0	1	0
2. Valuation Principles			
2.1 Acquisition and production cost			
a) Comprehensive definition of acquisition and production costs	1	0	2
b) Use of the equity method prohibited	2	1	1
c) No explicit regulation for foreign currency translation (receivables, liabilities)	2	0	0
d) Acquisition costs contain costs incurred to make an asset ready for operation	0	0	2
e) Subsequent costs are only included if timely connection with acquisition	0	1	0
f) Capitalisation of incidental expenses restricted to direct costs only	0	2	0

Specific regulations included in the Bilanzrichtlinie-Gesetz	*Lobbying groups*		
	Academics	*Auditors*	*Preparers*
g) Optional valuation for barter transactions	2	1	1
h) Direct costs as minimum value for production cost	1	0	2
i) Necessary and adequate for the inclusion of material and manufacturing overheads in production cost	0	2	2
j) Selling expenses excluded from production cost	2	2	2
k) Optional inclusion of interest in production cost	0	1	0
l) Interest treated as an optional item for acquisition costs of products	0	1	1
m) Interest capitalised as production cost is not an accounting convenience	0	0	2
n) No distinction between direct and indirect attributable expenses in the definition of production cost	0	0	1
2.2 Write-downs and depreciation			
a) Write-down of financial fixed assets to lower attributable value in case of temporary reduction	2	0	1
b) Optional write-down of current assets in order to avoid changes of value in near future	2	1	1
c) Option to write down all fixed assets to lower current value in case of temporary reduction in value (non corporations)	0	0	1
d) Depreciation of goodwill of at least one-quarter in every subsequent financial year	0	0	2
e) Possibility for depreciation of goodwill in the tax account, too	0	1	1
f) Depreciation of at least one-quarter in the subsequent financial years for start-up expenses	0	0	2
g) Lower attributable value if market price does not exist	1	0	0

Specific regulations included in the Bilanzrichtlinie-Gesetz	Lobbying groups		
	Academics	Auditors	Preparers
2.3 Hidden reserves			
a) Additional depreciation according to reasonable businessman's judgement permitted for non-corporations	2	0	1
b) No specification of conditions for additional depreciation	0	0	1
2.4 Write-ups and write-backs			
a) Write-backs must pass the P&L (Profit and Loss) account	0	0	1
b) Mandatory write-backs for corporation only if no tax consequences	2	0	1
c) Option to built a non-distributable reserve in case of write-backs	0	0	1
d) 'Reserve for write-backs' made either in the amount of the write-back or net of tax	0	1	1
e) Undistributable reserve for write-backs to be built via the appropriation account	1	0	2
2.5 Simplified valuation methods			
a) Base stock valuation restricted to insignificant items	0	0	2
b) Base stock also applicable to non-movable assets	0	1	1
c) LIFO, FIFO etc. restricted to inventory items only	0	2	2
d) Besides the average cost method only time-oriented methods (LIFO, FIFO), but no other simplified methods (HIFO) are allowed	0	0	2
e) No explicit regulation that average cost method cannot be applied to machinery and equipment	2	0	0
2.6 Further valuation principles			
a) Consistency principle obligatory for all legal forms of business	1	1	2
b) Option to depreciate goodwill over either 5 years or useful economic life	2	0	1

Specific regulations included in the Bilanzrichtlinie-Gesetz	Lobbying groups		
	Academics	*Auditors*	*Preparers*
c) Maximum period for depreciation of capitalised start-up and expansion expenses restricted to 5 years	1	0	2
d) Acceptance of an interest rate interval in the discounting of pension obligations	1	0	1
e) No explicit legal rule regarding the highest-value principle for liabilities	2	0	0
f) Continuation of 'reverse authoritativeness principle' in tax rules	2	0	0
g) Depreciation in tax accounts is also allowed for financial accounts, too	2	0	1
h) No explicit materiality principle for individual accounts	0	0	2
i) Broad definition of extraordinary expenses and revenues	0	0	2
j) No definition of current assets	0	1	0
k) Assets: ... which are proven at the balance sheet date ...: do not leave out time reference in the definition of fixed assets	0	2	2
l) No obligation to value provisions necessarily at the present value of future cash outflows	0	1	1
3. Formats			
3.1 Equity			
a) No distinction between equity of limited and unlimited liability partners	2	2	1
b) Optional treatment for uncalled contributions	0	0	1
3.2 Format of the balance sheet			
a) Account format as obligatory format for the balance sheet	1	1	1
b) Abbreviated format for small corporations	0	1	1
c) Format of the balance sheet mandated in law	0	1	1
d) No explicit format for non-corporations but a minimum structure according to HGB § 246.	2	0	1

Specific regulations included in the Bilanzrichtlinie-Gesetz	*Lobbying groups*		
	Academics	*Auditors*	*Preparers*
e) Requirement for sufficiently detailed classification of B/S accounts	1	1	0
f) Optional (rather than mandatory) aggregation of classification levels when at individual classification level the items are immaterial	0	0	1
g) No further classification of balance sheet items beyond that proposed in the 4th Directive	2	2	1
h) Optional (rather than mandatory) prior year adjustments	2	1	1
i) For disclosure of subscribed capital neither the obligations to pay up share nor the maximum amount of liability has to be disclosed	2	0	0
j) No position 'amounts receivable from shareholders'	0	2	0
k) Explicit position for other assets in the balance sheet format	0	1	0
l) Disclosure of shares on ruling corporations or corporations with a majority of shares under the position 'own shares'	0	1	0
m) A loss should be openly disclosed on the liability side of the balance sheet in a pre-column to the annual profit	0	2	0
n) No disclosure of not accounted performances under 'accounts receivable'	0	2	0
o) Joint disclosure of all prepaid expenses which do not belong to fixed assets under a special position of inventory	0	0	1
p) Real property like rights belong to tangible assets	0	0	2
q) No separate item for general allowances on accounts receivable	0	0	1
r) No extra disclosure of loans which are secured by encumbrances in real property	0	0	1

Specific regulations included in the Bilanzrichtlinie-Gesetz	*Lobbying groups*		
	Academics	*Auditors*	*Preparers*
3.3 Format of the P&L (Profit and Loss)			
a) Presentation of P&L account using vertical format	1	1	1
b) Option to use either total cost or cost of sales method in the P&L account	2	1	1
c) No explicit regulation for separate disclosure of subsidies	2	0	0
d) Restriction on extraordinary income and expenses to 'rare items'	2	0	1
e) No further break-down of the item ('other operating income and expenses')	2	2	1
f) Income and expenses at set up or release of special items with an equity portion must be disclosed separately in P&L or in the notes	0	1	0
g) Income from letting and leasing to be treated as turnover	1	0	0
h) Turnover and increase in stocks explicitly defined in law	0	0	2
i) No explicit definition of the increase in the stock value of self-produced fixed assets	0	0	1
j) No additional intermediate aggregate positions in the P&L accounts	2	1	1
k) No inclusion in the P&L account of a position called 'results from consolidated companies'	2	0	0
l) Option to aggregate first six positions in the P&L into one item called 'gross results'	2	1	1
m) Tax expense in the P&L account of corporations not covered by corporation tax law to be based on the individual income tax of the owners	1	0	0
n) No distinction of tax expenses according to 'taxes on income of normal business activity' and 'taxes on extraordinary income'	0	1	0

Specific regulations included in the Bilanzrichtlinie-Gesetz	*Lobbying groups*		
	Academics	*Auditors*	*Preparers*
o) Taxes on income must not be disclosed together with assets taxes	0	0	2
p) Positions which refer to associated companies have to be disclosed separately in the profit and loss account	1	0	0
4. Notes			
4.1 Valuations			
a) No requirement to disclose hidden reserves in the notes	2	0	1
b) Mandatory disclosure in the notes of the difference between book value derived using the base stock methods and market value	0	0	2
c) Disclosure in the notes of the effect (not the amount) of a change in valuation methods	2	2	1
d) No inclusion of non-scheduled depreciation in the mandatory disclosure of the differential amount according to HGB § 284 No. 4	0	0	1
e) No clear rule for the disclosure of the direction (+ or –) of the differential amounts	2	0	0
f) Prohibition to offset differential amounts from changing valuation methods	0	2	1
g) Differential amounts must also be disclosed if they do not exceed 10% of net profit	1	2	1
h) Disagio must also be disclosed in the notes	0	0	1
4.2 Pre-paid expenses and deferred income			
a) Option to disclose the redemption premium on loans either under deferred assets or in the notes	0	0	1
4.3 Provisions			
a) No requirement to disclose the discount rate for pension liabilities in the notes	2	0	0

Specific regulations included in the Bilanzrichtlinie-Gesetz	*Lobbying groups*		
	Academics	*Auditors*	*Preparers*
b) Mandatory disclosure of off-balance sheet pension obligations in the notes for corporations only	0	2	0
c) No requirement to recognise off-balance sheet pension obligations under 'financial commitments'	2	0	0
4.4 Commitments			
a) Option to disclose financial commitments either in the balance sheet or by way of the notes	2	2	1
b) No disaggregation of financial commitments for non-corporations	2	2	1
c) No separate disclosure of liabilities associated with finance lease contracts	0	2	1
d) No examples of 'other financial commitments' listed in the legal provisions	0	0	1
e) No obligation to explain certain financial obligations like tenancy and leasing agreements, obligations from investment projects already started, future general overhauls, and measures for environmental protection	0	2	0
f) Disclosure of 'other financial obligations' not restricted to obligations outside the normal corporate and industrywide scope	0	0	2
4.5 P&L			
a) Requirement to disclose a break-down of material expenses in the notes if cost of sales method is used	1	0	0
b) Requirement to disclose a break-down of personnel expenses in the notes if cost of sales method is used	0	1	0
c) No requirement to disclose 'other own work capitalised' in the notes if cost of sales method is used	2	0	0
d) No decomposition of profit taxes according to ordinary and extraordinary results	1	1	1

Specific regulations included in the Bilanzrichtlinie-Gesetz	Lobbying groups		
	Academics	Auditors	Preparers
4.6 Balance sheet			
a) No requirement for general partnerships and sole traders to disclose notes	0	0	1
b) Mandatory disclosure of a schedule of fixed assets in the balance sheet of general partnerships and sole traders	0	0	2
c) Mandatory disclosure of a break-down of depreciation with an attachment to fixed assets	0	0	2
d) No requirement to disclose cumulative write-ups	0	0	1
e) No explicit rule governing the treatment of low value business goods in the fixed assets schedule	2	2	0
f) In case of applying the new law for the first time, book value of assets may be stated at a fictional acquisition cost only when the information on factual acquisition costs is too costly to obtain	0	0	2
g) No requirement to disclose a schedule of movements on current assets	2	0	0
h) No requirement to disclose a schedule of movements on equity	2	0	0
i) Appropriation of profit disclosed either on the face of the P&L or in the notes	1	0	1
j) Separate disclosure of write-downs on current assets	0	0	2
4.7 Additional disclosures			
a) No requirement to disclose a funds statement	2	1	1
b) No requirement for revaluation accounting in the notes	2	2	1
c) No requirement for value-added accounting in the notes	2	0	0
d) No restrictions on information disclosed in the notes	1	0	0
e) Obligation to disclose advances and credits according to HGB § 285 No. 9c	0	2	0

Specific regulations included in the Bilanzrichtlinie-Gesetz	*Lobbying groups*		
	Academics	*Auditors*	*Preparers*
f) Voluntary disclosure in the notes is possible	0	0	1
g) No obligation to explain the position 'loss not balanced by equity' in the notes	2	0	0
h) No obligation to disclose future general overhauls and investments	0	1	0
i) Obligation to present a management report depending on legal form, not on size of corporation	0	0	2

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6 Greece

George Venieris

INTRODUCTION

Greece is a presidential parliamentary democracy. According to the Greek constitution, the legislative power is exercised by Parliament although, on special occasions, the President of the Republic can perform this function. While judicial power is exercised by the courts of law, executive power is exercised by the government and its ministers. In fact, the government is the only true rule-issuing body in Greece, and therefore it is the government which issues the rules for financial reporting.

There are two main reasons for the Greek government's direct involvement in financial reporting: first, tax liabilities in the corporate sector are calculated on the basis of published financial statements; second, these statements must be accurate, clear and reliable, containing undisputable information to be used by investors in the capital and money markets.

As taxes collected from the corporate sector represent a significant proportion of total taxes, the concern of the government to regulate financial reporting is self-evident. For the period 1991–94, the Bank of Greece (1994) states that the contribution of corporate income tax to total direct taxation and the contribution of value added tax to total indirect taxation was as follows:

	1991	*1992*	*1993*	*1994*
Corporate income tax: total of direct taxation	18.8%	19.9%	21.1%	20.6%
Value Added Tax: total of indirect taxation	31.2%	29.4%	39.7%	43.1%

The corporate sector has grown substantially in recent years. For instance, the number of industrial companies in Greece increased from 3210 in 1986 to 4112 in 1990 while the number of commercial companies increased from 2753 in 1986 to 4180 in 1990. Given the existence in 1990 of another 2022 companies rendering services, a total of 10 314 companies published end-of-year financial statements. It is these companies which are subject to financial reporting regulations in Greece.

The legal form of these companies is predominantly either that of the 'société anonyme' (*ανώνυμη εταιρεία*) or the 'limited liability company' (*εταιρεία περιορισμένης ενθύνης*). A 'société anonyme' is a company whose equity capital is divided into shares that can easily change hands, and is similar in form to a 'public company limited by shares'. The minimum capital required for the formation of a 'société anonyme' (except for banks, insurance and financial companies) is 10 000 000 drachmas. The shareholders' liability is limited to their participation in the société anonyme's common capital. A limited liability company, on the other hand, is a company whose common capital is divided into lots. The minimum capital required for the formation of a limited liability company is 3 000 000 drachmas and the liability of the partners is either limited to their participation in the company's common capital or extended to their personal property (for example, in the case of debts to social security organisations). Whilst the advantages of limited liability companies are that less capital is required for their formation and that partners do not have unlimited liability, as in partnerships or other types of personal companies, the requirements for financial disclosure are similar to those of the société anonyme.

At the begining of the 1990s, according to ICAP (1992), the basic financial characteristics of companies that published end of year financial statements were as follows:

	Industrial companies	*Commercial companies*	*Service companies*
Net income: total assets	1.9%	5.4%	0.2%
Net income: own capital	6.7%	20.9%	3.8%
Debt: total assets	71.1%	74.4%	8.3%
Net income: number of employees (drachmas)	251 000	895 000	262 000

Table 6.1 Liabilities of Greek industrial companies (%)

	Short-term liabilities		*Long-term liabilities*		
Time period	*To banks*	*To other companies*	*To banks*	*To other companies*	*Total*
1975–79	32.9	34.9	24.2	8.0	100.0
1980–84	33.5	37.7	22.2	6.6	100.0
1985–89	33.0	44.0	17.6	5.4	100.0
1990–92	39.5	42.6	15.3	2.6	100.0

The high level of indebtedness reflects the fact that the banks are the major source of funds in Greece and, therefore, one of the main users of financial statements. In total, there are 27 commercial banks, three investment banks, four special purpose financial institutions, 32 branches of foreign banks and 10 leasing companies, which are all subsidiaries of banks. The analysis of the liabilities of industrial companies shown in Table 6.1 underlines the importance of funding by financial institutions, particularly in providing short-term finance.[1]

For many years, the banks operating in Greece encountered considerable difficulty in using published accounts to assess the financial position and the profitability of companies requesting loans. These difficulties were due to the fact that the financial statements published by Greek companies did not follow standard rules, despite the fact that most had been audited by external auditors. The difficulties experienced by the banks were lessened by the introduction of greater uniformity in company accounting after Greece's entry into the European Community. Representatives of the Greek Banking Association were influential members of the committee that formulated the GAP, the General Accounting Plan (*Ελληνικό Γενικό Λογιστικό Σχέδιο*), through which Greece implemented the Fourth and Seventh European company law directives. As will be explained later, such committees have played an important role in the process of preparing and issuing regulations in Greece, and it is primarily through their involvement in such committees that financial institutions and other providers of capital have exerted an influence over the development of accounting in Greece.

Table 6.2 The Athens Stock Exchange

	1988	*1991*	*1994*
Price index	279.65	809.71	868.91
Market capitalisation (in billion drachmas)	598.40	2 355.20	3 628.70
Trading value:			
Yearly (in billion drachmas)	44.38	437.55	1 262.05
Daily average (in million drachmas)	177.52	1 762.27	5 048.20
Trading volume (in million shares)	15.81	90.00	446.17
Capital raised (in million drachmas)	49 544.20	150 429.70	268 334.80
Listed companies	119	159	186
New listings	4	22	45

Source: ASE.

The other main source of long term financing for Greek companies is the Athens Stock Exchange, or ASE (*Χρηματιστήριο Αξιών Αθηνών*). The ASE has been in operation for the last 116 years, but it is during the last seven that its organisational and operational structure has changed substantially and this has attracted many more Greek as well as foreign, mainly institutional, investors (Niarchos, 1995). The statistics shown in Table 6.2 indicate the growing importance of the ASE as a source of capital as well as a market for equity trading.

Whilst investment analysts and investors themselves make considerable use of financial statements, their influence over financial disclosure and accounting methods is indirect, as is that of the banks. The only way in which they exert any influence over the rule-issuing process is via participation in various rule-preparing committees or by making complaints and suggestions to the administrators of the ASE, an approach which would also be categorised as indirect.

THE ACCOUNTING AND AUDITING PROFESSION IN GREECE

In Greece, training in accounting is provided in high schools, private colleges, institutions of technical education and universities.

An Institute of Certified Public Accountants (*Σώμα Ορκωτών Λογιστών*), the ICPA, was founded by law in 1955. In 1993 its structure changed and it has now been replaced by the Institute of Certified Auditors (*Σώμα Ορκωτών Ελεγκτών*), in accordance with the provisions of Presidential Decree 226/1992.

The ICPA was a state-supervised, self-governing body with members authorised to audit the financial statements of certain companies which met the criteria of the law. The ICPA often advised the government on accounting issues and contributed greatly to the structure of the GAP. In addition, some of its senior members participated in the National Council of Accounting (*Εθνικό Συμβούλιο Λογιστικής*) when it was first established. The ICPA was a member of the IASC and contributed to the incorporation of IASs into the body of regulations and recommendations in force in Greece. At one time, the ICPA maintained a so-called Technical Office which issued opinions that were adopted by its members. Membership requirements of the ICPA were very strict and were based on a combination of a university degree, work experience and the passing of specialised exams.

In 1979 the Association of Certified Accountants and Auditors of Greece (*Σύλλογος Εγκεκριμένων Λογιστών και Ελεγκτών*), was founded. This Association, known as the ACAA, consisted of independent professionals who audited companies which did not have to be audited by a member of ICPA. The clients of ACAA members were mainly subsidiaries of multinationals and the membership requirements of ACAA were also very strict. The ACAA has also been absorbed by the new Institute of Certified Accountants, the ICA.

The new ICA has a similar statutory function to the discontinued ICPA: that is, companies which satisfy two out of the following three criteria must be audited by members of the ICA: if they employ more than 50 persons, have total assets more than 400 million drachmas or turnover of more than 800 million drachmas. In addition, all companies listed in the ASE must be audited by members of ICA. In 1993, the ICA numbered about 1000 members, 600 of whom originated from the ICPA and the other 400 from the ACAA. There has been no considerable membership increase since that date.

In order to become a member of the ICA it is necessary to be a university graduate, having as a main subject graduated from a department where accounting is taught. It is also necessary to pass through four grades (that is, trainee, novice, assistant, full auditor), exercise the auditing profession for a certain period of time (that is, two or three years) at each of the first three grades and sit professional qualifying exams at the end of each period.

The influence of the ICA in the preparation and issuing of rules is also indirect, in a sense that has already been explained. Further and equally indirect influences come from the international auditing firms, multinational enterprises and the academic world.

The International Environment

Financial reporting in Greece has been influenced to a significant extent by international developments, particularly as a result of the recommendations of the IASC and the requirements of the Fourth and Seventh European Company Law Directives (Papas, 1995). The ICPA's membership of the IASC meant that the content of many IASs could be incorporated into the Greek system, through the influence and the participation of its representatives in various law-making committees in Greece. However, some IAS provisions have been changed, while others have been adopted only partially or not at all. Some examples of partial adoption are given in Table 6.3. Moreover, the following IAS have not yet been adopted:

IAS 7	Cash Flow Statements
IAS 12	Accounting for Taxes on Income
IAS 14	Reporting Financial Information by Segment
IAS 17	Accounting for Leases
IAS 24	Related Party Disclosures
IAS 26	Accounting and Reporting by Retirement Benefit Plans
IAS 29	Financial Reporting in Hyperinflationary Economies
IAS 31	Financial Reporting of Interests in Joint Ventures

(*Source*: Varvatsoulis, 1995)

The most important international influence on financial reporting in Greece has been the implementation of the Fourth and Seventh European Directives. Indeed, Greece became the tenth member of the European Economic Community in 1981, and the project to implement the directives in Greek law led directly to the development of the new Greek GAP. The Fourth Directive was enacted in 1987 and the Seventh Directive in 1990. The adoption of these directives is considered as a milestone in Greek accounting history, as will be discussed below.

However, it should be noted that there are two main differences between the provisions of the Fourth Directive and its adoption in Greece. The first of these concerns accounting issues that have been covered by Greek accounting regulations but have been more or less ignored by the Fourth Directive, such as retirement benefits, government grants, currency translation, mergers and investment in debentures. The second concerns issues which have been dealt with in a different manner in the Greek regulations and by the Fourth Directive. A typical example concerns the treatment of income tax in financial statements. According to the regulations in Greece, no distinction is made between the tax on operating income and that on non-operating income whereas, according to the Fourth Directive, such a distinction should be evident. Another example concerns the treatment of interest on loans used for the construction of a fixed asset, to the extent that it refers to the construction period. According to the Greek regulations, such interest payments can either be deducted from the revenue for the period in which the interest charge was incurred or be treated as an expense to be depreciated over a period of up to five years. According to the Fourth Directive, such costs can either be deducted from the revenue for the period in which it was incurred or be included in the acquisition cost of the fixed asset (see Table 6.3 regarding the difference between Greek accounting regulations and IAS 23).

THE EVOLUTION OF ACCOUNTING IN GREECE

The evolution of financial reporting in Greece can be traced step by step through the legal texts which have brought about regulatory change (see the Appendix). More broadly, the modern history of

Table 6.3 Differences between IASs and Greek accounting regulations

IAS No	*Subject*	*IAS provisions*	*Greek regulations*
1	Disclosure of Accounting Policies	Accruals principle is basic while conservatism basis is used auxiliarily in cases of choice among alternative accounting treatments.	Both principles are basic and equivalent (L 2190/1920).
2	Inventories	Accepted methods to evaluate the historical acquisition cost: FIFO, LIFO, weighted average.	Accepted methods: FIFO, LIFO, weighted average, basic cost, standard cost (GAP).
9	Research and Development Costs	These costs are taken into consideration for the calculation of the net income of the period in which they are incurred. Development costs can be treated as formation expenses (under certain conditions) and can be depreciated in the financial years in which products developed will be used or sold.	Both costs can either be deducted from the revenue of the period in which they are incurred or be treated as formation expenses and be depreciated within five years (L 2190/1920).
42	Accounting for Taxes on Income	Deferment of income tax is allowed.	Deferment of income tax is not allowed (GAP).
17	Accounting for Leases	In the case of financial leasing: payments are posted in the books of the lessee, partly as a depreciable fixed asset and as a liability and partly as interest expense to be depreciated over more than one year and also as a liability. Payments are posted in the books of the lessor, partly as a receivable and sales revenue and partly as a receivable with interest revenue on credit given to the lessee.	Payments are posted as expenses in the books of the lessee and as revenues in the books of the lessor. Depreciation expenses are calculated by the lessor (L 1665/1986 on leases).

Table 6.3 (cont.)

IAS No	Subject	IAS provisions	Greek regulations
21	The Effects of Changes in Foreign Exchange Rates	Translation differences at the full payment or at the end of year evaluation of loans or credits used for the acquisition of fixed assets are deducted from the revenue of the period in which they are incurred. If they have been caused by extreme and severe devaluation of the relevant currency they are included in the acquisition cost of the asset.	These differences are treated as expenses to be depreciated over more than one years. Annual depreciation is calculated on the basis of the rest of the actual life of the loan or of the credit (L 2190/1920 and GAP).
23	Borrowing Costs	Interest on loans used for the construction of a fixed asset and to the extent that it refers to the construction period, increases the acquisition cost of that fixed asset.	This interest can either be deducted from the revenue of the period in which it is incurred or be treated as an expense to be depreciated over more than one year. It is to be depreciated over the next five years (L 2190/1920 and GAP).

accounting in Greece can be divided into three phases: the first covers the initial efforts towards accounting standardisation up to about 1975; the second covers the period up to the adoption of the Fourth Directive and the development and application of the GAP, that is up to 1987; the third phase covers the period up to the present day.

The regulation of accounting started rather late in Greece. The Commercial Code of 1835, which was a translation of the French *Code de Commerce*, covered only basic issues. Some further general provisions were introduced through a Company Law in 1920

(L 2190/1920), but the almost total absence of specific requirements concerning business accounting and bookkeeping (as well as the attitude of entrepreneurs towards accountability itself) had led to a situation where systematic bookkeeping was regarded as nothing more than a pointless luxury by the majority of Greek enterprises. With the exception of banks, insurance companies and few large commercial companies, accounting was limited to recording transactions in order to keep track of cash. In fact, owners of most small businesses would usually have had no knowledge of how to keep books of accounts. Because of this situation, tax was not assessed on the basis of information provided by account books but on other criteria such as the business's size and location. The natural consequence of this situation was arbitrary tax assessment devoid of any reference to the company's own financial records.

It was not until 1948, when Legislative Decree 578/1948 made it mandatory for firms to keep certain books of account, that the state of accounting anarchy in Greece was partly regulated. Nevertheless, this new legislation aroused strong feelings in the business world because of the belief that such measures would only lead to higher taxation and extra costs arising from the effort to be expended in preparing books of account.

Four years later, in 1952, new regulations concerning the books and records that businesses and professionals ought to keep were codified for the first time. The text, which took the form of a Royal Decree, was named the Tax Data Code (*Κώδικας Φορολογικών Στοιχείων*). The Tax Data Code has been amended several times since its introduction: in 1968, 1977, 1982, 1986 and 1992.

The Tax Data Code dealt primarily with rules on bookkeeping and the issuance of invoices and of other documents demanded by the fiscal authorities. Its introduction contributed to the expansion of the tax base and the augmentation of the state's income from the taxation of business activities. In summary, the requirements of the code obliged companies to implement accounting systems which could provide information on their performance and thus allow them to be taxed objectively.

Naturally, the aims of the Tax Data Code were mainly to satisfy the information requirements of the tax authorities. As a result, financial reporting in Greece was characterised by a strong tax orientation together with a lack of uniformity in those areas not covered by a mandatory ruling. Eventually, there were calls by academics and professionals for standardisation of financial reporting practices. This demand became more intense as the process of accounting standardisation developed pace internationally, particularly in Europe. In 1953, the Australian General Accounting Plan was published in translation in Greece and 1954 saw the publication of the French *Plan Comptable*. The French plan became the focus of accounting research at that time and certain large companies adopted its structure for internal accounting purposes. In 1954, the first General Accounting Plan Commission was formed to prepare a Greek version of a national accounting plan but, due to a lack of concern on behalf of the state and the negative reaction in certain professional circles, this effort made little progress.

From 1954 onwards, various working groups were formed by academics or practitioners with the one aim of introducing greater uniformity in accounting practice. The most important attempts were made in 1962, 1963, 1967 and 1972. However, none of these completed their proceedings because of the problems besetting Greece at the time and the successive changes in Greek political life. The continued contribution of the ICPA to these efforts was nonetheless important. By 1965, the Institute had given its firm backing to the creation of a General Accounting Plan. When, in 1975, the question of accounting standardisation was again posed, the circumstances had changed radically and the Prime Minister (Konstantinos Karamanlis) showed an interest in the formation of the GAP in view of Greece's entry into the EEC.

The Development of the General Accounting Plan

The main events which characterise this period were the development of the GAP and its implementation in 1987, as well as the amendment of L 2190/1920 which incorporated the Fourth and Seventh EU Directives. These were serious efforts towards establishing accounting standards.

In 1976, a committee was formed to prepare and finalise the GAP. In preparing the plan, the committee studied the accounting plans of other member states of the EEC and international accounting standards. It also took into account the recommendations made by previous committees and other working parties, and suggestions made by banks, public organisations and professional organisations.

By 1978, the committee had prepared a draft GAP which was examined by experienced accounting professionals and economists, university accounting professors, and professional and public organisations, all of which submitted further proposals and suggestions. The plan was finalised in 1980 and, although its application was not compulsory initially, a large number of companies adopted it. At the end of 1986, the GAP became the obligatory basis of accounting by all 'sociétés anonymes' and all limited liability companies (see Ministries of National Economy, Finance and Trade, 1987).

The Greek GAP embodies the Fourth and Seventh Directives and is characterised by flexibility and clarity which enables it to be adopted by all kinds of companies regardless of size, form or sector. The introduction of the GAP in Greece has been a great step forwards in the process of producing information which is more useful to the management of the company, its investors and the public in general, and which is free from tax orientation, at least in principle. It also facilitates uniformity in terminology and in financial statement presentation, and lays down common valuation rules. Accounting information today is more extensive and reliable, which contributes towards the development of Greek companies and also helps the authorities to exercise a fairer taxation policy.

Laws 2190/1920 and 3190/1955 which govern the activities of the société anonyme and limited liability company, respectively, were amended in 1986 and 1987 in order to incorporate the Fourth and Seventh Directives and to conform to the regulations of the Greek GAP.

Recent Developments

The recent past has been characterised by a sustained effort to promote the acceptance of accounting principles by both the tax authorities and companies, as well as to align the various legal texts which include regulations concerning the same accounting issue.

Having achieved alignment between the GAP and L 2190/1920, through PD 409/86, the new Books and Documents Code PD 186/

1992 (*Κώδικας Βιβλίων και Στοιχείων*) was intended to align the tax authorities' point of view to that of the Plan, and to expand its application to include nearly all types of companies. Furthermore, the National Council of Accounting or NCA (*Εθνικό Συμβούλιο Λγιστιλής*) was established in order to ensure that the GAP could be applied in a problem-free manner by companies. The role of the NCA was reinforced by extending its responsibility to the design and introduction of an accounting plan for banks, which has been in use since 1 January 1994.

RULES AND RULE-ISSUING BODIES

The regulation of accounting in Greece has led to the creation of a body of accounting principles, contained in legal texts that deal with accounting matters in both broad and more detailed ways. As the binding principles must be given in texts which have the force of law, it follows that the only true rule issuing body is the government. The legal texts that include Greek accounting regulations are: (a) the GAP, (b) Company Law and (c) the Books and Documents Code. As mentioned earlier, these three texts are aligned to a very considerable degree. It should be emphasised that Greece has not followed the practice of IASC of developing accounting standards by subject (for example, inventories, disclosure of accounting policies and so on). On the contrary, in Greece, the rules of accounting occupy large sections of various legal texts.

Given that the only body that issues rules concerning financial reporting in Greece is the government, it does so either via Parliament or via various government ministries, such as the Ministry of National Economy, the Ministry of Trade and (mainly) the Ministry of Finance. The President of the Republic is also involved in the rule issuing process in a specific way. Other bodies which issue rules in the sense of amendments, resolutions or interpretations are the NCA and the Accounting Books Committee (*Επιτροπή Λογιστικών Βιβλίων*). Finally, there is the Committee for the Resolution of Accounting Disputes (*Επιτροπή Επίλυσης Λογιστικών Διαφορών*). The role of each of these institutions in the regulatory process is discussed in detail below.

Parliament

The Greek Parliament consists of an assembly of 300 members who are elected for four years by direct and secret ballot and thus reflects the political trends of the Greek electorate. Parliament institutes laws. The proposal for a new statute may originate either in Parliament or in the Cabinet. Laws of a financial character can only be introduced by the Cabinet. All proposals are discussed in Parliament and, in order to become law, a proposal must receive a majority vote. Within a month, the President of the Republic must promulgate and publish the Act of Parliament.

The Ministries of National Economy, Finance and Trade

Whenever a law with financial content is passed by Parliament (and laws on accounting are of such character) an interpretative circular (*Ερμηνευτική Εγκύκλιος*) is then issued by the relevant Ministry, that is, the Ministry of National Economy, Trade or Finance. This circular provides explanations or examples pertaining to the proposed clauses and provisions of the new or amended law. Through this process of interpretation and itemisation, new 'rules' are created. In order to follow and apply the law in Greece, it is necessary to be aware of the content of each interpretative circular referring to the issue in question. Indeed, although Ministerial circulars are only interpretations, they are nonetheless formal and valid rulings.

In addition to the interpretative circulars, Ministerial rulings (*Υπουργική Από αση*) are issued on certain occasions by one or other of the three Ministers for the Economy. These have similar interpretive power and are aimed at clarifying (or amending) clauses in existing financial law. Sometimes such rulings are issued after the law is drafted but before the law is passed by Parliament, and are included *ex post* in the law which is passed. Like interpretative circulars, Ministerial rulings must be followed as though they were law.

The President of the Republic

The President is elected for a five-year term by Parliament. In most cases, the President only promulgates and publishes the acts of

Parliament but in some cases, following a proposal by the Cabinet, the President can also legislate. The legal rules that the President may issue must be approved by Parliament within a certain period of time.

Apart from the President's specific legislative power in extraordinary circumstances, it is not unusual for a law which is approved by Parliament with regard to the broad principles involved also to include an authorisation that permits the President of the Republic to issue a Presidential Decree (*Προεδρικό Διάταγμα*). Such decrees are able to set out the various aspects relating to the implementation of the law in greater detail. Formally, Presidential Decrees are issued after a proposal is made by the relevant Minister to the President on the basis of the authorisation given by law.

It should be noted that Presidential Decrees contain regulations with the same standing as Parliamentary law. It follows that the interpretative circulars mentioned earlier may refer to Presidential Decrees as well as Parliamentary law. The following example in the area of financial reporting may underline the situation. Law 1041/1980 set down the requirements for the introduction and application of a General Accounting Plan in Greece. Article 49 of this law authorised the issue of a Presidential Decree within two years, on the basis of a proposal by the Ministers of National Economy, Trade and Finance. The Presidential Decree was to specify the content of the GAP in two parts: the first on financial accounting and the second on management accounting. It was also to specify the classes of accounts (the Plan would contain ten account classifications), the codes for the subaccounts within each class and the format of the end of year accounts. On the basis of this authorisation, PD 1123/1980 was issued, which introduced the detailed rules governing these matters.

The National Council of Accounting

As the revision of the GAP is an ongoing process, and because new problems in its application are continually arising, Law 1041/1980 provided for the creation of the NCA. The NCA is a specialised government body and its objective is to issue opinions to the government (that is, to the Ministers of National Economy, Trade and Finance) which are necessary for both the smooth continuation of the accounting process and the correct and problem-free application of the Greek GAP. The opinions of the NCA are similar in some ways to interpretative circulars, but in fact benefit from greater authority. This is derived from the fact that L 1819/1988 requires that certified public auditors ascertain not only the correct application of the GAP, but also that a company's accounts are prepared in accordance with the opinions of the NCA.

The NCA was established formally by L 1819/1988 and is based at the Ministry of National Economy. Its staff consists of officials who have a specialised knowledge and experience of accounting and delegates from the public administration and professional organisations. The NCA is a standing committee consisting of the chairman, who arranges its meetings, and 23 other members. NCA members are not full-time, and their term in office is four years. They must be university graduates with experience in accounting, and the chairman must be one of the following: a university accounting professor; a university graduate with fifteen years' professional accounting experience; or the holder of a PhD in accounting with ten years' professional accounting experience. NCA meetings require the presence of all members (there are no subcommittees) and it is a body where scientific as well as professional or syndicalistic interests are represented. The membership of the NCA is given in Table 6.4.

Up to the present time, the NCA has issued opinions on a large number of issues (207 in all). These opinions have been on topics relevant to financial reporting (disclosure, valuation, recognition and presentation issues) but have not concerned tax issues. The most prominent among the opinions to date have been:

The Accounting Treatment of Goodwill Capitalisation Taxes (No. 656/642, 15 January 1985)
The Application of the Greek General Accounting Plan by Shipping Companies (No. 771, 29 January 1986)
Accounting for Value Added Tax (No. 882, 23 January 1987)
Accounting for EU Subsidies (No. 1063, 2 January 1989)
Accounting for the Branches of Foreign Companies in Greece (No. 1362, 28 May 1990)

The Function of Management Accounts in the Greek General Accounting Plan (No. 1632, 19 September 1991)
Accounting for the Purchase of Merchandise Directly from Abroad (No. 1720, 8 May 1992)
Accounting for Leases (No. 1804/67022, 26 October 1992)

The opinion of the NCA on lease accounting provides an example of the way in which the NCA is able to interpret or to elaborate on the law. Previously, the only regulation concerning accounting for leases was restricted to certain provisions in L 1665/1986 (see Table 6.3), there being no reference in the GAP either in Company Law or in the Books and Documents Code. The NCA's opinion in 1992 was issued in order to supplement the basic legal text.

It should also be mentioned that the responsibility for the preparation of new accounting plans for particular types of companies belongs to the NCA. For example, the accounting plan for banks (PD 384/92) was worked out by NCA. Any major amendments to the Greek GAP in future will be carried out by the NCA.

Table 6.4 Membership of the National Council of Accounting (NCA)

1	Chairman
3	Senior officials from the Ministries of National Economy, Trade and Finance
1	Director of the National Service of Statistics
1	Director of the Accounting Harmonisation Directorate of the Ministry of National Economy.*
3	Representatives of the Greek Economic Council
2	Representatives of the Confederation of Traders
1	Representative of the Association of Chambers of Commerce
1	Representative of the Confederation of Greek Industries
1	Representative of the Union of Greek Banks
1	Representative of the Agricultural Union
1	Representative of the Union of Sociétés Anonymes and Limited Liability Companies
1	Representative of the National Union of Accountants
1	Representative of the Institute of Certified Auditors
6	Specialists in accounting matters.

* One of the objectives of this Directorate is to support the NCA in its work, but it is not fully in operation yet.

The Accounting Books Committee

Another rule issuing body in Greece is the Accounting Books Committee (ABC). The rationale for the existence of the ABC is provided by the Books and Documents Code. Among other tax rules included in the Code are those referring to inventory taking. Inventory taking is important because this is the basis for the calculation of cost of goods sold. The Books and Documents Code requires that companies follow and record every delivery into or out of the warehouse by kind, quantity and value. Sometimes doubts or disputes exist about the nature of a product and there are also technical difficulties as far as the recording of all sales by kind and quantity is concerned. In such situations, the interested parties (that is, the trader or the tax authorities) apply to the ABC for a ruling on the correct way of keeping and recording inventories as well as transactions concerning inventories. An appeal against the rulings of the ABC can be taken to the Court of State.

The ABC is a standing committee which functions on a permanent basis and meets at the Ministry of Finance. Its composition is given in Table 6.5. The total number of members of the ABC is eleven. They are not full-time. The committee meets whenever a meeting is convoked by its chairman. The rulings of the ABC are compulsory only for the particular parties involved in the dispute. However, an effort is made towards issuing similar rulings when similar cases are brought before the committee.

Table 6.5 Membership of the Accounting Books Committee (ABC)

1	The general director of the Income Tax Directorate of the Ministry of Finance, who acts as chairman
1	The director of the Books and Documents Department of the Ministry of Finance
1	Official from the Ministry of Finance specialising in income taxation
1	Representative of the Ministry of Trade
1	University professor of accounting
1	Certified auditor
2	Representatives of the Chamber of Commerce
1	Representative of the Economic Council
1	Representative of the National Union of Accountants
1	Representative of the Electronic Data Processing department of the Ministry of Finance.

The Committee for the Resolution of Accounting Disputes

It was intended that, whenever a dispute arose concerning the failure to apply the GAP, the company in question would be able to bring the issue before the Committee for the Resolution of Accounting Disputes (CRAD). Accordingly, the CRAD was established for this purpose by L 1819/1988. The Committee is a judicial body and meets at the Ministry of National Economy. It consists of the chairman, who is a judge, and six other members. The membership is indicated in Table 6.6, and it may be noted that all members of the CRAD must be University graduates with experience in accounting applications.

However, the CRAD has not resolved a single dispute to date. Indeed, although cases concerning the application of the GAP were originally to be decided by CRAD in accordance with L 1819/1988, they are now decided by the administrative courts under the provision of L 1882/1990 and PD 186/1992. In this way, the jurisdiction of CRAD has been given to the administrative courts.

Table 6.6 Membership of the Committee for the Resolution of Accounting Disputes (CRAD)

1	Chairman
1	Senior official from the Ministry of Finance
1	Representative of the Economic Council
2	Specialists in accounting matters
1	Representative of the Institute of Certified Auditors
1	Representative of the appealing company

THE SYSTEM OF ACCOUNTING REGULATION IN GREECE

The system existing in Greece for the regulation of financial reporting can be considered from different perspectives, by considering: first, the rule issuing bodies; second, the procedures of rule preparation and issue; and third, the various pieces of legislation that govern corporate financial reporting. The role and functioning of the rule-issuing bodies have already been discussed in detail. The description of the overall system of accounting regulation in Greece continues with an examination of the other two dimensions mentioned above.

It should be emphasised from the beginning that, despite the existence of the GAP and the efforts that have been made towards accounting harmonisation, financial reporting in Greece still has a very strong orientation towards tax assessment. In other words, there is still a degree of conflict between tax accounting and financial reporting, compounded by the fact that the state, the ultimate and most powerful rule-issuing body, has a greater immediate interest in collecting revenue from taxes than in the flourishing of accounting standards and practices.

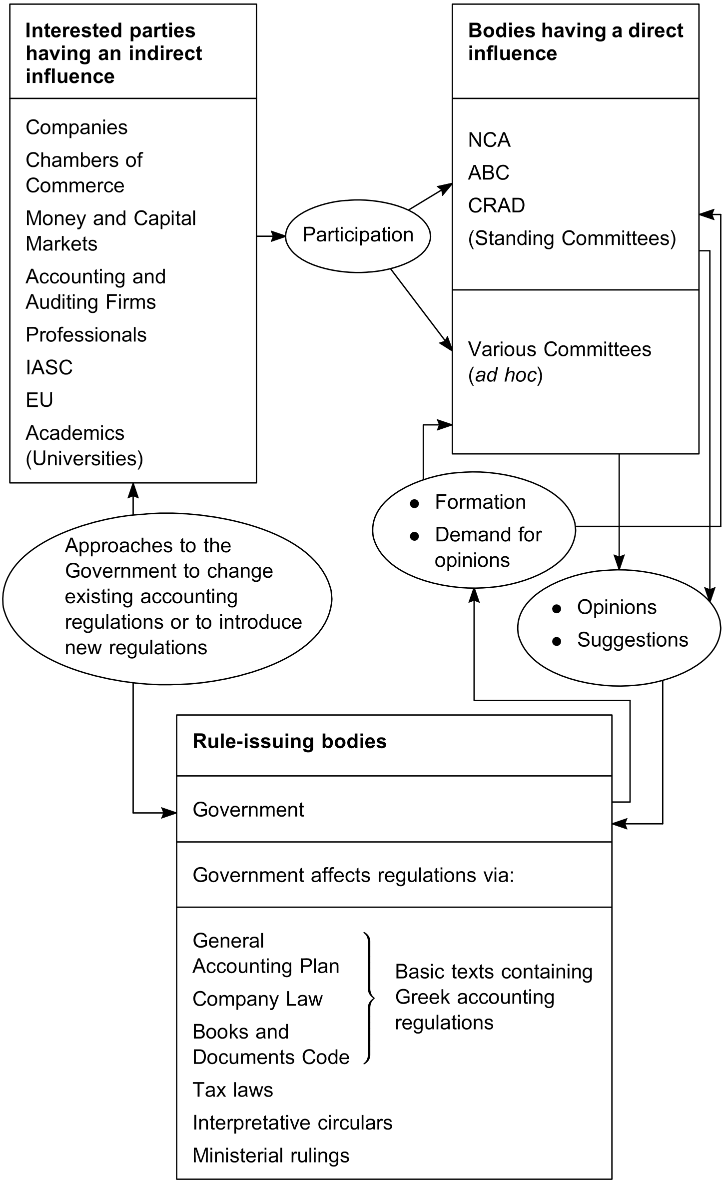
The Procedures Relating to the Preparation and Issue of Accounting Rules

Until the 1970s, the only procedure existing in Greece for the formulation of accounting rules was the preparation within the relevant Ministries of government legislation on financial reporting which was then passed by Parliament. Ultimately, all such laws governed all Greek citizens without exception. The aim of such legislation was invariably bound up with the assessment of tax liabilities arising from business activities.

The philosophy of the state appears to have changed over the last 20 years. Various developments have taken place in the economic life of Greece: for example, the creation of various accounting professional associations, the liberation of the banking system from tight governmental control, the development of the stock market, and so on. Among these influences, membership of the EU has been an important factor inducing change and this has led to some limitations being placed on the paramount role of the government.

One of the consequences of this change in approach was to broaden the procedures for the preparation and issuing of financial reporting rules. This has meant that the government now listens to various interested parties, in addition to itself. The voice of the outside interests is heard via their participation in committees which are formed in order to make proposals and prepare drafts of the legislative instruments through which their proposals may be enacted (see Figure 6.1).

Figure 6.1 The process of regulating accounting in Greece



A typical example was the *ad hoc* committee which was set up when Greece was about to adopt the Fourth and Seventh European Directives. As mentioned earlier, the adoption of these directives was facilitated by the development of the GAP. The committee was set up in 1976 and, in its final form, consisted of 30 members including public accountants, experienced professional accountants, users of accounting information, delegates from the public administration and from professional organisations. The committee allocated its work to teams of five members each and received support from the French CNC. In February 1978, the results of these deliberations were forwarded to five academics. In turn, their proposals were taken into account and, in June 1980, the GAP was approved by the plenary session of the committee. The Plan was instituted by L 1041, in the same year, after the recommendation of the Minister of Finance to Parliament.

Any improvements to the GAP or the development of Sectorial Accounting Plans (for banks, insurance companies, and so on) are now the responsibility of the NCA. However, in the case of major changes, it is almost certain that a committee with wider representation will be set up once again. Indeed, this has been the trend in recent years. It should not be forgotten, however, that the government will have the final word, through the relevant directorates in the Ministries of National Economy, Finance and Trade.

Legislation

Since its introduction, the GAP has embodied the basic 'accounting law' in Greece. In addition, financial reporting is influenced by the Books and Documents Code and by Company Law. These are the basic legal texts which underpin the body of accounting rules in use in Greece. Nonetheless, financial reporting is still influenced by taxation laws and, to a lesser degree, by various other laws.

The General Accounting Plan

The Greek GAP fulfils five objectives. First, it specifies the accounts which companies must use in order to record their transactions and prepare their end of the year financial statements. Second, it specifies the role that each account plays in the preparation of these statements. Third, it specifies all valuation rules that must be followed. Fourth, it specifies the layout of the financial statements that must be published at the end of the year by a société anonyme and a limited liability company. These statements are the balance sheet, the income statement, the statement of retained earnings and the annex, which contains all the notes to the accounts. Fifth, it provides management with information necessary for decision making.

In order for all of these objectives to be achieved, the GAP groups the accounts into three main categories: financial accounts (groups 1–8); management accounts (group 9); and memorandum accounts (group 0): see Table 6.7. The financial accounts are further divided into balance sheet accounts (groups 1–5); expense and revenue accounts (groups 6–7); and profit and loss accounts (group 8). Furthermore, there are three basic principles which underlie the structure of the GAP: first, that purchases, expenses and revenues should be grouped by kind; second, that the financial result for the year should be calculated on the basis of the balance of accounts in groups 2, 6 and 7; and third, that management accounts and memorandum accounts must be self-contained categories of accounts, independent of each other as well as of financial accounts.

Table 6.7 Classes of accounts in the Greek GAP

Category		*Group*	*Title*
I.	Financial accounts		
	A. Balance sheet	1	Fixed assets
		2	Inventories
		3	Receivables and cash
		4	Net worth, provisions and long-term liabilities
		5	Short-term liabilities
	B. Expenses and revenues	6	Operating expenses
		7	Operating revenues
	C. Profits and losses	8	Other income and expenses
II.	Management accounts	9	Cost accounts
III.	Memorandum accounts	0	Memorandum accounts

The GAP is considered in Greece to constitute the basic accounting law, all other relevant legal texts (such as the Books and Documents Code and Company Law discussed below) make cross-reference to it on all issues concerning financial reporting. The text of the Greek GAP is contained in PD 1123/1980.

The Books and Documents Code

The Books and Documents Code, published as PD 186/1992, governs the rights and obligations of businesses and professionals with respect to bookkeeping and the issuance of documents, and also sets down certain rules with reference to the assessment of taxation (Karadanis, 1992; Melas, 1992). Failure to comply with these regulations for tax purposes may result in heavy fines. Although basically tax law, the Books and Documents Code has nevertheless contributed to the development of the body of accounting principles in force in Greece.

The Tax Data Code (the predecessor of the Books and Documents Code) had given an almost total tax orientation to accounting. In contrast, the new Code incorporates to a greater extent other developments in accounting theory and practice by ensuring compliance with the GAP and by giving some validity to accounting records as the basis for the calculation of tax liabilities. Furthermore, the Books and Documents Code has a particular bearing on financial reporting in Greece in that it extends the provisions of the GAP on certain issues. For example, the method of keeping, and recording stocks and of inventory-taking, the definition of the financial year, the time limit for recording transactions in the books, the valuation of shares, and the incorporation of the transactions of branches into the books which are kept at company headquarters, are regulated in detail in the Books and Documents Code.

Company Law

Law 2190, first approved in 1920, governs all activities of Greek 'sociétés anonymes'. This law has been amended several times, most recently to incorporate the First, Second, Fourth and Seventh European Company Law Directives in compliance with the GAP.

According to L 2190/1920, every société anonyme must publish a balance sheet, an income statement, a statement of retained earnings and an annex containing the notes to the accounts. The annex has become an integral part of financial reporting in Greece since the incorporation of the Fourth Directive. The law also emphasises that financial statements must give a true and fair view of the company's financial position and its results. The principles that must be followed in the preparation of financial statements are set down in the law: that is, the entity principle, the consistency principle, the principle of conservatism, the accrual principle and the principle of valuation on an item by item basis.

The activities of limited liability companies, on the other hand, are governed by L 3190. This was introduced in 1955 and, like the law on sociétés anonymes, was amended recently to incorporate the European company law directives.

Together, these two laws form what may be referred to as Greek company law. Their content with respect to accounting matters is very similar.

The Interaction Between Accounting Law and Tax Law

In Greece, there are two basic laws regarding taxation: L 3323/1955 which concerns the taxation of persons, sole traders and unincorporated businesses and L 3843/1958 which concerns the taxation of companies. Both laws have undergone extensive amendment in the meantime.

Taxation still has a very strong bearing on financial reporting, despite the provisions of the GAP and the priority now afforded in the letter of the law. In fact, due in part to the long historical influence of taxation on financial reporting, there still exist situations where accountants are unsure whether to apply the accounting law or the taxation law when preparing the end-of-year financial statements. In order to understand better the interactions which may arise between the laws on accounting and taxation, the influence of the first on the second and the deviations of the first from the second will be examined next.

The Influence of Accounting Law on Tax Law

As we know, the influence of tax law on accounting in general, and on financial reporting in particular, has historically been very strong. However, it is also the case that the adoption of the Fourth and Seventh Directives by Greece, through the GAP, had a strong influence on taxation laws. This influence is evident in the following ways.

1. The GAP has been accepted by the tax authorities as the only basis for recording transactions and reporting end of year financial statements. All companies that operate within the Greek state and are audited by members of ICA are obliged to use the GAP, with the exception of banks and insurance companies which have their own sectoral accounting plans. This obligation is extended to both the financial accounting and management accounting classification schemes. Since the beginning of 1993, companies not audited by members of the ICA, including the remaining sociétés anonymes and limited liability companies, and any others which are obliged to produce financial statements, must use the GAP to a certain extent. This partial use extends only to the requirement to adopt the standard classification scheme for financial accounts, but not management accounts. In this way, all corporate taxable income is now assessed on the basis of the accounting principles laid down in the Greek GAP.
2. Certain of the valuation rules which have been adopted by the GAP are also to be found in tax law. These valuation rules concern: formation expenses (which are depreciated over five years and not over ten years as the tax regulations used to require), intangible assets and tangible fixed assets (for which depreciation must be based on cost), machinery (where installation expenses may be include in acquisition cost), inventories, participations in companies listed on the ASE, receivables and liabilities denominated in foreign currency as well as gains and losses on currency translation.
3. The layout of financial statements provided for the purposes of tax assessment is that suggested by the GAP which in turn adopted the provisions of the Fourth Directive.
4. A provision for bad debts of 0.5 per cent of yearly turnover is accepted by the tax authorities, in line with taxation law 2238/1994.

Differences Between Accounting Law and Tax Law

Unfortunately there are still certain areas where accounting law deviates from tax law. In these cases, accountants are in doubt as to which one of the two should prevail. The result is that the end users of financial statements are also left in doubt. When accountants comply with tax law, financial reporting practice deviates from the accounting regulations. The more important differences are as follows.

1. Depreciation calculations are compulsory according to the GAP, irrespective of the existence of yearly profits. However, taxation law 2065/1992 has ruled that the calculation of depreciation is optional.
2. The creation of provisions and reserves funds is allowed by the GAP. However, provisions for future devaluation of assets, for other risks or for the remuneration of retiring personnel are not recognised by taxation law, because they are not calculated on an accrual basis. Tax law only accepts provisions referring to personnel who will actually retire during the next financial year. In the case where companies do set up provisions and reserves, which will be shown in the balance sheet, these will not be recognised by the tax authorities. For this reason, companies tend to avoid the creation of disallowable provisions and reserves in the first place.
3. Tax law allows profits resulting from the sale of fixed assets or of shares to be taken directly to a special reserve on the balance sheet and not to the income statement as non-operating profit. This results in a tendency to disclose a less comprehensive profit figure.

Differences between accounting law and tax regulations are common in almost all countries. However, the disturbing feature of financial reporting in Greece is the common practice (required by the tax authorities) of recording tax related adjustments in the accounting books. Such an example is the case of additional depreciation that can be written off for tax purposes by companies whose investment has been in accordance with the provisions of certain development laws. Such adjustments should be included in the company's tax reconciliation statement, on the basis of which the actual tax liability is determined. The preparation of this reconciliation should not affect the end-of-year financial statements based on the legally required accounting principles, but it often does (Alifantis, 1995; Chevas, 1996).

SUMMARY

For many years, indeed since the beginning of the twentieth century, Greek companies functioned in such a way that the rules used in financial reporting appeared to result from the obligations imposed by the fiscal authorities. Until quite recently, the attitude of management was that it was necessary for firms to manoeuvre within and outside the law in order to reduce their liability for tax, which was potentially high and characterised by inequality. Consequently, firms and fiscal authorities strongly mistrusted each other and this led to strict laws which set down how the taxable income of companies should be calculated in order to prevent tax evasion. These laws, designed to safeguard the government's tax income, were not concerned with the information required by management, investors, banks or the stock exchange. Therefore, financial statements had a strong tax orientation and disregarded accounting principles.

However, the market discipline introduced along with membership of what is now the EU and the resultant pressure on Greek companies has forced them to become more competitive. Amongst other things, this has culminated in the development of accounting laws and the introduction of more effective accounting policies. The European accounting harmonisation programme has also pressured the Greek authorities to change the form and content of company financial statements. The Fourth and Seventh Directives and some of the recommendations of the IASC have been incorporated into the Greek GAP and subsequently into Company Law and the Books and Documents Code.

However, financial reporting in Greece is still tax driven. This situation will continue as long as accountants and financial statement users remain relatively uninterested in accounting standardisation, and as long as the tax law continues to contradict some of the provisions of the Greek GAP.

Notes

1 In an analysis of 3800 industrial companies, Provopoulos and Papadimitriou (1995) have shown that this strong dependence on bank finance is generally applicable to all Greek companies, whatever their size or operations. Further discussion is given in Ballas and Venieris (1996), particularly the impact on management accounting practices.

Appendix: Chronological Development of Greek Accounting Regulations

Year	*Legal text*	*Summary*
1920	L 2190	Concerned the organisation and the operation of the *société anonyme* (Company Law).
1948	LD 578	Bookkeeping was made compulsory.
1948	CL 810	Issue of documents was made compulsory.
1952	RD	Merged LD 578/48 and CL 810/48 into one text, called the Tax Data Code.
1955	L 3190	Concerned the organisation and the operation of the limited liability company (Company Law).
1962	LD 4237	Accounting provisions were introduced into L 2190/1920.
1977	PD 99	New Tax Data Code.
1980	L 1041	Introduction of the GAP.
1980	PD 1123	Publication of the text of GAP.
1981		Greece joined EEC (EU).
1981	L 1160	Authority was given to the Minister of Finance to impose the application of GAP by companies.
1984	PD 502	Amendments to GAP.
1984	PD 148	Accounting plan for insurance companies.
1985	PD 400	Compulsory application of the accounting plan for insurance companies, starting January 1985.
1986	PD 186	Amendments to GAP.
1986	PD 409	Amendments to L 2190/1920, to align with the Fourth EU directive.
1986	PD 419	Amendments to L 3190/1955, to align with the Fourth EU directive.
1986	PD 356	New Tax Data Code.
1987	PD 498	Amendments to L 2190/1920, to align with the Seventh EU directive.
1988	L 1819	Establishment of the NCA.
1990	L 1882	Expansion of the application of GAP to more types of companies.

Appendix continued

Year	*Legal text*	*Summary*
1992	PD 186	New Tax Data Code and change of name to Books and Documents Code. Further expansion of the application of GAP to nearly all types of companies with regard to size.
1992	PD 384	Accounting plan for banks. Compulsory application since 1/1/1994.

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7 Ireland

Edward Cahill

INTRODUCTION

In the context of financial reporting, regulation is concerned with the formal production of financial statements and their audit in accordance with requirements and criteria established outside the firm (Dyckman, 1988). Scholars recognise two theories of regulation, self interest theory and public interest theory, which operate in a linked fashion as regards accounting rules (that is, standards, laws and guidelines) and their implementation; see Sunden (1988) and Shipper (1994), for example. The rules of accounting focus on financial reporting, including recognition and disclosure. Self interest theory recognises that the reporting firms, along with the auditing profession and those who use the information reported, have an interest in the regulatory structure and in minimising the influence of outside bodies on the regulatory process. Public interest theory, on the other hand, is underpinned by issues of fairness, risk and imperfect information and the need for intervention by the state or an independent body to ensure credible rules and their enforcement.

This chapter shows that the nature of financial reporting regulation in the Republic of Ireland might best be described as a 'hybrid' framework. In its adoption of most statutory rules and all non statutory rules developed in the UK, there is considerable dependence on the UK. Ireland is not a 'free rider', however, as some financial contribution is made to UK agencies from the Irish non-state sector. This situation can be explained through a combination of history, geography, trade and professional accountancy body relationships and politics. There has been very limited public sector/public interest direct involvement other than through EU Directives. The dominant rule-making influence has been private sector (and until 1990) private interest activity, originating in the United Kingdom.

It would be difficult to ascribe the term 'regulatory system' to financial reporting behaviour in the Republic of Ireland because of the continued absence of a monitoring or enforcement mechanism. A *laissez faire* attitude of dependency on professional expertise continues to be the posture of the state, even more so than in the UK and most of the continental European and Nordic countries. Standard-setting in respect of accounting and auditing is primarily a private sector process, promulgated by the professional accountancy bodies. There are clear weaknesses in compliance mechanisms. The state has shown limited interest in the area and the current arrangements might be described as 'regulatory capture' by the professional accountancy bodies in Ireland. An interesting interdependence operates between the state and auditors (particularly through the Institute of Chartered Accountants in Ireland) as a delegated form of a self-regulatory mechanism in terms of financial reporting faithfulness. If the experience of the UK were to be replicated in Ireland, the reliability of the present arrangements would be problematical.

THE HISTORICAL BACKGROUND

The island of Ireland is small by European standards. It comprises two separate political domains: (a) the Republic of Ireland, with a population of 3.5 million, which is an independent sovereign state with full membership of the EU, accounting for 80 per cent of the island's territory; and (b) Northern Ireland, with a population of just over 1.5 million which is politically part of the UK though it is physically separate.

Following the long-term impact of the 'Great Famine' and the subsequent drain of emigration, the population of what is now the Republic of Ireland fell from 6.5 million in 1841 to 3.2 million in 1901 and then to a low point of 2.88 million in 1966. The population decline in Northern Ireland was very modest and, in contrast, started growing in the 1960s. In fact, Northern Ireland had traditionally been much more industrially developed than the Republic of Ireland. The latter was primarily an agrarian economy until the 1960s, with most of its output exported to the UK, but since then rapid industrialisation has taken place.

To repeat Jean Blanchard's telling phrase that '*L'Irlande est une île derrière une île*' ('Ireland is an island behind an island') is to explain to some degree the insularity of Ireland and the influence of Britain in relation to continental Europe. England conquered all of the island of Ireland in the sixteenth and seventeenth centuries, with the result that the alliances with Spain and France, the local controlling and administrative structures and the Gaelic culture of Ireland were all overthrown. It was a simple fact of the larger national group dominating the smaller one. Ireland followed Scotland and Wales in becoming an English province. With the extensive 'plantations' (i.e. the settlement of English and Scottish families as farmers in Ireland) in the late 17th century, there was a massive transfer of property. This helped create an elite class of different cultural and religious traditions whose loyalty was to Britain as their basis of origin and the generator of political and economic power (see Chubb, 1982). Prior to the seventeenth century, almost the whole country spoke the Irish language, Gaelic, but by 1851, with the impact of colonisation, emigration (particularly from the Gaelic speaking areas) and the particular absorption of English culture and values in Dublin and the other cities and towns, only 30 per cent of the population spoke Gaelic. There was a further slide to just 20 per cent in 1871 and to even more modest proportions by 1900.

There had been a reaction to this 'anglicisation', but the reasons for the change of dominant language (with complications for cultural traditions and ethos) are outside the remit of this chapter, other than to note that there were issues relating to modernisation and employment opportunity and the more recent influence of Catholic elites and clergy (Lee, 1973, 1989). In comparison to the UK and other developed European countries, Ireland would be viewed until recently as a relatively conservative country.

The foregoing is relevant to the theme of this chapter, which is the great similarity between the UK and Ireland in their financial reporting practices.[1] As a neighbouring province, Ireland experienced the development of the same administrative (civil service) structures, courts, laws and broad democratic processes. The various areas of Ireland elected representatives to the London Parliament. Thus, when the post war treaty with Britain was negotiated by the Irish Free State (now the Republic of Ireland) in 1921, the new Irish Government almost completely adopted the existing courts and laws and the administrative and democratic structures based on the Whitehall and Westminster models.

THE DEVELOPMENT OF FINANCIAL REPORTING REGULATION IN IRELAND

As a province of Britain until 1921, Ireland was subject to all laws emanating from London. Financial reporting regulation in the UK as a whole was initially stimulated by the establishment of a parliamentary 'Select Committee' to investigate insurance company frauds. The assumption of chairmanship of this committee in 1843 by Gladstone (who expanded its terms of reference and role) led to a report which created a most elaborate piece of pioneering legislation: The Joint Stock Companies Registration and Regulation Act of 1844.[2]

A more lenient regulatory regime resulted from 1856 in an easing of company regulation and financial reporting. This *laissez-faire* period ended with the enactment of the Companies Act of 1900 following concerns about corporate fraud and the subsequent Companies Acts of 1907 and 1908 which brought in the concept of a compulsory audit for all limited liability companies and the requirement that a balance sheet reflect a 'true and correct view' of the company's affairs. This represented a broad-brush approach to financial disclosure which proved to be extremely deficient in terms of accounting principles of measurement, valuation and the form of the balance sheet. Profit and loss accounts were not mentioned.

The foregoing is extremely relevant to Ireland as it remained the sole statutory basis of financial reporting legislation until 1963, more than 40 years after independence. Indeed, international scandals involving reserve accounting, non-consolidation of subsidiaries and the role and qualifications of auditors (as exemplified by the Kylsant/Royal Mail case in the UK, the Kreuger Match scandal in Sweden and the McKesson and Robbins case in the USA) all passed Ireland by. In the meantime, the UK had politically separated from Ireland and had enacted the 1928 and 1929 Companies Acts. It had also brought on to the statute books the more progressive Companies Acts of 1947 and 1948 as a result of the radical Cohen Report which was implemented speedily by the new Labour Government of the time. Consequently, in the UK, statutory recognition was given to certain professional accountancy bodies for auditing purposes, the profit and loss account was now legally required and the content of the balance sheet was prescribed in some detail, so that reserve accounting would be more difficult. Moreover, the preparation of consolidated accounts was made mandatory for groups of companies. Following the recommendation of the Institute of Chartered Accountants in England and Wales (ICAEW) to the Cohen Committee, the criterion of a 'true and fair' view was adopted.

In Ireland, on the other hand, the legislation still in force was the former Companies Act of 1908. In fact, it was not until the report of the Cox Committee on Company Law reform in the early 1960s that new accounting legislation was enacted. To a very large degree, the Company Law of 1963 mirrored the financial reporting elements of the UK 1948 Act as regards the duties of auditors, the details of disclosure, form and content, the requirement for consolidation by holding companies and the need for accounts to present a 'true and fair view'.

This reform of Irish company law and financial reporting requirements, albeit much delayed, sprang from the realisation of the need for such reform at government level rather than from any other external pressure. Five years earlier, the first economic development plan had been approved and the need for the modernisation and expansion of the Irish industrial base was agreed across political parties and government departments.

In 1982, an Amendment Act set out qualifications for auditors. Ireland, as with the UK, requires the financial statements of all limited companies to be audited. To date, there has been no size exemption in this respect, even though size threshold criteria were of particular concern when implementing European company law into Irish legislation.[3] The Second and the Fourth European Directives were adopted via the 1983 and 1986 Companies Acts. With regard to the Fourth Directive, this was considerably later than the initial approval by the Council of Ministers in 1978. It was worth noting, however, that implementation in Ireland was just 20 months after the Directive was revised following lobbying by Ireland and the UK to increase the threshold figures for small and medium-sized enterprises in terms of less onerous accounting and filing requirements and support for the inclusion of 'true and fair' as an overriding criterion.

Ireland enacted further financial reporting legislation under the 1990 Companies Amendment, legislation which was due on this occasion to changes in the local economy. The Act had to be put urgently before the *Oireachtas* (Parliament) during the holiday season in August 1990 to enable the Irish equivalent of the USA Chapter 11 corporate bankruptcy legislation to be approved in order to cope with the financial collapse of one of the largest private sector firms in the country (the Goodman Group, the largest meat processing group in Europe). The new Companies legislation was enacted in two parts, which brought in certain new accounting and auditing requirements. For the first time, some aspects of this 1990 corporate legislation moved away from the UK model.

The growing divergence between UK and Irish company law was also reflected in the long delay experienced over the implementation of the Seventh Directive, as discussed in greater detail later in this chapter. The serving of a legal notice on the Irish Government by the European Community authorities to appear before the European Court in September 1992 for breach of the Community legislation finally stimulated the Irish Government to act. The Seventh Directive was implemented by Ministerial Regulation in August 1992.

Private Sector Standard-Setting

It can be argued that, initially, the private sector in Ireland was even less interested or involved in setting accounting and auditing standards than the public sector. This attitude was to change dramatically in the 1970s and 1980s. The Institute of Chartered Accountants in Ireland had issued five guidelines of its own on accounting practice relating to issues of immediate concern such as government grants. However, in the 1960s the Irish Institute adopted a number of 'Recommendations on Accounting Principles' already developed by the UK Institute from the late 1940s through to the 1960s (Nobes and Parker, 1979). Ireland joined the UK private interest standard-setting initiative of the Accounting Standards Steering Committee in 1970 after the media and political outcry following a number of a financial reporting *causes célèbres* (Rolls-Royce, GEC–AEI and Pergamon/Leasco) and the criticisms of the late Professor Edward Stamp (Leach, 1981). The ASSC proceeded to issue the first series of accounting standards, at first on the initiative of the ICAEW, with the Irish and Scottish Chartered Institutes joining almost immediately afterwards during 1970.

It was not until 1972 that three other bodies joined, and the Institute of Chartered Accountants in Ireland (ICAI) then became one of the six founder members of the Consultative Committee of Accounting Bodies (CCAB). The ICAI agreed to adopt the Statements of Standard Accounting Practice developed by the ASSC (later named the Accounting Standards Committee, or ASC). The Irish Institute's membership of the ASC gave it a veto on the finalisation of a standard as it applied to Ireland, which occurred, for example, in the areas of accounting for grants and for leases.

In time, following the revelation of a series of auditing failures by Department of Trade and Industry inspections in the UK, the CCAB professional accounting bodies established the Auditing Practices Committee in 1976. It issued a series of Auditing Standards and Guidelines effective from 1980. Ireland, through the ICAI, was again a participant in this private interest, private sector initiative, with active involvement in various committees.

Following extensive criticism and the collapse of the credibility of the ASC (through the power of private interests which influenced many standards that were as a result unduly imprecise), the CCAB established a Review Committee chaired by Sir Ronald Dearing in the UK in late 1987. Ireland had a voice on this Committee through a partner in one of the large audit firms. The Dearing Report of 1988 proposed sweeping changes in the creation and focus of accounting standards, together with a new, more independent institutional framework to ensure their regulation (Perks, 1993). These included the Financial Reporting Council as the primary body, with the Accounting Standards Board (or ASB) as the rule-making body and the Review Panel as the enforcement mechanism. A new secretariat and staffing was provided and the costs were to be met by the UK government, the Stock Exchange and related financial interests in London and the accountancy profession, including the Irish profession (Barker, 1993). An absence of a reasonable conceptual framework of principles was also relevant to financial reporting weaknesses and led to the growth of an industry in cosmetic accounting techniques (Smith, 1992).

The ASB was established in the UK in 1990, following a pattern similar to that of the fall of the Accounting Principles Committee and the creation of the FASB in the USA over a decade earlier. Under the new standard setting regime in the UK, however, Ireland is no longer directly represented in the process, and neither does it have a veto on their adoption. This is an interesting anomaly. Thus it should be noted that Ireland still does not have a standing rule-making body in the areas of accounting or auditing.

The Role of the Accounting and Audit Profession in Ireland

The development of the accounting and audit professional bodies and firms in Ireland had almost paralleled the UK experience (Robinson, 1983). The ICAI was established under Royal Charter in 1888. As shown in Table 7.1, it is at present the largest professional body in the country. Its membership has grown relatively rapidly in the 1980s and 1990s. In the 1940s, a smaller professional body known as the Institute of Certified Public Accountants was formed, but not related to the USA body of Certified Public Accountants. In addition, two UK-based bodies, the Chartered Association of Certified Accountants and the Chartered Institute of Management Accountants, have significant membership and an active organisation in Ireland.

Three of the four bodies are recognised for auditing registration purposes according to the new arrangements required under the Eighth Directive established in the 1990 Companies Act. The Chartered Institute of Management Accountants is not included, though a small number of its members have made registration arrangements where they have modest auditing practices. Members of the ICAEW, and the corresponding body in Scotland, are also recognised as being permitted to practise as auditors in Ireland. This can be explained by the mutual recognition of accounting professional qualifications between the UK and Ireland, at least insofar as this regards Chartered Accountants; Irish Chartered

Table 7.1 Membership of professional accounting bodies in Ireland: 1993/94

	Total number of members	*Members registered as auditors*
The Institute of Chartered Accountants in Ireland	6 480	2 899
The Chartered Association of Certified Accountants	2 030	706
The Institute of Certified Public Accountants	1 100	320
The Chartered Institute of Management Accountants	790	Not available
Total	10 400	3 925

Note: Only included are those working in Ireland.
Source: McHugh (1995).

Accountants are recognised for auditing purposes under UK Company Law to register under their professional body as an auditor for accreditation and supervisory purposes.

It is important to note that the ICAI operates as a professional body in both the Republic of Ireland and Northern Ireland. This has a variety of political implications, particularly that of a commitment to a common approach to standard-setting in accounting and auditing with the UK. If we consider the interlocking relationships and activities between the professional bodies across the domains of the Republic of Ireland, Northern Ireland and the UK, it is not difficult to see why there should be commonality in standards.

The Irish state sees the current situation as a pragmatic solution in view of the connections not only between the professional bodies but also the long-standing link between the stock exchanges and the extensive trading, banking and other financial relationships with the UK. For instance, almost half of the companies listed on the Irish Stock Exchange are also listed on the London Stock Exchange, and the adoption of common financial reporting standards has principal-agency implications for these companies and their investors. Thus, whilst there are some cost savings, there are also other important benefits with regard to credibility and expertise arising from the mutual accounting standards in force which are to the advantage of both the state and the private sector in Ireland.

Nevertheless, this situation can give rise to problems, such as those which were associated with the long delay experienced until 1992 in the implementation of the Seventh Directive. In the UK, by contrast, the Community's requirements on accounting for subsidiary undertakings were enacted through its 1989 Companies Act. This had stimulated the former ASC to issue ED50 (Consolidated Accounts) in June 1990. ED 50 was the forerunner of FRS2 (Accounting for Subsidiary Undertakings), issued by the new ASB in July 1992. A problem immediately arose in Ireland, as the new ASB accounting standard was in conflict with the definitions of a subsidiary according to Irish company law but not according to UK company law. Irish companies had to be exempted from compliance with Financial Reporting Standard (FRS) 2 until the enabling legislation had been enacted. Thus, there were different definitions applicable for subsidiaries and for the basis of consolidation between Ireland and the UK, though they were both supposed to be within the same standard-setting regime.

The Financial Reporting Commission and the Ryan Report

Given the concerns expressed publicly by the then Minister of Industry and Commerce, and also partially in response to criticisms of the adequacy of financial statements in the light of a number of large and costly company failures in Ireland, the ICAI established a Financial Reporting Commission on 20 February 1991 to report by 31 December 1991 on the following terms of reference as set down in the Ryan Report (ICAI, 1992, p. 8):

> To research the extent to which the expectations of the various sectors of users of published financial statements of companies in the Republic of Ireland are met by such statements as currently provided, or as may reasonably be expected to be provided, or might reasonably be expected to be provided in line with existing law, accounting and auditing standards and general practice.

> Where significant disparity between expectation and provision, as set out above is identified, to put forward proposals to reduce or eliminate such disparity, bearing in mind the cost-benefit to accounts preparers and users of such measures.

The Irish Financial Reporting Commission specifically focused on closing the 'expectations gap'. The nine-person Commission drew on representatives from industry, the Stock Exchange, financial institutions and the universities, as well as the ICAI. This initiative by an Irish professional accounting body, which it financed itself, was unique. Indeed, there appears to have been no equivalent with such a broad remit elsewhere in Europe. In the UK, for example, the 1975 'Corporate Report' issued by the ICAEW and the 1988 Dearing Report each had a narrower emphasis and the Cadbury Committee's remit was related to the financial aspects of corporate governance. To a more modest extent, the Irish initiative followed the example of the Treadway Report in the USA and the Macdonald Report in Canada. The approach adopted in Ireland was more informal and less comprehensive. Despite this, the Irish Report (known as the 'Ryan Report' after its Chairman, Dr Louden Ryan) was a milestone in discussing publicly the role and context of financial reporting, the 'expectations gap' and the future of accounting regulation in Ireland.

The Commission's findings have been reviewed in detail elsewhere (O'Connor, 1995). Briefly, as regards financial statement regulation, the report pointed to shortcomings in Ireland's arrangements but concluded that accounting standard-setting should remain a private sector process and that a separate ASB for Ireland was unnecessary. Nevertheless, the need was seen for accounting standards to be recognised in law and for a Financial Reporting Review Panel to be established. These recommendations broadly followed similar lines to the Dearing Report in the UK. The Commission also concluded that current practices regarding the preparation and disclosure of financial accounting information in Ireland fell short of users' needs, thus effectively admitting that an expectations gap did exist. The Commission commented: 'Many published financial statements do not at present provide enough information to enable users to judge the performance of directors and management and make decisions about their future relationship with the reporting company' (p. 111). As part of an improved financial reporting process, the Report recommended that directors should include a separate statement about their responsibilities in relation to the financial statements of the company and that audit committees should be established in larger companies.

A New Role for Auditors in Ireland?

An innovative development in the 1990 Act (Section 194) is that auditors are required to advise the Registrar of Companies if proper books of account have not been kept, having first served a notice on their client company. The auditor has also new duties (Section 46) with regard to the disclosure of a wide variety of transactions between the company, its directors and other connected parties. This stems from suggested corporate abuses reported by receivers and liquidators. The 1990 Companies Act also introduced the concept of 'reckless trading' as part of the responsibilities of the directors of a company and potential personal obligations to creditors in a financial collapse.

There had been many criticisms of the role of auditors and directors, following a number of large company collapses (Cahill, 1995a). Surprisingly in Ireland, there have been no official public investigations specifically focused on company collapse and the nature of accounting and auditing practices (Cahill, 1995b). The Institute of Chartered Accountants has an investigation committee which examines alleged malpractices, but little information is available. The 1994 Report of a Tribunal of Inquiry into certain practices in Ireland's meat processing industry found (among many other matters), evidence of tax evasion and avoidance. The Tribunal was conducted by a leading judge, Mr Liam Hamilton, who was President of the High Court. Mr Hamilton's Report recommended a change in auditors' reporting responsibilities with regard to corporate taxation obligations to the state. The Report reviewed the obligations of auditors under the 'Legal, Ethical and Practical Guidance' issued by the ICAI and it commented:

> the Tribunal considers that in the case of tax evasion, the obligations placed on an auditor should not be limited to reporting such tax evasion to the 'appropriate level of authority

> within the entity or bringing the matter to the notice of shareholders' but should be extended to oblige them to report such evasion to the Revenue Commissioners and recommends that a provision which would have that effect, be included in the next Finance Bill. (p. 336)

In due course, in April 1995, the Minister for Finance published the Finance Bill which included a clause (Section 153) which required anyone involved with the preparation of company accounts or advising on tax affairs to inform their client company of suspected tax evasion. If the company failed to take correcting action within 30 days, then the person who has discovered the tax fraud must notify the revenue Commissioners.

This drastic change in proposed responsibilities was resisted strenuously by the professional accountancy, legal and taxation bodies. The professional bodies saw the proposal as an 'Informers' Charter' which would destroy the client confidentiality relationship. Eventually, partially but not completely bowing to the lobbies and threatened court action under the concept of 'constitutionality' by the professional bodies, the Minister for Finance made adjustments to the final draft of the Bill. The legal profession was treated differently and more leniently. However, auditors and tax advisers were required, if they became aware of serious tax evasion, to warn the company and request that it be rectified. The auditor must ask the company itself to report the offence to the tax authorities. If that is not done, the auditor (or tax adviser) must cease to act for the company. At the same time a new auditing guideline on fraud, developed by the Auditing Practices Board (APB), indicated broadly similar provisions on a self-regulatory basis.

This attempted move to make the auditor a 'tax evasion whistle-blower' was quite revolutionary. Even the watered down auditors'/tax advisers' obligations (which have since become law) have left the accountancy profession in Ireland somewhat uneasy. The recent requirements according to the 1990 Companies Act and the 1995 Finance Act suggest that the state is framing the role of the auditor in a wider context than that adopted in the UK and, perhaps, other European and Nordic countries. Thus, the auditor appears to be moving towards a regulatory 'policing' role. Of course, to an extent, the auditor already has such a role in respect of financial institutions in Ireland, where there is a reporting relationship which extends beyond shareholders to the Central Bank and the Department of Enterprise and Employment.

INTERNATIONAL INFLUENCES

The largest source of foreign investment in Ireland has consistently been from the USA since the 1960s. Many of the firms involved have been subsidiaries of multinationals with quotations on the New York Stock Exchange. Consequently, many Irish accountants and the larger auditing practices have become very familiar with US accounting, US GAAP and the terminology and regulations of the SEC. In addition to the above, a number of larger Irish companies have made substantial acquisitions in the USA in recent years. The larger Irish listed public companies have successfully raised equity capital in the USA as well, mainly by way of shares issued as American Depositary Receipts (ADRs) on NASDAQ. The first such issue was by Waterford-Wedgewood in 1987, followed by Allied Irish Banks, CRH, Elan and the Smurfit Group recently.

Irish companies with a NASDAQ quotation include a statement in the Annual Report which shows a reconciliation of net income, earnings per share and other financial data according to Irish GAAP and US GAAP. These often show different figures for profit and shareholders' funds because of the differences in measurement principles between the British Isles and North American accounting standards in certain areas. Undoubtedly, apart from UK standards, US GAAP are the only other major influence on Irish accounting and auditing practices. However, it is the historic link with the UK which still determines some of the most important aspects of the regulation of financial reporting in Ireland, including the institutional framework discussed below.

THE INSTITUTIONAL FRAMEWORK OF ACCOUNTING REGULATION IN IRELAND

Ireland operates with a common law framework but, unlike the UK, also has a written constitution which can only be altered by way of a referendum of all citizens who hold a vote. Similar to the UK, there are two sources of law in Ireland: (a) government legislation; and (b) decisions on cases by the courts.

Government legislation includes Companies Acts approved by the *Oireachtas*, and any ministerial regulations in respect of European Directives. For instance, whilst the Fourth Directive was enacted through the Companies (Amendment) Acts of 1986 and 1990, the Seventh Directive was adopted by way of a Ministerial Regulation in 1992. The latter approach does not allow, however, for the degree of consideration and discussion regarding the possible options under the Directive that would take place if the proposed law were to pass through the *Oireachtas* and its working committees.

In the areas of accounting or auditing, unlike the UK, there have been very few court cases in Ireland. Many cases tend to be settled out of court and consequently few new legal precedents are created. One recent out of court settlement involved the payment of IR£77 million by one of the Big Six accounting firms to the administrator of ICI, a large insurance company which had collapsed in 1985 and to Allied Irish Banks who had acquired the company before its collapse (Cahill, 1995b). Of course, it is unlikely that decisions would be materially different to the UK experience in view of the similarity not only of the law but also financial reporting standards and practices.

In summary, it can be said that the Fourth, Seventh and Eighth European Directives have had more impact on direct rule-making in accounting and auditing than any other statutory source since 1963.

The Rule-Making Bodies and the Rule-Making Process

The rule making bodies for accounting and auditing practices in Ireland are:

(a) Accounting Standards Board, London;
(b) Auditing Practices Board, London;
(c) The Irish Stock Exchange, Dublin;
(d) The Department of Enterprise and Employment and the Company Law Review Group.

The Accounting Standards Board

The ASB was established in London in August 1990. It took over the standard-setting role from the former ASC. This new Board's role is to make, amend or withdraw accounting standards. The Companies Acts in the UK recognise the ASB's standards for the purposes of accounting requirements of the Act. There is no equivalent recognition in Irish company law at present, which is a weakness in terms of regulatory underpinning. The ASB is an independent entity with ten members (of whom two are full-time: David Tweedie, Chairman, and Allan Cook, Technical Director). The Board employs a full-time group of technical specialists who are involved in developing new standards and related pronouncements and reviewing existing standards and Statements of Standard Accounting Practice (SSAPs). Ireland has no member on the ASB, though it does have a representative on the Financial Reporting Council (the ASB's governing council), and an Irish Government official acts as an observer.

The current process of developing an accounting standard, or reviewing an existing standard, by the ASB in London is very similar to the process adopted by the FASB in the USA. The full-time accounting specialists draw up a draft standard for submission and approval to the public as the Financial Reporting Exposure Draft (FRED), having earlier issued a 'Discussion Draft' to the Board. The ASB, which is constituted from the constituencies of professional accounting, business, financial institutions and government departments, publishes the FRED for comment by preparers, users and other interested parties. Having considered comments on the FRED, the ASB then issues a Financial Reporting Standard (FRS). An Urgent Issues Task Force (UITF) was set up in March 1991 to assist the ASB in areas where there appeared to be problems in practice or potential difficulties in interpretation and application of accounting principles, with UITF Abstracts providing interim guidance which would form the basis, where appropriate, on which to give a true and fair view.

As regards Ireland, a separate 'Consultative Committee of Accounting Bodies – Ireland', the CCAB–I, was established in 1990 at the recommendation of the Minister for Industry and Commerce (now Enterprise and Employment). It comprises representatives of the four professional accounting bodies operating in Ireland. The remit of CCAB–I is to provide a forum to consult and discuss issues relating to accounting standards proposed by the ASB in London. Thus, CCAB–I can submit common views, from an Irish perspective, to the ASB in London. It has not been perceived in some quarters as a particularly effective vehicle for review and analysis to date. Each of the individual professional accounting bodies in Ireland has reserved the right to forward its own views, either directly or indirectly to the ASB.

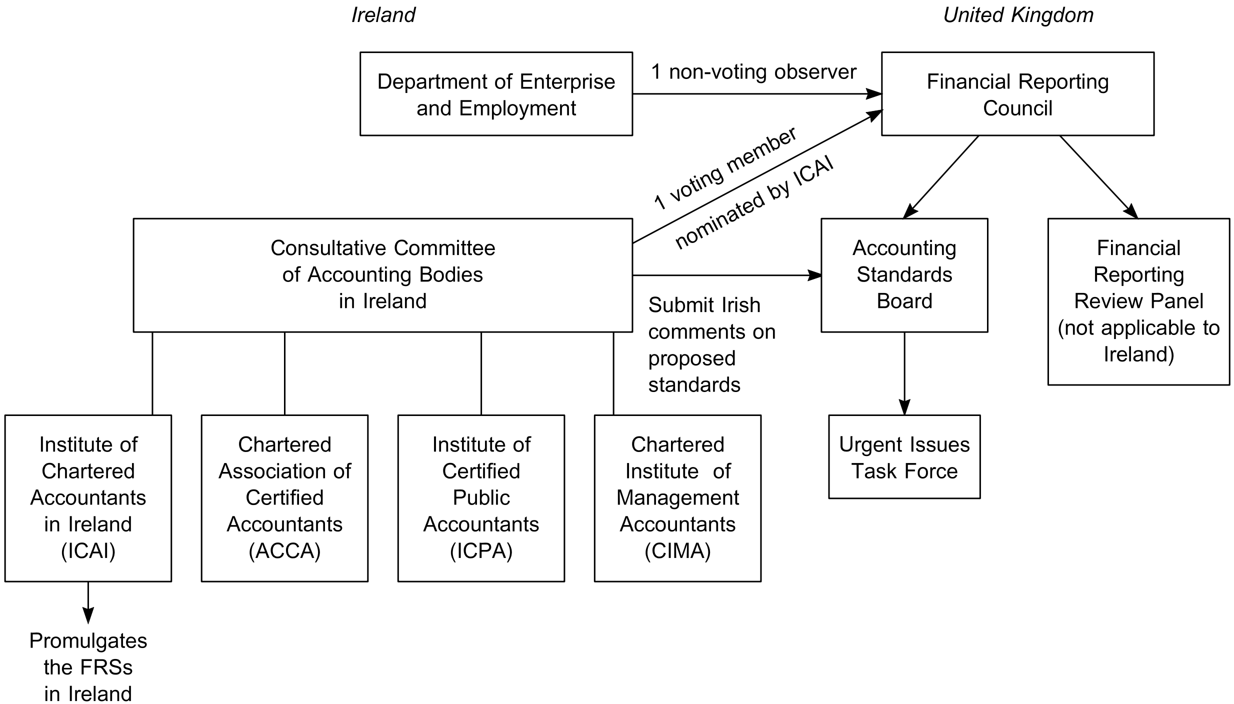
The close accounting links which operated between Ireland and Britain for decades have been maintained, to some degree, under the new regulatory regime (see Figure 7.1). There is considerable informal contact between ASB staff and the Irish profession, particularly the ICAI who promulgate the ASB's FRSs in Ireland with the approval of the Irish government. It is difficult to pin down the extent and influence of this involvement in the British standard-setting process, as Ireland does not have representation on the critical working parties on standards. It seems that the Irish profession does have the opportunity to comment on early drafts of standards but, unlike the regime under the ASC until 1990, the professional accountancy bodies in Ireland have no veto on the final content of an FRS and its adoption.

The Auditing Practices Board

Just as the ASC was 'transformed' into the ASB, so also was the Auditing Practices Committee (APC) in London reconstituted as the APB in April 1991. There was a difference, in that this new Board for auditing issues is much less independent than the ASB. It was established by the CCAB of which the ICAI is a member. Though it reorganised the structure and representation of its Board, exactly half of the voting control of the 18 members remains with practising auditors. Also, an auditing standard cannot be issued (or exposure draft or guidance note) unless 75 per cent of all voting members are in favour. The APB essentially remains a private sector and private interest body, although somewhat stronger than its predecessor.

Ireland has one voting member (a partner from a Big Six firm) and one non-voting member who is a government official from the

Figure 7.1 The regulatory framework for accounting standards in Ireland



Department of Enterprise and Employment. Thus, auditing standards for Ireland are developed in London. In turn, they are adopted by the members of the CCAB and thus they automatically become a requirement for all members of the ICAI and the Chartered Association of Certified Accountants who are registered as auditors.

Compared to accounting standards, there is a stronger monitoring and enforcement framework as regards auditing standards and practices in Ireland. The ICAI was the first accountancy body in the British Isles to establish a 'practice review' process for all auditor members. A special informal unit and visit process was established in 1988 on similar lines to (and with the help of) the Toronto Institute of Chartered Accountants. The Canadian model proved robust and this monitoring system is now well established. It visits a proportion of members each year (large and small firms) and reviews their audit organisation procedures, working papers and files. Cases not meeting audit standards are brought before an Investigations Committee. If a case of misconduct is established, it can then be brought before a Disciplinary Committee for sanctions and penalties.

Ireland (that is, the ICAI) did not join the Joint Disciplinary Scheme (JDS) established by the three auditing professional bodies in the UK in 1980. Thus its disciplinary activities are not as transparent as in the UK. Little information is publicly provided. Also, the composition of the Disciplinary Committee of the ICAI has less lay representation than that of the JDS in the UK.

The Irish Stock Exchange

In 1990, the Irish Stock Exchange joined the London Stock Exchange as part of the 'International Stock Exchange of the UK and the Republic of Ireland'. In 1995, the two Stock Exchanges separated and the Irish central bank became responsible for the regulation of the Irish Stock Exchange. The Irish listing rules require companies to produce financial statements 'in accordance with national law and in all material respects with UK Accounting Standards, US Accounting Standards or International Accounting Standards. Any departure from standards must be accompanied by a statement made by the directors as to the reasons for the departure (Section 12.43a, Yellow Book). Where an Irish company is considered not to be in compliance with the appropriate standard, then the Stock Exchange takes the matter up with the company's management.

If a listed company in the UK were deemed to be in breach of an accounting matter under ASB standards, then the Stock Exchange in London would formally refer the case to the Financial Reporting Review Panel, the body under the UK Financial Reporting Council which has been given powers to enforce compliance with accounting standards set by the ASB and with the accounting requirements of the UK Companies Acts. Although its jurisdiction is limited to the UK, it remains relevant to Ireland in view of the use of a common body of accounting standards. The Review Panel has considered a wide range of referred cases of recorded non-compliance with accounting standards and other legal requirements, as well as those brought to its attention by individuals and corporate bodies and through press comment. Public statements have been issued where it has been accepted that some remedial action to the financial statements is called for, and there have been cases where the Review Panel has proposed to apply to the Court for an order to obtain agreement from directors to prepare revised accounts.

As noted, however, the Review Panel in the UK does not act as regards Irish public companies. As no Irish Review Panel has yet been established, there is no basis of enforcement or sanction – other than the state through the Department of Enterprise and Employment appointing investigating inspectors under the Companies Act. This is considered a relatively drastic measure which has not yet been instigated in respect solely of accounting matters. It has been rarely used, though more frequently in the 1990s, the exception is where there appears to be some supported allegation of corporate irregularity.

Apart from the possibility of the professional accountancy bodies taking investigatory and disciplinary action in respect of their members, there appear to be no other regulatory remedies other than adverse media comment and/or investor actions, both of which are rarely pursued. Institutions have tended to sell their investment and walk away. Of course, an alternative regulatory mechanism would be for Ireland to establish a Securities Commission similar to France, USA or New Zealand.

The Department of Enterprise and Employment and the Company Law Review Group

Ireland does not have a standing company law or financial reporting rules review forum, with representation from a variety of public and private sector constituencies, as in some other European countries. An interesting initiative by the state was the establishment in 1994 of an *ad hoc* Company Law Review Group (CLRG) by the Minister for Enterprise and Employment. Its 16 members were from a wide variety of interests covering the law and accountancy professions, civil service, business, bankers, the Stock Exchange, tax authorities and trade unions. The Chairman was James Gallagher of Arthur Andersen. The creation of the CLRG partially reflected the Minister's response to the lobbying by bankers and the accountancy and law professions over aspects of the 1990 Companies Amendment Act involving the appointment and role of examiners in corporate bankruptcy cases. The remit of the first phase of CLRG's assignment was widened to several areas of corporate regulation, including the recommendations of the Ryan Commission on financial reporting.

The CLRG's first report (1994) commented extensively on the Ryan Commission's report and financial reporting issues as regards Ireland. The CLRG report supported the recommendations of the Ryan Commission in terms of a private sector basis for accounting and auditing standards. It also agreed that such accounting standards should be recognised by law and that a modest form of Review Panel (similar to the UK) be established to ensure compliance with the standards.

In a revealing insight into the interdependent relationship between the state and the private sector (principally the ICAI) as regards compliance with accounting and auditing regulations, the CLRG report commented:

> As we have remarked in relation to the accounting standards setting system, it is important, in accepting a non-statutory system as more appropriate then legislation, to keep that system under review and to evaluate continuously its effectiveness. In the case of auditing, the ultimate responsibility for the assessment of the effectiveness of the non-statutory system rests with the

> Minister for Enterprise and Employment who has the statutory responsibility for granting recognition to auditors for the purposes of the Companies Acts. We note that the Minister has the responsibility and powers under legislation (Part X of the Companies Act, 1990) to monitor and impose conditions for recognition on auditors. The existing legislation, in our view, makes adequate provisions for the evaluation and review of the system. In practice, it would be hoped that there would be no need to avail of these powers and that the standards setting system and the professional bodies would ensure that all standards and codes operated to the highest level of quality.
>
> While we have concentrated on the overall structure within which auditing standards are set rather than on the detail of those standards, we note that the Ryan Commission has made some recommendations in relation to the conduct of audit. These recommendations cover areas such as engagement letters, reporting to management, internal controls and solvency (in the context of going concern). We also note that the Auditing Practices Board has issued exposure drafts of proposed standards covering all these areas. At the time of writing the final standards are not available. As with accounting standards, we do not consider it appropriate that we should get involved in the detail of individual standards. The evidence is that issues are being addressed. It is important that the effectiveness with which they are addressed be reviewed continuously by the Minister in the context of the recognition process. (pp. 33–4)

The above indicates that the expected position is that the state will operate enforcement and compliance through the recognised auditor groups. These professional bodies are subject to the state's ultimate authority and as part of this process they will be required to exercise effective self-regulation. The degree of interplay between certain of the Irish accounting bodies and the state at formal and informal levels should not be overlooked, particularly between the ICAI and the relevant government department, where there appear to be mutually beneficial relationships.

DOES IRELAND HAVE AN INEFFECTIVE REGULATORY STRUCTURE?

Since 1990, in line with previous practice, Ireland accepted the new standard-setting process adopted by the ASB in London and the output of its activity as the basis of the rules of measurement and presentation for financial statements. Ireland has also accepted the Auditing Standards of the Auditing Practices Board of London. Though the Financial Reporting Review Panel came into operation in the UK in February 1991, Ireland has not established an equivalent body despite the recommendations of the Ryan Commission in January 1992 or its endorsement by the ICAI. The CLRG Report of 1994 also has recommended the creation of a Review Panel for the monitoring and enforcement of financial reporting rules. A reason for the absence of action appears to be the cost of operation and the participation by the state in its funding.

As Ireland does not have a Securities Commission on the lines of the SEC in the USA or Canada (or the COB in France which supervises companies listed on the Paris Bourse), there is a vacuum in the monitoring and enforcement of standards. The Irish Stock Exchange requires compliance with the pronouncements of the ASB as part of its listing agreement. The extent of its monitoring since it partially separated from London and the enforcement measures it can and does take are not transparent. It should also be noted that only a very small proportion of Irish industry has a Stock Exchange quotation. Thus it is not of relevance to a whole range of larger public interest firms such as state sponsored bodies, cooperatives, and privately owned firms.

The critical differences between the Republic of Ireland and the UK can be summarised as follows:

1. FRSs have no legal authority. They are not recognised in the various Companies Acts to date.
2. Companies are not required by law to state in their accounts whether or not they have followed applicable accounting standards and give the reasons for any material departures from them.

3. There is no Financial Reporting Review Panel or its equivalent, and neither is there a Securities Commission.
4. There is no basis for requiring a company to revise its accounts. It and its directors can be prosecuted and fined where it breaks statutory rules in the Companies Acts.
5. FRSs (developed by the ASB, London) are promulgated by the Institute of Chartered Accountants in Ireland, Dublin and Belfast (a professional body). There is no overarching independent body such as a Financial Reporting Council. Consequently, the involvement of the state, financial institutions, industry and academia is quite informal.
6. There have been no official published investigations into company collapses or accounting/auditing issues.
7. There have been very few court cases and legal decisions in the last 50 years.

Given that the UK has experienced a reasonable number of cases brought before the Review Panel, it is inconceivable that there are no equivalent cases of incorrect accounting treatment in Ireland, particularly as the accounting and audit practice standards are common to both countries. In the absence of a Review Panel, the sole guardian becomes the auditor. It is an onerous task when there is no legal backing for the standards and the competition for audit work is intense. It should be noted that the only regulatory structure in Ireland for accounting standards rests with the professional accounting bodies through their own members. These bodies have no direct or disciplinary influence over non-accountants who are directors of companies. The consequences are that, apart from those cases where it is up to the auditors to disclose non-compliance, there is no formal monitoring of larger companies' financial statements apart from reliance on the Irish Stock Exchange, Dublin. Those who are not accountants, such as company directors who are responsible for the preparation of financial statements, are not embraced (or constrained) by any private sector regulatory framework and are bound only through their relatively narrow obligations under company law.

In summary, then, we can view the regulation of financial reporting from the 'public interest' and 'private interest' perspectives. Each has its strengths and weaknesses. There are issues of credibility, authority, rigour, flexibility and ability to act reasonably quickly in an increasingly complex and changing business world. There is also the matter of costs and who pays the costs and obtains the benefit. Investors and financial institutions are primary beneficiaries, quite apart from the state in terms of taxation and the employees in terms of wealth allocation and future corporate risk and sustainability.

Rule-making and enforcement has an appreciable direct cost. It is understood that the cost of operating the Financial Reporting Council in the UK (including its associated bodies, the ASB and the Review Panel) is over £2.25 million per annum, low by comparison with the budget allocation to the FASB in the USA. The cost of operating the APB, the JDC and the Stock Exchange monitoring section and the professional accounting bodies' practice of monitoring should be added to the foregoing to appreciate that private sector 'rule-making' and enforcement has an appreciable direct cost which is being borne by the private sector.

In these circumstances, perhaps it is not surprising that, apart from cultural, historical and political traditions, the state has left the primary thrust of 'rule-making' to the private sector in both the UK and Ireland. In view of the fact that Ireland is a small open economy with such extensive professional, financial and trading links with the UK, it can be argued that it is 'practical' to adopt financial reporting standards which have been developed in London. The evidence to date both as regards corporate regulation generally and with regard to financial reporting in particular is that the Irish state has not been particularly interested in direct involvement in the development or enforcement of financial reporting rules. European Directives have been the primary 'public interest' rule-making activity as regards Ireland.

The recognised private sector activity emanating from London must be seen as a public good in Ireland. The ASB's and APC's standards carry greater credibility and authority than a small country could muster. They also link to IASs. Thus there is benefit to the efficient management of private sector organisations and the financial and capital markets. The weakness is the absence of any real oversight by the state of this important private sector activity. One can argue that this area of corporate regulation has been 'captured' by the private sector for its private interests and that the state has 'surrendered' it for practical reasons which include issues of expertise and the related costs and benefits. Undoubtedly the expertise, interaction, lobbying and positive reputation of the ICAI has also played a role in this situation. It will take a major financial scandal in Ireland involving accounting and auditing before current arrangements are altered materially. If leading professional accountants in the UK have questioned the reliability of the regulatory process (Swinson, 1993), then the potential reliability of the Irish regulatory system seems even more problematical.

Notes

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1. The term 'Ireland' is used for convenience and brevity to reflect the Republic of Ireland in the rest of this paper
2. Many modern commentators appear to miss the fact that the term 'regulation' was operational over one hundred and fifty years ago.
3. Auditing is an extensive service industry. The mandatory audit for small companies is presently being reviewed by the State, most companies in Ireland being very small.

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8 Italy

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INTRODUCTION

The first mention of annual accounts in Italian law can be traced back to the Commercial Code of 1865 when company directors were excluded from the vote to approve the accounts, but it was actually the 1882 revision of the Commercial Code which supplied Italy with its first official regulations obliging companies to prepare financial statements. Over the years, the requirements of codified law tended to be supplemented by fiscal regulations which then exerted a significant influence on financial reporting in Italy for a lengthy period. However, a fundamental change in the regulatory process occurred in 1974 with the establishment of the Italian Stock Exchange and Companies Commission, CONSOB (*Commissione Nazionale per le Società e la Borsa*), a regulatory agency which, amongst other things, was empowered to require audited annual accounts from companies quoted on the stock exchange. Although the number of companies affected was not large, the new law nevertheless acted as the long-awaited catalyst of change in Italian accounting (Riccaboni and Ghirri, 1995).[1]

The implementation of the European Company Law Directives in 1991 brought about a more wide-reaching change in accounting regulation through extensive revision of the Civil Code. At the same time, the Accounting Principles Commission (*Commissione per la Statuizione dei Principi Contabili*, or CSPC), a joint board of the professional accounting bodies which had been existence for some years and had issued a number of recommendations on accounting principles, set about revising its earlier recommendations to achieve consistency with the new provisions of the Civil Code and other sources of accounting rules. Although the principles of the CSPC have never been officially recognised in law, some acknowledgement has been given by CONSOB along with default recognition of IASs.

In general, it would appear that the regulation of accounting in Italy has maintained its traditional image of rigid legal prescription combined with flexibility in interpretation (Di Toro and Ianniello, 1996). This chapter attempts to explain how the current system copes with these seemingly contradictory goals, and to explain how the legislature, the fiscal authorities, the accounting profession and others contribute to the process of accounting rule-making in Italy.

A BRIEF HISTORY

Italian accounting in practice and theory has usually anticipated changes in the law concerning the preparation of financial statements. However, the link between accounting thought and the formal rules of accounting is an indirect one, and there is an inevitable delay between the formulation of a theory or the practical application of an idea and the eventual enshrinement of that idea in law. Nevertheless, in general terms, the history of accounting regulation reflects the developments that have taken place in accounting thought, the most relevant periods being the Middle Ages when double entry bookkeeping (*contabilità*) originated, the period of the unification of Italy when accounting (*ragioneria*) came into being and the modern period which has seen the development of business economics (*economia aziendale*) with its change of emphasis to accounting for the business entity. Over the same period, regulation has developed from its concern with record keeping to the accountability of traders and merchants and, ultimately, to the publication of financial reports by business concerns.

Undoubtedly, Italian scholars made a substantial contribution to the early history of accounting, and were responsible for setting down the first coherent set of rules to assist in monitoring the activities of a sole trader: see Melis (1950), Zerbi (1952), Giannessi (1980) and Pezzoli (1986). Leonardo Fibonacci of Pisa was the first of these contributors, his *Liber Abaci* (1202) being a text for commerce specifically written to record transactions relating to trade. Later in the Middle Ages, Italian merchant and banker families developed and expanded their activities all over Europe and the double entry method of bookkeeping, originating in Italy, gradually began to be introduced elsewhere (Ponzanelli, 1982). The oldest existing printed work in Italian on fundamental principles is the treatise entitled *Tractatus particularis de computis et scripturis* by Luca Pacioli, a Franciscan monk born in Tuscany. This treatise was part of his *Summa de arithmetica, geometria, proportioni et proportionalità*, first printed in Venice in 1494. The book is mainly known for its description of the double entry method using simple notions and appropriate examples, but it also tells us that it was obligatory in some Italian city states at that time for accounting ledgers to be stamped by officials before use and kept as evidence in case of disputes. Indeed, there is evidence in cities such as Venice, Milan, Florence and Siena of the existence before Pacioli's time of the 'official' nature of books of account kept by communal organisations such as city halls, hospitals, monasteries, churches and arsenals, although there is no trace of the regulations themselves.

The nineteenth century was also an important period in the evolution of accounting in Italy. To begin with, when some Italian-speaking regions were under French control and others were dominated by Austria, the main influences were from outside. For instance, a book by Dégrange was available in Italian by 1837, outlining a system of record keeping based solely on personal accounts which record transactions with other parties. By the 1860s, the political and administrative fragmentation of Italy was virtually ended, opening the doors not only to economic and social unification but also to a wider debate on matters concerning commercial life in Italy. Some Italian authors on accounting built upon the *teoria personalistica* introduced by Dégrange (1837), such as Parmetler (1863) and Queirolo (1863), whilst others put forward alternative views. Among them were Francesco Marchi (1822–1871) and Francesco Villa (1801–1884), the latter taking a distinctly managerial perspective which led to the idea of accounting for physical assets as well as personal transactions. The theoretical perspective is evident in their published works, such as Villa (1864) and Marchi (1867), and is confirmed in the retrospective assessment of Villa by Ferraris Franceschi (1970). An important ally was found in Giuseppe Cerboni (1827–1917) who held high office in the unified Italian state, becoming *Ragioniere Generale dello Stato*

(Chief Accountant of the State) in 1876. Under his influence, accounting studies were named *logismografia*: that is, a 'rational description' which separates the transactions of the owner from those of various agents (Cerboni, 1886).

The most authoritative scholar of this period, however, was Fabio Besta (1845–1922). He developed the concept of *amministrazione economica* whereby accounting is perceived as the economic control of a business, and proposed a fund accounting system (*sistema patrimoniale*) which was based on asset and liability valuations (Besta, 1909). The financial result for the year was to be expressed as the difference between profits and losses relating to each item of capital which would be shown in a statement of gross income (*a risulti lordi*) and which could be reconciled with the change in net assets during the period. The Commercial Code of 1882 introduced the *Stato Patrimoniale* as a legally required balance sheet but, consistent with the liberal politics of the time, much was left to the discretion of the administrators of a company with regard to the content of such balance sheets, and there was no requirement in law for an income statement. Indeed, article 176 of the 1882 Code merely required that they show 'clearly and truly the losses and profits' and there was no reference to their format or the criteria to be used in their preparation.

At the beginning of the twentieth century, the Italian economy was transformed from an agricultural basis to an industrial one, and the creation of large state-owned industrial holding companies IRI and ENI followed in the 1930s. The financial sector also came under strict state control. However, the small family firm provided the basis for the Italian economy. Somewhat belatedly, the Commercial Code concept of the sole trader or merchant (*mercante*) and his single-handed operations was replaced in the Italian Civil Code of 1942 by the notion of the entrepreneur (*imprenditore*) who organises, manages and develops a firm. Although the Code now contained an entire section on the annual accounts, the accounting regulations were still rudimentary and disclosure was restricted to the presentation of a balance sheet. It is in this context that Gino Zappa (1879–1960), one of Besta's students, had a considerable impact on the evolution of Italian accounting. Zappa's major contribution was that of defining a single area of study that would explore the various aspects of business activities. He argued that business economics (*economia aziendale*) is a single field of study involving management (*gestione*), organisation (*organizzazione*) and recording (*rilevazione*). Further discussion of Zappa's approach to business economics can be found in Amaduzzi (1960), Canziani (1980) and Zan (1994). In the field of accounting, Zappa replaced Besta's fund accounting system with an income-based approach (*sistema del reddito*) in which the income for the financial year (*reddito d'esercizio*) is determined as the result of accounting for the multi-faceted aspects of an organisation independently of its capital structure (Zappa, 1950). An income statement which represents such a viewpoint emphasises costs, revenues and inventories. In 1974, this type of income statement (*a costi, ricavi e rimanenze*) was prescribed for companies by the Civil Code, although it is also worth noting that the regulations governing the electricity industry have required a full balance sheet and profit and loss account since the late 1950s.

Following the reform in the 1970s, attention turned to the broader notion of generally accepted accounting principles – see Potito (1973), D'Ippolito (1975), Coda (1983) and Bruni (1984), for example – and a more complex process of accounting rule-making has emerged in Italy (Di Pietra, 1997). Nevertheless, the laws, decrees and regulations issued either by Parliament, the government or its ministers still take precedence over all rules enacted by other rule-making bodies. With the exception of the EU's legislative institutions, all other rule-making bodies are in fact under the control of the state or contribute in the initial phase of rule creation. In the following sections of this chapter, the institutions of Italian accounting regulation are discussed in detail.

THE ROLE OF THE LEGISLATURE

In Italy, the state exercises its authority through a number of regulatory instruments, not only parliamentary laws (*legge*) but also legislative decrees (*decreti legislativi*) and law decrees (*decreti legge*), both prepared by the Government within the limits of the Constitution. Law decrees are issued by the President of the Republic, in the form of presidential decrees (*decreti del Presidente della Repubblica*).

Parliamentary Law (*Legge*)

Parliamentary law is enacted following the approval of each of the two houses of Parliament, the Chamber of Deputies (*la Camera dei Deputati*) and the Senate (*il Senato*). Usually, any proposal of law is first discussed in a parliamentary committee which is nominated by the President of the Chamber or by the President of the Senate and which takes into consideration the composition of the Parliament. After a committee has completed its work, the bill is discussed by the Parliament and, if approved, becomes (with eventual modifications) a law of the Italian Republic.

When dealing with specialised matters such as accounting regulations, the parliamentary committee will delegate the preparation of a draft law to a subcommittee of experts, such as leading academics in commercial law or accounting. However, other experts in law-making are also often present on these commissions, and the tendency has been for accounting law to be drawn up primarily by lawyers rather than by accountants. This was the case in the *Uniconti* Commission of 1942 which attempted to draft an accounting plan for Italian companies, and the D'Alessandro Commission of 1986 which was responsible for the revision of the Civil Code to implement the Fourth and Seventh European Directives.

Legislative Decrees (*Decreti legislativi*)

Legislative decrees arise when the Parliament delegates powers to the government through a delegating law (*legge delega*) which places the necessary restrictions on the scope of the eventual legislation and defines its timetable. This was the case, for example, when Law 69 of 26 March 1990 delegated responsibility for the incorporation of the Fourth and Seventh Directives into Italian law, which was enacted through legislative decree Lgs.D 127 of 9 April 1991. In fact, in this case, the D'Alessandro Commission had already been at work for some years prior to the issue of the delegating law, having originally been established as a working group by the Ministry of Justice. A first draft of the proposed legislation was issued in 1986, and a second in 1988, both accompanied by Commission reports. Following the *legge delega*, a third draft and report of 8 February 1991 was sent to the President of the

Chamber of Deputies to be examined by a number of Parliamentary Commissions. After a few minor changes, Lgs.D 127 was approved.

After a legislative decree has been adopted by government, it is issued in the form of a decree signed by the President and then published in the Official Gazette. It comes into effect 15 days thereafter.

Law Decrees (*Decreti legge*)

A law decree is intended for urgent and exceptional matters only, and is issued with a decree signed by the President of the Republic and countersigned by the President of the Government (*Presidente del Consiglio*). It is then published in the Official Gazette and comes into effect on the day of publication. A law decree must be submitted to the Parliament for enactment into law on the day that it is issued and confirmed in law within 60 days. For instance, the removal of the requirement for a fiscal appendix reconciling accounting profits and taxable profits as part of the annual financial reporting package was legislated upon in this way (LD 416 of 29 June 1994 and L 503 of 8 August 1994). If a decree fails to become law within 60 days of publication in the *Gazzetta Ufficiale*, its effects are null and void starting from the day of issue.

Article 77 of the Italian Constitution states that the government can use law decrees in cases of exceptional urgency only. However, because of the traditional slowness of Parliament in legislating, the use of a law decree having immediate effect has been turned into a pragmatic expedient. Unfortunately, this procedure can limit the opportunity for public scrutiny, although it worth noting that recent changes have made their reiteration – when not converted into law – far less easy.

Presidential Decrees (*Decreti del Presidente della Repubblica*)

In addition to their use in ratifying legislative decrees and law decrees, Presidential decrees are also issued on specific points of law as an adjunct to enabling legislation. For instance, the law giving powers to a new stock exchange commission (Law 216 of 7 June

1974) which ratified a previous law decree (LD 95 of 8 April 1974) also authorised the government to lay down specific rules on auditing and accounting. These specific pieces of legislation were then covered by subsequent Presidential Decrees (DPRs 136 and 137 of 31 March 1975). Presidential decrees such as these are issued with the signature of the appropriate Minister and with the ratification of the President of the Republic. There are many examples in the field of tax regulation where, under the signature of the Minister of Finance, taxation changes have become law with a Presidential decree (for instance, DPR 42 of 4 February 1988).

Inevitably, delegated legislation has increased the power of the government, which is particularly evident in the field of business law. Indeed, the legislative powers of ministers is exercised through a further type of legislative instrument known as Ministerial Decrees (*decreti ministeriali*, or MD). Such decrees may either concern administrative matters (*atti amministrativi*) or contain ministerial orders (*regolamenti ministeriali*). In the latter case, if the law delegates the appropriate powers, a minister may issue supplementary regulations and, in cases where specific problems have arisen, official interpretations of laws and decrees which have already been enacted. Ministerial decrees have less authority than law, being categorised as *norme secondarie*. Nevertheless, they play an important role in accounting regulation.

ACCOUNTING LEGISLATION

The use of different instruments to legislate on accounting is apparent in Table 8.1 which provides an overview of recent accounting regulation in Italy. Before this, financial reporting was governed by the 1942 Civil Code. Indeed, until 1991, the year in which the European accounting directives were enacted in Italy, the annual accounts (*bilancio*[2]) of an Italian company were made up of a balance sheet (*stato patrimoniale*) and a profit and loss account (*conto dei profitti e delle perdite*) only.

By 1991, thirteen years had passed since the Fourth Directive had been issued. During this time, the potential consequences on Italian commercial law were debated widely, with respect not only to the Fourth Directive (see Bertini, 1980; Capaldo, 1980; Fanni, 1980)

Table 8.1 Accounting legislation in Italy

Year	*Date*	*Law/ Decree*	*No.*	*Objective*
1969	29 December	DPR	1127	Enactment of First EC Directive
1974	8 April	LD	95	Creation of CONSOB; disclosure requirements of listed companies
1974	7 June	L	216	Following LD 95/1974 re. CONSOB
1975	31 March	DPR	136	Following L 216/1974, audit and accounts of listed companies
1978	14 December	DPR	14	Layout of annual accounts of insurance companies
1980	4 February	MD	–	Layout of annual accounts of service companies controlled by regional authorities
1983	19 March	L	72	Revaluation of assets and equity
1985	4 June	L	281	Interim accounts of quoted companies
1986	10 February	DPR	30	Enactment of Second EC Directive
1988	4 November	L	481	Provisions by banks against foreign loans
1990	26 March	L	69	Delegation of legal authority to the Government to enact EC Directives
1990	27 April	LD	90	Income determination for tax purposes
1991	9 April	Lgs.D	127	Enactment of Fourth and Seventh EC Directives
1991	8 October	MD	–	Layout of annual accounts of electricity companies
1992	27 January	Lgs.D	87	Enactment of EC Directive 86/635 concerning the annual accounts of banks and financial institutions
1992	24 June	MD	–	Guidance on preparation of annual accounts following Lgs.D 87/1992

Note:

L	Law
LD	Delegated legislation
Lgs.D	Legislative decree
DPR	Presidential decree
MD	Ministerial decree

Table 8.1 (*cont.*)

Year	*Date*	*Law/ Decree*	*No.*	*Objective*
1992	21 October	MD	–	Changes in the layout of the income statement, including separate disclosure (21b) of interest on specific loans
1992	30 December	Lgs.D	526	Enactment of EC Directive 90/604 concerning the translation of annual accounts in ECU (Art. 2435 Civil Code) and abridged financial statements (Art. 2435b)
1994	2 May	Lgs.D	315	Enactment of EC Directive 92/101 concerning purchase of controlling company shares (Art. 2357 and 2357b of the Civil Code) as a consequence of changes in the layout of the balance sheet (Art. 2424)
1994	29 June	LD	416	Regulations concerning fiscal income
1994	8 August	L	503	Law ratifying LD 416/1994, whilst removing the requirement for a fiscal appendix (items 24 and 25 of income statement)
1995	7 January	LD	1	Mandatory elimination of fiscal items from group accounts (reversal of relevant legislation in L 503/1994)
1995	9 March	LD	64	Option to base group accounts on amounts used for tax purposes
1995	26 April	MD	-	Layout of annual accounts of service companies controlled by regional authorities
1995	27 October	LD	442	Annual accounts of publishing companies
1995	29 December	LD	554	Revision of LD 442/1995

but also to the Seventh Directive (see Brunetti, 1985; Canziani, 1985; Provasoli, 1988). As mentioned above, the Ministry of Justice had originally set up a technical committee to examine the issues in detail. On 20 December 1983, a Ministerial Decree gave the status of Commission to the existing committee, requiring it to report by the end of 1984 on the issues arising from the enactment of various EC Directives. With further decrees, the Committee's tenure was extended until the end of 1992.

The D'Alessandro Commission was mainly composed of jurists, its chairman being a professor of mercantile law. To begin with, its 20 members comprised eight judges, nine professors of law, one certified accountant, one professor of accounting and one official from the Ministry of the Treasury. Subsequently, the membership was extended and there were several changes in composition. The composition of the Commission is given in Table 8.2.

Table 8.2 Membership of the D'Alessandro Commission

	Original membership (1983)	*New members (1983–92)*
Judges	8	12
Professors of law	9	7
Professors of accounting	1	2
Dottori Commercialisti	1	1
Official of the Ministry of the Treasury	1	–
Official of Ministry for State Holdings	–	3
Officials from other ministries	–	2
IRI (State holding company)	–	1
ENI (State holding company)	–	1
Lawyers and notaries	–	3
Representative of the Banca d'Italia	–	3
CONSOB	–	4
Prime Minister's office	–	2
ASSIREVI (Association of audit firms)	–	2
Ragionieri Commercialisti	–	1
Total	20	44

Note: The new members include not only additional members but also those replacing retiring members.

The third and final report of the Commission laid down the choices to be made between the many options given in the Community text. The new regulations provided detailed guidelines on the preparation of annual accounts by a public company limited by shares (*Società per Azioni*). The annual accounts were to comprise a balance sheet (*stato patrimoniale*), an income statement (*conto economico*) and notes to the accounts (*nota integrativa*). Moreover, an annual management report (*relazione sulla gestione*) had to be included with the accounts. These same regulations were to be applied to private limited liability companies (*Società a Responsabilità Limitata*), incorporated partnerships in which the non-managing members have limited liability (*Società in Accomandita per Azioni*), cooperatives (*Cooperative*) and mutual insurance companies (*Mutue Assicurazioni*), except in cases where special laws exist for companies carrying out specific activities.

When the Fourth and Seventh European Company Law Directives were implemented by Lgs.D 127 on 9 April 1991, Articles 1–20 of this decree amended the Civil Code with respect to the provisions of the Fourth Directive and Articles 21–46 set out the new law concerning groups of companies. No reference was made to the Civil Code in the latter case, as the concept of a group of companies was not codified. The revision of several articles of the Civil Code dealt with changes in the preparation of annual accounts, balance sheet layout, income statement layout, valuation criteria, the notes to the accounts and the management report, as shown in Table 8.3. The Directives introduced a number of new concepts, and they have undoubtedly had a strong influence on the regulations governing financial reporting in Italy (Riccaboni and Di Pietra, 1996). The concept of a true and fair view (*rappresentazione veritiera e corretta*) has superseded the expression 'clarity and accuracy' (*chiarezza e precisione*) which was previously used in Italian regulations. In accordance with the Fourth Directive, the new Italian regulations require that accounting policies incompatible with a true and fair view be avoided when preparing financial statements (Article 2423 of the present Civil Code), and that additional information should also be supplied if it facilitates the presentation of a true and fair view of a company's assets and liabilities (*situazione patrimoniale*), its financial position (*situazione finanziaria*) and the annual profit or loss (*risultato economico dell'esercizio*).

Table 8.3 Articles of the Italian Civil Code relating to annual accounts

Civil Code Articles	*Content*
2423	*Redazione del bilancio* – Preparation of annual accounts
2423 bis	*Principi di redazione del bilancio* – Preparation principles
2423 ter	*Struttura dello stato patrimoniale e del conto economico* – Balance sheet and income statement layout
2424	*Contenuto dello stato patrimoniale* – Balance sheet contents
2424 bis	*Disposizioni relative a singole voci dello stato patrimoniale* – Regulations governing balance sheet items
2425	*Contenuto dello conto economico* – Income statement contents
2425 bis	*Iscrizione di ricavi, proventi, costi ed oneri* – Recording of revenues, other income, costs and other charges
2426	*Criteri di valutazione* – Valuation criteria
2427	*Contenuto della nota integrativa* – Contents of the notes to the accounts
2428	*Relazione sulla gestione* – Management report
2435	*Pubblicazione del bilancio e dell'elenco dei soci e dei titolari di diritti sulle azioni* – Publication of the annual accounts and of the list of shareholders and owners of equity rights
2435 bis	*Bilancio in forma abbreviata* – Abridged version of the annual accounts

Note: The development of Article 2435 illustrates the piecemeal evolution of codified law. Article 2435 of the Code was redefined for its current contents by Lgs.D 127/1991. The title was reworded to '*Pubblicazione del bilancio e dell'elenco dei soci e dei titolari di diritti sulle azioni*' in Art.4 of L 310, 12 August 1993. A second paragraph was added by Art.3 of Lgs.D 526, 30 December 1992. A third and last paragraph was added by Art.4 of L 310, 12 August 1993. Finally, Art.7–bis of LD 357, 10 June 1994 (converted into law as L 489, 8 August 1994) extended the first paragraph.

Although Lgs.D 216 of 1974 gave CONSOB the power to require companies quoted on the Stock Exchange to prepare group accounts (later extended to financial institutions not quoted on the stock exchange and to institutions managing investment funds), the regulations at the time included neither the definition of a group nor the consolidation procedures to be followed. Now, the criteria determining which companies are subject to the obligation of consolidation are based on Article 2359 of the Civil Code, which defines a subsidiary company as a company in which another company commands a majority of shareholders' voting rights, or has a dominant influence (*influenza dominante*) at its meeting of shareholders, based on the parent company's participating interest, or has a dominant influence based on contractual ties (Colucci and Riccomagno, 1997). For consolidation purposes, cases where control is due to specific contractual ties are excluded. Lgs.D 127 of 1991 states that, for consolidation purposes, subsidiaries are also considered to be those companies on which a dominant influence is exerted due to contracts or clauses in the articles of association, and, in addition, companies in which the majority of the voting rights are controlled by the parent company following an agreement with other shareholders. In defining the subsidiary company, other sets of rules are sometimes followed, owing to the lack of certainty before Lgs.D 127 of 1991 was adopted. Among them are Document 8 issued by the CSPC, and IAS Nos 3, 21, 24 issued by the IASC.

Interpretations and Judgements

Due to the slowness and rigidity of the law-making process, there are a number of ways in which interpretations of the law can arise. As shown in Table 8.4, these include official circulars produced at the Ministerial level which provide legal clarification as well as rulings on cases heard in the courts.

THE FISCAL AUTHORITIES

The present fiscal system in Italy dates back to 1951 when the Minister of Finance, Ezio Vanoni, initiated a complete review of tax laws and introduced the annual income tax return. A more general framework for reform, however, came into force in the 1970s. Nevertheless, the relationship between financial reporting requirements and tax regulations has remained somewhat unclear in Italy, given internal contradictions which persist within the laws. According to Article 52 of the Consolidated Law on Income Tax (*Testo Unico delle Imposte sul Reddito*, or TUIR), taxable income should be determined in the tax return by adjusting the profit which has been disclosed in the income statement and which has been

Table 8.4 Clarification of Italian accounting law by government departments and rulings on accounting law by the courts

Year	*Date*	*Document reference*	*Content*
Ministry of Finance			
1994	27 May	Circular 73/E	Income statement and notes to the accounts
1994	September	Committee report	Principle of clarity and truthfulness
1995	15 February	Ministerial decree	Anticipated depreciation allowed for tax purposes without being recorded in the income statement
1996	3 May	Circular 108/E	Leasing companies
Ministry of Justice			
1993	19 March	Note 1624/13/1/UI	Application of LD 127 to partnerships
1994	14 June	Circular 13/94	Statutory auditors

Year	*Date*	*Court*	*Ruling*
Italian courts			
1970	7 September	Corte di Cassazione (Judgment 1281)	Proof of debt (the annual accounts, as any other accounting record, represent proof of a debt)
1978	4 September	Tribunale di Milano	Anticipated depreciation (not to be recorded in the annual accounts)
1984	12 January	Tribunale di Milano	Anticipated depreciation (may be recorded in the annual accounts if the principle of clarity is respected by providing detailed information in the Management Report – Notes to the Accounts were not required at the time)

Table 8.4 (*cont.*)

Year	*Date*	*Document reference*	*Content*
Italian courts continued			
1985	27 February	Corte di Cassazione (Judgment 1699)	Inventories (LIFO)
1986	18 March	Corte di Cassazione (Judgment 1839)	Fiscal and civil valuation criteria
1988	5 May	Tribunale di Genova	Reinvested profit (annual accounts prepared in accordance with certain fiscal laws are valid if this is required in order to take advantage of tax benefits and if adequate information is given in the Management Report)
1993	11 March	Corte di Cassazione (Judgment 2959)	Principle of clarity
1994	21 March	Tribunale di Torino	Negligence of auditing firms
1994	18 June	Tribunale di Sondrio	Subsidiary companies

Note: The *Corte di Cassazione* is the Supreme Court. *Tribunali* are held on a regional basis.

determined according to Civil Code regulations. However, Article 75 of TUIR presents a different view as it indicates that expenses and charges are not deductible if they have not been charged to the income statement in the period under assessment (Olivieri, 1994). The effect of article 75 is to induce Italian companies to include tax-based valuations in their income statements, particularly in respect of depreciation. In effect, Article 52 (which implies that depreciation should be calculated according to the principles of the Civil Code) is rendered ineffective by Article 75 when the rates of depreciation set by the fiscal authorities are more favourable.

An example of the influence of tax regulation on financial reporting is the case of depreciation. In fact, until 1991, provisions for depreciation were included among liabilities in the balance sheet of an Italian company, but Lgs.D 127 of 1991 now requires disclosure of the assets' net value with depreciation deducted from the purchase price or production cost. Article 2426 of the Civil Code states explicitly that the purchase price or production cost are to be 'systematically' depreciated in each financial year. The depreciation method used and the rate applied, together with any modifications, must be explained in the notes to the accounts. However, the treatment of depreciation for tax purposes is more complex and sometimes difficult to interpret and to apply.

Subsequent tax rulings have reconfirmed that assets must be depreciated within precise limits established by the Ministry of Finance, where fiscally-deductible depreciation is classified in four ways (Viganò, 1994). Ordinary depreciation (*Ammortamento ordinario*) must not exceed the amount obtained from applying the depreciation rates established by a Ministry of Finance decree and published in the Official Gazette, where specific depreciation rates are given for each category of asset and each industrial sector. The second category, accelerated depreciation (*Ammortamento accelerato*), allows rates of depreciation higher than the official rates, to account proportionally for more intensive utilisation of an asset than the norm for the industry. With anticipated depreciation (*Ammortamento anticipato*), it is possible to double the annual rate of depreciation on certain assets during the first three years, even without a proportional increase in usage. Finally, decelerated depreciation (*Ammortamento decelerato*) involves recording an amount lower than that established by ministerial decree and which may, in certain circumstances, be recoverable in future periods.

Due to the conflict in law between Article 52 and Article 75 of the TUIR, many companies have reported fiscal depreciation in their published financial statements, perhaps using depreciation schedules which do not reflect the economic depletion of the assets in question. Thus, as a direct consequence of the differences between the requirements of the Civil Code and those of the tax authorities, it is still the case in Italy that annual accounts may show an amount of depreciation which is far from an accurate representation of wear and tear.

A second example of the strong influence of fiscal rules on financial reporting procedures concerns the way in which assets are revalued in Italy. In general, the revaluation of an asset could arise from events affecting the company as a whole, specific situations concerning a particular asset or extraordinary events which cause an increase in the value of an asset or assets. However, the present Civil Code has established that the revaluation of assets is allowed only in extraordinary cases and that any eventual gain must be transformed into a restricted reserve. As inflation cannot be considered an extraordinary event, revaluations due to inflation are allowed only under specific conditions regulated by law, where the relevant decree will stipulate the categories of assets involved, the procedures to be adopted including the changes to be made to the financial statements, and the fiscal effects.

During the last 20 years, laws allowing the revaluation of assets were issued, in 1975, 1983, 1990 and 1991. The first of these, L 576 of 2 December, 1975, provided for a voluntary and tax-free monetary revaluation of tangible assets, where the asset value and related depreciation were adjusted on the face of the balance sheet, the revaluation surplus being taken to revaluation reserve as part of shareholders' equity. Under this law, any distribution from the revaluation surplus would be subject to taxation. The second, L 72 of 19 March 1983 introduced 'indirect' revaluation which was subject to a maximum revaluation limit. The revaluation surplus had to be allocated to a special revaluation surplus account among liabilities, and distribution was again permitted subject to taxation. L 408 of 29 December, 1990 was intended to achieve fiscal objectives through a voluntary but taxable revaluation of certain categories of assets. However, because of the tax rate of 16 per cent on the surplus on buildings and 20 per cent on other depreciable assets, this opportunity was not taken by many firms. Finally, L 413 of 30 December, 1991 made revaluation compulsory on certain assets such as buildings and development land. A tax equal to 16 per cent of the revaluation was levied, with various provisions for offsetting.

The most recent conflict between fiscal regulations and accounting law concerns the introduction and then abandonment of a requirement to publish as part of the income statement a reconciliation relating to tax charges, known as the 'fiscal appendix' (*appendice fiscale*). As Lgs.D 127 stated that the valuation criteria to be applied in drawing up an income statement were to be those laid down in the Civil Code, whilst article 75 of TUIR stated that costs, to be fiscally deductible, need to be charged to the income statement, there was an inherent conflict of laws. As a result, Lgs.D 127 required a reconciliation to be made on the face of the income statement, whereby 'Value adjustments made exclusively as a consequence of tax policies' (item 24) and 'Provisions relating to tax benefits' (item 25) showed the effect of the tax-allowable amounts of items such as accelerated depreciation. Thus, the 'Result for the year' (item 23) would be stated in accordance with Civil Code criteria whilst 'Net income/loss' (item 26) would be in accordance with fiscal requirements. Guidance on accounting treatment was offered both by the Ministry of Finance and CONSOB.

The legitimacy of this kind of legal compromise had been raised in the past in a court case before the Tribunal of Milan, and the high court (*Corte di Cassazione*) had found in 1985 that a company may disclose tax-based figures if it would be against its interests not to do so. Since Lgs.D 127, however, there has been an ongoing debate on this matter concerning technical issues of anticipated depreciation and deferred taxation (Ruggieri, 1993; Viganò, 1994; Rizzardi, 1995; Valacca, 1995) and the more pragmatic matter of applying the regulations (Feliziani, 1994; Spoletti, 1994; Dezzani, 1994, 1995; Previti Flesca, 1995).

One apparent benefit of the fiscal appendix was its effect on increasing financial disclosure (Picolli, 1995). On the other hand, companies took the opportunity to account for the maximum amount permitted by the fiscal authorites, even where this was not justified, and it also gave rise to a variety of treatments of the effect on the balance sheet items and on deferred taxation in particular (Mio, 1995).

During the short-lived right-wing Berlusconi government, the requirement of a fiscal appendix was abolished. This was brought into effect through L 503 of 8 August 1994, when the earlier law decree, LD 416 of 29 June, 1994, was finally converted into law. LD 416 was in fact one of the law decrees issued by the previous left-wing Ciampi government and was concerned with routine fiscal arrangements with respect to business income (*Disposizioni fiscali in materia di reddito d'impresa*), having been issued first in December 1993 as LD 554, second in February 1994 as LD 139 and third in April 1994 as LD 261. The parliamentary debate that took place with respect to the draft converting LD 416 into law included criticism of the growing complexity of financial statements by a member of the left coalition Gruppo Progressisti Federativo (On. Agostini) and concern over fiscal evasion by the member of the extreme right Alleanza Nazionale who introduced the amendment (On. Barra). In fact, on this occasion, the opposition voted with the government to remove the fiscal appendix, the change in the law occurring as a result of last minute amendments introduced during the session of the Parliamentary Finance Committee.

The last minute changes to LD 416 were in complete contrast to the lengthy procedures which had required the fiscal appendix in the first place. This led to questioning in the Press of the appropriateness of direct Parliamentary intervention in accounting matters (Caramel, 1994; Piazza, 1994) and further reflection on the

Table 8.5 Revaluation laws in Italy and fiscal regulations influencing accounting

Year	*Date*	*Law/Decree*	*No.*
Revaluation laws			
1952	11 February	L	74
1975	2 December	L	576
1983	19 March	L	72
1990	29 December	L	408
1991	30 December	L	413
Fiscal regulations			
1986	22 December	DPR	917
1988	4 February	DPR	42
1990	27 April	LD	90
1991	30 December	L	413
1995	23 December	LD	542
1996	23 December	L	662

usefulness of the fiscal appendix (Adamo, 1995; Fusa, 1994; Monfregola, 1994; Moroni, 1994; Albertinazzi, 1995; Guerini, 1995; Artiaco, 1995). The current situation is that Italian companies must now give details of any consequences of fiscal influences as a note, an interesting outcome in that it raises the profile of the notes to the accounts.

CAPITAL MARKET REGULATION

In the last decade, the Italian stock exchange has been drastically modified. The stock exchange has been privatised and has become an electronic market with continuous trading, the turnover increasing almost tenfold. However, the number of listed companies has increased only marginally. As to stock market regulation, reference must still be made to L 216 of 7 June, 1974, which established the National Stock Exchange and Companies Commission (CONSOB) to regulate the activities of the capital market and to guarantee, together with the Bank of Italy, the functioning of a market in stocks and shares. CONSOB carries out its activities under the supervision of the Minister of the Treasury, and is periodically accountable to Parliament. The Commission operates independently with a President and four members named by Presidential decree on the basis of 'their qualification, morality, independence and competence'.

As mentioned earlier, the regulatory power of CONSOB is relevant to the preparation of annual accounts as the Commission oversees the listing of securities issued by companies. It can request annual consolidated statements from listed companies, and was empowered to do so even before the enactment of the Seventh Directive, and can also request any necessary information additional to that available in a company's annual and interim accounts. As CONSOB's role has developed, it has influenced the financial reporting procedures not only of listed companies but also of those companies which, potentially, are interested in being quoted on the Italian Stock Exchange. In order to increase comparability within Italy and internationally, the Commission recommended the application of 'Correct Accounting Principles' and, through resolution No. 1079 of 1989, CONSOB gave official acknowledgement to the CSPC accounting guidelines, recognising them as the most advanced among those available in Italy at the time. Moreover, in cases where these principles were found to be inadequate, the Commission stated that reference should be made to IASs on the condition that these did not conflict with the legal provisions. In fact, the resolution in question states that 'when accounting principles drawn up by the CSPC are incomplete or non-existent, those of the IASC are to be applied as long as they do not conflict with laws in force'. In addition to the default recognition of IASs contained in the Commission's statement, more specific acknowledgement is to be found in another CONSOB resolution (No. 4088, 1989) which stipulated that IAS 8 should be followed when dealing with extraordinary items, prior period items and changes in accounting policies.

In spite of the tacit recognition of CSPC by CONSOB, the CSPC has never been given official recognition in law. Indeed, the only occasions on which the legislature explicitly has delegated the formulation of accounting regulation were in 1975 to CONSOB concerning listed companies and later, through a legislative decree (Lgs.D 87 of 27 January 1992) and a subsequent MD (24 June 1992), to the Bank of Italy with regard to the accounts of financial institutions.

CONSOB releases circulars (*circolare*), formal decisions (*delibere*) and other communiqués (*comunicazioni*) which tend to be in the form of responses to particular queries. These are published in the monthly bulletin of the Bank of Italy (*Bolletino mensile della Banca d'Italia*) and if *circolare* or *delibere* are mandatory, they are also published in the Official Gazette (*Gazetta Ufficiale della Repubblica Italiana*). The Bank of Italy often coordinates its regulation of such issues as disclosure by financial institutions with CONSOB, sometimes requiring agreement (*d'intesa*) as in the case of brokers and other times requiring only consultation at a hearing (*sentita*), as in the case of pension funds. Its regulations (*provvedimenti*) are published in the Official Gazette. A list of the most relevant regulations on accounting issued by CONSOB and by the Bank of Italy is given in Table 8.6.

Table 8.6 Accounting regulations issued by the Italian Stock Exchange Commission and the Bank of Italy

Year	*Date*	*Regulatory instrument*	*Content*
CONSOB			
1982	8 April	Delibera 1079	Reference to accounting principles issued by CSPC
1987	8 April	Delibera 2837	Interim reporting by listed companies
1993	31 March	Communicazione 93002423	Differences between Civil Code regulations and CSPC recommendations (re. Delibera 1079/1982)
1994	23 February	Communicazione 94001437	Information disclosed by holding companies (re. Lgs.D 127)
1994	12 April	Communicazione 94003771	Auditors and the treatment of anticipated depreciation (under Art. 67 TUIR as modified by LD 139/1994)
1994	30 June	Delibera 8195	Interim reporting by listed companies
1994	1 August	Delibera 9389	Interim reporting by listed companies
1995	20 June	Communicazione 95005249	Consolidated accounts
Banca d'Italia			
1992	15 July	Provvedimento	The preparation of annual accounts and consolidated accounts by banks and financial institutions
1992	31 July	Provvedimento	The layout and rules of preparation of the accounts of financial institutions
1993	1 February	Provvedimento	Changes to Regolamento of 2 July 1991

THE ACCOUNTING PROFESSION

Regulation of the Italian accounting and auditing profession dates back a number of centuries (Alexander and Latini, 1992; Took, 1995). A *Collegio dei Ragionieri* was established in Venice in 1581 following a decree issued by the Venetian Council of Doges and, by the eighteenth century, the *ragionati* had organised themselves into local colleges in a number of Italian city states. Eventually, this led to recognition in law, albeit under the influence of the French Civil Code during the period of Napoleonic domination in the early 1800s. In Bologna, for instance, a local government ordinance of 1813 created the forerunner of the present *Accademia Nazionale di Ragioneria*. However, the first national recognition of the profession of *ragioniere* by the unified Italian state was through L 327 of 1906 giving the *ragioniere* the right to act as a public accountant. The first mention in law of the more highly qualified commerce graduate (*dottore commercialista*) is in a Royal Decree of 1929. Both qualifications are now fully recognised in law as, in 1953, the *dottore commercialista* was given legal status by DPR No.1067 and the *ragioniere* by DPR No.1068.

In Italy, legal status is also afforded to a number of other occupations which may be involved in accounting practice. These include auditors of accounts (*revisore contabile*), instituted by Presidential DPR 88 of 1992 (Caratozzolo, 1993). It should be noted that the revisore contabile is an official title which is assigned at the time of entry in the appropriate register (the *Albo dei Revisori Contabili*, having replaced the old Register of Official Auditors, the *Registro dei Revisori Ufficiali dei Conti*) and that it is usual for a *revisore contabile* to belong to one of the two main bodies of qualified accountants.

The main contributors to the process of developing and updating accounting rules are the *dottori commercialisti* and the *ragionieri*, whose respective national administrative bodies are the *Consiglio nazionale dei dottori commercialisti* (the CNDC) and the *Consiglio nazionale dei ragionieri* (the CNR).

In 1975, the CNDC created an Accounting Principles Commission (*Commissione per la Statuizione dei Principi Contabili*, CSPC) with the aim of setting down accounting principles that would be accepted by auditors, the preparers of accounts and the market alike. When it was constituted the members of the CSPC were nominated solely by the CNDC, but subsequently the CNR was provided with one-third of the seats. Now, the commission is composed of a President and eleven representatives nominated by each of the CNDC and CNR for a period of three years (Zappalá, 1982). In addition, the President may appoint external collaborators.

It should be noted that the administration of the CSPC's activities is still carried out by the CNDC, whilst the CNR is responsible for the administration of the equivalent auditing Commission, the Auditing Principles Commission (*Commissione per la Statuizione dei Principi di Revisione*). Moreover, the CNDC and the CNR still have a large number of subcommittees and study groups, (around 30 each).

The CSPC is not a recognised body in a legal sense, because the Civil Code does not make reference to a separate corpus of accounting principles issued by a subcommittee. However, according to many, the CSPC ought to be perceived as a standard-setting body, a view which would take into consideration the indirect official recognition already given by CONSOB and in TUIR, both of which refer to 'Correct Accounting Principles'.

Since its inception, the CSPC has issued a series of documents which provide a body of detailed accounting principles (Tomasin, 1982). The CSPC documents issued to date are listed in Table 8.7. Although the rules express the point of view of the Italian accounting profession, the CSPC does not represent other interested parties. Participants in CSPC working groups are generally professional accountants, academics and representatives of CONSOB.

Each issue which reaches the agenda of the CSPC is assigned to a working group of about 10 people, or to a single draftsman. There is no set procedure, but normally the draft document is distributed for comment to the stock exchange commission (CONSOB), the association representing Italian limited liability companies (ASSONIME), the association representing audit firms (ASSIREVI), the Italian Banking Association (*Associazione Bancaria Italiana*), academics and other interested parties. A copy is also sent to the Ministry of Finance for an informal response, and eventually a revised document is published. The procedure generally takes a year or more.

Table 8.7 Recommendations issued by the Italian Accounting Principles Commission, the CSPC

No.	*Subject*	*Year*
1	Annual accounts – aims and requirements	1975
2	Composition and layout of annual accounts of commercial and industrial enterprises	1977
2 bis	Integration and explanation of statement 2	1982
3	Inventories	1978
4	Basic principles of accounting for property, plant and equipment	1979
5	Cash and bank overdrafts	1980
6	Receivables	1980
7	Payables and other liabilities	1981
8	Securities, investments and consolidated annual accounts	1983
9	Translation of operations in a foreign currency into national currency	1988
10	Long-term contracts	1991
11	Annual accounts – aims and requirements (Update of number 1)	1994
12	Composition and layout of annual accounts of commercial and industrial enterprises (Update of number 2)	1994
13	Inventories (Update of number 3)	1994
14	Cash and bank overdrafts (Update of number 5)	1994
15	Receivables (Update of number 6)	1996
16	Property, plant and equipment (Update of number 4)	1996
17	Consolidated annual accounts (Update of number 8)	1996
18	Accruals and deferred items	1996
19	Provisions for risks and charges – Employee severance indemnities – Payables (Update of number 7)	1996
20	Securities and investments (Update of number 8)	1996
21	The equity method (Update of number 8)	1996
22	Memorandum accounts	1997
23	Contract works	1997
Draft	Tangible assets	
Draft	Intangible assets	

In addition to the above, the work of the CSPC is coordinated with the activities of international bodies. As indicated earlier, in cases where the CSPC does not cover a particular topic, it is usual for reference to be made to the IASC rules. Furthermore, the CSPC also provides an interpretation of the law. For instance, when the European Directives were put into effect in Italy, the existing CSPC recommendations were replaced by revised versions.

A Market for Interpretations?

The contribution of ASSONIME and ASSIREVI has gone beyond that of acting as representatives in the process of agreeing upon standards of accounting practice. As noted above, ASSONIME (*Associazione fra le Società Anonime*) represents the interests of Italian limited liability companies. It assists companies in interpreting the law, particularly through its *Circolari* ASSONIME. For instance, ASSONIME's Statement No. 139/94 provided a timely commentary on L 503/94, abolishing the fiscal appendix. ASSONIME also publishes a newsletter which provides technical guidance on the problems which Italian companies face in interpreting business law. ASSIREVI, the Association of Italian Auditing Firms (*Associazione fra le Società di Revisione*), comprises those audit firms registered by CONSOB, 23 firms at present. It also publishes commentaries, dealing with both auditing standards and accounting principles. Details of relevant interpretative documents issued by the two associations are given in Table 8.8. Another organisation which has also offered interpretations on accounting law is the Milan-based *Associazione di Dottori Commercialisti*, which includes guidance on certain accounting issues amongst the Rules of Conduct (*Norme di Comportamento*) which govern its members.

SUMMARY AND CONCLUSION

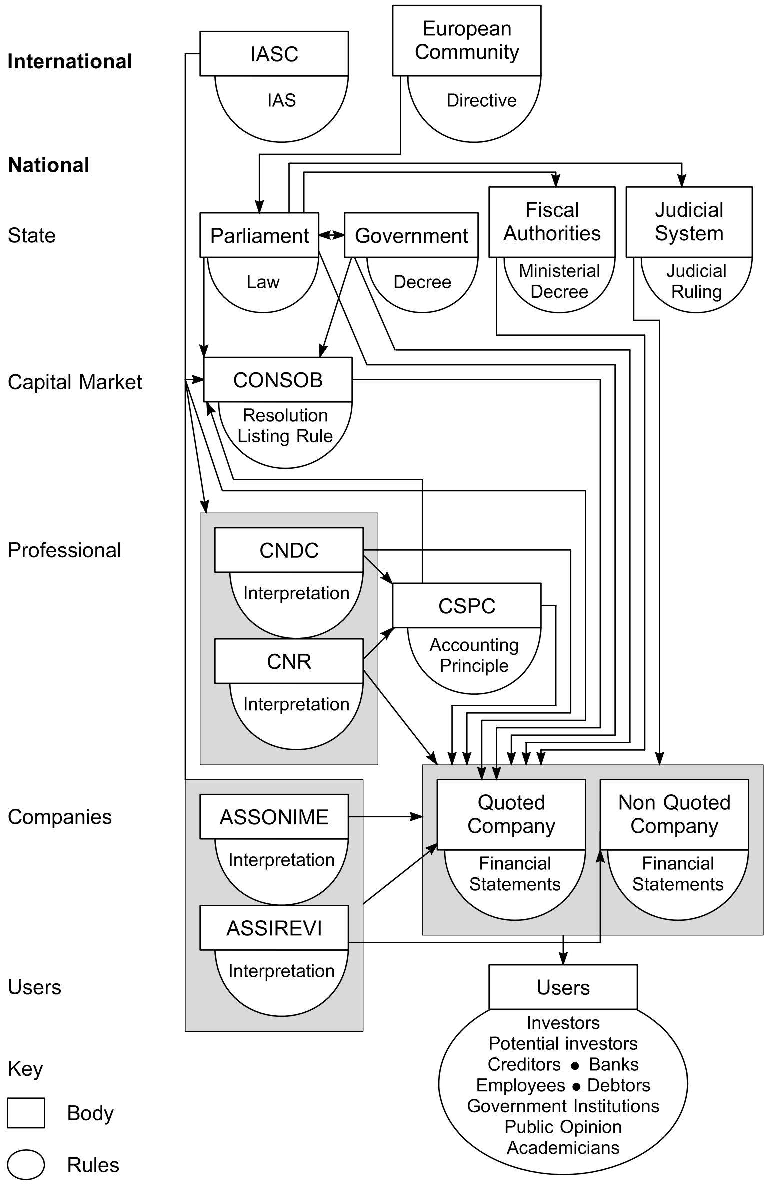
In Italy, the law must be adhered to, and the Civil Code norms in particular, when annual accounts are prepared. However, the criteria for valuation are greatly affected by tax law. Other useful reference points for guidance in the preparation of annual accounts

Table 8.8 Influential interpretations of Italian accounting regulations

Year	*Document reference*	*Content*
ASSONIME Circulars		
1982	Circolare 96	Accounting principles and the preparation of annual accounts
1994	Circolare 1	Application of LD 127 to financial holding companies
1994	Circolare 34	Layout of annual accounts of industrial holding companies
1994	Circolare 42	Preparation of annual accounts
1994	Circolare 139	Changes to the rules on business income and to the Civil Code regulation on annual accounts
1995	Circolare 53	Income tax and taxation on net equity
1996	Circolare 50	Annual accounts of leasing companies
ASSIREVI Research Documents		
1993	Documento di ricerca 26	Differences between Civil Code regulations and CSPC recommendations
1994	Documento di ricerca 35	Accounting treatment of anticipated depreciation
ADC Rules of Conduct		
1993	Norma 112	Operating assets
1993	Norma 116	Anticipated depreciation
1993	Norma 120	Losses and provision for risks

can be found in CSPC documents and IASs. CONSOB plays a major role pertaining to companies which are quoted on the Italian Stock Exchange. Greater responsibility has recently been bestowed on the auditors of accounts, and this has affected the activity of the professional accounting bodies as well as stimulating interventions by the judicial system. However, more could be done in the field of accounting regulation in Italy in order to create an environment where annual accounting measures are able to meet the needs of traditional and modern commercial entities.

Figure 8.1 Accounting regulation in Italy



Notes

1. Over this period, studies of accounting published in Italian include those by Ceccherelli (1970), Superti Furga (1976), Amaduzzi (1981), Catturi (1989, 1992), Ferrero and Dezzani (1989), Paolone (1992), Terzani (1993), Cattaneo and Manzonetto (1993), Marchi (1994) and Dezzani, Pisoni and Puddu (1996).
2. The term *bilancio* could easily be translated incorrectly as 'balance sheet'. In fact, there has been some confusion in Italian over these two terms, even amongst the legislators who drew up the Italian Civil Code of 1942.

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9 The Netherlands

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INTRODUCTION

In general, financial reporting regulation emanates from legislation, often in conjunction with self-imposed standards issued by private sector institutions. In the Netherlands, the source of financial reporting regulation is its Parliament. Furthermore, in cooperation with organisations representing employers, employees and financial analysts, and with the encouragement of the Ministry of Justice, Dutch auditors participate in a financial reporting standards body known as the Council for Annual Reporting (*Raad voor de Jaarverslaggeving*, or RJ). Additionally, the Parliament in the Netherlands has created a special court, known as the Enterprise Chamber (*Ondernemingskamer*, or OK), which is responsible for administering justice in cases involving financial reporting, as well as other matters relating to the governance of Dutch companies.

Dutch financial reporting regulation is part of company law and, thus, it is the Minister of Justice (*Minister van Justitie*) who initiates legislation in this area. There is an advisory body, the Social and Economic Council (*Sociaal-Economische Raad*, or SER) which considers proposed legislation in 'economic' areas including financial reporting before the draft law proceeds to Parliament. The Council is made up of representatives of employers and employees, as well as independent experts appointed by the government. A further assessment of proposed legislation is routinely made after the advice of SER has been received by the Council of State (*Raad van State*), the government's senior advisory body. In Parliament, it is the role of the Second Chamber (*Tweede Kamer*) to discuss draft legislation proposed by the government. It can also initiate legislation itself, although this does not often happen. Finally, the First Chamber (*Eerste Kamer*) reviews the legislative proposals that have already passed through the Second Chamber and either approves the proposed legislation or refers it back to the Second Chamber.

The main types of company affected by financial reporting legislation in the Netherlands are the public limited company (*Naamloze Vennootschap*, or NV) and the private limited company (*Besloten Vennootschap*, or BV). The NV has either bearer or registered shares which can be traded publicly, whether on the Amsterdam Stock Exchange as is the case with some 300 Dutch NVs, or on other international exchanges, whilst the BV has only registered shares which cannot be traded on the exchange. A statutory audit is required for large and medium sized NVs and BVs, to be carried out by qualified members of either The Royal Netherlands Institute for Registered Accountants (*Koninklijk Nederlands Instituut van Registeraccountants*, or NIVRA) or The Netherlands Order of Accountants and Administrative Consultants (*Nederlandse Orde van Accountant-Administratieconsulenten*, or NOVAA), the two legally-recognised professional bodies.

In fact, it is only since 1993, when Parliament adopted a law implementing the Eighth European Company Law Directive (Staatsblad, 9 September 1993, No. 465), that accountants who are members of NOVAA have been able to carry out the statutory audit of large and medium-sized companies. At the present moment, it is not clear whether and how NOVAA will be involved in the process of regulating accounting in the Netherlands (but note that late in 1998 NIVRA and NOVAA decided to attempt a merger). NIVRA, on the other hand, has had an important effect on the development of the rules and regulations surrounding Dutch financial reporting, due not only to its dominant position within the Netherlands but also to its long-standing membership of the IASC.

It is worth noting that one of the major characteristics of the Dutch economy is the presence of a number of companies which are extremely large even by global standards, and which operate internationally and also have shares listed on foreign stock exchanges. This results in a significant international influence on the Dutch system of financial reporting regulation, which has been compounded in recent years by the effect of Dutch membership of the EU through the European company law directives.

The rest of this chapter describes the development of financial reporting regulation in the Netherlands and elaborates in greater detail on the present state of the regulatory system and the institutions involved. The discussion of the historical development has benefited greatly from the study published by Zeff, Van der Wel and Camfferman (1992).

THE EARLY DEVELOPMENT OF STATUTORY FINANCIAL REPORTING REGULATION IN THE NETHERLANDS, 1838–1929

Mandated financial reporting in the Netherlands began in 1838. However, some bookkeeping regulations already existed in the Commercial Code (*Wetboek van Koophandel*) and had been in operation since 1807. Under the Code, merchants were required to keep accounts for receivables, liabilities, receipts and expenditures, and to retain their records for a period of 30 years. In addition, they had to draw up an annual balance sheet within three months of the end of the year, although there were no reporting requirements. These regulations had been translated directly from the French *Code de Commerce* which was in effect in the Netherlands until the end of the 1830s (see Van der Zanden, 1983). In 1837, however, a new company law was prepared as part of the Commercial Code, and one of its articles required the NV to report yearly to its existing shareholders by providing a balance sheet, also mentioning the results for the year (Staatsblad, 10 May 1837, No. 21). Details of the 1838 legislation are given below.

The 1838 legislation:
First financial year affected: 1838
Publication requirement: to existing shareholders
Disclosure rules: balance sheet; statement of results
Scope: all NVs
Number of companies affected: 137 (number of NVs in 1850: see Van Stuijvenberg, 1967)
Audit: not required

In the remainder of the nineteenth century, there were two unsuccessful attempts to extend the regulation of financial reporting in the Netherlands. In 1871, a revision of the Commercial Code was drafted by Justice Minister Jolles, containing additional requirements for the publication of the articles of incorporation of NVs and of any losses incurred in excess of a stipulated percentage of paid-in capital. During discussions of the draft by a parliamentary committee, the mandatory publication of financial statements was suggested but the draft law was withdrawn after criticism from within the parliamentary committee. Later, in 1890, a government-appointed committee prepared another draft law containing far-reaching extensions to financial reporting regulation. The Kist Committee proposed annual publication in the Dutch Official Gazette (*Staatscourant*) of a balance sheet in which specified items would be disclosed, and an income statement whose content was not specified. However, this draft law was also never submitted to Parliament.

In 1909, the Amsterdam Stock Exchange introduced the requirement that, from then on, companies issuing new shares would have to publish an annual balance sheet and a profit and loss statement, but without prescribing the contents of these statements. At that time, 325 NVs were listed on the Amsterdam exchange, which was not an active player in the field of financial reporting regulation, either then or later. In 1910, a draft law was put forward by Justice Minister Nelissen which contained much of what had already been suggested by the Kist Committee 20 years before. All NVs would be required to publish financial statements annually, although the Nelissen Draft did not specify which items were to be disclosed. However, there was some disagreement between the Minister and Parliament over Parliament's desire that there should be differential publication requirements for 'open' and 'closed' NVs, the latter typically being family-owned. Consequently, this draft followed the same fate as its predecessors and was not acted upon.

In 1925, a revised version of the Nelissen Draft was prepared by the new Minister of Justice, Heemskerk. The Nelissen–Heemskerk draft revision of the Commercial Code required, for the first time, the disclosure of measurement rules in notes to the balance sheet and profit and loss account. Also, official publication was no longer required in the Dutch Official Gazette but, instead, in the Commercial Register (*Handelsregister*) of the local Chamber of Commerce (*Kamer van Koophandel*). Moreover, from the day of invitation to the shareholders' meeting until the end of this meeting, the shareholders would be able to examine the financial statements and notes at the company's head office. They could also receive a copy at a price not higher than cost. Again, there was no suggestion that there should be different publication requirements for 'open' and 'closed' NVs. Instead, in a revised draft of the law prepared in 1927, the Justice Ministry was to be given the right to exempt companies in certain industries from the obligation to publish, although this was eventually overturned by an amendment introduced during the parliamentary debate in the Second Chamber in 1928. It was suggested in Parliament, however, that the disclosure of specific items in the balance sheet should be required. This suggestion was not acted upon, partly because it was considered by some to constitute excessive government intervention and also because it was seen as unnecessary given that the publication of misleading balance sheets and profit and loss statements would be a criminal offence anyway.

The First Chamber accepted the draft on the condition that the matter of the differential treatment of 'open' and 'closed' NVs would be reconsidered soon after enactment of the law (Staatsblad, 2 July 1928, no. 216). To this end, a committee to be chaired by a Supreme Court judge was appointed by the Justice Minister. The Visser Committee eventually concluded that publication should be required only in the case of banks, insurance companies and companies listed on the Stock Exchange. The committee also suggested items that should be disclosed on the asset side of the balance sheet, and considered it unnecessary to prescribe specific items for disclosure on the equity side or in the profit and loss account. The committee's conclusions were incorporated as an addendum to the new draft law, called the *Visser Novelle*, and this was accepted by both the Second and the First Chamber without amendment, in the spring of 1929 (Staatsblad, 25 June 1929, No. 363).

As we have seen, it took from 1838 until the revision of the Commercial Code in 1929, for the regulation of financial reporting in the Netherlands to undergo significant development. All 'open' NVs were required to publish annual information on their financial position in the form of a balance sheet lodged with the Commercial Register of the Chamber of Commerce. A profit and loss account was also required. Finally, the possibility of an external audit was suggested for the first time in Dutch company law, but was not required.

The following are details of the 1929 legislation.

The final 1929 legislation:
First financial year affected: 1930 (full implementation 1935)
Publication requirement: to be deposited at Chamber of Commerce
Disclosure rules: balance sheet, income statement, some notes on asset valuation
Scope: 'open' NVs only
Number of companies affected: 2449 (number of open NVs in 1929)
Audit: optional

1930–1970: POLITICAL POSITIONS ON FINANCIAL REPORTING

For the 40 years which followed the 1929 Act, there were no changes in financial reporting legislation. However, during this period, and particularly in the 1950s and 1960s, there was an active debate concerning the future of financial reporting. The Stock Exchange Association (*Vereniging voor de Effectenhandel*) had issued two circulars entitled *Mededelingen van het Bestuur aan de Leden* (No. 270, 15 January 1949, and No. 285, 15 October 1951) in which it asked listed companies to improve their financial reporting practices. In the second circular, it even made recommendations regarding the content and timing of financial reports, but compliance was not mandatory. Subsequently, five important position papers appeared, one of which was commissioned by the legislator, discussing the actual and desired quality of financial reporting by Dutch NVs.

In 1954, the four Dutch employers' federations instituted the Rijkens Committee, in order to study the annual financial reporting of listed companies. This committee presented its report, *Het Jaarverslag*, in 1955 (Rijkens Committee, 1955). The report concluded that the provisions of the Commercial Code in force at that time (that is, the law passed in 1929) did not satisfy the demands for modern financial reporting, suggesting that an annual report should give shareholders and the public a faithful picture (*getrouw beeld*) of the affairs of the company during the reporting period and of the composition of net assets at the balance sheet date. In order for a faithful picture to be given, the report had to contain: (a) a detailed presentation of operating income in order to provide an insight into its composition and into the rate of return on the enterprise's invested capital; (b) a detailed presentation of assets and liabilities, to give an insight into solvency and liquidity; (c) an explanation of the principles applied in the calculation of operating income and in the valuation of assets and liabilities; and (d) mention of any changes in the principles and the composition of the figures from the previous year and, if possible, of the effect on the figures in order to enable a comparison with previous periods.

The committee was specific on a number of issues. It noted that the use of secret and undisclosed reserves was only acceptable if a faithful picture of the composition of net assets and operating income would not be impaired. The committee conceded that circumstances might arise that would bring about the need to form reserves to protect against latent risks, such as expected downturns in the business cycle. The committee was also convinced that depreciation on the basis of current cost was necessary in order to calculate profits accurately and to avoid the risk of draining the company of its financial resources. Furthermore, it recommended a revaluation of fixed assets according to current price levels, but only when it was anticipated that these assets would have to be replaced. For assets other than fixed assets, the committee considered that the application of current cost should be advised. It also recommended the separate inclusion of the taxation charge for the reporting period in the profit and loss statement. Because of differences in the fiscal and business economic principles for profit calculation, the taxation expenses for the reporting period could differ from the tax to be paid for that period. A provision for deferred tax liabilities was to be used to indicate the effect of these differences in the balance sheet.

In their report, the Rijkens Committee recommended that standard formats be adopted for balance sheets and profit and loss accounts, including comparative figures. The committee also recommended that the directors' report should provide an insight into the commercial, technical, financial and social development of the company during the reporting period and should include forecasts of the company's prospects in the near future. Finally, the inclusion of a summary statement was recommended, containing information on the last five years, both in order to give continuity and to provide an overview of the company's affairs.

In 1959, the research department of the Labour Party (*Partij van de Arbeid*) issued a report entitled *De Hervorming van de Onderneming*, proposing a revision of company law along different lines, with the aim of increasing employee participation in company affairs (Wiardi Beckman Stichting, 1959). One of the subjects of this report was access to information on the employing company's financial position. In the report, the formation of a Companies Commission (*Vennootschapskamer*) was recommended. The Companies Commission was to supervise the financial reporting of limited companies on behalf of shareholders, employees and the general public. The US Securities and Exchange Commission and the Dutch Insurance Companies Commission (*Verzekeringskamer*) served as models.

In 1962, in the third important position paper, the idea of a Companies Commission was rejected by the Liberal Party (*Volkspartij voor Vrijheid en Democratie*) when its own research institute reported that such a commission was unnecessary (Teldersstichting, 1962). The report *Open Ondernemerschap* claimed that business practices in the Netherlands were different from those of the USA and that few scandals had occurred. Shareholders were aware of the risk to their investment and could be expected to take care of themselves, it was argued. The Liberal Party instead suggested an adaptation of the section of Dutch company law that dealt with financial reporting to expand the reporting requirements of NVs along the lines recommended by the Rijkens Committee.

The federations of employers responded to this discussion by instituting a follow-up committee to the Rijkens Committee, which was called the Hamburger Committee. Its report, *Verslaggeving, Verantwoording en Voorlichting*, was also published in 1962, in which the Hamburger Committee expressed the view that there was no need to establish a Companies Commission and in which the idea that companies were accountable to the general public was also rejected (Hamburger Committee, 1962). The provision of information to employees could be arranged through workers' councils, it argued, and shareholders' rights were already protected under current legislation. The Hamburger Committee opposed the expansion of legislation concerning corporate financial reporting. Legal regulation was considered impractical because of the variety of companies, and was in fact undesirable because it would potentially restrict the progress of financial reporting. A further difficulty was that, at that time, there was no legal basis for providing the general public with information on companies' affairs. In its description of the desirable contents of financial reports, the Hamburger Committee stayed close to the recommendations of the Rijkens Committee but did take a much stronger stand against secret and undisclosed reserves. In addition, it elaborated on topics such as the classification and valuation of financial interests in other companies.

Meanwhile, in 1960, the government had appointed the Verdam Committee to make recommendations for the revision of company law, with a view to the 'democratisation' of enterprises, which would include certain corporate financial reporting obligations. The particular problem was whether it was sufficient to rely on the business sector for guidance in reporting a clear picture of the affairs of a limited company, or whether there would be a need for more specific legislation in this area. Also, the matter of the supervision of compliance with the law was to be addressed, with a view to ascertaining whether the establishment of a Companies Commission was desirable.

The committee's report, *Herziening van het Ondernemingsrecht*, was the fifth and last important position paper and was published at the beginning of 1965 (Verdam Committee, 1965). The Verdam Committee acknowledged that it was indebted to the reports of the Rijkens and Hamburger Committees and had followed their recommendations on many issues. The Verdam Committee favoured legislation on regulation but made some rather general statements which, on the one hand, showed with sufficient clarity the norms to which financial reporting should conform whilst, on the other hand, leaving sufficient freedom to adapt the implementation to the company's circumstances. The most obvious example of the latter was the statement that 'the principles used in valuing the assets and the liabilities shall satisfy norms that are considered to be acceptable in the economic and social climate'.

However, the recommendations of the Verdam Committee did include reference to the purposes of financial reporting. The proposal in Article 2 stated that 'the financial statements shall give, in accordance with the requirements of this law, an insight such that a well-founded opinion can be formed concerning the financial position and return on invested capital of the enterprise, as well as its solvency and liquidity'. In fact, the phrase 'return on invested capital' was replaced in the draft law by the term 'income', after a comment by both the Nederlands Instituut van Accountants (NIVA) and the Vereniging van Academisch Gevormde Accountants (VAGA). Article 3.1 described the balance sheet, which 'with the notes thereto, shall present faithfully and consistently the amount and composition of the financial position of the enterprise at the end of the financial year'. Article 3.2 was concerned with the profit and loss statement, which 'with the notes thereto, shall present faithfully and consistently the amount and composition of the net income of the enterprise during the financial year'. The Verdam Committee articulated the principles of 'insight' (*inzicht*) and 'faithful representation' (*geeft getrouw weer*) to replace the then current guiding principle of 'sound business practice' (*goed koopmansgebruik*), which was rooted in income tax law and considered unsuitable for financial reporting.

The Committee did not follow the Rijkens and Hamburger Committees in stating that current cost accounting was considered superior to historic cost accounting, but allowed both approaches. However, like the Hamburger Committee, it did consider excessive secret and undisclosed reserves as unacceptable. On the subject of securing compliance, the Committee concluded that instituting an administrative body to review all annual reports (a Companies Commission) would be too costly, so a specialised judicial body at the Court of Justice in Amsterdam was instead proposed. The Enterprise Chamber (*Ondernemingskamer*) would have the power to declare deficient financial statements null and void and to demand that they be revised. Its rulings would constitute jurisprudence, and would indicate to companies the minimum acceptable standard of financial reporting.

A draft law based on the report of the Verdam Committee was drawn up by a committee appointed by the Minister of Justice. This draft was submitted to Parliament in 1968 and, after amendment, was passed in 1970 (Staatsblad, 24 September 1970, No. 414). The Act on the Annual Financial Statements of Companies, the WJO (*Wet op de Jaarrekening van Ondernemingen*), took effect on 1 May 1971. This act applied not only to public limited liability companies (NV) but also to private companies with limited liability (BV), the introduction of the *besloten vennootschap* into Dutch law in 1971 (Staatsblad, 21 May 1971, No. 286) being a consequence of the implementation of the First Directive of the EEC, which was adopted in 1968. However, only 'open' BVs (banks, insurance companies and companies with total assets over 8 million guilders or with 100 employees or more) were required to publish their financial statements and to have an audit.

The proposals of the Verdam Committee resulted in the introduction of the mandatory audit of companies' published annual financial statements in the Netherlands. Details of the 1970/71 legislation are given below. It is evident that this legislation changed financial reporting in the Netherlands considerably, which is why we refer to 1970 as the watershed year in Dutch financial reporting regulation.

The 1970/1971 legislation:
First financial year affected: 1971
Publication requirement: to be deposited at Chamber of Commerce
Disclosure rules: balance sheet, income statement, notes on asset valuation
Scope: all NVs and 'open' BVs
Number of companies affected: ± 3000 (Maijoor, 1991)
Audit: mandatory
Standard-setting body: *Tripartiete Overleg* (Tripartite Study Group)
Accounting court: *Ondernemingskamer* (Enterprise Chamber)

THE MATURING OF FINANCIAL REPORTING REGULATION: 1971–PRESENT

In the Explanatory Memorandum accompanying the initial draft of the new law, the Minister of Justice voiced the expectation that organised business, together with the auditors' professional institute, would 'make an inventory of and test the applicability of the valuation principles used in the context of the economic and social climate' (Bijlagen Handelingen Tweede Kamer, Zitting 1967–68, 9595, No. 3). In 1971, the Tripartite Study Group (*Tripartiete Overleg*) was formed by the Council of Dutch Employers' Federations (*Raad van Nederlandse Werkgeversverbonden*), the Consultant Council of Trade Unions (*Overlegorgaan Vakcentrales*) and NIVRA. The Tripartite Study Group made use of the preparatory work of NIVRA's Advisory Committee on Annual Reporting (*Commissie van Advies inzake Jaarverslaggeving*) which had come into being in 1969. Publications by the Tripartite Study Group were given the title of 'Considered Views' (*Beschouwingen*), indicating their advisory nature.

The employers' delegation did not initiate any proposals that would lead to an extension of financial reporting requirements and the employees' delegation did not play an active role since financial reporting was of relatively low priority to the unions. In fact, of the three parties involved in the Tripartite Study Group, the auditors played the most active role although they were not always the dominant force. For instance, in the early 1970s, when there was renewed discussion about current cost accounting, the auditors' delegation was in favour whilst the employers' delegation was opposed in spite of the position taken in the Rijkens and Hamburger reports. According to Zeff, Van der Wel and Camfferman (1992), there was now considerable concern that the Netherlands should not go its own way in using current value as some countries in the EEC used historical cost as the only method of accounting. Finally, in 1975, the Tripartite Study Group agreed to follow a two-track policy: ' the financial statements should present, in the income statement or in the notes, the amount of operating profit (exclusive of interest) calculated on the basis of current values, and the corresponding figure calculated on the basis of historical prices, as well' (Paragraph 5 of the preface to Section IVa in the third Exposure Draft of Considered Views).

In 1976, the Act on Annual Financial Statements which had come into effect in 1971 was incorporated, with very minor changes, into Book 2 of the new Civil Code (*Burgerlijk Wetboek*), as part of Title 6 (Staatsblad, 6 May 1976, No. 228, and Staatsblad, 22 July 1976, No. 395).

In January 1977, the first judgment of the Enterprise Chamber was handed down. It concerned the 1974 financial statements of Douwe Egberts BV. In its first few judgments, the Enterprise Chamber did not refer to the Tripartite Study Group's Considered Views. Indeed, in cases such as Douwe Egberts, the judgments of the Enterprise Chamber differed slightly from the Considered Views, without any evident motivation, placing a question mark over the authority of the Tripartite Study Group. Indeed, even today, the Enterprise Chamber still does not refer to the Guidelines of the RJ (the successor to the Tripartite Study Group) in its verdicts.

The decision was taken in 1977 to rewrite the Considered Views in order to integrate IASs into Dutch practice. To NIVRA, the Dutch professional body affiliated to the IASC, it seemed that this would be the best way to gain acceptance of IASs, as the involvement of the Tripartite Study Group would ensure the participation of the employers' and employees' associations. It was also considered desirable to distinguish affirmative pronouncements (*stellige uitspraken*) from those which were purely advisory (*aanbevelingen*) and enhance the authority of the Tripartite Study Group statements. Thus, the IASC's standards were duly integrated, as were the verdicts of the Enterprise Chamber, and affirmative pronouncements were typed in a bold typeface. The Tripartite Study Group stated its assumption that affirmative statements would, in principle, be applied by all companies and that deviations from affirmative pronouncements would only be acceptable if they significantly enhanced insight into the financial position and income as required by law. It was also stated that the Tripartite Study Group expected deviations from its affirmative pronouncements to be explained and, if possible, quantified by the enterprise, or otherwise mentioned by the auditor, although it is worth noting that the Tripartite Study Group's successor withdrew this statement in 1984 after comments from the employers' associations and from NIVRA.

When the entire project to rewrite the Considered Views was completed in 1980, the title was replaced by 'Guidelines for Annual Financial Statements' (*Richtlijnen voor de Jaarrekening*), in order to stress the function of guidance rather than the idea of legislation.

In 1981, the Tripartite Study Group was restructured, a major issue being the financing of its secretariat by NIVRA alone. Moreover, although the credibility of its pronouncements had been increased by replacing the Considered Views by the Guidelines, and by distinguishing affirmative pronouncements from advisory statements, there was some concern as to whether the scope of its activities should be limited to financial statements or should extend to such matters as the directors' report, and whether the users of financial statements were adequately represented. As of 1982, the *Tripartiete Overleg* became known as the RJ, and the name of its statements changed from 'Guidelines for Annual Financial Statements' to 'Guidelines for Annual Reporting' (*Richtlijnen voor de Jaarverslaggeving*). This new name also indicated the broader scope of the RJ, which now included the directors' report. Furthermore, in the new Council, those who prepared, used and audited company financial information were to be more fully represented, although the users were for the moment only represented by the employees' associations. The financing of the RJ also changed, with its activities being financed one-third by NIVRA and two thirds by the government's SER.

The Fourth and Seventh Directives

When the final version of the EU's Fourth Directive was incorporated into Dutch law in 1983 as Title 8 of Book 2 of the Civil Code (Staatsblad, 30 December 1983, No. 663), the formats for financial statements and the principles governing the valuation of assets were set out in two administrative decrees: *Besluit tot vaststelling van modelschema's voor de inrichting van jaarrekeningen* (Staatsblad, 30 December 1983, No. 666) and *Besluit houdende regels voor de inhoud, de grenzen en de wijze van toepassing in de jaarrekening van waardering van activa tegen actuele waarde* (Staatsblad, 30 December 1983, No. 665).

The main changes in the new law which took effect on 1 January 1984 were an increase in the number and details of disclosure rules and the introduction of rules prescribing the valuation of assets. In addition, the consolidation of financial statements of subsidiaries became mandatory (unless 'insight' were to demand separate statements). Publication requirements were extended to include all NVs and BVs, instead of just NVs and 'open' BVs, although small and medium-sized companies could publish simplified statements. Audits became mandatory for both large and medium-sized companies.

It is worth mentioning that, in the initial draft law concerning implementation of the EC's Fourth Directive, the legislature seemed to take a stand in favour of the application of current values. Article 384 Paragraph 5 included the provision that if the book value of an asset was substantially lower than the current value, the company must revalue that asset to its current value, if it was apparent that otherwise the financial statements would be seriously distorted, even if additional information were provided in the notes (Bijlagen Handelingen Tweede Kamer, Zitting 1979–80, 16326, No. 2). This stand encountered a lot of resistance, so the Minister of Justice decided to rephrase Article 384 in such a way that no preference for either current values or historical cost was indicated (Bijlagen Handelingen Tweede Kamer, Zitting 1981–82, 16326, No. 9). Thus, as a result of the implementation of the EC's Fourth Directive in 1983, the application of current value was allowed but not required for tangible and financial fixed assets as well as inventories. The administrative decree on the valuation of assets defined three possible interpretations of current value and indicated when each interpretation should be applied, if current value is used. In particular, current cost accounting would be applied if there is a reasonable assumption that an asset will be replaced by an asset with an economically equivalent function with respect to operations, but if it can reasonably be assumed that the asset will not be replaced, then it must be valued at net present value if it still contributes to operations. Otherwise, it must be valued at net realisable value.

The final version of the EU's Seventh Directive, which had first appeared in 1983, was incorporated into Title 8 of the Civil Code in 1988 (Staatsblad, 24 November 1988, No. 517). It came into effect on 1 January 1990 but had only a limited effect on the practice of financial reporting. With the implementation of the Fourth Directive, the legislator had already anticipated the Seventh Directive, prescribing consolidation. In 1988, however, the two criteria for consolidation that were already used in practice (that is, belonging

Table 9.1 Index of Title 9, Book 2 of the Dutch Civil Code

Topic	*Chapter*	*Article*
General provision	1	360
General provisions in respect of annual accounts	2	361–363
Provisions in respect of the balance sheet and the notes	3	364–376
Provisions in respect of the profit and loss account and the notes thereon	4	377
Special provisions in respect of the notes	5	378–383
Provisions in respect of the principles of valuation and the determination of the results	6	384–390
Annual report	7	391
Additional information	8	392
Audit	9	393
Publication	10	394–395
Exemptions based on the size of the business of the legal person	11	396–398
Provisions in respect of various types of legal persons	12	399–404
Consolidated annual accounts	13	405–414
Provisions for banks	14	415–426
Provisions for insurance companies	15	427–446

Note: This table follows the translation of Title 9 in the 'Guidelines for Annual Reporting in the Netherlands from 1990' (1997, appendix 1).

to one economic entity and being united in one organisation) were formally introduced into the law, these criteria having previously been mentioned by the Minister of Justice in his Explanatory Memorandum on the 1983 legislation (Bijlagen Handelingen Tweede Kamer, Zitting 1979–80, 16326, No. 3).

At about the same time as the provisions of the Seventh Directive were enacted in the Netherlands, all legislation concerning financial reporting was incorporated into Title 9 of Book 2 of the Civil Code (see Table 9.1), after the introduction of a new title on cooperative associations and mutual guarantee companies necessitated the renumbering of titles (Staatsblad, 12 July 1988, No. 305), the law also undergoing some simplification and clarification (Staatsblad, 11 January 1990, No. 1). Details of the effect of the aforementioned developments are given below.

The 1983 and 1988 legislation:
First financial year affected: 1984 and 1990
Disclosure requirement: to be deposited at Chamber of Commerce
Disclosure rules: balance sheet, income statement, notes to the accounts
Scope: all NVs and all BVs
Number of companies affected: 1984: ± 80 000;
1990 (full implementation of 1984 and 1988 legislation): ± 200 000 (Bollen, 1996)
Audit: mandatory
Standard-setting body: *Raad voor de Jaarverslaggeving* (Council for Annual Reporting)
Accounting court: *Ondernemingskamer* (Enterprise Chamber)

Other Developments

There were also some further changes at the RJ in the mid-1980s. In early 1984, it became apparent that the trade unions were having financial difficulty in maintaining their delegation in the RJ. They decided to replace their representatives with 'trusted persons' who would participate in the RJ without necessarily consulting the unions on the positions to be taken. The seats of the users' delegation remained vacant until early 1986, when the unions appointed three 'trustees'. Also in 1986, the Society of Financial Analysts, the VBA (*Vereniging van Beleggingsanalisten*) appointed a representative, and from then onwards the financial community was represented in the users' delegation of the RJ.

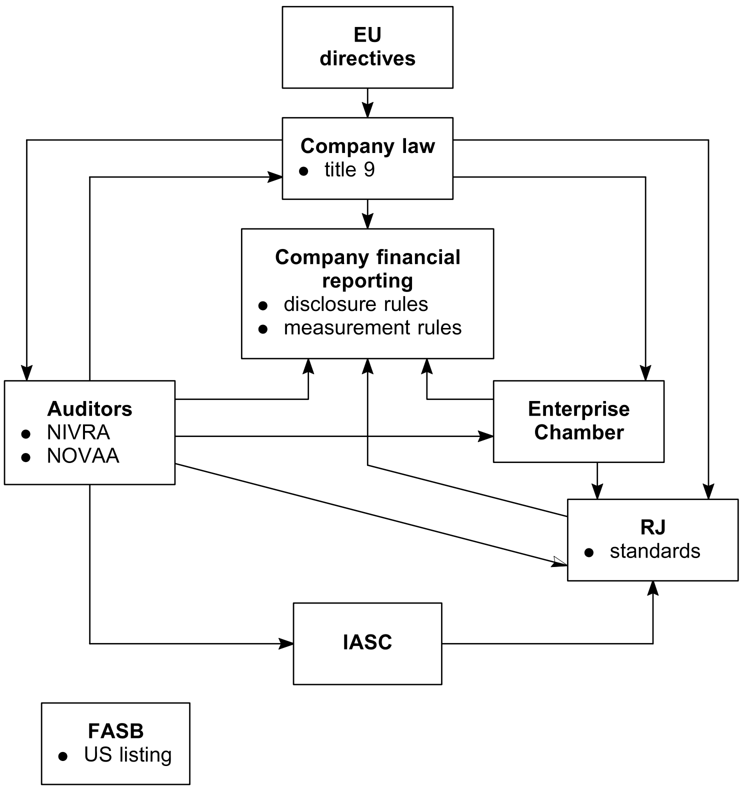
An interesting illustration of the position of the RJ concerns its reaction to the capitalisation of publishing rights by three well known companies. In 1991, the RJ was confronted with the fact that the publishing companies in question, backed up by three of the largest Dutch audit firms, were adopting accounting policies which contradicted the RJ's standpoint that capitalised intangibles should be amortised. Two of these companies (Elsevier and VNU) had changed their accounting policies with respect to publishing rights in 1989. Elsevier, which had capitalised acquired publishing rights since 1985, stopped their amortisation on the grounds that their economic value was not, in principle, subject to periodic diminution. VNU capitalised acquired publishing rights for the first time in 1989, also without amortising, arguing that it was necessary to correspond to international developments. In 1990, a third large publisher (Wolters Kluwer) followed the example set by the other two and stopped the amortisation of publishing rights which, in its case, had been capitalised separately since 1979.

The RJ received advice that the Justice Ministry was expecting a pronouncement on the matter of accounting for intangibles (Zeff, Van der Wel and Camfferman, 1992). In June 1991, the RJ issued a Discussion Memorandum with respect to some aspects of the treatment of intangible fixed assets, which it included as an Appendix to Chapter 2.01 of the Guidelines on Annual Reporting. This memorandum did not have the status of a Guideline and was intended to stimulate discussion on the subject, in anticipation of a revision of Chapter 2.01. In Paragraph 13, the RJ added the notion of 'marketability' to the existing principle that intangibles should only be entered on to the balance sheet if there was a well- founded expectation that the future revenues from these assets would leave sufficient room for amortisation. Together, they became the 'identifiability and separability' criterion. The RJ's provisional judgement was that an intangible fixed asset which did not satisfy this criterion was an inextricable part of the goodwill of the company and, therefore, did not need to be capitalised separately. If an intangible did satisfy the criterion, however, it was the RJ's provisional judgement that it should be capitalised separately, providing that conservativeness is maintained, and in this context the RJ explicitly stated that it considered the capitalisation of publishing rights to improve financial reporting.

In principle, the RJ stated that capitalisation was acceptable for both acquired intangibles and the intangibles produced by the company itself. It went on to say, however, that intangibles produced by the company itself would hardly ever satisfy the identifiability and separability criteria. The RJ was unable to reach a unanimous standpoint regarding the annual amortisation of intangibles. In the Discussion Memorandum, it lists arguments both in favour of as well as against, intending to wait for the response to the memorandum, and for the results of the international discussion, before giving judgement.

In summary, the regulatory system that has developed in the Netherlands is based on legislation which provides an outline of financial reporting requirements, whilst the details are dealt with by the RJ, an expert standard setting body. To an important degree, the RJ follows the standards issued by the IASC. The RJ does not have powers of enforcement and has to find solutions which are acceptable to the interested parties, although there is an accounting court which deals with complaints against companies' financial statements. This regulatory system, which has changed little since the early 1980s, is summarised in Figure 9.1. Its institutional framework is discussed below.

Figure 9.1 A model of the Dutch accounting regulation system



THE REGULATORY INSTITUTIONS IN THE NETHERLANDS

The previous sections described the historical development of the system of financial reporting regulation in the Netherlands. A more detailed discussion of its present structure is provided in this section, focusing not on the basic legislation but on each of the different institutions involved: the Council for Annual Reporting, the Enterprise Chamber, the capital market regulator and industry-specific regulators.

The Council for Annual Reporting

Company law in the Netherlands demands that financial statements provide insight into the company's financial position and performance, in accordance with norms that are 'acceptable in the economic and social climate'. The current standard setting body, the RJ, considers its task to be that of defining these norms. It is supported in this view by the Minister of Justice in the Explanatory Memorandum which accompanied the draft law concerning the implementation of the Fourth Directive (Bijlagen Handelingen Tweede Kamer, Zitting 1979–80, 16326, No. 3).

Formally, the RJ was set up by the Foundation for Annual Reporting (*Stichting voor de Jaarverslaggeving*) to develop and publish pronouncements and recommendations. The Foreword to *Richtlijnen voor de Jaarverslaggeving* (1984) explains that the Foundation was established in September 1981 by:

(a) the Federation of Dutch Industries (*Verbond van Nederlandse Ondernemingen* or VNO);
(b) the Dutch Christian Employers' Federation (*Nederlands Christelijk Werkgeversverbond* or NCW);
(c) the Federated Dutch Trade Union Movement (*Federatie Nederlandse Vakbeweging* or FNV);
(d) the Christian National Trade Union Federation (*Christelijk Nationaal Vakverbond* or CNV);
(e) the Dutch Institute of Registered Accountants (NIVRA).

The RJ meets once a month on average and is composed of members who are recommended by the founding organisations

Table 9.2 Membership of the RJ, 31 December 1997

Name	*Appointed by:*	*Member since:*
President		
J. van Helleman RA		August 1997
Delegation of preparers of information		
M. Arentsen RA (Pres.)	VNO/NCW	December 1993
J. F. Leeuwerik RA	VNO/NCW	November 1987
H.J.A.F. Meertens	VNO/NCW	March 1996
P. Vergroesen RA	VNO/NCW	June 1988
Delegation of users of information		
A. F. M. van Klaren RA (Pres.)	CNV/FNV	January 1986
C. D. Knoops	CNV/FNV	April 1992
P. J. Maat RA	CNV/FNV	April 1986
H. Haarbosch	VBA	June 1987
Delegation of auditors		
M. A. van Hoepen RA (Pres.)	NIVRA	January 1988
E. Eeftink RA	NIVRA	December 1997
M.N. Hoogendoorn RA	NIVRA	January 1997
A. Schilder RA	NIVRA	April 1996

and appointed by the Foundation's board, plus the member of the delegation of users who is appointed on the recommendation of the Society of Financial Analysts (VBA). The president of the RJ, who is independent, is appointed by the Foundation's board. The composition of the RJ at the end of 1997 is presented in Table 9.2.

The Foundation is financed by annual contributions from NIVRA and the SER, and also receives royalties from the publication of its statements. According to the Council's 1997 annual report, the costs and financing for the year 1997 can be summarised as follows (in guilders):

Activities, accommodation and facilities	288 000
Remuneration for attendance	249 000
Total	537 000
Royalties	279 000
To be covered	258 000
Covered by NIVRA (1/3)	86 000
Covered by SER (2/3)	172 000

When dealing with a new subject, the RJ first issues a draft guideline which, if necessary, is revised before its publication as a definitive guideline. The RJ usually leaves a period of six months for comments on drafts to be submitted. Through this procedure, the RJ strives to incorporate the experience and views of the preparers, users and auditors of annual financial statements into the development of the guidelines. Users of the guidelines are also invited to comment in the realisation that, as the demands on the form and contents of annual financial statements evolve, the definitive guidelines may have to be revised to reflect this evolution.

Decisions on the RJ's publications must be backed by a five-sixths majority of votes and by at least one vote from each delegation. This means that each delegation in the RJ has the right of veto. Thus, the delegations must work to reach a consensus before any decision can be taken.

The statements of the RJ are published in a loose-leaf publication entitled 'Guidelines for Annual Reporting'. The Guidelines have been adapted as a consequence of the amendments to the law in 1988 and 1989, an adaptation which was completed in December 1994. The Guidelines are now laid down in a new volume, *Richtlijnen voor de Jaarverslaggeving vanaf 1990*, of which an English language version is also available entitled 'Guidelines for Annual Reporting in the Netherlands from 1990'. This second edition (Council for Annual Reporting, 1997) of the English version includes releases up to No. 18 (April 1997). The most recent release in Dutch is No. 19 (December 1997). By the end of 1997, there were around 5,700 subscribers to the loose-leaf edition of the RJ, but the decrease in subscriptions has been amply compensated by an unspecified increase in other publications, including the electronic versions of the RJ's Guidelines.

An index to the Guidelines for Annual Reporting is provided in Table 9.3.

Until recently, a number of RJ pronouncements were still in draft form. For instance, by early 1996 the RJ had published 43 Guidelines of which five were draft Guidelines and four more were still partly in draft form. With Release No. 17 in September 1996, most were made definitive. The RJ appears to prefer to develop guidelines relatively slowly. One advantage is that by the time a guideline is issued, norms that are acceptable to all the parties involved have

Table 9.3 Contents of the RJ's Guidelines for Annual Reporting

Introduction	
Framework for the preparation and presentation of financial statements (*Note*: the *Richtlijnen voor de Jaarverslaggeving* opens with a Dutch translation of the IASC Framework, entitled *Stramien*.)	
Part 1	*General*
1.01	Introduction
1.02	Objectives and basic assumptions
1.03	Valuation principles
1.05	Criteria for inclusion and disclosure of information
1.06	Changes in accounting policies
1.07	Correction of fundamental errors
1.10	Presentation of financial statements
1.19	Other general matters
Part 2	*Annual accounts; specific guidelines*
2.01	Intangible fixed assets and associated charges
2.02	Tangible fixed assets and depreciation
2.03	Financial fixed assets
2.11	Stocks and cost of goods sold
2.12	Debtors
2.13	Securities
2.14	Prepayments and accrued income
2.15	Cash
2.41	Shareholders' equity
2.51	Liabilities (general)
2.53	Provisions
2.54	Long-term liabilities
2.55	Current liabilities
2.62	Accruals and deferred income
2.65	Commitments not shown in the balance sheet
2.71	Profit and loss account
2.72	Contingent income
2.81	Notes
2.83	Profit appropriation and treatment of losses
Part 3	*Annual accounts; special topics*
3.01	Government grants and comparable facilities
3.22	Investment institutions
3.23	Insurance companies
3.31	Cooperatives
3.41	Effect of size of legal entity
3.42	Exemptions for group companies
3.61	Officially recognised social housing institutions (not included in English edition)
3.81	Fund-raising institutions (not included in English edition)

Table 9.3 (cont.)

Part 4	*Directors' report, other information and other items*
4.01	Directors' report
4.02	Other information
4.03	Post-balance sheet events and dating of annual accounts
4.10	Audit
4.15	Publication
4.20	Cash flow statement
4.22	Key figures, ratios and historical summaries
4.24	Earnings per share
4.28	Added-value statement
Part 5	*Miscellaneous*
5.01	Interim reports
Appendices (of which included in English edition:)	
1	Text of Part 9, Book 2, of the Netherlands Civil Code
6	Incorporation of IASC Standards in the Guidelines and Draft Guidelines

Source: Council for Annual Reporting (1997).

taken shape. Moreover, according to Broekhuizen and Van Kalles (1993), the RJ sees no use in being ahead of the development of IASC standards. Indeed, the IASC's standards have been included in the guidelines when considered applicable to the Dutch situation (a comparison between the IASC standards and the Guidelines for Annual Reporting is provided in Table 9.4).

As noted earlier, the Guidelines take the form of affirmative pronouncements (in bold typeface) or advisory statements. Companies, and their auditors, should only depart from affirmative pronouncements if they have sound reasons to do so. However, if a company decides to depart from an affirmative pronouncement, it does not have to mention or justify this fact; neither does an auditor have to mention it in the audit report. The RJ also regards advisory statements and draft guidelines as helpful in financial reporting, but they do not carry the same weight as affirmative pronouncements. Although the RJ does not have the authority to enforce compliance with its guidelines, the definitive pronouncements embody authority because of the care and expertise brought to bear on their

Table 9.4 IASC Standards and the Guidelines for Annual Reporting

IASs 1–33 have been incorporated into the (draft) Guidelines for Annual Reporting insofar as these standards are considered acceptable for Dutch practice by the RJ. This means that, in some respects, a number of IASC standards are not entirely subscribed to by the RJ. These standards are indicated below, under A. Some parts of standards have not yet been incorporated, either in part or entirely, because their provisions relate to subjects not considered by December 1997 in the draft guidelines on Annual Reporting issued since 1990. These standards are indicated below under B.

Standard	*Subject*
A. IASC standards not entirely subscribed to by the RJ:	
IAS 2	Inventories
IAS 8	Net profit or loss for the period, fundamental errors and changes in accounting policies.
IAS 9	Research and development costs
IAS 10	Contingencies and events occurring after the balance sheet date
IAS 11	Construction costs
IAS 13	Presentation of current assets and current liabilities
IAS 14	Reporting financial information by segment
IAS 16	Property, plant and equipment
IAS 17	Accounting for leases
IAS 21	The effects of changes in foreign exchange rates
IAS 25	Accounting for investments
IAS 27	Consolidated financial statements and accounting for investments in subsidiaries
IAS 28	Accounting for investments in associates
IAS 29	Financial reporting in hyperinflationary economies
IAS 31	Financial reporting of interests in joint ventures
IAS 32	Financial instruments: disclosure and presentation
B. IASC standards not yet or not completely incorporated:	
IAS 12	Accounting for taxes on income
IAS 19	Retirement benefit costs
IAS 22	Business combinations
IAS 26	Accounting and reporting by retirement benefit plans
IAS 30	Disclosures in the financial statements of banks and similar financial institutions
IAS 33	Earnings per share

Note: Details concerning those parts of IASs which are not subscribed to in the Netherlands can be found in Council for Annual Reporting (1997), Appendix 6.

development. Indeed, they represent the consensus of expert counsel from those who are preparers, users and auditors of companies' annual financial statements.

Although the law does not grant any formal authority to the Guidelines, it is worth remembering that, initially, the Minister of Justice indicated that the RJ had an important role to play in giving meaning to norms for financial statements. Indeed, in his Explanatory Memorandum to the draft of the Act on Annual Financial Statements of Companies, the Minister of Justice stated that the task of compiling a comprehensive set of accounting principles would serve as a point of reference for the Enterprise Chamber. The verdicts of the Enterprise Chamber and the Supreme Court are incorporated into the Guidelines in cases where the RJ considers these to have general significance. The refusal of the Enterprise Chamber to acknowledge the Guidelines explicitly in its verdicts seems to be at odds with this general process of integration, and it is worth recording that recent evidence based on interviews with judges of the Enterprise Chamber reported in Zeff, Van der Wel and Camfferman (1992) suggests that it clearly benefits from referring to the definitive guidelines during its judicial process.

The Enterprise Chamber

The rules governing the Enterprise Chamber can be found in Section 11 of the Code of Civil Procedure (*Wetboek van Burgerlijke Rechtsvordering*), and are summarised in Klaassen (1980). The Enterprise Chamber is a separate section of the Court of Justice at Amsterdam, and deals with disputes involving legal entities. The Enterprise Chamber is comprised of three judges and two experts, preferably from the field of business economics and accountancy.

Parties with an interest in the financial statements of a company can bring a charge against the company of failure to comply with Title 9 Book 2 of the Civil Code. This must be done within two months of either the date of publication of the financial statements or the date on which they are approved by the shareholders. Interested parties should belong to either of two constituencies: the first consists of shareholders and other residual claimants, the works council and employees; the second is made up of parties that have incurred or may incur a specific and actual disadvantage due to the way in which the company has drawn up its financial statements. In fact, the Enterprise Chamber will not itself dispute that a plaintiff is an interested party. It is up to the defendant to bring any such objection forward (Joosten, 1989).

The perceived disadvantage may be tangible or intangible but, in bringing the charge, the plaintiff must specify the way in which the financial statements should be revised. If the Chamber grants the claim, it gives the defendant specific directions on the revised publication of the relevant annual report. The Chamber may also decide that the directions apply only to future annual reports of the defendant. The above procedure is not aimed at providing compensation for damages, although the outcome of a case that goes before the Chamber may influence the outcome of such a trial. Parties may lodge an appeal against a verdict of the Chamber with the Dutch Supreme Court (*Hoge Raad*, or HR) in the Hague.

From the early 1970s until the end of 1997, 58 cases on financial reporting have been brought before the Enterprise Chamber (see Beckman and Volgenant, 1981). The contribution of the Enterprise Chamber and the Supreme Court to the development of accounting regulations is well illustrated by the problematic issue of deferred taxation. In an early case, concerning Pakhoed's 1977 annual report, the Enterprise Chamber concluded that capitalising a deferred tax debit was not conservative, and therefore unacceptable (OK, 31 May 1979). The Supreme Court, however, annulled the verdict of the Enterprise Chamber and remarked that, in order to give a faithful representation of the financial position, it was acceptable to capitalise a deferred tax debit if it could reasonably be assumed that the claim would be realised in due course (HR, 26 March 1980). This position of the Supreme Court was adopted by the Enterprise Chamber in its subsequent ruling in the Pakhoed case and also by the RJ in its October 1983 draft on deferred tax (RJ, 2.53.5). Zeff, Van der Wel and Camfferman (1992) point out that before the draft appeared, there had been a lengthy discussion between preparers and auditors in the RJ about the method of allocating taxes. The preparers defended partial allocation, citing developments in the UK (SSAP 15). The auditors preferred the more conservative comprehensive approach. In its draft, the RJ implied that the comprehensive allocation was acceptable, but stated that it was not yet prepared to make a pronouncement on the acceptability of partial allocation. Since May 1992, however, the RJ has stated its preference for comprehensive allocation (RJ, 2.53.509). In the case against Tuinbouwveiling Kampen-Zwolle-IJsselmeerpolders, the Enterprise Chamber concluded that deferred tax credits resulting from revaluation should be deducted from the revaluation reserve and entered as a provision (OK, 21 February 1991) and thus it seems that, as far as revaluation is concerned, entering a deferred tax provision is no longer just optional.

The Capital Market Regulator

There is only one stock exchange in the Netherlands, and this is located in Amsterdam (Amsterdam Exchanges or AEX). In the Stock Exchange Rules on Securities Trading (*Fondsenreglement*), the Stock Exchange Association (*Vereniging voor de Effectenhandel*) includes a number of rules relating to financial reporting, which go beyond Title 9 of the Civil Code. First, listed companies must publish interim (half-year) financial statements although these need not be audited (Article 29). Furthermore, they must inform the public of developments that could have a significant influence on the prices of their stocks (Article 28). In addition, companies issuing shares must publish a prospectus, which gives a faithful picture (*getrouw beeld*) of the position of the issuing company on the balance sheet date of the last financial year for which financial statements were published (Article 8). This prospectus should also provide information on important events which may have occurred after the end of the last financial year, as well as a forecast of company business. The prospectus should specify which financial information in the prospectus has been audited and, if the auditor's report was qualified, the qualification should be included in its entirety.

With respect to the contents of annual financial statements, however, the Stock Exchange Association does not impose any regulations in addition to Title 9. Nor does the Stock Exchange Association participate in the RJ other than as an observer. Therefore, the Stock Exchange Association is not regarded as an important force in the regulation of financial reporting.

There are a number of large multinational companies of Dutch origin that are listed in the USA and which therefore must follow the rules determined by the SEC regarding financial reporting. These rules sometimes go beyond the requirements of Title 9 and the Guidelines. In these cases, the company may decide to follow the rules only in statements to be submitted to the SEC, or it may apply the rules in preparing its statutory financial statements as well. This situation is not unique to the Netherlands, and is not elaborated upon here.

Industry-Specific Regulators

In some branches of industry, additional financial reporting regulations are imposed on companies. For example, regulations concerning the financial reporting of certain non-profit organisations are laid down in laws such as the Act on Hospital Provisions (*Wet Ziekenhuisvoorzieningen*), the Housing Act (*Woningwet*) and the Social Insurance Management Act (*Organisatiewet Sociale Verzekering*). Furthermore, rules concerning the financial reporting of governmental institutions can be found in the Accountability Act (*Comptabiliteitswet*) and in the Provisions for the Accountability of Municipalities (*Gemeentelijke Comptabiliteitsvoorschriften*).

With regard to the financial sector, the Dutch National Bank issues specific regulations for banks and the Insurance Chamber (*Verzekeringskamer*) issues specific regulations for insurance companies. In the Act on Supervision of Investment Institutions (*Wet Toezicht Beleggingsinstellingen*), additional regulations which are not found in Title 9 are imposed on investment institutions. It may be noted here that, in 1993, sections of the law dealing with the financial reporting of banks (Staatsblad, 27 May 1993, No. 258) and insurance companies (Staatsblad, 14 October 1993, No. 517) were included in Title 9 of Book 2 of the Civil Code as a consequence, first, of the European Directive of 1986 relating to the consolidated financial statements of banks and other financial institutions and, second, the European Directive of 1991 which dealt with the consolidated financial statements of insurance companies. Details of the rules concerning the financial statements of banks were made public in an administrative decree, *Besluit houdende bepalingen voor de balans, de winst- en verliesrekening en de toelichtingen daarop van banken* (Staatsblad, 27 May 1993, No. 259).

CONCLUSIONS

In the Netherlands, the introduction of the first accounting regulations appears to have been the 'price' paid for limited liability and a potential substitute for the royal consent previously needed to obtain limited liability status. Subsequent regulations in the 1920s were a late consequence of similar regulatory efforts in the UK, Belgium and Germany, all of which had been passed in the previous century (explicit references to this influence can be found in the Kist Committee report). However, until 1970, there was little restriction in the choice of financial accounting methods in the Netherlands. What was mandated was the publication of financial statements: which companies were to publish and, to a minor extent, what they had to publish. After 1970 this changed, especially in terms of what companies were to disclose.

The 1970 regulations are the most significant regulatory event to have occurred in the Netherlands in the area of financial reporting and had been initiated in the late 1940s and early 1950s. Three forces were operating in the background of this legislation. The first was the international influence of the larger Dutch companies after the Second World War, which brought them into contact with US and UK developments. This made the companies pursue a more open financial reporting policy without, however, obliging them to accept the need for government regulation. The second factor, which led more directly to regulation, was the trade-off which occurred between the need for the Dutch trade unions to cooperate in the post-war economic reconstruction of the Dutch corporate sector, and the release of more detailed public information about Dutch companies. This trade-off did in fact result in the greater involvement of employees in the governing of Dutch companies, and the 'Verdam' reforms both increased mandatory financial reporting and led to the creation of works' councils. A third factor, operating more in the background, was the self-interest of the auditing profession which had two basic aims almost since its creation: that is the aim of restoring mandated financial reporting, which had been dropped in the 1920s, and the aim of requiring statutory audits by a licensed profession (De Vries, 1985). A combination of these three factors led to the 1970 financial reporting regulations.

It is interesting to note that successive Dutch governments maintained a somewhat ambivalent position over the issue of public regulation of financial reporting. The preparation of financial reporting standards has not been formally linked with financial reporting law. The Dutch government has instead supported a private sector financial reporting standards body, albeit with some state funding through the SER. On the other hand, the Dutch government has created and funded the Enterprise Chamber which, with the Supreme Court as its ultimate authority in the case of appeal, can be viewed as the element providing official 'closure' in Dutch financial reporting regulation. Note that, again, Dutch auditors have played an important role. They organised the Council for Annual Reporting, and its predecessor, the Tripartite Study Group, and have acted as advisers to both organisations as well as to the Enterprise Chamber. Nonetheless, NIVRA has not yet moved to oblige its members to comply with the standards issued by the Council for Annual Reporting.

Dutch auditors have also been instrumental in developing financial reporting techniques, disclosure and measurement rules in the Netherlands. They have either created these themselves or, more often, have imported financial reporting techniques from abroad. Because of their influence on regulation, the auditors have shaped the perception of which financial reporting techniques are, or are not, acceptable. Because leading Dutch auditors have traditionally been (and still often are) financial accounting academics, it is therefore difficult to separate the impact on Dutch financial reporting regulation of pragmatic self-interest from the purely academic.

All these factors have resulted in a strongly auditor-influenced system of financial reporting regulation in the Netherlands. Contrary to developments in other countries, the development of financial reporting regulation in the Netherlands was not the result of economic 'accidents' such as stock market crashes or scandals. The Dutch system has evolved to its present state as a result of forces operating from within. One of these, as emphasised above, has been the influence exercised by the audit profession. The other important force has been the 'democratisation of the company' which originated in the post-war period of economic reconstruction. It is these two forces which forged the regulations and the regulatory framework in the Netherlands, particularly in the 1970s.

Since then, Dutch EU membership has taken over as the most important factor in the development of financial reporting regulation in the Netherlands, although the auditors still play an important role.

Appendix: Chronological table of events

Year	*Event*
1838	The first Dutch regulation of financial reporting is included in the Commercial Code
1871	Justice Minister Jolles drafts new law on financial reporting
1890	The Kist Committee drafts new law on financial reporting
1910	Justice Minister Nelissen drafts new law on financial reporting
1925	The Nelissen-Heemskerk draft of a new law on financial reporting is prepared
1928	Revision of financial reporting regulation in the Commercial Code
1929	Parliament passes the *Visser Novelle*, amending financial reporting regulation in the Commercial Code
1955	Report of the Rijkens Committee on the financial reporting of listed companies
1959	Report of the Wiardi Beckman Stichting on the revision of company law
1962	Report of the Hamburger Committee on the financial reporting of listed companies
1964	Report of the Teldersstichting on the revision of company law
1965	Report of the Verdam Committee on the revision of company law
1970	Parliament passes the Act on Annual Financial Statements of Enterprises
1971	Establishment of the Tripartite Study Group
1976	The WJO is incorporated into Book 2 of the new Civil Code, under Title 6
1977	First judgement made by the Enterprise Chamber
1982	The Tripartite Study Group is succeeded by the Council for Annual Reporting (RJ)
1983	Incorporation of the EU's Fourth Directive into the Dutch Civil Code: Title 8 Book 2 of the Civil Code
1988	Incorporation of the EU's Seventh Directive into Title 8 Book 2 of the Civil Code
1989	Title 8 Book 2 of the Civil Code is renumbered to Title 9 Book 2 of the Civil Code
1993	Inclusion of provisions concerning banks and insurance companies into Title 9 Book 2 of the Civil Code
1997	Title 9 of Book 2 of the Civil Code is declared to apply also to foundations and associations that conduct a business

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10 Portugal

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INTRODUCTION

During the last 20 years, Portugal has seen the creation of the Portuguese Accounting Plan, the approval of new codified legislation on taxation and business, the incorporation of the Fourth and Seventh European Company Law Directives into Portuguese law and, amongst other things, legislation on securities markets and the accounting and auditing professions. Not surprisingly, in a country where the public sector has occupied a position of considerable importance in the economy, the state has been the main authoritative source on many aspects of corporate governance. The trend in recent years, however, has been towards a sustained reduction in the public sector with a programme of privatisation beginning in 1988. Moreover, with the opening of the banking sector to private initiative and Portugal's entry into the European Community, the financial system underwent a major liberalisation and the deregulation of capital followed. In matters of accounting, however, regulation continues to be dependent primarily on legislative instruments. Indeed, accounting principles usually require legal backing in Portugal if they are to be treated as valid because there is no tradition of general acceptance of the accounting principles issued by professional bodies.

The Portuguese legal system is a structured hierarchy of laws, the most important of which is the Constitution Law which acts as a foundation for other legislation. In descending order of priority, other sources of legislation are *leis* (laws) passed by Parliament, *decretos-lei* (laws by decree) issued by the Government, *decretos-regulamentares* and *portarias* (orders) issued by Ministries and *despachos normativos* (official communications) signed by Secretaries of State. In the area of financial accounting, the principal legal statutes in force in Portugal comprise the *Plano Oficial de*

Contabilidade (Official Accounting Plan, or POC) and three codes: *Código Comercial* (Commercial Code, or CC), the *Código das Sociedades Comerciais* (Companies Business Code, or CSC) and the *Código do Registo Comercial* (Commercial Register Code, or CRC) and, in addition to these three, codes which were approved by decree law. In this context, it should also be noted that Portuguese law recognises several types of legal entity, the most significant being the *sociedade anónima* (corporation), and the *sociedade por quotas de responsabilidade limitada* (private limited liability company), while the *sociedade em nome colectivo* (general partnership), and the *sociedade em comandita* (limited partnership) are less important.

A more detailed listing of the legislation governing corporate accounting in Portugal is given in Table 10.1. The evolution of these regulations and the role of the institutions which shape them provide the main focus for this chapter.

A BRIEF HISTORY OF ACCOUNTING REGULATION IN PORTUGAL

Accounting regulation in Portugal has experienced a number of stages of development from the emergence of commercial law, to the recognition by accountants of the need for greater uniformity, standardisation of accounting through legislation and, finally, the international harmonisation of accounting.

To begin with, the techniques used in recording commercial activities were at a rudimentary level and this remained the case from the foundation of the Portuguese nation in 1143 until the beginning of the sixteenth century when Venetian-style double-entry bookkeeping was adopted. For the next 250 years, very little is known regarding the extent to which such methods were used. There are no books on accounting in Portuguese which date from this period, neither original works nor translations, and legal requirements regarding accounts were not introduced in Portugal at this time. In fact, the first efforts to lay down a legal structure for trade and commerce, including accounting, were made under the Marquis of Pombal's ministry. In 1755, a Royal Decree created the *Junta de Comércio*, a trade association which played a lasting role in

Table 10.1 Accounting legislation in Portugal

Date	*Regulation*	*Content*
February 1977	Decree Law 47/77	Creation of the CNC Approval of the first POC
September 1986	Decree Law 262/86	Business Companies Code
December 1986	Decree Law 403/86	Commercial Registry Code
November 1988	Decree Law 442–B/88	Companies Income Tax Code
November 1989	Decree Law 410/89	New POC incorporating the Fourth EU Directive
April 1991	Decree Law 142–A/91	Regulation of the stock market
July 1991	Decree Law 238/91	New POC incorporating the Seventh EU Directive
March 1992	Decree Law 36/92	Consolidated accounts of banks and financial institutions
January 1993	Decree Law 23/93	Regulation of banks and financial institutions
December 1993	Decree Law 422–A/93	Regulation of the auditing profession in line with Eighth EU Directive
January 1994	Norma Regulamentar 35/93	Regulation of insurance companies according to EU Directives
May 1994	Decree Law 147/94	Consolidated accounts of insurance companies
July 1994	Norma Regulamentar 7/94	Accounting plan for insurance companies
October 1995	Decree Law 265/95	Regulation of the official body of the accounting profession

the teaching of accounting and business methods. The first accounting texts in Portuguese appeared in 1758 as *Mercador Exacto nos seus Livros de Contas*, edited by João Baptista Bonavie, and in 1764 as *Tratado das Partidas Dobradas*, by an unknown writer. The earliest legal requirement concerning accounting related to Government activities in the kingdom and was imposed in 1791 by a *Carta de Lei* (Law Letter).

The reforms introduced by Pombal were neither as rapid nor as durable as he had intended. It was not until the nineteenth century that effective commercial codes were prepared, first by Ferreira Borges in 1833 and then by Veiga Beirão in 1888. Under the influence of the French commercial code, the Portuguese code set down requirements for the keeping of books of account and other records. Some of the provisions of the 1888 code are still in force today. Such provisions include the obligation to keep a journal, a ledger and a balance sheet book, which must be written up within 90 days of the year end and retained for ten years.

In the 1920s, accounting in Portugal became recognised as a body of knowledge having a relationship with business economics and the theory of the firm. Several influential books on accounting by Portuguese authors were published, as well as translations of foreign classics. In 1933, a journal called *Revista de Contabilidade e Comércio* (Review of Accounting and Commerce) first appeared and continues today. A scientific and cultural association, the *Sociedade Portuguesa de Contabilidade*, was founded in 1945 and later became a member of the *Union Européenne des Experts Comptables, Economiques et Financiers* (UEC). At the same time, the teaching of accounting had begun to make its appearance in certain economics and law faculties. Until the 1960s, however, there was considerable diversity in the approaches taken to accounting and in the terminology used.

Standardisation

One of the consequences of Portugal's legal reform of the 1960s was the approval of a tax code (the *Código da Contribuição Industrial*, or CCI (Companies Income Tax Code)) in 1963 which introduced greater uniformity into accounting for tax purposes. This code established that taxation of the income of larger companies must be calculated as a percentage of its accounting profit and, accordingly, the CCI required companies to apply *sãos princípios de contabilidade* (generally accepted accounting principles). The code did not specify the precise meaning of this expression, although it may be inferred that the intention was to motivate greater conformity in practice as well as to comply with certain legal regulations concerning the allocation of costs and revenues in the process of computing taxable profit. In the absence of a recognised set of generally accepted accounting principles, the taxable income of companies was calculated according to definitions and rules in the tax law.

From 1965 onwards, several attempts to implement accounting standardisation were made in order to achieve a commonly accepted way of calculating accounting profit. When accounting professionals began to express their views on the need to standardise accounting measures (Lopes Amorim, 1971), the influence of French ideas was apparent. In 1973, the *Ante-projecto de Plano Geral de Contabilidade* (Draft of the Accounting General Plan) was completed under the aegis of the *Direcção-Geral das Contribuições e Impostos* (Directorate General of Taxes) with the objective of producing proposals for an accounting code, and these identified the French *Plan Comptable Général* as a suitable model. Later, in 1975, the accounting standardisation process was facilitated by the publication of the document *Normalização Contabilística – I fase* (Accounting Standardisation – Phase I) by the Ministry of Finance. Again, the French accounting plan was taken as a model.

Table 10.2 lists the accounting plan drafts put forward by the various organisations involved. However, none of these drafts gained general acceptance. In spite of the initial lack of support for uniform accounting measures, the process took a step forward in 1977 with the law establishing the Accounting Standardisation Commission (*Comissão de Normalização Contabilística*, or CNC) and the publication of the first POC. The approval of the 1977 POC signified the adoption of the French institutional model for accounting regulation, with a standard-setting body attached administratively to the Ministry of Finance and having the power to lay down a national accounting plan (R. Ferreira, 1984).

It was intended that the norms established by the CNC would be submitted to the Ministry of Finance for approval and would have

Table 10.2 The emergence of the Portuguese Accounting Plan

Year of publication	*Title of document*	*Published by*
1965	Project for a Portuguese General Accounting Plan	Research Centre of the National Union of Office Employees
1970	Draft for a General Accounting Plan	Office Professionals Union (Lisbon District)
1973	Draft of the General Accounting Plan	Finance Ministry, General Directorate of Taxes
1974	Portuguese Accounting Plan	Portuguese Society of Accounting
1975	Accounting Standardisation Phase I	Finance Ministry, State Secretary of Budget

legal force in the form of a decree or a decree-law. However, although the law creating the CNC was issued in 1977, the regulation specifying its structure and powers did not appear until October 1980 and the members of the Commission were not appointed until March 1983. Moreover, the Commission only began to operate in 1987. Thus, the political and economic vicissitudes of the 1970s and early 1980s caused a delay of several years before the implementation of accounting regulation in Portugal.

International Harmonisation

In 1986, Portugal became a member of the European Community. From that year onwards, French influence in the field of accounting began to decline and international standards, mainly from the English-speaking countries, became more influential (the regulation of lease accounting is an example of this change) (Ferreira and Regojo, 1994). In November 1989, a revised version of the POC was issued to incorporate the provisions of the Fourth European Company Law Directive on individual accounts.

The political events besetting Portugal before its membership of the EC had resulted in the temporary demise of industrial and financial groups, so that consolidated accounts were largely unnecessary until new industrial groups emerged in the late 1980s. To some extent, this helps to explain the lack of urgency in implementing the Seventh Directive. In July 1991, a new version of the POC was issued to include these requirements. Codified law was also adapted to take account of the contents of European Directives. For banks and other financial institutions, as well as for insurance companies, sectoral plans in line with EU Directives were approved in 1993 and 1994, respectively.

Portugal has long been a member of international accounting organisations, such as the UEC. However, the adoption of IASs has only taken place since the late 1980s, with the large multinational audit companies playing a key role in this respect. The influence of the IASC can now be observed in the *directrizes contabilísticas* established by the CNC and in the disclosure requirements of the Stock Exchange authority.

To a considerable extent, however, these external forces continue to have relatively little influence on the mainstream of accounting developments in Portugal. It must be remembered that the great majority of Portuguese companies are small, around 80 per cent having less than 20 employees, and that such companies prepare and disclose accounting information only to meet fiscal requirements. Furthermore, most Portuguese companies are family-owned firms and, usually, the shareholders in such companies are involved directly in the activities of the firm or have close links with management. They have other sources of information and do not depend solely on the financial statements. A second point to recall is that a significant proportion of the larger companies operating in Portugal in the 1970s and 1980s were state-owned. Together, these two types of company – small family-owned and the remaining large state-owned – passively accept the official regulations.

To date, the accounting and auditing professions in Portugal have not developed a set of accounting principles and procedures that are generally accepted by companies (Ferreira and Regojo, 1994). Establishing a true and fair view is interpreted by accountants and auditors as ensuring that accounts are drawn up in accordance with the POC and other legal requirements (Vieira dos Reis, 1996).

REGULATION THROUGH THE ACCOUNTING STANDARDISATION COMMISSION

In Portugal, the regulation of accounting is now the responsibility of the CNC which is attached administratively to the Ministry of Finance. The Commission was created in 1977 through a decree-law and was empowered to improve the process of national accounting standardisation. The first members of the CNC were appointed in March 1983, but the Commission only began to operate in 1987.

The CNC has a President, a General Council and an Executive Commission. The President is designated by the Minister of Finance. The General Council is the decision-making body and its powers are set down by law. They are (a) to advise the Minister of Finance on accounting and (b) to approve the annual plan of activities and the programme of research to be carried out by the Executive Commission or by working groups. In addition to the President, there are 39 members of the Council, drawn from the constituencies shown in Table 10.3. The General Council meets normally once a quarter, and a quorum of at least 12 members must be present. Decisions are made by a simple majority of those present, with the President casting a deciding vote.

The Executive Commission has eleven members who are chosen from the membership of the General Council, again so as to represent the various constituencies mentioned above, and appointed for a renewable period of three years. The Executive Commission carries out work laid down by the General Council. It sets up working groups and coordinates their activities, decides on the submission of draft proposals to the General Council and prepares annual activity programmes and budgets. The Commission meets regularly four times a month.

The Executive Commission submits for approval of the Secretary of State of the Ministry of Finance the names of the members of the working groups and their fees. Working groups are usually composed of three members of the Executive Commission and, in some cases, include external assessors. Usually, these working groups study and present proposals on specific topics, such as cash-flow statements, accounting for pension funds and accounting for

Table 10.3 Composition of the Portuguese Accounting Standardisation Commission

Constituencies		*Number of representatives*
Tax authorities		4
National Statistical Institute		1
Bank of Portugal		1
Insurance Institute of Portugal		1
Department of Treasury		1
Professional associations		
Auditing	2	
Accounting	6	
Economics	2	10
Academic and scientific institutions		
Universities	4	
Accounting Institutes	4	8
State-owned companies		4
Employer organisations		8
Stock Market Commission		1
Total		39

options. However, it was also such a working group which prepared the draft revision of the POC to incorporate the Seventh Directive. The members of working groups are paid for their specific tasks but members of the Executive Commission and the General Council offer their services on a part-time basis and are paid according to their attendance at meetings. The operating costs of the CNC are included in the annual budget of the Ministry of Finance.

Of the members of the General Council, employer organisations and state-owned companies hold about 30 per cent of seats. Whilst the trade unions are not represented, academic and research institutions hold almost 20 per cent of seats. The other constituencies comprise those which may themselves issue rules or regulations influencing accounting practice in Portugal. These include the tax authorities, professional associations and the Stock Market Commission, each of which is discussed in greater detail below.

Any person or organisation may question the CNC about accounting issues. Queries of this nature occur about three or four times each week, most frequently raised by the Tax Authority. There are often simple solutions to the problems raised and the permanent staff answer directly. Occasionally, however, the response requires the formulation of accounting policy, and when this is the case the Executive Commission includes the question in its agenda or nominates a working group. If the CNC considers that the answer to a specific question is generally applicable, then it will be published in the form of a directive (*directriz contabilistíca*). Sometimes, the CNC itself takes the initiative in interpreting ambiguous points in the POC. However, the CNC does not publish a bulletin describing its work in progress.

The Tax Authorities

Accounting in Portugal has been considerably influenced by tax regulations since the early 1960s (R. Ferreira, 1992 and 1994). Until then, there was no strong link because both accounting regulation and fiscal regulation were underdeveloped. However, from 1963 to 1987, detailed accounting regulations based on the fiscal law were in force. In 1963, when the *Código da Contribuição Industrial* was approved, it not only pronounced on certain issues of accounting method (depreciation, inventory valuation, and so on) but also established that expenses must be recorded in the books of accounts for them to be accepted as tax deductible. The design of the 1977 POC reinforced the rationale for tax accounting (the basis for the calculation of company taxation would be book profit rather than the disclosure of information to the shareholders and the public). The influence of taxation on accounting continued with the *Código do IRC* (Companies' Income Tax Code, or CIRC) of 1988. This law provides a set of rules for the valuation and recording of items in order to assess taxable income.

The fiscal authorities have four representatives on the General Council of the CNC. Two are from the *Direcção-Geral das Contribuições e Impostos*, a department of the Ministry of Finance charged with implementing the government's fiscal policy and with managing the system of tax collection. The other two are from the *Inspecção-Geral de Finanças*, the tax audit division of the Ministry of Finance. The tax section of the Ministry of Finance is supported by a permanent staff (*Centro de Estudos Fiscais*), who undertake research into accounting topics as well as fiscal policy.

Company Accountants

In common with certain other European countries, Portugal has separated the accounting and auditing professions. Under the Portuguese tax reform of 1963, company accounts prepared for tax purposes had to be signed by an accountant who had to be registered with the Tax Department of the Ministry of Finance. As a result of the 1988 fiscal reform, however, it was no longer necessary for an accountant to be so registered in order to sign a company's tax return, provided he or she was named as the company's official accountant. The requirement for registration changed again in 1995, this time making it compulsory to be a registered member of the recognised professional accounting association.

Although there were no official professional accounting associations in Portugal until 1995, there were several scientific and cultural associations, the oldest of which was the *Sociedade Portuguesa de Contabilidade*, or SPC, founded in 1945. In recent years, the *Associação Portuguesa dos Técnicos de Contabilidade* or APOTEC, has had more members but, as mentioned, it was not necessary to be a member of these associations in order to carry out the various duties of a company accountant. In 1995, however, partly as a result of the efforts of accountants, the Government was authorised through the state budget to create and fund an officially-recognised professional association of accountants, the Association of Official Accountants (*Associação dos Técnicos Oficiais de Contas*) or ATOC. The by-laws of the ATOC were approved by a decree law published in October 1995 (Vieira dos Reis, 1995). In order to carry out the official duties of a company accountant, membership is now required. The task of the ATOC is to represent members and undertake disciplinary measures. ATOC is presently the largest professional association in Portugal with about 40,000 members.

Table 10.4 shows the number of members of each of the professional associations, as well as the names of the journals that they publish. In addition it is worth mentioning the *Jornal do Técnico de*

Table 10.4 The professional accounting associations in Portugal and their journals

Professional association	*Year of formation*	*Number of members (approx)*	*Journal*
Sociedade Portuguesa de Contabilidade (SPC)	1945	500	*Jornal do Técnico de Contas* (out of press)
Associação Portuguesa de Contabilistas (APC)	1975	2500	*Boletim da APC* (trimestrial)
Associação Portuguesa de Técnicos de Contabilidade (APOTEC)	1977	8000	*Jornal de Contabilidade* (monthly)
Câmara dos Técnicos de Contas (CTC)	1977	3000	*Boletim da CTC* (monthly)
Associação dos Técnicos Oficiais de Contas (ATOC)	1995	40000	*Eurocontas* (monthly)

Contas e da Empresa, a monthly magazine issued by a national private company which provides an accounting service; this has been one of the most influential journals in accounting. The companies which provide accounting services have their own association, named *Associação de Empresas de Contabilidade e Administração* (APECA), which issues a monthly bulletin (*Boletim APECA*).

In comparison with many other countries, the accounting associations in Portugal have not had an important role in rulemaking. However, they have influenced the process of accounting regulation in a number of ways. In particular, their journals include sections which provide professional advice on accounting and taxation, often in response to questions posed by members. The views expressed in the professional journals are generally those of acknowleged experts and tend to be followed closely by companies. During the 1960s, the associations issued draft standardised accounting plans although these did not gain general acceptance. Now, however, the associations contribute actively to the workings of the CNC and have six representatives on the General Council.

Auditors

Auditors in Portugal are members of a professional body and must be registered in the *Câmara dos Revisores Oficiais de Contas* (The Chamber of Statutory Auditors, or CROC) which was established in 1974. The CROC issues a periodical bulletin and approves technical auditing standards (*normas técnicas*) which are part of the Official Audit Manual (*Manual dos Revisores Oficiais de Contas*). Since 1994, the auditing profession has been regulated under the provisions of the Eighth European Company Law Directive. All auditors in Portugal must be registered in the CROC which is responsible both for issuing professional standards and for taking disciplinary action.

By the end of 1997, CROC had 820 individual members known as *revisores oficiais de contas* (statutory auditor, or ROC) and 136 *sociedades de revisores oficiais de contas* (registered unlimited liability partnerships of statutory auditors, or SROC). It is estimated that, from the total number of individual members, only 88 per cent were actively practising as auditors, while perhaps 45 per cent practised on a limited scale only. All partners of a SROC must be individually qualified as a statutory auditor.

Until the beginning of the 1970s, members of a company's statutory board of auditors were not required to have any particular qualifications. Since then, however, at least one member of the statutory board of auditors must be a qualified ROC or a SROC who takes part in the activities of the statutory board of auditors and issues an independent external annual statutory audit that is summarised in a document known as the *Certificação Legal de Contas*. It is estimated that some 7500 business entities in Portugal are currently subject to a statutory audit requirement. All corporations and private limited companies must appoint a statutory board of auditors (*Conselho Fiscal*), the size and composition of which depend on the size and class of the company. Corporations must have a three member audit board, one of the members being the company's ROC. If the company's share capital is less than 20 million escudos, the statutory board may consists of a single person who must be a ROC and is appointed at the shareholders' meeting for a period of not more than three years.

The CROC has two representatives on the General Council of the CNC, although it is worth noting that most CNC members representing the various constituencies are also statutory auditors and members of the CROC. One of the functions of the CROC is to propose to the government, jointly with CNC, the regulation of accounting subjects in order to allow more efficient auditing. The CROC is also the national representative in the *Fédération des Experts Comptables Européens* as well as the IASC, and is a member of the International Federation of Accountants.

The Capital Market

Traditionally, Portuguese firms have had a high debt-to-equity ratio and financing was channelled through the banks, to which companies would send accounting information, such as quarterly and annual financial statements. The importance of the stock market as a financing source has greatly increased in recent years but it still remains secondary. Indeed, most business in Portugal is conducted on the basis of sole proprietorship or by small limited companies. Larger companies are either private or public, and it is the latter which have a stock exchange listing. Until recently there were two stock exchanges, one in Lisbon and the other in Oporto, in which corporate shares and bonds traded. Since 1996 all spot trading has been based in Lisbon whilst a newly-created national derivatives market now operates in Oporto. During the 1970s and 1980s the Portuguese securities market did not develop at the same pace as the Portuguese economy, which had shown sustained growth. The government adopted a set of measures to ensure the publication of relevant information and thereby to increase the transparency of the stock market. In 1991, Portugal's new law regulating stock exchange operations, the *Código do Mercado de Valores Mobiliários* (Stock Markets Code), which is usually known as *Lei Sapateiro*, was approved.

The Stock Exchange Commission in Portugal is the *Comissão do Mercado de Valores Mobiliários* (CMVM) and has a Board of Directors, a Consulting Board and an Auditing Commission. The Board of Directors comprises the president, a vice-president and three members, designated by the government. The Consulting

Board, which consists of between 11 and 13 members, gives opinions on matters presented by the Board of Directors and brings forward any proposals it may find appropriate to the operation of the markets. The Auditing Commission supervises the financial and accounting operations of the CMVM itself and is composed of two members, in addition to the President, who are designated by the Minister of Finance.

The CMVM is a public and autonomous institution comparable to the SEC in the USA, and plays a leading role in the operation of the securities market in Portugal. The CMVM may propose statutes to the Minister of Finance and issue regulations as well as technical rules (*regulamentos*). Since 1994, CMVM has published a review entitled *Estudos*, which includes papers and opinions about accounting topics. The CMVM has one representative on the CNC.

Banking and Insurance

Even though the accounting rules which apply to companies operating in certain specific sectors differ from those in the POC, the CNC has to give its opinion about these sectoral accounting plans. That is the case for banks and other financial institutions which are subject to separate sets of accounting requirements issued by the Bank of Portugal and drawn up in the light of the 1986 EU Directive. Details of accounts format and preparation are also prescribed by the Bank of Portugal. Moreover, the insurance companies have their own sectoral accounting plan which was prepared by the Insurance Institute of Portugal following the 1991 EU Directive. The General Council of the CNC includes one representative from each of these entities.

THE RULES OF ACCOUNTING IN PORTUGAL

The regulations surrounding company accounting are complex. As elsewhere, some accounting rules are mandatory, while others are optional. Some are generally accepted in practice and others are controversial. Some are applicable to all companies while others have specific relevance to companies operating in specific sectors. Moreover, in Portugal, the rules which are taken into account when preparing financial statements include not only those approved in the form of decree laws and other forms of regulation with the force of law, but also other types of rules such as recommendations and opinions issued by professional organisations. In certain cases, interpretations by experts in company law, taxation, finance and accounting or other authorised Portuguese specialists can be seen to have an observable influence on accounting practice (Vieira dos Reis, 1995).

In Portugal, accounting law is usually published in the Portuguese Official Journal (*Diário da República*). The most important, such as the POC, are published in the main series (*Série I*) while others such as the *directrizes contabilísticas* appear in a separate series to which less importance is attributed.

Table 10.5 The main rules governing accounting in Portugal and the issuing bodies

Year	*Source*	*Issuing Body*
1888	*Código Comercial* (Commercial Code)	
1986	*Código das Sociedades Comerciais* (Companies Business Code)	MJF[1]
1986	*Código do Registo Comercial* (Commercial Registry Code)	MJF
1988	*Código do Imposto sobre o Rendimento das Pessoas Colectivas* (Companies Income Tax Code)	DGCI[2]
1990	Tax treatment of Depreciation	DGCI
1991	*Código do Mercado de Valores Mobiliários* (Stock Market Code)	CMVM
1991 (rev.)	*Plano Oficial de Contabilidade* (Official Accounting Plan)	CNC
1993 (rev.)	*Normas Técnicas de Auditoria* (Auditing Standards)	CROC
various	*Directrizes Contabílisticas*	CNC
various	*Circulares*	DGCI
various	*Oficios-circulados*	DGCI
various	*Recomendações Técnicas*	CROC
various	*Interpretações Técnicas*	CROC
various	*Regulamentos*	CMVM

Notes: [1]Ministries of Justice and Finance
[2]General Directorate of Taxes
Further details are provided on p. 287 (Figure 10.1)

The main rules that govern the form and content of the financial statements of individual companies and groups in Portugal are listed in Table 10.5. A general model of the system which generates these regulations is presented in Figure 10.1, and relates to the situation at the time of writing. The arrows indicate the differing strength of the various influences, with a double line indicating greater influence.

The Commercial Codes

The most significant forms of business organisation are governed primarily by the Companies Business Code (CSC). The current version of this document has been in force since 1 November 1986 and was prepared in accordance with European Directives.

The Commercial Registry Code (CRC) lays down the requirements of companies with regard to publication of financial information. The disclosure and auditing requirements for all corporations and limited liability companies above a certain size are the same. They include the following which must be made public:

(a) the balance sheet, profit and loss account and the notes to the financial statements;
(b) the report of the board of directors;
(c) the report of the statutory auditors;
(d) the report of the audit board, where it is required;
(e) minutes of the general meeting approving the accounts and the distribution of profits.

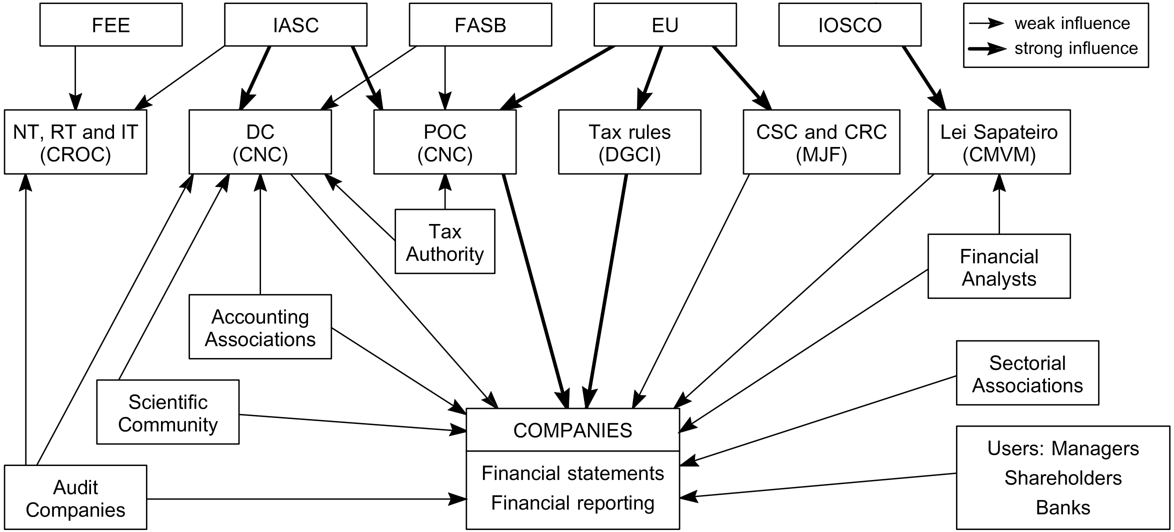
Previously, the aforementioned documents had to be published both in the official journal and in a newspaper in the city where the headquarters of the company were situated. Since 1990, however, the requirement to publish in the press has ceased to apply to non-listed companies and the accounts must instead be deposited in the Commercial Registry.

The Accounting Rules Established by the CNC

The Official Accounting Plan

The first POC was published on 7 February 1977 and followed the French accounting model: see R. Ferreira (1984) for further details.

Figure 10.1 The overall model of accounting regulation in Portugal



Notes

CMVM	*Comissão do Mercado de Valores Mobiliários* (Stock Exchange Commission)
CNC	*Comissão de Normalização Contabilística* (Accounting Standardisation Commission)
CRC	*Código do Registo Comercial* (Commercial Register Code)
CROC	*Câmara dos Revisores Oficiais de Contas* (Chamber of Statutory Auditors)
CSC	*Código das Sociedades Comerciais* (Companies Business Code)
DC	*Directriz Contabilística*
DGCI	*Direcção-Geral das Contribuições e Impostos* (Directorate General of Taxes)
EU	European Union
FASB	Financial Accounting Standards Board (USA)
FEE	*Fédération des Experts Comptables Européens* (Federation of European Experts-comptables)
IASC	International Accounting Standards Committee
IOSCO	International Organisation of Securities Commission
IT	*Interpretação Técnica*
MJF	*Ministerio da Justiça e das Finanças* (Ministries of Justice and Finance)
NT	*Norma Técnica*
POC	*Plano Oficial de Contabilidade* (Official Accounting Plan)
RT	*Recomendação Técnica*

It is noteworthy that the publication took the form of a document annexed to a decree law which was approved by the Council of Ministers and not simply by the Finance Ministry, indicating the national importance attributed to such a document. The POC is compulsory for the following organisations: entities regulated by the CSC, limited or unlimited liability companies, sole proprietorships above a certain size and state-owned companies and cooperatives.

Portuguese corporations and private limited companies are subject to a statutory audit that ascertains whether the company has followed the POC. External auditors, financial institutions, shareholders and the government occasionally monitor whether firms are effectively following the POC. Whilst the POC itself contains no reference to penalties applying to companies that do not respect accounting rules, the CSC and CMVM are empowered to impose fines on companies that do not meet the deadlines or fail to provide information which adheres to the formats and contents established by law. The CIRC does, however, oblige companies to record expenses in their accounts, in order for them to be tax deductible.

Between 1977 and 1989, certain changes were made in the POC in order to account for specific issues such as foreign currency differences and, in November 1989, to bring the plan in line with the Fourth European Company Law Directive. In fact, compliance with the Fourth Directive did not necessitate great modification to the original POC, except with regard to disclosure in the notes to the accounts and with regard to the format of the balance sheet and income statements. The CNC decided to keep changes to a minimum in order to aid both preparers and users of the financial information. Corporate accounting practice was not significantly affected by these changes. The 1989 version of the POC also provided an opportunity to incorporate certain improvements and clarifications in terminology in the light of twelve years' experience of the plan and in order to remove some minor differences between Portuguese accounting and the internationally accepted principles of IASC. (L. Ferreira, 1997 and R. Ferreira, 1996).

Another revised version of the POC was published in July 1991 when decree law No. 238/91 incorporated the requirements of the Seventh European Directive on group accounts, implementing the use of the equity method in individual accounts for investments in

Table 10.6 Contents of the Portuguese Accounting Plan

1.	Introduction
2.	General considerations
3.	Objectives and qualitative characteristics of financial information
4.	Accounting principles
5.	Valuation criteria
6.	Balance sheet: formats and contents
7.	Profit and loss account: formats and contents
8.	Notes to the balance sheet and to the profit and loss account
9.	Statement of sources and application of funds
10.	Overall chart of accounts
11.	Detailed code of accounts
12.	Explanatory notes on the operation of certain accounts
13.	Group accounts: methods and procedures
14.	Group financial statements: formats and contents

subsidiaries and associated companies. Table 10.6 shows the current contents of the POC and the accounting topics covered by the plan.

The CNC Pronouncements

The Executive Commission of the CNC approved a number of pronouncements on accounting matters (*directrizes contabilísticas*) from 1992 onwards, as listed in Table 10.7. It is worth noting that, in preparing its pronouncements, the CNC has been strongly influenced by the IASC and, in some cases, the pronouncements are little more than a translation of the relevant IAS. Usually, however, the guidelines issued by the CNC have the aim of explaining in detail the contents of the POC relating to a specific issue. It is not clear whether the *directrizes contabilísticas* are mandatory, and neither is it known whether they influence financial reporting practices to any great extent (R. Ferreira, 1994).

The initiative to issue a pronouncement sometimes comes from proposals by the Ministry of Finance, and in other cases they are motivated by the CNC's own members. In a few cases, the CNC pronouncements have resulted from issues raised by individual companies.

Table 10.7 Directrizes contabilísticas issued by the CNC

Number	*Title*
1	Accounting for business combinations
2	Accounting for assets received through donation
3	Accounting for long term contracts
4	Accounting for concession contracts
5	Accounting for costs and revenues from the lottery
6	Elimination of profits and losses resulting from transactions between group undertakings
7	Accounting for research and development expenses
8	Clarification of the contents of the *Resultados Transitados* account*
9	Accounting for investments in subsidiaries and associated companies
10	Transitional procedures for leasing contracts
11	Intracommunitary value added tax accounting
12	The accounting concept of goodwill
13	The concept of fair value
14	Cash-flow statements
15	The redemption and amortisation of shares
16	Revaluation of tangible fixed assets

* Preceeding years' income not appropriated and/or losses carried forward, concerning unusual and significant adjustments.

Tax Regulations

Traditionally, accounting in Portugal has been greatly influenced by tax regulation. Since the income tax reform dating back to the beginning of the 1960s, the basis of income tax calculations of companies has been the profit shown in the accounts.

The influence of taxation on accounting continued with the tax code approved in November 1988. This tax code defined basic principles and rules concerning the computation of taxable income. In some cases the details have been set down in specific regulations, as in the case of the depreciation of tangible and intangible fixed assets. In other cases, the tax authorities have issued circulars and explanatory rules (*circulares* and *ofícios-circulados*) covering accounting topics with the primary objective of helping its own employees in their assessment of taxation. Tax rules still affect financial accounting in many areas: inventory valuation, revaluation of fixed assets, depreciation of fixed assets, provisions for loss of value of assets, costs of social provision in the workplace, donations for cultural purposes, capital gains and losses, tax charges and liabilities, dividends from group companies and so on.

Below is a list of the main topics in the CIRC which impinge on accounting.

Definition of companies' taxable income
Definition of the taxation period
Long-term contracts
Subsidies for non-operating purposes
Stock valuation criteria
Depreciation of fixed assets
Provisions for bad debts and other assets
Rules concerning specific costs
Capital gains and losses

Sometimes, the tax rules and the accounting rules do not differ. For example, the valuation criteria that apply to stocks for tax purposes are the same as those which must be followed in accordance with the POC. More often, the tax rules are more detailed. This is the case for depreciation of fixed tangible assets, for example. On the other hand, there are some specific cases in which the tax regulations differ markedly from accounting requirements (R. Ferreira, 1996). For example, in the case of the amortisation of goodwill, the POC requires that goodwill be written off over a period of five years or over a longer period, which must not exceed 20 years and which must be justified in the notes to the accounts. However, the amortisation of goodwill is not deductible in computing taxable income.

The Rules of Auditing

The CROC has issued a number of auditing standards (*normas técnicas*) which have been published in the Official Journal, first in

1983 and, more recently, in 1993. All audit work must be carried out in line with these standards. In addition, the CROC has issued certain rules on auditing that are related to accounting: technical recommendations (*recomendações técnicas*) and technical interpretations (*interpretações técnicas*). Although these guidelines are not compulsory, and are not published in the Official Journal, they assist auditors in adhering to the rules of accounting. These guidelines are followed by most auditors, who consider them necessary in order to issue unqualified statements of accounts.

The rules issued by the CROC have been strongly influenced by international standards of accounting and auditing. This may be due to the fact that this professional association is the Portuguese national representative on the main international organisations.

Capital Market Regulation

The regulation of the Stock Exchange follows the Stock Market Code (*Lei Sapateiro*), which has been in force since 1991. This law sets out the functions and the powers of the CMVM and specifies the minimum information which must be disclosed by listed companies.

There is a specific requirement for all listed companies to publish financial statements in the Stock Exchange Gazette (*Boletim das Cotações*). They must publish end of the year accounts as well as mid-year and trimestrial financial information, though these need not be as detailed as the annual accounts. Some additional information is required beyond the general provisions of company law. For instance, listed companies are obliged to disclose provisional information for the year-end, such as projected total assets and turnover.

The rules issued by the CMVM (*regulamentos*) are published in *Série II* of the Official Journal. In specifying these compulsory rules, the CMVM has been influenced by the International Organisation of Securities Commissions (IOSCO). Interestingly, it was the CMVM which compelled the CNC to define a model cash flow statement (*Directriz Contabilística 14*) and to set out the obligation for listed companies to present this information, the format of which is influenced by IAS 7.

SOME EXAMPLES OF ACCOUNTING RULE-MAKING IN PORTUGAL

In the final section of this chapter, three areas of accounting are selected to illustrate the model of accounting regulation in Portugal which has been described above. At the end of each subsection, a figure illustrates the application of the general model of accounting regulation to the specific issue that is described. As before, the arrows indicate the direction of influence, with a double line indicating a stronger influence.

Accounting for Foreign Currencies

Accounting for operations in a foreign currency consists of two different aspects: the translation into escudos of foreign currency transactions and the consolidation of financial statements prepared in another currency by foreign subsidiaries. While the first of these situations is common amongst Portuguese companies, the latter is only relevant to a small number of Portuguese holding companies.

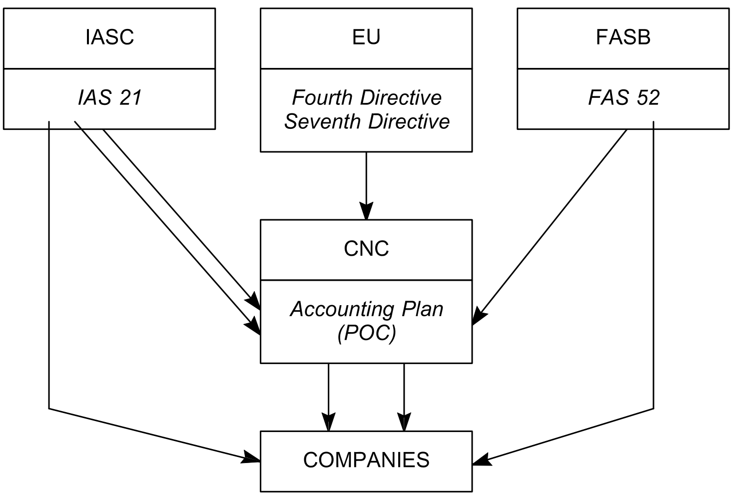
The rules relating to foreign currency transactions are set out in the POC (Chapter 5) where it is required that any such transaction be translated into escudos at the rates of exchange on the date of the transaction whilst, for balance sheet purposes, foreign currency balances are to be converted at the exchange rates prevailing at the year end. The 1989 version of the POC requires that the resulting unrealised foreign exchange gains or losses should be taken to the income statement as financial costs or financial proceeds, influencing the current income for the year. Unrealised medium and long-term foreign exchange gains are to be deferred if there is a reasonable expectation of a reversal of that gain (the 1977 version required currency differences to be accounted for as accruals or deferrals). According to the POC, the minimum disclosure required is the exchange rate used to express in Portuguese currency the items included in the annual accounts which are (or were originally) expressed in a foreign currency. It is noteworthy that Portuguese law refers to the 'exchange rate' while the EU Directives refer to the 'basis of conversion'.

Foreign currency translation rules for valuation have been influenced by international standards, such as IAS 21 and FAS 52.

Groups of Portuguese companies have been obliged to prepare and disclose consolidated accounts for all years beginning on or after 1 January 1991. However, not many Portuguese companies are obliged to consolidate foreign subsidiaries. The main reasons for this seem to be attributable to (a) exemptions due to size where the foreign subsidiary is small with respect to the group as a whole, and (b) exclusions due to the existence of severe restrictions in controlling the subsidiary. Rules for foreign currency translation into escudos of the consolidated financial statements of foreign subsidiaries of Portuguese groups for the purpose of the preparation of consolidated financial statements are set out in the POC (Chapter 13). However, the POC does not refer to the methods to be used in the translation of foreign subsidiaries. The few cases found in practice follow the closing rate method according to IAS 21.

Figure 10.2 illustrates regulation with regard to foreign currencies, showing the combination of IAS and POC rules in operation in Portugal in this instance.

Figure 10.2 Accounting regulation and foreign currency translation in Portugal



Revaluing Assets

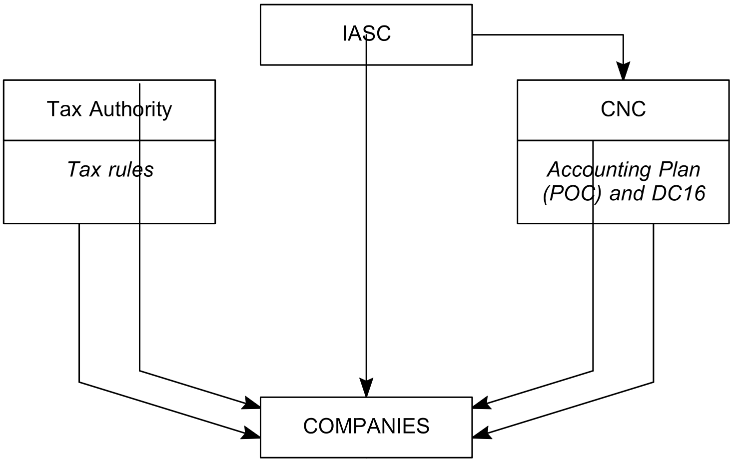
Until 1995, the main influence on the revaluation of tangible fixed assets was the tax law, although the POC played a subsidiary role in permitting companies to include revaluation allowed by fiscal law (R. Ferreira, 1995). The POC, in defining in Chapter 4 the principle of historical cost, states that 'assets must be registered at the acquisition or production cost, at nominal or constant escudos'.

Revaluation is not compulsory but there is some evidence that most companies take advantage of the opportunity to do so as the few companies which do not revalue their fixed tangible assets usually show losses in that year. This is because revaluations are generally linked to tax incentives where the tax benefits from additional depreciation are obtained only when the revaluation and the additional depreciation thereon are shown in the accounts. Only profit-making companies will benefit, claiming 60 per cent of the additional depreciation as a tax deductible cost.

The first tax law allowing the revaluation of fixed assets was approved in 1963 and expired in 1979. Since then a number of laws of limited duration (approximately two years) have been introduced, allowing the revaluation of fixed assets using prescribed price coefficients. The most recent revaluation law was published in 1998 and stated that the net book value of tangible operating fixed assets held on 31 December 1997 could be revalued on the basis of a set of prescribed price coefficients. Those coefficients were based on the consumer price index published annually by the Ministry of Finance.

According to the POC, the revaluation of assets should be disclosed in the balance sheet under the account named 'Revaluation reserves'. The notes also provide information related to the way in which assets are to be revalued in the individual and consolidated accounts. The difference between the new net book value of the tangible fixed asset and the old was accounted for as a revaluation reserve representing a net increase in the assets and also in the equity of the company. The revaluation reserve cannot be distributed as dividends, although it is possible to use it to increase the nominal value of the capital but only if there are no accumulated losses to be offset against the reserve. Due to the fact that an increased number of companies have been freely revaluing their

Figure 10.3 Accounting regulation and the revaluation of assets in Portugal



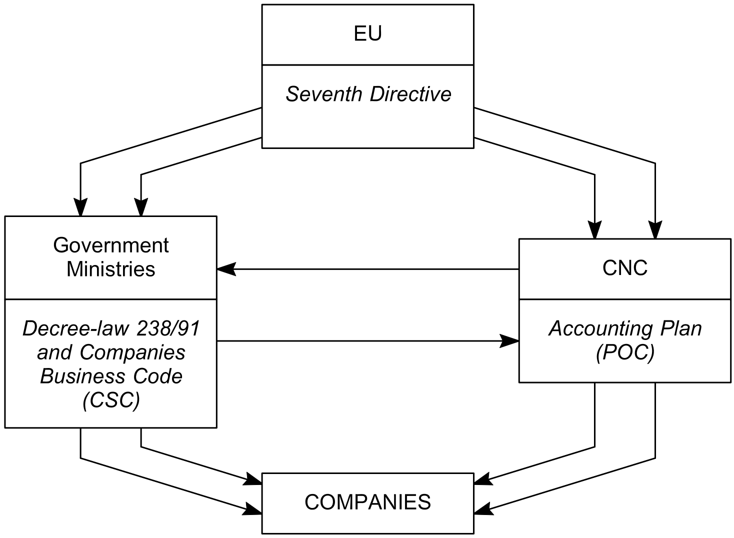
assets, the CNC issued a guideline (*Directriz Contabilística 16*) in January 1995 specifying the conditions and the methods which should be applied.

Figure 10.3 illustrates the regulation of asset revaluation, showing how the provisions of the Tax Code, the rules of POC and the guidelines of the CNC combine to govern both disclosure and valuation.

Defining Subsidiaries

The definition of a subsidary company (*empresa filial*) is given both in the POC (Chapter 2.7) and in Decree law No. 238/91 (Article 1). Both definitions of a subsidiary company were influenced by the Seventh Directive and the wording used in the POC and in the decree law are the same. These define subsidiary companies as those companies over which a mother company has the power to dominate or control. But there are differences between the POC

Figure 10.4 Accounting regulation and the definition of a subsidiary company in Portugal



and tax legislation concerning the concept of control. According to the POC, the concept of the subsidiary company is based on the percentage of control exercised. Although participation in share capital must exist in order to exercise control, it is not necessary to own over 50 per cent of the shares to control a company. For fiscal purposes, however, the concept of the subsidiary company is based on the percentage of participation in the share capital.

Portuguese legislation does not include the Seventh Directive options regarding those cases in which (a) the controlling company need not be a shareholder if it has the right to exercise a dominant influence over a subsidiary pursuant to a contract or by-law clause, and (b) the consolidation of investee companies is required if the controlling company exercises a dominant influence over them and manages them on a unified basis. The POC does provide definitions, however, of parent company (*empresa-mãe*) and associated companies (*empresas associadas*). The latter are those companies where the capital held is between 20 and 50 per cent. The Companies Business Code, on the other hand, distinguishes between totally controlled subsidiaries (*sociedades em relação de dominio total*) and simply controlled subsidiaries (*sociedades em relação de dominio simples*), the former being a company that holds 90 per cent or more of the capital of another, either directly or indirectly, and the latter a company that holds a majority of the shares or the majority of the voting capital of another, either directly or indirectly, or controls it by other means (Gonçalves da Silva and Esteves Pereira, 1998 and Vieira dos Reis, 1991).

Figure 10.4 illustrates the manner in which the definition of a subsidiary company has entered Portuguese legislation, leading to definitions in a number of different legal texts, some in agreement, others in conflict.

Appendix: Relevant events in Portuguese accounting regulation

Year	*Event*
1975	Nationalisation of Portugal's largest companies
	Accounting plan draft by Tax Authority
1977	Creation of the Accounting Standardisation Commission
	Approval of the first official accounting plan
1986	Portugal becomes a member of the EU
	Business Companies Code
	Commercial Registry Code
1987	Powers given to the Accounting Standardisation Commission
1988	Companies Income Tax Code
	Beginning of the privatisation process
1990	Implementation of the Fourth EU Directive
1991	Stock Market Regulation
	Implementation of the Seventh EU Directive
1994	Implementation of the Eighth EU Directive
1995	Creation of the official body of the accounting profession

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11 Spain

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INTRODUCTION

Accounting regulation in Spain is essentially a modern phenomenon, even though the accountability of companies has a long history. The first regulations date back to the reign of Queen Juana in the sixteenth century, and that of her son the Emperor Charles V. However, until as recently as the 1970s, corporate reporting was of little importance in Spain.

It is worth recalling that, in the years following the Second World War, the economic development that took place in much of western Europe did not occur in Spain – the ideological proximity of the Franco regime to that of the defeated powers had given rise to political and economic isolation. It was only in the 1960s that Spain's economy began to open up to the outside world, following guidelines set down by the International Monetary Fund. This led to an annual GNP growth between 1961 and 1974 of 6.8 per cent. On the death of Franco in 1975, Spain was able to accelerate economic change, to adopt democratic institutions and to take the necessary steps to become a member of the European Community.

It was during this period of social, political and economic change that accounting regulation emerged and the rules of accounting broke free from the influence of tax law (Cañibano, 1995a). The pressure came from many different sources, including accounting and auditing associations, international accounting firms, financial executives and company accountants, government specialists and accounting academics (Cañibano, 1995b). A new private professional accounting body appeared on the scene, capable of self-regulation and of interaction with international standard-setters. Thus, when Spain joined the European Community in 1986, accounting practices were already undergoing a process of internationalisation. As a result, the adaptation of Spanish legislation to EC directives took a relatively short time (Gonzalo and Gallizo, 1992). The main factors now influencing accounting regulation in Spain are discussed in greater detail below.

The Influence of the Professional Accounting and Auditing Bodies in Spain

AECA, the Spanish Accounting and Business Administration Association (*Asociación Española de Contabilidad y Administración de Empresas*), has played a leading role since its formation in 1979 in providing Spanish accountants with a substantial corpus of standards to supplement the gaps in the legal regulations (Tua, 1983). Its major contribution was made prior to the 1989 legal reform which brought Spanish accounting regulation in line with the European company law directives. Indeed, the inspiration for much of the reform of Spanish accounting legislation, particularly the new methods introduced through the General Accounting Plan (the *Plan General de Contabilidad,* or PGC) was drawn from accounting recommendations already issued by AECA. This was particularly evident in the case of issues such as the accounting treatment of exchange rate differences, the requirement to record a lability with respect to pensions, the use of the tax effect method and, amongst other things, the inclusion of leased assets in the balance sheet (Cañibano, 1995c).

As indicated above, Spanish accountants make considerable use of the statements by AECA on Accounting Principles and Standards (*Principios y Normas de Contabilidad*) to supplement the mandatory legal regulations in this area. AECA's Statements have been recognised by the professional auditing bodies in Spain as containing valid standards which their members can use to supplement the legal regulations. Moreover, none of the three professional auditing bodies in Spain – the Spanish Institute of Chartered Accountants (*Instituto de Auditores-Censores Jurados de Cuentas de España*), the Register of Economist-Auditors (*Registro de Economistas Auditores*) and the Register of Commerce Graduate-Auditors (*Registro de Titulares Mercantiles Auditores)* – issues accounting standards. They simply publish technical standards for the performance of statutory audits by their members. However, some of these technical standards may include criteria or rules with accounting content and, thus, they have some impact on financial statement presentation as a direct result of the auditor's influence on the preparation of accounts. This occurs in particular in the case of technical standards relating to issues such as the going concern, materiality and so on, which directly affect the wording of the auditor's report.

The regulatory contribution of the professional auditor bodies in Spain, as regards the issue of rules on accounting and guidelines to supplement the requirements promulgated by law, is not great. It is worth noting, however, that the largest body of Spanish auditors, the *Instituto de Auditores-Censores Jurados de Cuentas,* is a member of IASC and is responsible for having translated International Accounting Standards into Spanish, an achievement that has been particularly influential as the IASs were circulated widely to professionals as a result.

The Influence of Foreign Regulations through the International Audit Firms

Since the 1970s, there has been an increase in independent audit activity in Spain, starting prior to when such audits became mandatory for most companies. Initially, these were mostly carried out by prestigious international accounting firms, and have clearly contributed to the improvement of financial reporting by Spanish companies. Quickly, the accounting principles adhered to by international audit firms obtained validity with regard to the financial statements prepared not only by the Spanish subsidiaries of their multinational clients but also by other companies. For a while, the international audit firms took a leading role in creating an awareness of accounting developments elsewhere, particularly through the pressure exerted by them on client companies to recognise the authority of foreign accounting standards in order to avoid a qualification of the audit opinion (Cea, 1989).

The accounting principles adopted by the international audit firms operating in Spain were directly inspired by prevailing regulations in the USA, particularly the pronouncements of the

FASB, and to a lesser degree by the Statements of Standard Accounting Practice issued in the UK. The strong influence which they exerted in the 1970s and 1980s was largely due to the paucity of legal requirements under the old accounting regime in Spain. Nowadays, the new legal framework governing the preparation of financial statements has lessened the effective influence of US accounting standards, firstly because of the increased number of Spanish legal accounting regulations and secondly because of the greater number of private-sector accounting standards issued by AECA.

However, it is worth noting that the new laws and professional standards in Spain have drawn much of their inspiration from US accounting, and thus many of the rules in force in the USA have eventually found their way into Spanish regulations and standards. In fact, the various committees that have drafted either accounting law or AECA accounting standards have included representatives from the leading international audit firms operating in Spain. Although there is less recourse to US accounting standards than previously, the adoption of proposals already formulated in the USA is still the solution most often used in Spain for issues not covered by Spanish regulations.

The Influence of Preparers

Until the advent of professional standard-setting in 1980, it was difficult to speak of a sustained business influence in the field of accounting regulation. However, the overlap at that time between accounting and taxation meant that the development of certain accounting principles, such as those concerning the revaluation of assets, was subject to a significant input from the business sector, just as there has been more recently in the preparation of current standards and regulations. For instance, the fact that many of the members of AECA's Accounting Standards Committee are employed in the accounting and finance function of leading Spanish companies makes it possible for business to exert influence on the accounting standards issued by this association. Moreover, this influence becomes even more evident in the adaptations of the General Accounting Plan (*Plan General de Contabilidad*) for specific sectors of the economy, where business representation is greater.

It is evident that, for companies quoted on the Stock Exchange, the content of annual accounts has acquired increased relevance, and thus accounting policies and the standards on which they are based have become part of companies' strategic concerns. In this context, certain sectors have had a more visible influence on accounting rulemaking than others (Giner, 1995).

Foreign currency translation provides an interesting example. The approach required by the accounting standard issued by AECA in 1983 was embodied in the 1990 PGC as a valuation method (*Norma de Valoración*) which was mandatory and generally applicable. Amongst other things, it required that differences arising on debt financing for the construction of fixed assets be capitalised until the related assets come into service. Whilst the parity of the peseta remained relatively stable, there was little difficulty in applying this policy. However, the situation changed dramatically in 1992 and 1993 when the peseta was devalued on several occasions (by around 25 per cent against the ECU), causing companies with a large foreign currency debt (such as electric utilities, motorway constructors and Spain's national telephone company) to realise substantial exchange losses.

These companies all had one important feature in common; namely, that they operated in regulated industries and, consequently, the prices of their goods and services had to be approved by the Government regulatory agencies. The regulators refused to authorise sufficiently large price increases to absorb the losses arising from negative exchange differences in a single year. An accounting crisis thus became unavoidable.

An Order of the Ministry of Economy and Finance dated 12 March 1993, on the accounting treatment of exchange differences by regulated companies, relaxed the general standard described earlier by establishing a method under which a portion of the negative exchange difference did not have to be recorded as a period loss and could be included under the 'Deferred charges' caption on the assets side of the balance sheet, thus affecting the results of future years. The Order limited the definition of 'regulated companies' to the abovementioned sectors, i.e. electricity companies, motorway constructors and the national telephone company. However, since certain other regulated companies were affected, the Ministry had to issue another Order on 18 March

1994, extending the authorisation to apply the accounting policy to Canal de Isabel II (a water utility company), Hispasat (a telecommunications company) and Ferrocarriles de Cataluña (a railroad company).

These were not the only exceptions to the general rule. On 23 March 1994, the Ministry issued a third Order detailing the accounting treatment of exchange differences in certain companies in the air transport industry, which also permitted negative exchange differences on foreign currency debt used to finance the purchase of aircraft to be capitalised and added to the carrying value of the aircraft, which of course were already in service (Cañibano and Mora, 1997).

When exceptions of this magnitude are permitted, it can hardly be said that the notion of 'generally accepted accounting' is to the forefront of accounting regulation in Spain. However, it is important to note that this procedure of allowing exceptions to the rule, illustrated here in relation to the accounting treatment of exchange differences, has not been extended to the amendment of other accounting regulations.

The Influence of Tax Law on Financial Reporting

A major feature of business accounting in Spain until the accounting reform in 1989 was the excessive influence exerted by tax legislation on corporate accounting for general-purpose financial statements. Indeed, the situation was almost one of outright subordination of accounting to tax legislation. The fiscal authorities established detailed mandatory rules of accounting which defined the computation of revenues and expenses for calculating taxable net income, specified the methods of recognizing revenues and expenses, and even formalised the mechanisms of recording business transactions. The avowed purpose of these rules was to maximise the revenue from taxes on business activity and on business profits in particular, but they did not necessarily take into account principles which would enable a true and fair view of a company's activities to be presented in the corporate financial report (Gonzalo, 1992).

The reason why the preparation of financial statements in Spain before 1989 was strongly conditioned by the tax regulations was simply because the tax rules mandating certain accounting practices had to be complied with in order to gain the full tax benefits. For instance, expenses and revenues qualified as tax-deductible only if reported in accordance with the regulations, and entitlement to tax credits and tax relief followed. In effect, the tax regulations, and most notably those relating to corporate income tax, set out certain accounting methods in much greater detail for tax purposes than the accounting legislation of the time. For a long period, the tax law went beyond its proper role of facilitating the attainment of tax policy objectives in the collection of business taxes.

The scene changed spectacularly when the new business accounting legislation enshrined in Law No. 19 of 1989 and subsequent legal provisions came into force. The influence on companies' financial statements of rules imposed under the corporate income tax regulations was eliminated. The new accounting legislation made it absolutely clear that mandatory accounting regulations were to prevail for both public or general-purpose presentation of financial statements. Furthermore, the accounting-related rules in tax law were now applicable only for income tax reporting purposes and their only impact on the official accounting records required by corporate law would be in relation to tax effect recognition.

Thus, in many ways, the regulatory conflict that traditionally existed in Spain between company law and tax law has been settled. The current legislation states expressly that the two are mutually independent and that, for the purposes of keeping a company's official books of account and hence of preparing individual or consolidated financial statements, the accounting regulations established under corporate law are mandatorily applicable. In fact, the Company Income Tax Code (*Ley del Impuesto sobre Sociedades*) issued in 1995 now specifies the relation of tax rules to accounting standards, recognizing the application of the tax effect method to record the differences between both sets of rules.

However, an issue which remains partially unresolved is that of asset revaluation. The valuation method generally applicable for accounting purposes in Spain is acquisition price or production cost and, consequently, assets are valued in accordance with the historical cost principle. However, there have been a number of exceptions to the general rule which continue to influence the financial statements of Spanish companies.

The first of these exceptions concerns the laws passed throughout the 1960s and 1970s permitting certain assets to be revalued for both tax and accounting purposes, that is, these revaluations were only effective for tax purposes if recorded in the accounts. The first such law was Law No. 76 of 1961 on the Restatement of Balance Sheets, similar legislation being issued on a number of occasions up until 1983 (Cañibano and Bueno, 1983). When the 1990 PGC was promulgated, existing book values were accepted including the effects of the aforementioned revaluations. Thus, the fixed assets and related depreciation in the financial statements of Spanish companies are not strictly speaking carried at historical cost because a portion of their present value, albeit a small one, reflects the effects of the revaluations from 1961 to 1983. The contra item for these revaluations was in principle a Restatement Reserves account, but in many cases these accounts now have no balance as a result of successive legally-authorised transfers to capital, to the legal reserve or to other reserves.

A second exception to the historical cost principle was due to a law (No. 76 of 1980 on the Taxation of Mergers) which granted merging companies certain tax benefits consisting basically of the exemption for tax purposes of any increases in asset book values resulting from the merger. As a result, post-merger book values did not strictly reflect the historical cost. In fact, some companies adopted this route more as a way of revaluing their assets than because they were really interested in merging. These tax benefits were abolished in 1991 (by Law No. 12 of 1991, which adopted certain tax principles under European Directives) and assets cannot now be indirectly revalued in this way. However, the carrying values reflected in the financial statements of companies which were involved in mergers prior to 1991 still do not strictly conform to the historical cost principle.

The third and final exception to the historical cost principle is also tax-related but applies only in the Basque Country and not elsewhere in Spain. In 1990–91, the provincial governments of Vizcaya, Giupúzcoa and Alava, which have certain fiscal powers, enacted tax laws applicable in their own provincial territories. The Central Government of Spain initially appealed against these in the High Court in the Basque Country, but the ruling was not favourable. Further appeals failed to have any effect, given the agreements signed by the different political powers to assure parliamentary or government majorities in Spain and the Basque Country. The audit reports on financial statements of companies domiciled in the Basque Country which have revalued their assets to reflect the restated asset values generally include a qualification on the grounds of uncertainty as to whether the law which permitted the revaluation was legal. It goes without saying that the significance of this qualification and the importance attached to it by the readers of the related audit reports will diminish in time.

Spanish business associations have been calling for another revaluation of assets with tax effects. The present conservative Government considered the adoption of such measures in accordance with the programme of the *Partido Popular* which supports it and some companies have in the meantime restated fixed assets according to a general index published by the government. Despite the present separation between accounting and tax regulations, it would be hard to imagine that the new values recognised for tax purposes would not also be recorded for accounting purposes. It must be clearly stated that at present the revaluation of fixed assets is not a generally accepted accounting principle in Spain except in the case of legal restatements. The traditional influence of tax legislation has led to departures from the historical cost principle at certain points in the past and in certain territories, and this has had some effect on the book figures shown in the financial statements of Spanish companies.

Academic Influences on Accounting Regulation

During the last 20 years there has been remarkable growth in Spain in the teaching of accounting and other disciplines relating to financial statement preparation, and this is now a well-established field of university education. Consequently, research has proliferated in this field in the form of doctoral theses, books on technical issues, journal articles, etc. Moreover, there is also a vigorous school of Spanish accounting thought regarding numerous aspects of business accounting, and the theoretical viewpoints which are formulated constitute an obvious potential source of non-legal guidance which can supplement the accounting regulations set down by law (Gonzalo, 1992). Their impact, however, has probably been only circumstantial or confined to specific issues, and of much less practical relevance than the pronouncements of Spanish professional bodies referred to earlier.

Nevertheless, the influence of accounting theory makes itself felt indirectly through the participation of leading academics in the committees or working parties that have drafted, or are drafting, statements on accounting principles and standards. For instance, when AECA began its activities in 1979, its Committee on Accounting Principles and Standards comprised 13 members, eight of whom were university professors. Although the proportion is now reduced to seven out of 27 committee members, the academic accountants are still an influential group in AECA. Moreover, they have also played an important part in lawmaking. On the occasion of the legal changes carried out to align Spanish law with EC directives, the working parry formed to prepare a draft Accounting and Auditing Bill contained four academic experts from a total of 10 members. When this Bill was split in two, accounting issues being included in the Commercial Reform Law and auditing issues in the Auditing Law, academic representation on the two new working parties continued at the same level. There was similar involvement in the preparation of the laws introducing the General Accounting Plan and consolidated accounts. Whilst there is no formal responsibility for such involvement, the influence of academic experts on accounting regulation in Spain has been relatively high by international standards.

A Complex Process

As discussed above, the main influence on financial reporting in Spain came traditionally from taxation. The first PGC in 1973 was itself a consequence of tax law (the Law on the Restatement of Balance Sheets). From the 1970s onwards, however, the international audit firms were instrumental in diffusing anglo-american standards of accounting, which are more oriented to the capital market than to tax purposes. At the same time, business studies became a separate branch of University education, with more attention being paid to disciplines such as accounting, and the demand for accounting academics led to a pool of expertise which became increasingly influential (Garcia-Benau, 1996). The creation of AECA in 1979 reflected these trends and was promoted by the international accounting firms and university professors as well as other professionals, with the aim of reconciling Spanish accounting with international practice.

When Spain joined the European Community in 1986, the nucleus of accounting experts able to bring about change was therefore already in existence. The new accounting regulations were able to proclaim their independence from tax law, and the disclosure of information in financial reports for more general purposes became the main goal of accounting regulation. As a result, preparers have begun to pay greater attention to the rules of accounting, and to lobby lawmakers and standard-setters accordingly.

The complex process of building the system of accounting regulation that exists today in Spain is a direct consequence of the various influential factors discussed above, as demonstrated by the brief history of accounting regulation that follows.

A BRIEF HISTORY OF SPANISH ACCOUNTING REGULATION

Although some accounting rules existed during the Middle Ages in the various kingdoms of Spain, the first generally applicable regulation in Castilian Spanish was the *pragmáticas* (edicts) issued by Charles V and Queen Juana in Cigales (1549) and in Madrid (1552), and which required merchants to record transactions in a cash account and a journal. Later, during the eighteenth century, the accounting obligations of merchants were defined in increasing detail and obligatory books of account had to be kept. Furthermore, the first problems concerning the confidential nature of accounting information arose, and the frequency with which balance sheets had to be prepared was regulated. In short, the basis was established for what was soon to become the Commercial Code.

The commercial regulations of the Cádiz Ordinances of 1800, which established that a merchant's account books could be used as probative evidence against him, were followed by Spain's first Commercial Code in 1829, which made it obligatory to keep three books, namely a journal, a ledger and a book for inventories and balance sheets. The formal requirements concerning book-keeping, disclosure, confidentiality and evidence, as well as the need to retain these obligatory books for future reference, were defined far more strictly by the new Code.

Spain's accounting regulations then remained virtually unchanged until the enactment of the 1951 Corporations Law, plans to reform the Commercial Code in 1926–1927 not being brought before the Spanish Parliament at the time. The Act of 1951 contained numerous accounting provisions concerning (a) the valuation of assets; (b) minimum disclosure requirements in the balance sheet and statement of income; (c) restrictions on the distribution of dividends and changes in capital stock; and (d) verification of accounts by shareholder-auditors. The 1951 Corporations Law was followed quickly by the 1953 Limited Liability Companies Law which dealt with accounting matters in a more cursory way (Cañibano, 1995a).

The Introduction of Standardised Accounting in Spain

A landmark in the history of accounting regulation in Spain was the establishment of a government agency to introduce and implement accounting standardisation. This innovation was a result of the government's concern that better, more comprehensible and more readily verifiable economic information should be generated in Spain, which would lead to greater accounting veracity and better compliance with tax law, not to mention the role that accounting information might play in improving and modernizing business management.

The first step towards the creation of this government agency, within what was then the Ministry of Finance, was the establishment of the Central Accounting Planning Commission (*Comisión Central de Planificación Contable*) by a Ministerial Order dated 24 February 1965. This was supplemented by a further Ministerial Order on 9 August 1969 and subsequently by a third Ministerial Order on 25 September 1971. The latter repealed the previous orders and restructured the membership, responsibilities and funding of the Commission.

Thus, at this particular time in Spain's history, accounting regulation remained unquestionably official in nature since the

Central Accounting Planning Commission was an agency of the Ministry of Finance and was staffed by civil servants. However, its members also included leading figures from university and professional circles, who acted as advisors to the permanent commission members.

The First Spanish Accounting Plan

The initial and prime objective of the Commission was to draw up a national chart of accounts, similar to that adopted by France after the Second World War. The process of accounting standardisation in Spain thus closely followed the model adopted by France in this field, both as to content and in its public nature, with the result that the first General Accounting Plan adopted in Spain in 1973 was a close copy of the French version of 1957. Although the PGC took the form of tax legislation (it was enacted under the Balance Sheet Restatement Law referred to earlier), rather than through reform of the Commercial Code, it did include some technical specifications of the very general precepts of the Code.

The enactment of the General Accounting Plan by decree dated February 22 1973, was a decisive step in the history of Spanish accounting regulation. It extended the meager regulations then in force within the commercial law (essentially, Title III of Book 1 of the 1885 Commercial Code and the Corporations Law of 17 June 1951). At the same time, it consolidated some of the fragmented (and in some cases contradictory) regulations on accounting which until then dealt under separate legislation with the accounting requirements of different kinds of companies (Cubillo, 1973).

It should be noted that 1973, the year of the enactment of the first PGC, was also the year of reform of the Commercial Code. To some extent, the Code was amended because of the rapid development of computerised accounting procedures which conflicted directly with the outdated requirement of bound books of account. The salient points of the reform of Book I of the Code regarding 'The Books of Traders' were (a) the abolition of the obligation to keep a ledger; (b) the option to post monthly summary entries in the journal, with supporting detail in auxiliary records; (c) *a posteriori* authorisation of books, enabling them to be mechanised; (d) recognition of the right of the courts to determine the probative value of books of account and other accounting documents; and (e) the introduction of substantive accounting principles.

These new accounting principles included the declaration that the balance sheet and the income statement were to be prepared in conformity with generally accepted accounting principles; disclosure in the income statement of the gross volume of operations and segregation of operating income and atypical or extraordinary income, the valuation of balance sheet items by consistent objective methods to safeguard third-party interests and ensure proper and orderly economic management, and the verification of the balance sheet and the income statement by an appropriately qualified professional in accordance with stipulated regulatory standards. However, although 1973 marked the beginning of progress towards the regulation of accounting, no similar advance was made in the field of auditing. The role of the 'shareholder-auditor' (*accionista censor de cuentas*) mentioned in the 1951 Corporations Law was more symbolic than effective and the office of 'qualified professional' (*experto titulado superior*) created by the 1973 reform of the Commercial Code was so ill-defined that it was never put into practice.

Although the 1973 PGC became the backbone of accounting regulation in Spain under the old system, the public regulator successively issued other rules that helped to expand the field of effective coverage. The impulse for all of the subsequent developments which supplemented the 1973 PGC came from the official Spanish accounting regulatory body, which became administratively stronger and operationally more significant after it was transformed by Royal Decree No. 1982 of 1976 into the Accounting Planning Institute, or IPC *(Instituto de Planificación Contable)*. The services of this new regulatory body were thoroughly reorganised and it was assigned more precise powers in the field of accounting regulation, although its resources of all kinds were still clearly insufficient to cater for the tasks assigned to it on paper.

It was under the accounting system then in force in Spain that the Spanish Accounting and Business Administration Association, AECA, started to issue standards of a private nature, which constituted a valuable auxiliary tool for the presentation and audit of the financial statements of Spanish companies, in view of the many gaps in the then current legal accounting regulations.

Legal Reform

Spain's entry into the European Economic Community, and the need to conform with European Company Law Directives, made the revision of its corporate law imperative. This was particularly necessary in the field of accounting regulations for the presentation of individual and consolidated financial statements by companies (this area was addressed in the 4th and 7th Directives of the EEC) and also as regards the independent audit of financial statements (which was addressed in the 8th Directive of the EEC).

In addition to membership of the EEC, which was undoubtedly the main cause of the profound change in Spanish corporate law and in the more technical issues of business accounting in particular, there was another reason that called for a change from the previous system, namely widespread proliferation of stockmarket investment during the 1970s and 1980s, which made it very much more important for there to be sound, reliable and comprehensive accounting information about companies (Cubillo, 1990)

A process thus started of reforming and adapting Spanish corporate law in general and accounting law in particular, and this did away with the previous system and brought in the regime now in force, the main accounting regulation aspects of which are discussed below.

The Audit Law

The reform of business accounting regulation was formally undertaken with the enactment of Law No. 19 of 1988 (*Ley de Auditoría de Cuentas*) which was subsequently supplemented by the related regulations enacted by Royal Decree No. 1636 of 1990. The Audit Law regulated the practice of auditing individual and consolidated financial statements and made audits obligatory for many Spanish companies and corporate groups which were not previously subject to audit. In addition to regulating the professional practice of auditing, the Audit Law abolished the former IPC, and set up a new official body called the Accounting and Audit Institute, or ICAC (*Instituto de Contabilidad y Auditoría de Cuentas)*. This autonomous agency of the Ministry of the Economy and Finance was given responsibility for issuing mandatory accounting standards to govern the presentation of individual and consolidated financial statements and for regulating and supervising the practice of the auditing profession.

As regards the issuance of accounting standards, the newly created ICAC took over the responsibilities from the IPC, but its new taskload brought about considerable restructuring and the new regulatory body was provided with increased staffing and material resources, and the assignment of civil servants with higher responsibility (Royal Decree No. 302 of 1989 approved the statute and organic structure of ICAC). Accordingly, ICAC became much more active than IPC had been, and this has been evident during the years that have elapsed since it was formed, as will be discussed later with reference to the statements issued by ICAC in the field of accounting.

The Commercial Reform Law

The new regime of Spanish accounting regulation really came into being with the enactment of Law No. 19 of 1989 which partially reformed and adapted Spanish corporate law in line with the European Company Law Directives. This new legislation constituted a fairly thorough reform of previous Spanish corporate law, which had consisted basically of the regulations in the Commercial Code dealing with the accounting of traders, whether individual persons or legal entities. The new regime was made applicable, by extension, to limited liability companies and general partnerships with shares.

The new regulations of the Commercial Code provided the basic regulatory framework requiring the preparation of financial statements by any trader, whether an individual or a legal entity. These include the documents to be presented and their purpose, the necessity of giving a true and fair view, the role of legal regulations in this process and, amongst other things, a brief definition of the generally accepted accounting principles which had to be applied in this process. The requirements for consolidated financial statements and management reports were also defined. This latter reporting obligation was a major change since, under the old regime, the presentation of consolidated accounts was voluntary. Law No. 19 of 1989 also included a fairly detailed enumeration of the principal technical accounting rules to be followed in preparing consolidated financial statements (Cañibano and Gonzalo, 1993).

In addition to the mandatory presentation of financial statements, companies listed on official secondary stock markets must, under Article 35 of the Securities Market Law (Law No. 24 of 1988), also publish quarterly provisional balance sheets and income statements, containing a level of detail similar to that required in the annual financial statements.

The 1990 General Accounting Plan

Law No. 19 of 1989 also authorised the Government to enact by Royal Decree a new PGC to conform with the new company law. The Ministry of the Economy and Finance was authorised to act, at the behest of ICAC, on proposals for relevant sectorial adaptations of the new PGC, when the nature or specific character of the business activities of such sectors necessitated changes in matters such as structure, nomenclature and valuation rules. In addition, the Ministry could promulgate other detailed regulations of lesser significance in the field of accounting regulations.

A committee of experts was set up, consisting of technical staff from ICAC, a small number of representatives from the accounting profession (particularly from AECA) and experts from amongst the Spanish university teachers of accounting. Using a draft of the new PGC prepared by ICAC, and after mandatory consultation with various agencies, entities and professional practitioners affected by the problems, the definitive wording of a new PGC was proposed by the officers of ICAC, approved by the Spanish Council of Ministers and enacted by Royal Decree No. 1643 of 1990.

The 1990 PGC was congruent with the regulatory content of other commercial legislation in Spain dealing with company accounting, namely the Commercial Code and Corporations Law. As noted in the preamble to the Royal Decree, the PGC is the regulatory implementation of the provisions of the Commercial Reform Law relating exclusively to the preparation and presentation of individual corporate financial statements. The criteria to be used in preparing consolidated financial statements were issued separately through Royal Decree in December 1991 (*Normas para la formulación de las Cuentas Anuales Consolidades*), again developing the earlier provisions of the Commercial Reform Law.

For better or for worse, the 1990 PGC had to accept and conform to the basic accounting rules imposed by company legislation, and therefore had to repeat any possible discrepancies or even conceptual errors of an accounting nature that might hypothetically have existed in company law. In fact, there were such cases. For example, an amended Article 197 of the Corporations Law required that the redemption premium for debt securities maturing in the future be shown separately as an asset in the balance sheet, even though a deferred financial expense may normally not be considered to be an asset or a right of the borrower company. Inconsistencies of this nature were included in the 1990 PGC due to their previous inclusion in company law.

On the other hand, the 1990 PGC made use of the freedom granted by company law as regards issues such as: the addition of new items in the formats for financial statements and the disclosure in greater detail of such items; the clearer definition of the basic accounting principles enunciated in the Commercial Code; the description in greater detail of the basic valuation rules set forth in the Commercial Code and in the Corporations Law; and the regulatory definition of accounting concepts. The systematisation and design of the new accounting plan was also addressed in those cases which had not been considered by company legislation, such as the funds statement, the optional analytical income statement and the format for the notes to the accounts. The traditional view of the PGC as a codified chart of accounts together with the rules for application no longer applies. Indeed, standardised book-keeping itself is no longer obligatory.

Since the enactment of the 1990 PGC, there have been various supplementary regulations, either adaptations of the PGC for specific sectors or detailed pronouncements on accounting issues, some enacted by Ministerial Order and others as ICAC Resolutions. These are listed in Table 11.1.

Table 11.1 Regulations adapting and supplementing the 1990 Spanish PGC

Adaptations of the 1990 PGC for specific sectors

Enacted by Royal Decree
- Insurance companies (1997)
- Private non-profit entities (1998)
- Electric utility companies (1998)

Enacted by Ministerial Order
- Construction companies (1993), Sporting federations (1994)
- Real estate companies (1994), Sports corporations (1995)
- Health care centres (1996)
- Water utility companies (1998)
- Toll highway companies (1998)

Currently being prepared
- Economic interest groupings (1997), Wine producers (1997)

Accounting regulations

Enacted by Royal Decree
- Accounting for Euro implementation (1998)

Enacted by Ministerial Order
- Provision for pensions in Electrical Utility Companies (1991)
- Valuation of investments in marketable fixed income securities at insurance companies (1992)
- Exchange rate differences at regulated companies (1993)
- Exchange rate differences at air transport companies (1994)

Enacted by ICAC Resolution
- Calculation of net sales (1991), Valuation of tangible fixed assets (1991)
- Recording of prepaid tax in relation to pensions allowance (1991)
- Valuation of intangible assets (1992), Recording of income tax (1992)
- Recording of participations in money market asset mutual funds (1992)
- Valuation of non-monetary capital contributions (1992)
- Accounting for the Canary Islands General Indirect Tax (1992)
- Calculation of net worth (1996)
- Net worth concepts for capital reductions and dissolutions (1996)
- Accounting for taxes on income (1997)
- Disclosure of '2000 effect' in annual accounts (1998)

Currently being prepared
- Corporate mergers and spinoffs (1993)
- Companies in temporary receivership (1993)
- Financial futures and options (1995)

ACCOUNTING RULE-MAKING BODIES IN SPAIN

As stated earlier, the model of accounting regulation adopted in Spain is legalistic, and there are numerous sources of regulations on accounting for different kinds of business activity. Indeed, Spain has various official bodies with the power to issue mandatory accounting rules and regulations in their fields of responsibility. Since these official bodies are part of the Spanish Administration, the rules they issue are enacted at different levels of authority either as laws (*Leyes*), Royal Decrees (*Reales Decretos*), ministerial orders (*Ordenes ministeriales*) or resolutions (*Resoluciones*) issued by ICAC. The various legislative levels and the types of rule issued at each level are listed in Table 11.2.

The Accounting and Audit Institute, ICAC, is the main official body which is responsible for the regulation of accounting. Although there are other official bodies with powers with respect to accounting regulation in specific areas (that is, the Bank of Spain, the Spanish Securities Market Commission and the Directorate General of Insurance), their prime missions are very different from that of accounting regulation. The latter therefore occupies a secondary place in their overall activities and, as a consequence, the few resources which are devoted to accounting regulation in the specialist sectors tend to be applied on an intermittent and sporadic basis. In the field of accounting, these other bodies derive much of their inspiration from resolutions issued by the main rule-making body, ICAC, which are then adapted by the other rule-makers to the particular problems of the entities subject to their supervision and control.

ICAC was established to address both the regulation of accounting and the regulation, control and discipline of auditing in Spain (the latter is not considered in this study). Furthermore, accounting regulation involves the issuance of mandatory accounting standards for companies not subject to special accounting regulations, a function which covers a broad range of issues including the preparation of the General Accounting Plan and its sectorial adaptations and the preparation of supplementary regulations for implementing and improving accounting planning.

ICAC is an autonomous public-sector agency which is part of the Ministry of Economy and Finance. The statutes and the

Table 11.2 Regulatory instruments in Spain

I. Official regulatory instruments

The various levels at which official accounting rules and regulations must be approved are in descending order, as follows:

a) Accounting legislation adopted by the Spanish Parliament and ratified by the King.
An example in this case would be the accounting content of the Commercial Reform Law (Law 19/1989) adapting Spanish mercantile legislation to European directives.

b) Accounting legislation which must be formally approved by the Council of Ministers and which is published in the form of a Royal Decree.
This relates in general terms to the basic texts of accounting regulation, implementing detailed regulations on accounting issues addressed in the commercial legislation enacted by the Spanish Parliament. Legal texts at this level include:
  - General Accounting Plan 1990 (PCG)
  - Consolidated Financial Statement Preparation Standards 1991 (NFCAC)

c) Accounting regulations which must be formally approved by the Ministry of Economy and Finance, and which are issued in the form of a Ministerial Order.
These are generally of lower rank or importance than the above, and arise as developments, extensions, improvements, adaptations or amendments relating to the technical accounting aspects included in relevant Royal Decrees. Although the regulations which require approval by means of a Ministerial Order have not been definitively listed or identified, the Royal Decree enacting the 1990 PGC gives a fairly close indication (in its final provisions), as follows:
  - Sectorial adaptations of 1990 PGC
  - Modification of the method of amortisation of research and development expenses, as established in the 1990 PGC
  - Changes in the legal provisions concerning the adaptation of financial statements to the specific conditions of the reporting entity
  - Changes relating to certain provisions of the Royal Decree enacting the 1990 PGC *(i.e.* exchange losses on transactions in force when Law 19/1989 came into force and the shortfalls at that date in provisions for employee pensions).

  Similarly, in connection with the rules governing consolidated financial statements, the final provisions of the Royal Decree enacting the NFCAC identified the following as issues requiring approval in the form of a Ministerial Order:
  - Adaptation of the legal provisions concerning valuation and the preparation of consolidated financial statements to the specific conditions of the reporting entity.
  - Adaptation of the NFCAC to specific sectors.

Table 11.2 (*cont.*)

This requirement for formal approval at a higher level than ICAC does not signify any change in the general procedure for preparing accounting standards, but merely that the technical texts of this administrative rank prepared within ICAC require the approval or sanction of the Ministry of Economy and Finance before their definitive publication.

d) Regulations which must formally be approved by the Chairman of ICAC, in the form of Resolutions.
This category generally encompasses all regulatory issues of lesser importance arising in connection with the 1990 PGC and its various sectorial adaptations, and also with respect to the NFCAC and its sectorial adaptations, involving extensions, improvements, etc. to the legal text. Although there is no clear line of demarcation for the Resolutions of the Chairman of ICAC, some idea of where it lies may be drawn from the Royal Decree enacting the 1990 PGC and the 1991 NFCAC, in the following terms:
  – As regards the 1990 PGC, ICAC may approve, by means of a Resolution, mandatory regulations implementing the 1990 PGC and its sectorial adaptations in connection with the principles of valuation and the preparation of financial statements. Nevertheless, the extent of the legal capacity of the Chairman of ICAC to issue Resolutions was unclear, as shown by the decision of the Superior Court of Madrid following the appeal of the Spanish Association of Leasing Companies, which disagreed with the regulations on lease accounting contained in an ICAC Resolution. The Court declared this ICAC Resolution to be null and void, based on the argument that ICAC lacks the power to issue binding regulations through its Resolutions. Later, however, the Supreme Court recognised ICAC's power to issue accounting regulations.
  – With respect to the 1991 NFCAC, ICAC may approve, also by means of a Resolution, mandatory regulations implementing the 1991 NFCAC and its sectorial adaptations in connection with the principles of valuation the preparation of consolidated financial statements (without prejudice to the powers of the Minister of Economy and Finance to regulate, by Ministerial Order, adaptations for specific reporting entities).

e) Technical Rulings
The power to respond to technical enquiries lies exclusively with the Chairman of ICAC, and the response may be published in the ICAC Gazette, although this is not strictly mandatory. Responses to inquiries are not formal pronouncements in the field of administrative law, and their nature is that of mere information provided to users of Spanish accounting standards to enable them to more correctly interpret and apply them.

II. Professional regulatory instruments
The only professional body that issues accounting standards in Spain is the Spanish Accounting and Business Administration Association, AECA. These standards are not compulsory in legal terms. However, they are considered as generally accepted accounting principles in Spain.

organisational structure of ICAC were approved by the Government in Royal Decree No. 302 of 1989. Its Chairman has the rank of Director-General, and is appointed and can be removed by a Royal Decree adopted by the Council of Ministers at the proposal of the Minister of Economy and Finance. Although the relevant Royal Decree does not stipulate any requirements or conditions for the chairmanship of ICAC, this office has traditionally been held by a state finance inspector. The Chairman represents the executive power of ICAC and ultimately approves the contents of ICAC *Resoluciones* before they are legally enacted.

The ICAC Consultative Committee, the *Comité Consultivo,* is an advisory body which is headed by the Chairman of ICAC and consists of 12 other members appointed by the Minister of Economy and Finance. Six of these members are civil servants from the Ministry of Economy and Finance, who do not necessarily have any background or experience in the issuance of accounting standards. The other six members are proposed by the professional auditing and accounting bodies (the three auditing bodies currently recognised in Spain, as mentioned above, plus AECA). Although these latter representatives are drawn from the professional accounting field or closely related areas, they need not necessarily have a background in the issuance of accounting standards either. The Secretary General of ICAC is a non-voting member of the Consultative Committee.

The Consultative Committee, as its name indicates, advises the Institute and in particular its Chairman on matters relating to the subject of accounting regulation but, as might be expected, it does not go into detailed technical issues relating to proposed standards. On the contrary, it generally confines itself to a general evaluation of draft documents prepared elsewhere in the rule-making body. This is reasonable, given that its members are unremunerated. What actually happens is that the draft documents reach the Consultative Committee at the end of a filtering process through the successive working parties that have drafted them, and although they are still formally only draft standards, they have been approved by the Chairman of ICAC. Thus although the Consultative Committee may participate in the evaluation of the major criteria expressed in the draft standards, it is unlikely to alter any the detailed technical aspects. Generally speaking, all matters relating to accounting regulation dealt with by ICAC will be submitted to the Consultative Committee for report, and this Committee must report favourably before they receive official approval.

The Accounting Committee (*Comisión de Contabilidad*) and the Auditing Committee (*Comisión de Auditoría*) are two technical subcommittees of the Consultative Committee which enable it to better perform its advisory functions. Their members are experts in their respective fields, and each of these two committees has the same proportion of members from the Ministry of Economy and Finance and from the auditing and accounting professional bodies as in the Consultative Committee. These technical committees each have 24 members, their appointment being within the powers of the Chairman of ICAC.

The 24 members of the Accounting Committee should, ostensibly, be persons of higher technical qualifications in the field of business accounting who may play a more active and decisive role in processing ICAC's draft pronouncements which are submitted after discussion and preparation by the technical working parties set up for this purpose However, in actual fact the Accounting Committee is not normally of great influence since, as in the Consultative Committee, its members are unremunerated and participate irregularly. Thus, the individuals involved effectively in the preparation of ICAC pronouncements on accounting are to be found neither in the Consultative Committee nor in its Accounting Committee but in the special working parties set up for each specific accounting topic or document.

The working parties are the genuine driving force behind ICAC pronouncements. A working party normally consists of between six and ten members and is set up to prepare a statement on a specific regulatory subject or topic. Its staff are technical officers of ICAC (seconded to the working party on a full time basis) and a similar but not fixed number of outside experts who are not remunerated. These are drawn from the business sector which will be particularly affected by the future accounting regulation, from the audit firms, from the universities and from certain areas of the State administration. The working parties are generally decided upon by the Chairman of ICAC but the Consultative Committee must be notified of the appointment of members of working parties.

A working party is responsible for discussing a draft of the pronouncement to be made on the topic in question. Although there is no fixed rule, one of the external experts on the working party is normally invited to prepare the draft. A series of meetings are then held, normally not very frequently, to discuss the draft before it is finally agreed upon. The draft is then submitted to the Accounting Committee and to the Consultative Committee, after it has previously been published in the *Boletín de l'ICAC* in order to allow suggestions for improvement to be received from outside. Indeed, in some cases, it is mandatory to publicise the draft. In practice, nearly all drafts have been published in advance, one exception relating to the 1993 Ministerial Order on foreign exchange translation by regulated companies. After this formality has been complied with and any changes to the draft which the Chairman of ICAC considers appropriate have been made, it goes to the final stage of reporting prior to its formal approval.

It should be noted that although the role of the working party is decisive in the process of preparation of a particular ICAC pronouncement on accounting, the discussion of topics tends to be spontaneous rather than formally regulated, and the role of the ICAC representatives on the working party is obviously different from that of the external experts. Thus, although every effort is made to reach majority-agreed solutions in the working party, there are occasions when this is not possible and then it is obviously the Chairman of ICAC's opinion which has the greatest weight in deciding whether to include one accounting criterion or another. The role of the experts in the working party is to assist in the drafting of ICAC accounting pronouncements, but not to take responsibility for them which is the function of the governing bodies of ICAC.

The organisation structure of ICAC consists of the following service units or departments:

(a) General Secretariat
(b) Accounting Standardisation and Techniques Department
(c) Technical Auditing Standards Department
(d) Technical Control Department

Each of the above departments is headed by a civil servant with the rank of Subdirector General, drawn from among the State Finance Inspectors and proposed by the Chairman of ICAC. Each of these departments is subdivided into sections which are also headed by a civil servant who is recruited by open competition among State Finance Inspectors. Each section is staffed by civil servants from lower levels of technical or clerical categories. All of the staff of ICAC at the various levels of authority work full-time and their salaries are paid out of credits allocated to ICAC in the general State Budget. The present staff of 45 includes 20 technical officers (7 with accounting standard-setting qualifications) and 25 administrative personnel. In 1998, the annual budget of ICAC, in its two major functional areas of accounting standardisation and auditing, was 483 million pesetas (2.9 million Euros), 55 per cent of which was for personnel expenses and 45 per cent for other expenses.

The Accounting Standardisation and Techniques Department is responsible for preparing accounting regulations (the 1990 PGC itself, the sectorial adaptations thereof, developments of the 1990 PGC and all activities relating to the updating and improvement of accounting regulations). It is also responsible for preparing draft rulings in response to inquiries made to ICAC on issues relating to accounting.

The accounting regulations issued by ICAC are binding for all individual entrepreneurs and companies except those that, because of the particular nature of their business activity, are generally subject to supervision and control by another public-sector body. These other official supervisory bodies are legally empowered to issue specific accounting regulations for the companies within their sphere of responsibility, but any such regulations must be submitted for report to ICAC, the overall accounting regulator, before they are officially promulgated. These additional regulatory bodies are described briefly below.

The Bank of Spain and the Regulation of Accounting by Banks

Because of the specific nature and importance of the activities of banks and similar financial institutions, they are traditionally subject to close supervision and control by the central bank, the *Banco de España*. One manifestation of this supervisory and control function is, and always has been, the legal power to set down detailed accounting rules for obligatory use by Spanish banks, which nevertheless must conform to the general accounting provisions of the Spanish Commercial Code and other relevant legislation, especially the Corporations Law.

The Bank of Spain's accounting guidelines are issued in the form of circulars. The main circular currently in force is Circular No. 4 of 1991, the provisions of which have been adapted or further developed as necessary in subsequent circulars. The accounting regulations established in the Bank of Spain circulars conform basically to European directives on the operations of banks and other credit entities and on how their individual and consolidated financial statements should be prepared.

Apart from this role of setting down accounting standards for banking institutions, the Bank of Spain also has a Central Financial Statements Data Department to compile and summarise the figures reported by Spanish companies in their published financial statements. These are classified by sector and aggregated at various levels, thus constituting a very useful statistical data base for financial analysis of Spanish companies. This Department of the Bank of Spain also contributes indirectly to the process of accounting standardisation by defining certain accounting aggregates (added value, business volume, and so on) which are of considerable influence in this field.

The National Securities Market Commission and the Regulation of Accounting by Securities Companies

Following the enactment of the Securities Market Law in 1988, the National Securities Market Commission (*Comisión Naciónal del Mercado de Valores*) became the body responsible for supervising and controlling all operations relating to the capital markets in Spain. The specific powers of the CNMV include the supervision and control of the stock market operators (securities companies and agencies, the governing companies of the four exchanges and companies involved in stock market transaction settlement and clearing) which intermediate and execute stock market orders, as well as the regulation, supervision and control of investment firms (property companies, mutual funds, etc.).

A specific facet of these supervisory and control functions of the CNMV is the issuance by it of mandatory accounting standards for the presentation of individual and consolidated financial statements by the regulated entities. However, the CNMV's regulatory remit in accounting matters does not extend to companies whose securities are listed on Spanish stock exchanges, but is confined to the types of entity indicated above.

The Directorate-General of Insurance and the Regulation of Accounting by Insurance Companies

Because of the special nature of the insurance business and the risks assumed by insurance companies, they have always been subject to special legal regulation, in which supervision and control, closely linked with financial reporting, play a prime role.

The responsibility for supervising and controlling insurance companies is assigned to the Directorate-General of Insurance (*Direción General de Seguros*), an agency of the Ministry of Economy and Finance. The specific powers of the DGS include the issuance of regulations governing the preparation of financial statements.

The DGS accounting regulations must comply not only with the relevant provisions of the Commercial Code and of the Corporations Law but also with the requirements of the specific legislation for insurance in Spain (the Insurance Law and its implementing regulations) and with EU directives on insurance and financial reporting by insurance companies.

In 1997, the DGS finally exercised its regulatory powers in the field of financial reporting by issuing an adaption of the PGC for insurance companies, enacted by Royal Decree. Before this, insurance entities were, by default, subject to the general (ICAC) system of accounting regulation, supplemented by the occasional provisions officially promulgated.

The State Audit Agency and the Regulation of Accounting by Public Sector Entities

Apart from the various official bodies mentioned so far with powers to issue accounting standards for private-sector companies, there is also the special case of the State Audit Agency (*Intervención General de la Administración del Estado*), a department of the Ministry of Economy and Finance which performs this same function for public-sector entities. This is a separate area of accounting regulation in Spain, distinct from that applicable to all private-sector companies, even those that are wholly or majority owned by public sector entities.

The accounting regulation of public-sector entities (sometimes referred to as 'government accounting') naturally has its own special characteristics which differentiate it from the accounting regulation of private-sector companies. There has been a constant flow of regulatory pronouncements which are applicable to different areas of the State Administration: central government, autonomous community governments, local authorities and public sector business entities. A notable example in this latter respect is the comprehensive chart of accounts drawn up for RENFE, the Spanish state-owned railroad company.

IGAE is continuing its supplementary activity of developing regulatory approaches in this field. A new General Accounting Plan for the public sector was issued in May 1994. Nevertheless, despite clear and unsurmountable differences between the activities of private- and public-sector entities and the consequent natural differences in their respective systems of accounting regulation, government accounting in Spain today is largely similar to accounting for business.

The role of AECA as a Private Standard-Setting Body

As mentioned earlier, the Spanish Accounting and Business Administration Association (AECA) was set up in 1979, and has played an important role as an issuer of professional standards in accounting. Its Accounting Principles and Standards Committee (*Comisión de Principios y Normas de Contabilidad*) has so far issued 21 pronouncements and two proposals covering in considerable detail all the main components of the financial statements (ACEA, 1996).

Table 11.3 AECA accounting principles and standards

AECA Statements	
1.	Accounting principles and standards in Spain (1980)
2.	Tangible fixed assets (1981)
3.	Intangibles and deferred charges (1983)
4.	Foreign currency exchange differences (1983)
5.	Suppliers, creditors and other accounts payable (1984)
6.	Trade receivables, debtors and other accounts receivable (1984)
7.	Accrual accounts and deferred collections and payments (1984)
8.	Inventories (1986)
9.	Income tax (1989)
10.	Accounting principles for equity (1988)
11.	Provisions, contingencies and events subsequent to the date of the financial statements (1988)
12.	Deferred revenues (1989)
13.	Revenues (1989)
14.	Reversion reserve (1989)
15.	Financial investments (1990)
16.	Pension plans (1994)
17.	Expenses (1995)
18.	Long-term financial liabilities (1995)
19.	Commodities futures and options (1997)
20.	Cash flow statement (1998)
21.	Income tax in consolidated accounts (1998)
Exposure drafts	
22.	Foreign currency exchange differences (Amendment of No. 4, 1998)
23.	Conceptual framework for financial statements (1998)

The Accounting Principles and Standards Committee has 25 members drawn from the profession (issuers, auditors and users of financial statements), academic institutions and government agencies. The bodies and entities represented on the Committee are listed below.

Asociación Española de Asesores Fiscales (Spanish Association of Tax Advisors)

Asociación Española de Ejecutivos Financieros (Spanish Association of Finance Executives)

Asociación Española de Leasing (Spanish Association of Leasing Companies)

Asociación Naciónal de Entidades Financieras (Spanish Association of Finance Companies)
Banco de España (Bank of Spain)
Colegios de Titulados Mercantiles y Empresariales (Official Colleges of Commercial Graduates)
Instituto de Analistas Financieros (Institute of Financial Analysts)
Instituto de Auditores Internos (Institute of Internal Auditors)
Instituto de Auditores-Censores Jurados de Cuentas de España (Spanish Institute of Chartered Accountants)
Instituto de Contabilidad y Auditoría de Cuentas (Accounting and Audit Institute)
Intervención General de la Administración del Estado (Government Audit Department)
Registro de Economistas Auditores (Register of Economist-Auditors)
Catedraticos Universitarios de Contabilidad (University-Faculty of Business Administration)

The Committee operates through plenary meetings (including all members) and in working parties (of 8–10 members). Its pronouncements are initially published as 'exposure drafts', which are open to suggestions and comments, and six months later are issued in their definitive versions as AECA Statements.

AECA Statements have a fairly wide circulation, as evidenced by an average distribution of about 25,000 copies for each AECA Statement and by the findings of a study on 'The Implementation of AECA Accounting Principles' carried out in 1991 and 1996 by the Department of Accounting and Finance of Zaragoza University (Gabas *et al.*, 1991, 1996). These studies, based on a survey which included Spain's 500 largest companies, registered auditors and university teachers of accounting, concluded that 90 per cent of auditors recommend that the companies they work with use AECA accounting principles, that 58 per cent of companies polled already use AECA accounting principles and that nearly all university teachers take AECA positions into account when planning their syllabuses.

The first 15 AECA Statements were issued before enactment of the 1990 PGC and their content had a significant impact on the PGC. The main changes introduced by the 1990 PGC were based on standards previously set by AECA in an attempt to bring Spanish accounting practices into line with more widely accepted accounting practices internationally. Examples of AECA's influence on the 1990 PGC include, amongst other things, the recording of leased assets on the assets side of the balance sheet, the recognition of prepaid and deferred taxes, and the recording of pension commitments on an accrual basis.

Since the enactment of the 1990 PGC, AECA has continued to issue accounting standards, thus completing the set of rules governing the main balance sheet and income statement captions and branching out into new fields where there have previously been no generally accepted rules in Spain, such as commodities, futures, options and cash flow statements.

In defining generally accepted accounting principles (*principios de contabilidad generalmente aceptados*) for the purposes of the audit report, Spanish auditing standards (*Normas Técnicas de Auditoría*) list the accounting principles established by law and then state:

> In the case of transactions or economic events not addressed in the foregoing rules, the auditor shall base his professional opinion on optional accounting standards issued by solvent Spanish or international organisations, provided that such standards meet all the following conditions:
>
> (a) They do not contravene the mandatory accounting principles and standards.
> (b) They have been generally accepted by the profession by means of express statements issued by the auditor bodies.
> (c) Their application permits the presentation of a true and fair view of the net worth, financial position and results of the entity being audited.

AECA standards meet all the foregoing conditions and are widely supported in professional, institutional and academic circles – see, for instance, the Guide to Business in Spain published by Arthur Andersen (1990, 1992). Indeed, the professional accounting standards issued by AECA can be said to satisfactorily supplement the official accounting regulations issued by ICAC and the other specialist government agencies, and so far there have been no conflicts between the two. AECA's main recommendations were included in the 1990 PGC and, since its enactment, AECA has focused its attention on those areas of accounting whose technical complexity or novelty makes their official regulation difficult, thus enabling AECA guidelines to be adopted by the official regulators who have had the opportunity to observe their application in practice.

To conclude, during its first 19 years of existence, AECA has had a major impact on the accounting profession in Spain. AECA has succeeded in unifying the accounting standards used by auditors who are members of three different professional organisations; it has developed and tested accounting standards which are available to the public regulators; it has laid down strict accounting guidelines for issuers of financial statements; and it has disseminated internationally accepted and reliable practices among users of financial information. In short, AECA has helped to ensure that the financial statements of Spanish companies present the true and fair view required by the European Fourth Directive and by Spanish commercial law.

SUMMARY

Spanish accounting regulation is formally dependant on the government, the specialised governmental agency charged with the standardisation of accounting (ICAC) being a branch of the Ministry of Economy and Finance. Other official regulators (that is, for banks, insurance companies and state-owned companies) are also located within that Ministry.

Professional influence in Spain is exerted through AECA, which is the only private body to issue accounting standards in Spain. These standards are not compulsory by law. However, they have broad acceptance in the profession. As AECA was active at the time of the major accounting change that occurred in Spain as a result of the country's entry into the European Community, the PGC included many of the principles set down in AECA accounting standards.

In a study of the implementation of AECA accounting principles (Gabas, 1996), the majority of the respondents (68 per cent) were in favour of a mixed model of accounting regulation – governmental and professional. Only 2 per cent preferred governmental regulation exclusively and the rest (30 per cent) expressed a preference for professional standards only. Taking this majority view into account, the current mixed model of accounting regulation in Spain which was set up by company accountants, auditors and educators, is expected to continue.

Appendix: The Development of Spanish Accounting Regulation

1829 The first Spanish Commercial Code makes it obligatory to keep accounting books
1885 New Spanish Commercial Code develops formal accounting requirements
1951 Corporations Law
1953 Private Limited Companies Act
1965 Central Accounting Planning Commission created to draw up a national chart of accounts
1973 Title III of Book I of the Commercial Code 'The Book of Traders', was amended
1973 General Accounting Plan (PGC)
1974 PGC for small and medium-sized companies
1976 The Institute of Accounting Standardisation (*Instituto de Planificación Contable*) was created as a Governmental Agency to develop the PGC.
1977 First Sectoral Adaptation of the PGC. In following years different Sectoral PGC *Adaptacións* were enacted.
1978 Cost Accounting Model. Implementing group 9 of PGC.
1979 The Spanish Accounting and Business Administration Association (AECA) was set up. AECA Statements issued after 1980 are included in Table 11.3.
1981 General Accounting Plan for Governmental Accounting
1982 Standards for preparation of consolidated financial statements by corporate groups
1986 Spain joins the European Community. Accounting and Auditing Bill, to align with the 4th, 7th and 8th directives
1988 Auditing law, to align with the 8th directive. The Institute of Accounting and Auditing (*Instituto de Contabilidad y Auditoría de Cuentas*) was created by the law. It substitutes the Institute of Accounting Standardisation with increasing functions.
1989 Commercial Reform law, to align with the 4th and 7th directives
Limited Companies Act, to align with the Commercial Reform Law
1990 General Accounting Plan (PGC), implementing the Commercial Reform Law

1991 Consolidated Financial Statements Preparation Standards, implementing the Commericial Reform Law
1993 First Sectoral Adaptation of the 1990 PGC (see Table 11.2)
1994 General Accounting Plan for Governmental Accounting
1995 Private Limited Companies Act, to align with the Commercial Reform Law

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12 The United Kingdom

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INTRODUCTION

The effective regulation of accounting practice is still an emergent phenomenon in the UK. Although there is now an influential rhetoric of accounting order that, for many, serves to define the state of practice in terms of aspirations, a careful examination of the reality of corporate accounting would show that until very recently practice has remained both fluid and diverse. Whilst there has been a growth of mechanisms and institutions for the standardisation of financial accounting, there equally has been an impressive record of accounting innovation and creativity as companies have sought to play a proactive role in the creation of accounting knowledge and practice (Shah, 1996). Creativity functioning alongside a rhetoric of standardisation has been an important feature of contemporary British accounting, as was evidenced by the concerns with both 'creative accounting' and 'creative compliance'. The debates over brand accounting, off-balance sheet financing and accounting for goodwill all point to the potential of British practice to push continually at the frontiers of what is acceptable.

An interest in accounting autonomy on the part of the corporate sector in the UK has been (and still is) very real. As circumstances have changed, the autonomy that is available has been differentially exercised: in good times and bad, in periods of heightened and weakened trade union power, and in relation to different states of the market for corporate control. But however corporate discretion has been and still is exercised, accounting regulation has to be seen as an active and often vigorous attempt to constrain and modify that very discretion. Hardly surprisingly the resultant regulatory processes have been dynamic, often quite full of conflict and subject to frequent modification and change. In the past, at least, the regulatory authorities also have rarely had sufficient legitimacy, authority and power. Regulating accounting in the UK has never been an easy exercise.

One continuing manifestation of the difficulty of accounting regulation is the fact that the diversity of practice is still far greater than what initially might be expected in a regulated regime. Indeed, it would be difficult to characterise any singular notion of 'British accounting'. The variability in the pressures on corporate reporting across different companies is very real. Whilst for the larger company, capital market pressures have stimulated an increased awareness of the strategic potential of accounting in the context of an active market for corporate control, for smaller enterprises more traditional concerns with secrecy and tax minimisation have preserved an interest in conservative and cautious modes of accounting. At least two very different approaches to accounting operate side by side in the UK.

Characterised by both tensions and diversity, any examination of the regulation of British accounting needs to look beyond the rhetoric which accompanies it to the consequences which it has and the dynamic properties of the institutional mechanisms which seek to further it. In the UK, where standardisation is still compatible with diversity, rhetoric can be very different from action, and the processes implicit in the historical emergence of practices have usually been more important than contemporary attempts to change them.

THE DEVELOPMENT OF ACCOUNTING REGULATION

The ambiguity and vagueness which has been so prevalent a feature of British accounting regulation characterised the first early attempts to provide a regulatory framework. While the 1844 Joint Stock Companies Act had required a 'full and fair' balance sheet to be prepared, audited and presented to both the ordinary meeting of shareholders and the Registrar of Joint Stock Companies, this requirement was removed by the 1856 Companies Act. Not until 1900 was an annual audit again made compulsory for all registered companies. For public companies a 1907 Act required the publication of an annual balance sheet and the 1929 Companies Act added to this the requirement for a profit and loss account. Only with the Companies Act of 1948 was a more comprehensive and recognisably modern approach to accounting incorporated into the law with the requirement for group accounts, numerous new disclosures and an audit report on whether the accounts provide a 'true and fair' record. For much of the earlier period it was a general view that 'matters of accounting should be dealt with by private contract between shareholders and directors' (Edey and Panitpakdi, 1956, p. 86).

The courts did not fill the resultant regulatory void left by the legislature. Although there were numerous judicial rulings on accounting matters in the late nineteenth and early twentieth centuries 'by and large [the law] had little effect' (Yamey, 1979, p. 236). As Yamey goes on to say:

> Provision for compulsory disclosure in accounts moved slowly, and did not touch the basic conventions. The case law relating to the determination of profits available for dividends also did not call for any modification in the conventions or in their application. On dividend questions, the Courts, especially after 1889, were unwilling 'to formulate rules for the guidance and embarrassment of business men in the conduct of business affairs'.
>
> Provided accounts were drawn up in good faith in the interests of the company and approved by auditors, the Courts were loath to intervene. In fact, the leading cases pointed to broad legal principles which were more permissive and lenient than the accounting conventions in the determination of profit. It was the accounting conventions and not the legal requirements that imposed the real restraints on the calculation of divisible profits in practice – though some of these restraints could, of course, be broken within the wider limits of the law.

So, relatively unregulated by either statute or the wider law, corporate accounting was primarily shaped by custom and practice, as were (and still are) many other features of British life. Rather than appealing to codified texts or authoritative opinions, accounting practice emerged in a more pragmatic manner, directly shaped by the pressures of corporate and financial affairs. The result was a series of accounting conventions that were embodied in working manuals and educational texts rather than more abstract regulatory tomes.

Such conventions inevitably left considerable discretion to corporate management and auditors. In practice the exercising of such discretion was in general in line with a policy of conservatism. Unlike today, for much of the first half of the twentieth century British accounting practice had many similarities with prevailing approaches in continental Europe. As Yamey (1979, p. 237) points out:

> by and large . . . it was better to err on the side of understatement rather than of over-statement. Thus asset values in the balance sheet were to be under- rather than over-stated; and possible losses were to be anticipated rather than deferred in the accounts, while the recording of gains was to be deferred until they had been realised. The creation or setting-up of secret (or inner) reserves, however, went well beyond the caution of this ordinary conservatism; and their resuscitation in the accounts of later years clearly involved overstatement of their profits. Provided that it was done in good faith and in the interests of the company, the directors could, within wide limits, present final accounts embodying deliberate deviations from the application of the accounting conventions. In appropriate circumstances profits, and hence net assets, could be understated. In this way smaller profits could be disclosed, without shareholders being made aware of the approximate magnitude of the undisclosed reserves; and reinvestment of profits could be made easier. Moreover, if it was considered in the interests of the company, reported profits in later, leaner years could be augmented by drafts on the previously undisclosed reserves. In this way year-to-year changes in reported profits could be reduced, and a more stable profit record established.

Such a deeply ingrained *laissez-faire* approach to accounting has shaped accounting practice until recently, and most likely still does. Behind a more recent British interest in creative accounting (Shah, 1996) lies a belief in almost a right to innovate and create practice in the accounting domain rather than merely apply any pregiven code or manual. A conception of a dynamic, changing and purposeful accounting practice remains deeply embedded in both the British corporate and professional accountancy mentality.

From the Second World War onwards, however, increasing attempts have been made to regulate and constrain the dynamism and instrumentality inherent in the practice of accounting in the UK. The 1948 Companies Act made group accounts compulsory, attempted to distinguish between 'reserves' and 'provisions', and introduced many new disclosure requirements. The principle of *laissez-faire* was beginning to be modified. Shortly thereafter in 1949 the Institute of Chartered Accountants in England and Wales (ICAEW) started to issue Recommendations on Accounting Principles. Although by no means binding, these nevertheless acknowledged that there might even be 'principles' implicit in the dynamic practice of accounting and started to introduce a distinctively normative orientation to policy discussions in the area. During the 1950s and 1960s an increasingly active policy domain started to emerge in and around accounting. As questions of corporate, industrial and economic policy became more visible and important in the public eye, accounting started to be examined, questioned and analysed much more than it ever had. More and more Recommendations and other related normative documents were issued, such that by 1969 the ICAEW appointed its first Technical Director and in 1970 an Accounting Standards Steering Committee was established, later to become the Accounting Standards Committee (ASC). For the first time a potential regulatory mechanism for accounting was in place, albeit one with no formal legal basis and powers. The ASC was established as a response to pressure from the state and the media, but it was established within the institutional context of the audit industry and could appeal neither to the authority nor legitimacy of the state. That institutional positioning alone would ensure that *laissez-faire* accounting principles were far from dead in the UK, but the basis for a new dynamic in accounting practice certainly had been introduced.

It is worth briefly reviewing some of the major factors lying behind this institutional transformation. Although these remain to be explored in a systematic manner (however, see Zeff, 1972), it is nevertheless important to identify some of the significant rationales for change.

The Changing Conception of the Company

Historically the private nature of the company had provided a basic rationale for the *laissez-faire* approach to accounting regulation. With little or no recognition of the wider public consequences of accounting, a view had emerged that matters of accounting should be dealt with by private contract between shareholders and directors.

The experiences of the Depression of the 1930s and particularly the emergence of a more consensual understanding of society during and immediately after the Second World War were to change that, providing a clearer rationale for the wider disclosures required by the Companies Act of 1948 and its emphasis on 'true and fair' accounting. In its evidence to the Cohen Committee on company law which recommended the basic shape of the legal changes incorporated in the 1948 Act, *The Economist* had articulated some of the wider pressures for change on accounting:

> The Economist . . . discuss[ed] the public policy implications of accounting. They commented that state intervention in economic matters had greatly increased since the [Companies Act of 1929] and would go on increasing. Yet such intervention generated a need for facts. In that respect therefore the supply of standardised information about corporate activities to economic policy makers was a matter of urgent public importance. They stressed that the doctrine that the state was responsible for the economic health of the country was a new one but it was nevertheless widely accepted. Yet that doctrine had implications for accounting very different from that which prevailed before it became accepted. The regulation of accounting data must accordingly be approached with the needs of the economic policy makers in mind. (Bircher, 1989, p. 256)

Such views continued to develop in the post-war years. The company increasingly became recognised as a more public institution.

The Development of the Financial Press

A significant impetus for the continued enhancement of the wider public visibility of accounting was provided by the growth of a specialist financial press. The development of the *Financial Times* and the emergence of business and financial sections and supplements in the quality newspapers provided both a forum for and a group of skilled writers on accounting policy matters. Indeed this section of the press played a vital role in communicating to a wider public the accounting implications of a series of prominent corporate take-overs and mergers in the 1960s. The days when accounting policy discussions were confined to the corridors of the British establishment were over. Increasingly accounting was asked to be accountable: a very novel concept.

Significant Actors and Influential Ideas

Throughout these developments a key role was played by a few individuals. The mass of the accounting community remained silent, entrapped in the status quo. The wheels of change on group accounts were turned by the likes of Sir Gilbert Garnsey and Professor E.R.M. de Paula (Kitchen, 1979, pp. 86–123). The emergence of the Recommendations on Accounting Principles did not reflect any internal dynamic of reform within the ICAEW. Rather they resulted from the perseverance and struggles of two industrial accountants, Basil Smallpiece and once again Professor E. R. M. de Paula (Noguchi, n.d.). A vital catalytic role which resulted in the establishment of the Accounting Standards Steering Committee was played by Professor Edward Stamp. Asking 'Who shall Audit the Auditors', he crystallised the widespread feeling that institutional and regulatory change was needed.

Indeed it is worthwhile to note the significant role played in regulatory change in British accounting by senior members of the academic community. Although the UK is not a country noted for the emphasis which it places on intellectual ideas, the development of more theoretical understandings of accounting has nevertheless been important in providing both a conception of a better accounting potential and a cadre of accounting statesmen who could operate at the interfaces between the institutions of the audit industry and the state, for auditing itself has seemingly been unable to develop people with such statesman-like qualities. Over the years it has had to rely on the likes of Professors de Paula, Stamp, Edey, Carsberg, Macve and numerous others, including Professor Sir David Tweedie today.

A Market for Corporate Control

From the early 1960s a very active market in corporate control developed in the UK. Prior to that, contested take-overs were rare, if not unknown. With their arrival, however, accounting quickly started to take on a more strategic role. Companies sought to protect themselves by enhancing profits by accounting means. And companies taking over others quickly started to realise the fragility and unreliability of the accounting art. During the later years of the 1960s, there were a whole series of take-over situations in which accounting was involved. With the advent of the financial press, what previously might have been private scandals, entered the public arena. With the likes of the GEC–AEI merger, the Leasco bid to take over Pergamon Press and the consolidation of the textile industry by Courtaulds, accounting scandals and crises became highly visible to the public eye. Accounting was now a more public art and the wider calls for its regulation could not be ignored.

It is also interesting to note one very significant absence from the factors inducing change: the audit industry itself. Throughout most of the century the accountancy institutes had adopted a highly conservative stance vis-à-vis change, seeking both to maintain the status quo and protect the corporate interest. In submission after submission to government inquiries and investigations, the accountancy institutes singularly failed to exhibit any more progressive stance. Even when institutional change did come in 1970, the establishment of the Accounting Standards Steering Committee showed all the signs of acting reluctantly, as a result of pressures from the government, the financial authorities and the media.

That regulatory reluctance was to permeate the activities of the Accounting Standards Committee (ASC). Established within the institutional orbit of the accountancy profession, it had a history of ponderous debate and a great deal of sensitivity to the interests and demands of interested parties. Although a programme of accounting standardisation emerged, the will behind it showed all the signs of external incentives rather than an internalised rationale. And lacking a wider legal legitimacy and authority, questions of enforcement became ever more significant. In several areas, accounting standards stood alongside unstandardised practice and creative accounting emerged out of a seemingly regulated context.

By the late 1980s there was quite widespread pressure for change. Increasingly aware of the limitations of regulation by the audit industry, it started to be possible to think of a wider role for the law in accounting regulation. Particularly as a result of the introduction of European accounting directives into British law, the explicit role of the state in both accounting specification and policy making had grown (Bromwich and Hopwood, 1992). With this, a new basis emerged for the further institutional development of accounting regulation in the UK.

THE PRESENT REGULATORY ARRANGEMENTS

In 1990 Britain implemented an overhaul of the accounting standard-setting structure as recommended by the Dearing Report (Dearing, 1988) published by a committee appointed by the Consultative Committee of Accountancy Bodies (CCAB), the body that pulls together all the separate accounting institutes in the UK. The committee was chaired by the then Sir Ronald Dearing. The Report identified a number of problems with the extant standard-setting structure. First, both the ASC's large size (21 members) and its lack of funding restricted its flexibility. Second, a requirement for agreement from all six member bodies of the CCAB resulted in delay and compromise. Standards were watered down to avoid non-compliance. Third, and possibly most importantly, enforcement of the standards was perceived to be weak as it relied more or less exclusively on the discipline of the auditor. Finally, the lack of a theoretical framework was seen to leave accounting standards without any general basis.

The Dearing Committee considered how standards should be set, their relationship with the law, enforcement procedures and funding. The Committee's proposals aimed at alleviating these problems and were largely adopted by the Department of Trade and Industry (DTI) when it appointed Dearing to set up the new structure.

The new standard-setting structure is overseen by a Financial Reporting Council (FRC). The FRC usually convenes three times a year. Its responsibilities include the general promotion of good financial reporting, guidance on policies and ensuring the adequate funding of the Accounting Standards Board (ASB). Furthermore, the Council is intended to act as a forum for the public advocacy of accounting standards. In this capacity it has jointly initiated and sponsored investigations of the financial aspects of corporate governance.

The Chairman of the FRC is appointed jointly by the Secretary of State for Trade and Industry and the Governor of the Bank of England. First to hold the position was Sir Ron Dearing, a non-accountant. Three deputy chairmen are selected in the same way to represent users, preparers and the audit industry. Thus the Chairman of the London Stock Exchange, the President of the Confederation of British Industry and the Chairman of the CCAB are currently deputy chairmen. The FRC's 25 members are appointed by the Chairman and Deputy Chairmen, and together they give a voice to user, preparer and audit industry interests. Observers from the government and the Bank of England attend Council meetings.

For the actual standard setting task, the FRC appoints members of the ASB. The ASB is headed by a full-time chairman, Sir David Tweedie, former Chairman of the Auditing Practices Committee and both a former academic and former technical partner at one of the large accountancy firms. A full-time technical director with a small staff assists the Board in drawing up standards. The ASB consists of a maximum of ten members who are versed in accounting but are not all practising accountants. Of these, two – the Chairman and the Technical Director – are full-time and the rest are part-time. Thus the number of members has been substantially reduced from the days of the ASC. To further speed up the standard-setting process and reduce the need for compromise, the ASB issues standards on its own authority with a two-thirds majority. It requires the agreement of neither the FRC nor the CCAB.

The Urgent Issues Task Force (UITF) was created as a committee of ASB to provide a capability for responding to new and emerging issues. In cases where conflicting interpretations of existing standards arise or new practices surface for which the normal standard-setting process is too slow, the UITF produces non-mandatory guidance.

The UITF aims to reach a consensus of opinion on the issues it considers. There are up to 15 voting members, of whom 11 constitute a quorum. A consensus is deemed to emerge when no more than two of the members dissent. The consensus so established is expected to be regarded as accepted practice in the area in question, with companies striving to conform to it. As of the end of 1996 twelve UITF pronouncements were still operative on issues such as disclosure of changes in accounting policy, disclosure of substantial acquisitions and transfers from current assets to fixed assets.

The final part of the standard-setting machinery is the Financial Reporting Review Panel. Established to sharpen the enforcement of accounting standards, the Panel is responsible for examining material departures from standards by large companies. It currently has 20 members appointed by the Appointments Committee of the FRC and is chaired by a Queen's Counsel, a high standing lawyer.

Rather than scrutinising company accounts on a regular basis, the Review Panel acts on matters drawn to its attention. Operating through case-specific subcommittees, the Panel normally aims to obtain the voluntary agreement of the directors of a company on any necessary revisions to the accounts. However, if that voluntary approach fails, the Panel can seek a declaration from the courts that the company's accounts do not comply with the requirements of the Companies Act of 1985 and ask for an order requiring the directors to prepare revised accounts. If the court grants such an order, it may also require the directors to meet the costs of the proceedings and of revising the accounts. The Reporting Panel has a substantial legal costs fund to ensure that it can always take such action.

By 1998 no such court action had been taken, although preliminary moves have been initiated. Most investigations undertaken have been of an informal nature, although each year there are a small number of public announcements concerning amendments made to published accounts. Overall, it is still too early to evaluate the effectiveness of these monitoring and enforcement procedures, although it would appear that together they have played some role in increasing the authority of the new regulatory structure for accounting.

With the advent of the FRC and its constituent organisations, for the first time the UK has the basis for more effective and independent regulatory mechanisms in the accounting area. No longer solely dependent on the mediating interest of the audit industry for enforcement and improvement, the interrelated group of institutional structures together provide for an enhanced legitimacy for accounting regulation, considered means for the formulation of accounting rules and the basis of mechanisms for their enforcement.

A number of features of the present institutional structure for accounting standard setting in the UK are worthy of further comment.

First, for the first time accounting standard-setting is recognised in British law. With the Companies Act of 1989, the existence of both accounting standards and bodies for their issuance are noted in the law. Moreover the Act also required companies to state whether their accounts have been prepared in accordance with applicable accounting standards and, if they have not, both the nature of any material departures from standards and the reasons for these have to be given.

Although the law still requires accounts to give a 'true and fair' view rather than comply with current accounting standards, increasingly it is thought that the Courts would interpret the law to mean that accounting standards give an authoritative insight into what should be regarded as 'true and fair'. Indeed, the latest legal opinion by Mrs Justice Arden is of this view (Arden, 1993):

> Just as a custom which is upheld by the courts may properly be regarded as a source of law, so too, in my view, does an accounting standard which the court holds must be complied with to meet the true and fair requirement become, in cases where it is applicable, a source of law in itself in the widest sense of that term.

Such an authoritative legal positioning of the new accounting standard-setting regime in the UK is reinforced by the fact that the 1989 Companies Act also enables the court to require the revision of accounts where it is satisfied that the original ones do not show a true and fair view or otherwise comply with the requirements of the Companies Act of 1985. Linked to the Financial Reporting Review Panel's mechanisms for monitoring and examining the observance of accounting standards, this new legal provision adds the power of the law to that monitoring mechanism. Should the Review Panel deem it necessary, it can ask the court to order the revision of a set of accounts and the circulation of the revised accounts to all those who received the original ones.

The new institutional basis for accounting regulation in the UK undoubtedly has shifted the influence structure surrounding accounting rulemaking. Having a body with independent authority has introduced a dynamic of development different from that existing when the ASC operated within the institutional nexus of the audit industry. Corporate interests are still highly significant. Audit firms still find it difficult to display an independent stance. But such traditional elements of the influence processes surrounding accounting regulation in the UK must now operate somewhat more publicly in a forum where the interests of the state and the wider financial community are also present. Such a public forum demands an articulation of the rationales for disagreement and opposition, something which itself can influence the conduct and outcome of accounting policy making. Being relatively new, it is still too early to engage in a study of the precise locus of influence and power under the new arrangements. The impression that is emerging, however, is, on the one hand, a more explicit recognition of the power of the corporate interest and, on the other hand, a view that the new forum now has some authority to shape and influence the outcomes of debates. It is as if accounting rulemaking is emerging as an explicit policy domain rather than being implicit within the wider politics of professional infighting and debate.

THE WORKINGS OF THE RULE-MAKING SYSTEM

This section illustrates the workings of the rulemaking system in the UK by looking into five areas of accounting regulation: foreign currency translation, revaluation of assets, definition of subsidiary companies, reporting the substance of transactions and capital instruments. Three broad analytical themes will guide the discussion of the standard-setting system: the issue of economic substance over legal form, the preparer-driven nature of accounting innovation and the economic impact of rules.

Debates about economic substance versus legal form arise in the UK because many accounting rules are devised by the ASB while some are contained in company legislation. The accountant is required to assess the 'economic reality' of the reporting entity. However, the legal form of a transaction may yield a conflicting view. An early example of this debate was SSAP 21, 'Accounting for Leases and Hire Purchase Contracts'. Issued in 1984, the standard distinguishes finance and operating leases. In the case of a finance lease, the risks and rewards of ownership of the asset are transferred to the lessor. Hence the lessor is required to record the asset on the face of the balance sheet. Economic substance prevails over legal ownership.

The growth of multidivisional firms and off-balance-sheet financing schemes has given rise to the perceived need for standards to regulate the reporting of the substance of transactions (Financial Reporting Standard No. 5, or FRS 5) and that define subsidiaries by means other than legal ownership (FRS 2). McBarnet and Whelan (1991) suggest that the role of the accountant is less important than the profession might like to think because the issue is not economic substance versus legal form, but legal substance versus legal form. The accountants did not subscribe to this view but nevertheless have had to consider the views of the government in drawing up their standard on 'Reporting the Substance of Transactions'.

A second issue is the ability of preparers to defend accounting innovations against opposition from the standard-setting regime. The example that springs to mind is the brand accounting debate. This will be looked at in more detail when consideration is given to the rules relating to the revaluation of assets. Rather than simply formalising innovation *ex post*, the new ASB tries to shape accounting in the name of a wider set of principles. Consequently both the accounting regulators and the audit industry may find it harder to maintain the balancing act between safeguarding the reputation of the standard-setting regime and satisfying the demands of corporate interests. In fact, much more is at stake for the large accountancy firms than simply avoiding the loss of an audit client. Accounting innovations create opportunities for lucrative consultancy work. Napier and Power (1992) argue that the Arthur Andersen report 'The Valuation of Intangible Assets' 'represents, simultaneously, both an explicit articulation of particular valuation methods and an implicit claim for professional jurisdiction over the practice of those methods'. Outright prohibition of new treatments will anger preparers and eliminate potential advisory roles for the accountant. New regulations, on the other hand, make the accountant indispensable. An impression of the relations of power in the standard-setting arena can be derived from the resulting compromises and (in some cases) defeats.

The third analytical perspective looks into the role of the economic impact of new accounting rules as an argument in the rulemaking process. While it is important to consider whether a proposed standard would change economic decision-making, this perspective is more interested in whether the economic impact of a new regulation is discussed in the standard-setting process. The rhetoric of competition usually comes up in the discussion of exposure drafts.

Each incidence of rulemaking emerges from a different constellation of actors (see Burchell, Clubb and Hopwood 1985). Some standards were issued by the old ASC, recent rules by the ASB. Usually participants in the debate are placed in three categories: the audit industry, preparers and users. The DTI, acting on behalf of the government, is another important party. On some issues other parties, like the Law Society or the Bank of England, become involved.

Foreign Currency Translation (SSAP 20, 1983)

With increasing international trade and higher levels of overseas investment several methods of translating foreign currency exposure developed. According to Davies, Paterson and Wilson (1994) there was no consensus on the choice between four main methods: current rate, temporal, current/non-current, monetary/non-monetary. As exchange rates became more volatile with the collapse of the Bretton Woods system, foreign currency translation found its way onto the ASC's agenda in the early 1970s.

SSAP 6, 'Extraordinary Items and Prior Year Adjustments', issued in 1974, mentioned problems associated with foreign currency translation but did not offer any treatment except that policies should be disclosed in accordance with SSAP 2. In September 1975 the ASC issued Exposure Draft No.16 (ED 16), its first pronouncement on currency translation. Because of the range of conflicting views held on the subject, the ASC restricted the exposure draft to requiring exchange differences to run through the profit and loss account. No translation method was prescribed, except that the closing rate method should be used for foreign currency borrowing.

Two years later in September 1977 the ASC published ED 21. This draft restricted the choice to either the closing rate or temporal methods. Some respondents claimed there was no need to allow two methods because the closing rate method was so widely adopted. Support for the use of the average rate and closing rate was equally divided. Many argued in favour of keeping exchange differences out of operating profits but only a few supported displaying them as quasi-extraordinary items as proposed by ED 21.

After further consultation and discussions with the US and the Canadian accounting standard setting bodies, the ASC issued ED 27 in 1980. The favoured approach was based on the closing rate/net investment concept. Under this method exchange differences that give rise to cash flows are reported in the profit and loss account. Others are accounted for as movements in reserves.

The passing of the Companies Act 1981 resulted in a further delay and SSAP 20, 'Foreign Currency Translation', was released only in April 1983. The standard prescribes the closing rate/net investment method except where the affairs of a foreign enterprise are so closely linked with those of the investing company that it may be regarded as being more dependent on the economic environment of the investing company's currency than its own reporting currency. In such exceptional circumstances the temporal method may be used. The standard is still in force under the new ASB.

Revaluation of Assets (SSAP 19, 1981 and FRS 7, 1995)

Britain operates a hybrid system combining historical cost with market valuations under certain conditions. For instance, with acquisitions the target company's assets may be revalued at fair value. In what amounts to a long history of revaluations in the UK, both Yamey (1978) and Edwards (1989) name revaluation as one of several methods of accounting for fixed assets common as far back as the seventeenth century. Gains and losses were taken to the profit and loss account, mixing realised and unrealised profits. During the second half of the nineteenth century the railway companies were pioneers in fixed asset valuation (Edwards, 1989). There was no profession to rely on and under a philosophy of *laissez-faire*, company law did not prescribe accounting methods. Because tracks and rolling stock have very long lives their expense was capitalised but no depreciation was provided; only maintenance was charged to the profit and loss account. A similar argument has recently been used by companies for not providing for depreciation on buildings. It is argued that the premises are maintained to such standards that the property value does not fall and therefore no depreciation needs to be provided. In the early part of this century, depreciation had not yet become widely accepted practice. The Companies Act 1928 merely required disclosure of the method of asset valuation. According to Yamey (1979, p.11) the restatement of fixed asset values became more common from 1945 onwards because of a perceived higher replacement cost.

Davies, Paterson and Wilson(1994) cite evidence suggesting that revaluations were widespread during the high levels of inflation in the 1970s. In the second half of the 1980s the number of companies revaluing their assets dropped and then levelled off during the 1990s. A significant number of major corporations restate the value of their fixed assets despite the resultant drop in earnings per share under FRS 3. Usually the revaluation is confined to land and buildings.

SSAP 12, 'Accounting for Depreciation', actually encourages regular revaluations. The problem has been that the companies usually do not disclose their policy for so doing. Davies, Paterson and Wilson (1994) suggest this is because most companies do not have a policy; assets are restated on an *ad hoc* basis. In 1990 the ASC issued ED 51, 'Accounting for Fixed Assets and Revaluations', to restrict piecemeal revaluations. The exposure draft took a pragmatic approach. Although there is not much conceptual validity in including revaluations in a historical cost framework, the practice has become so widespread that attempts to ban it would be met with non-compliance. Legislators have not taken a strong stance either. The Companies Act 1985 provides only vague guidance on revaluations, merely prescribing the basis of restatement. For tangible assets, market or current value may be used but, for intangibles, only current value is permissible.

For certain classes of fixed assets, revaluations are endorsed by an accounting standard. One example is accounting for investment properties (SSAP 19). Davies, Paterson and Wilson (1994) claim that the property industry invented the asset class 'investment properties' in the 1970s to avoid depreciation. The property industry successfully made its case, although the standard was delayed because it conflicted with legal requirements. At the time, the EC Fourth Directive, which made depreciation compulsory, was incorporated in the Companies Act 1981. A politically expedient solution was found in the form of invoking the true and fair override and SSAP 19 was released in November 1981.

Recent controversy over fair value accounting surrounds the rise of brand accounting in the late 1980s. In June 1988 the ASC published a discussion paper entitled 'Fair Values in the Context of Acquisition Accounting'. The document proposed using replacement cost from the perspective of the acquiring enterprise for setting a fair value for separable net assets, except where the asset is to be disposed of immediately after acquisition. At the time, the ASC perceived understatement of assets to be a problem. Companies undervalued the acquired assets and wrote off the increased goodwill against reserves.

A new dimension was added to the valuation debate when Rank Hovis McDougall (RHM) decided to capitalise internally generated items in the balance sheet in the name of a valuation of its brands. With the help of consultants Interbrand, RHM added £678 million to its balance sheet with the full support of its auditors. The company argued that the brands were valued at current cost and not at market value, which would have contravened company law. The audit industry was criticised for its inability to issue guidance on the issue of brands.

When the ASC decided to condemn the valuation of brands, its response suffered from unfortunate timing because the London Stock Exchange gave its effective approval the same day. The ASC gave the lack of a generally accepted valuation method and the resultant unreliable figures as the reasons for its decision. Meanwhile Lonhro became the second company to value brands on its balance sheet. The ASC suggested providing additional information in the notes. The Confederation of British Industry joined the debate by urging companies to be aware of the economic importance of their brand names. However, it did not insist that brands should appear on the face of the balance sheet.

Brand accounting can be used to absorb high goodwill that arises in acquisitive companies. Especially in the service industries, goodwill has been increasing and Britain's rules on goodwill, which allowed companies to bypass the profit and loss account, are said to have given them a competitive advantage. Proposed changes requiring the write-off of goodwill through the profit and loss account have important implications for the valuation of assets on acquisition. The rhetoric of competitive advantage has been used in relation to the inclusion of brands in the balance sheet. The recognition of brands will reduce goodwill and thus reduce the amount of amortisation, mitigating thereby the impact of acquisitions on corporate profits.

By the end of 1989, the ASC's stance began to shift in the light of brand accounting's popularity among preparers. After discouraging brand accounting in January 1989, it denied intentions to outlaw the practice in January 1990. Instead it was considering permitting the valuation of acquired brands. However in February 1990 it published ED 52 'Accounting for Intangible Fixed Assets', which banned the inclusion even of acquired brands as assets in the balance sheet. Although accountants in industry strongly opposed the recommendations, some saw it as merely a stage in the debate because the ASC was due to be replaced by the ASB.

Shortly after the ASC published its statement, Cadbury Schweppes openly defied the draft rules by adding £307 million to its assets for brands acquired since 1985 and electing not to amortise these assets against profits. The episode reveals the strength of preparers in driving accounting innovation and the limited ability of the old ASC to impose unpopular rules, especially when perceived 'real' economic effects are at stake. Placing brands on the balance sheet reduces goodwill write-offs and improves the value of acquisitions in terms of assets and profitability ratios. It is also perceived to deter predators because the company is made to appear less undervalued. Certainly the large accountancy firms were also quick to grasp a new area of advisory work and had no interest in seeing the practice banned. The Arthur Andersen report lobbied the newly set up ASB on behalf of the Hundred Group of finance directors yet it also served to declare the practitioners' position whilst at the same time articulating a marketing stance *vis-à-vis* new services. Power (1992) takes the analysis one step further and argues that social acceptance of the valuation method is central to the inclusion of brands on the balance sheet.

The ASB maintained the ASC's line on brands but did not include the issue among its first priorities, possibly because of strong preparer opposition. In a discussion paper, 'Goodwill and Intangible Assets', issued in December 1993, the ASB argued that brands cannot normally be separated from other goodwill and therefore should not appear as separable assets on the balance sheet.

In FRED (Financial Reporting Exposure Draft) 7 and later in FRS 7 (1994), the ASB called for revaluing assets on acquisiton not from the acquirer's point of view but reflecting the condition of the acquired assets at the date of acquisiton. Sir David Tweedie, the ASB's chairman, is generally unhappy with the combination of historical cost with some unsystematic revaluations. He proposes regular revaluations at least for properties, quoted investments and inventories, where ready markets exist. Indeed, Tweedie has given some indications that he prefers converting to a current cost system.

Definition of a Subsidiary (FRS 2, 1992)

Although Britain has a relatively long tradition of consolidation with legislative enactment in 1948, accounting standards on the subject have been prompted by external developments. SSAP 14, 'Consolidated Accounts', was issued in 1978 following a standard issued by the IASC. In 1992, SSAP 14 was superseded by FRS 2, 'Accounting for Subsidiary Undertakings'. The implementation of the EC Seventh Directive in the Companies Act 1989 necessitated amendments to the definition of a subsidiary in the accounting standards.

The ASB's official explanation of the need for a new standard is based on company law amendments. However, the need for change in the definition of a subsidiary dates back beyond the implementation of the Seventh Directive. International harmonisation is only part of the story. The other part is made up of complex off-balance sheet financing structures which emerged during the 1980s and which were not adequately addressed in existing legal as well as accounting rules. Debates on off-balance sheet finance centred around the issue of economic substance versus legal form. This theme is developed in detail in the next section.

Many off-balance sheet schemes rely on circumventing consolidation requirements by employing a highly leveraged 'non-subsidiary' for raising additional finance. Because UK company law based the definition of a subsidiary on ownership, essentially 50 per cent of equity capital, it was relatively easy to establish entities which did not meet the legal form of a subsidiary. In contrast, German and US definitions relied on the notion of control. In March 1988 the ASC released ED 42, 'Accounting for Special Purpose Transactions', which required companies to treat 'controlled non-subsidiaries' in the same way as legally defined subsidiaries.

The DTI saw the need for legislation, given the audit industry's apparent inability to curb off-balance sheet financing. The Department considered an entirely new definition of a subsidiary which would have involved determining the extent of influence in every corporate relationship. However, it reconsidered its proposals in the face of opposition from, amongst others, the ASC. In August 1988, the DTI then announced changes in the definition of a subsidiary from ownership of capital to control of voting rights. The 50 per cent of equity capital rule was replaced by 20 per cent of capital and the exercise of 'dominant influence'. Significantly 'dominant influence' was not defined, leaving substantial room for judgement by the audit industry.

Once the new definition of a subsidiary had been enacted following implementation of the EU's Seventh Directive in the amendment Act of 1989, the accounting standard relating to subsidiaries had to be revised. The ASC issued ED 50, 'Consolidated Accounts', in June 1990. It covered associated companies and joint ventures as well as subsidiaries. ED 50 defined 'dominant influence' in terms of control. When the ASB took over in late 1990 it decided to focus exclusively on subsidiaries.

The ASB issued FRS 2, 'Accounting for Subsidiary Undertakings', in July 1992. FRS 2 contains a list of circumstances that define a subsidiary including: majority of voting rights, the right to appoint directors who hold a majority of voting rights, and the right to exercise dominant influence. The standard defines dominant influence no longer in terms of control but by the ability to achieve the operating and financial policies desired by the holder of the influence. FRS 2 severely restricts exemptions to consolidation on the basis of dissimilar activities. Non-consolidation is permitted only in cases where inclusion in the consolidated accounts would be incompatible with a true and fair view. Thus a link is achieved between consolidation and the true and fair view. The role of professional judgement is maintained in the wake of increasing legalisation.

In an attempt to further restrict opportunities for off-balance sheet schemes, the ASB has created the notion of a 'quasi-subsidiary' in its FRS 5, 'Reporting the Substance of Transaction'. A 'quasi-subsidiary' is defined as a vehicle that does not meet the definition of a subsidiary but gives rise to the same benefits as if it were a subsidiary. This definition was incorporated in the standard despite opposition from the Law Society on the grounds that 'quasi-subsidiaries' do not enjoy legislation recognition and the ASB therefore seems to suggest automatic overriding of the Companies Act.

Reporting the Substance of Transactions (FRS 5, 1994)

During the early 1980s the number of complex 'off balance sheet' financing schemes being set up by companies reached a critical mass beyond which some form of regulation was deemed necessary. Accounting for schemes following merely the letter of the law resulted in certain assets or liabilities being hidden from the reader of the financial statements.

The ICAEW was the first to issue an official document on the issue. Technical Release (TR) 603, 'Off Balance Sheet Financing and Window Dressing', published in 1985, urged accountants to consider the economic substance of a transaction rather than the mere letter of the law. In early 1986, UK standard-setters were even discussing adopting substance over form as a fifth accounting concept (along with going concern, accruals, consistency and prudence concepts: see SSAP 2).

The technical release had the support of the DTI. However, for the DTI it was 'axiomatic that any emphasis on substance over form must not be at the expense of compliance with the law.' This statement was made by the Department of Trade following the Argyll Foods case in which the directors were successfully prosecuted for including a subsidiary in the balance sheet which was only purchased three months after the balance sheet date. The DTI statement caused considerable ambiguity for auditors at a time when innovative financing schemes began to grow.

At this time the Bank of England was also beginning to worry about off balance sheet schemes developed in the US being adopted by UK banks. Pressure to improve their capital ratios had led US banks to securitise parts of their assets and sell them to off balance sheet subsidiaries.

Thus, three parties have developed a strong interest in regulating the balance between legal form and economic substance: the DTI, the institutions of the audit industry and the Bank of England. At the same time, preparers (and, among them, especially banks), increasingly enjoyed the attractions of off balance sheet finance. A side-effect of bringing the off balance sheet debate into the open with TR 603 had been increasing consultancy work for accountants to determine what needed to be reported in the financial statements.

However, it soon emerged that accountants and bankers have differing perceptions of the off balance sheet problem. Accountants aim to show a true and fair view of the assets and liabilities from which profits are generated. Bankers, on the other hand, are interested in the risk contained in balance sheet items. The finance houses are said to follow a 'no risk, no accounts' policy. The Bank of England's concern was also directed at capturing off balance sheet credit risk rather than interfering in external reporting.

The accountants found no easy congruence of interests with the DTI either. Following the Department's response to the Argyll case, the audit industry had to be careful not to be seen to be attributing blame. The wording of TR 603 was carefully chosen so as to avoid a direct challenge of DTI opinion. Within the audit industry there was some doubt as to whether it was necessary to apply substance over form to the balance sheet. Many technical partners appeared to prefer additional disclosure in the notes.

Outright opposition to the technical release came from the Law Society. It argued that the substance over form approach was inherently subjective, and perhaps unsurprisingly favoured legal form over economic substance.

After the initial activity caused by TR 603, the ASC then fell silent. Accountants however became concerned about bankers and lawyers promoting off balance sheet schemes in the absence of guidance on how to account for them. Only in March 1988 did the ASC issue its first exposure draft (ED 42, 'Accounting for Special Purpose Transactions') on off balance sheet items. ED 42 set out general guidelines for recognising assets and liabilities, and favoured inclusion in the balance sheet over additional information in the notes. The draft introduced the notion of a 'controlled non-subsidiary' and required these to be consolidated as if they were legally defined subsidiaries. Although the ASC saw its proposals as controversial and expected opposition from lawyers and finance directors, it nevertheless planned to issue a full SSAP by the beginning of 1989.

The debate then turned to definitions of subsidiaries (see above) and questions of consolidating off balance sheet subsidiaries. In 1990 attention returned to the substance over form controversy with an exposure draft (ED 49) entitled 'Reflecting the Substance of Transactions in Assets and Liabilities'. ED 49 was essentially the same as the original ED 42. The main change was detailed application notes, which were added in response to practitioner complaints about the theoretical nature of the earlier draft. Detailed guidance was provided for five types of transactions: consignment stock, sale-repurchase agreements, factoring, securitised mortgages and loan transfers.

When the ASB took over in 1991 it published proposals for tightening up the rules on securitisation. Because the orginating entity usually retained substantial proportions of the profits from the securitised assets, the ASB argued that the assets should remain on the balance sheet even if the exposure to losses is limited. These proposals, published in Bulletin 15, drew immediate criticism from the banking community. Although securitisation was not yet very prevalent in the UK, bankers wanted to maintain flexibility in the management of their balance sheets. In defence of their opposition, banks relied on a rhetoric of competition. While the Bank of England was prepared to disregard securitised loans in assessing capital adequacy, the implementation of the EC Solvency Ratio Directive would require banks to base the prudential ratio on published financial statements. They argued that the ASB's proposals would place them at a competitive disadvantage.

The ASB admitted that more onerous capital requirements could result from its proposed standard but it was not prepared to grant special exemptions to banks. Two conflicting views of the balance sheet were at the core of the debate. Those in favour of securitisations being accounted for on the balance sheet believed that the accounts should show total resources and the claims against those resources to enable users to assess future cash flows. Those in favour of accounting for securitisations as a sale, and therefore off balance sheet, argued that the balance sheet should show the maximum exposure to downside risk. The standard was further delayed because neither view could be rejected out of hand.

National Westminster Bank openly defied the standard-setters when it extended its securitisation activities beyond mortgages to become the first European bank to securitise part of its corporate loan book. The arguments of competitive disadvantage, put forward by the banking community, carried enough weight for the ASB to seek a compromise solution. In February 1994 the ASB issued FRED 4, 'Reporting the Substance of Transactions'. The draft introduced the so-called 'linked presentation' which allowed banks to net gross asset value against finance received for securitised assets. However, the net amount had to appear on the face of the balance sheet. Following further debate of the draft, the ASB finally issued FRS 5 in December 1993. For the purpose of deciding when an asset should cease to be recognised, the FRS distinguishes three types of transactions. First, all significant benefits and risks are transferred. For such transactions, assets should cease to be recognised. Second, if no significant benefits or risks are transferred, the asset should continue to be recognised in its entirety. Finally, if not all benefits and risks are transferred, the monetary amount of the asset can be amended.

The ASB has maintained its position even in the light of IASC proposals to allow the removal of securitisations and continuing opposition from UK banks. The rhetoric of competition has led only to partial success for the banks. The ASB was forced to compromise, but crucially securitised assets remain on the balance sheet, albeit at a reduced amount. The fact that the Bank of England took no open position on the issue possibly weakened the banking community's stance.

Capital Instruments (FRS 4, 1993)

Accounting standardisation in the area of capital instruments has a very short history. The need for a standard arose with the increasing sophistication of capital markets that offered companies financing methods which could not unambiguously be integrated into existing balance sheet categories. According to Tweedie and Whittington (1990), complex capital issues are a key area where existing standards have either not kept up with innovation or leave too much choice for creative circumvention of rules.

The rise of instruments like redeemable preference shares, convertible bonds and warrants during the 1980s overstretched the traditional distinction between debt and share capital. Such innovation had been driven by the fact that instruments which are similar in substance can have different tax and accounting effects due to differences in legal form. Once again, standard-setters were faced with the problem of balancing economic substance and legal form.

In 1987 the ICAEW's Technical Committee released TR 677, 'Accounting for Complex Capital Issues', as a discussion paper. The Technical Release dealt with fairly straightforward forms of financing and suggested a number of general principles (Davies, Paterson and Wilson 1994). For instance, only the net proceeds of equity issues should be added to shareholders' capital and the expenditure may be written off to a share premium account. Cash proceeds from the issue of options on the company's own share capital should be treated as capital. For deep discount bonds, the difference between proceeds and the higher cost of repayment should be accrued over the life of the bond.

The first issue the new UITF tackled related to capital instruments. Abstract 1, published in July 1991, required that the 'supplemental interest' in convertible bonds (which is paid only if the bond is not converted), must be accrued from the outset even if conversion is likely to occur. The Abstract was followed in December 1991 by a discussion paper, 'Accounting for Capital Instruments', published by the ASB. The paper suggested a distinction between debt and equity, as well as measurement principles and disclosure requirements.

One year later, in December 1992, the Board published FRED 3. This exposure draft took up the main proposals of the discussion paper. In March UITF Abstract 8 provided that where a company repurchases its debt, the gain or loss cannot be deferred but must be accounted for in the year of the repurchase. As with UITF 1, the Abstract was withdrawn as a consequence of its requirements being included in FRS 4.

FRED 3 was substantially converted into FRS 4, Capital Instruments, in December 1993. Most of the examples of capital instruments that Tweedie and Whittington (1990) give in their Table 2, 'An Analysis of Complex Capital Issues', create problems of equity and liability definitions. Thus the rationale of the FRS starts out from the distinction between debt and equity. Based on the ASB's draft Statement of Principles, the criterion for determining whether a capital instrument is a liability is whether it contains an obligation to transfer economic benefits. Equity represents a residual interest in the company with ownership rights to any increases in net assets. The standard adds the category of non-equity shares which contain an element of priority in payouts at the expense of limitations of rights.

A number of issues caused debate among respondents and among Board members. For instance, there was concern about consistency with FRED 4 (later FRS 5), 'Reporting the Substance of Transactions'. Some argued that FRED 3 gave precedence to legal form in the requirement that convertible debt should be reported as a liability until it is actually converted, irrespective of the probability of conversion. The argument is that, where conversion is likely, convertible debt has the substance of equity. The ASB counters that convertible debt entails obligations to pay until the conversion date. If the economic circumstances of the company deteriorate, the holders of convertibles hold more valuable legal rights than shareholders.

The discussion paper had illustrated 'split accounting' as a method for disclosing the value of an option embedded in a convertible bond. However, most respondents felt that this method was too complex and too subjective to make it a compulsory requirement. On the issue of renegotiated debt, FRED 3 proposed recognising the gain on renegotiation based on market values of the debt from the period in which the renegotiation is concluded. Critics of the proposal argued that the deteriorated credit position of the company would increase the discount rate, leading to the perverse situation of inflated gains on renegotiated debt. In the light of this criticism, the ASB decided to re-address the issue at a later date.

Review

The five cases of standard-setting have provided examples of the parties involved in rulemaking in the UK. The standard-setting body and the audit industry are involved by definition. Despite claims and characterisations of self-regulation in Britain, company law also needs to be considered, especially in the wake of the EU's harmonisation initiative: for instance, the true and fair override had to be invoked to allow the revaluation of investment properties. The government is not always a passive bystander; indeed, the government has become involved in a number of controversial issues such as the debate on substance over form. Overall, however, the power of preparers over accounting policy agendas is striking. Be it investment properties, brand accounting or off balance sheet transactions, preparers have achieved at least partial success in pursuing their preferred treatment of accounting items.

CONCLUSION

After a long period of a predominantly *laissez-faire* approach to accounting regulation, it is possible that institutional arrangements have now been found which can ensure that the formulation of accounting rules is recognised as a more public rather than a purely private endeavour. Although the ASB is still relatively new and has still to operate without the crusading zeal of its founding chairman, within its relatively short history it has started to make accounting rulemaking a more visible, thoughtful and accountable process in the UK. Although changes in the capital markets and shifts in political power could put added pressures on the accounting rulemaking process, it seems unlikely that it will revert to its former *laissez-faire* state. Now that accounting regulation has received legal recognition, it seems more likely that pressures on the present institutional structure will result in even greater incorporation into the regulatory processes of the state or one or other of its agencies.

However, the current mechanisms are new. For most of its history the UK has adopted a very *laissez-faire* approach to accounting regulation. The rhetoric of order and standardisation has been far ahead of the reality. Particularly in European and wider international circles, the UK has tended to talk about a normative order that was only loosely coupled to the fluidity and diversity of practice. An institutionalised hypocrisy prevailed at home and abroad.

The increasing public nature of corporate and financial activity provided the basis on which such hypocrisy was called to account. At first a questioning media, and subsequently the rise of a more demanding state, created the context in which more regularised and visible modes of accounting regulation could prevail.

Still, the influence structure surrounding the regulatory process is a relatively confined one. Although there have been pressures for a wider public accountability of accounting rulemaking, the sphere of a legitimate public for corporate affairs is not a wide one in the UK. The interests of the financial authorities are recognised, as are related bodies of economic and financial expertise. But unlike many continential European countries, there is little or no role for any wider set of social interests, particularly in the present political circumstances. So trade union and consumer interests are minimal, as are those of the environmentalists and agencies of local government. Accountability and influence in the UK remain highly constrained processes, and that is unlikely to change in accounting or in other spheres of life.

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13 Accounting Regulation in Europe

Stuart McLeay

In the EU, it is required that financial information concerning a company be made available on a regular basis to its shareholders and the public at large. Indeed, the disclosure of such information in company accounts is regarded as a matter of public policy. In spite of this public interest, the process of regulating accounting is sometimes seen as merely a technical issue relying on informed analysis by experts in the field. In reality, however, there are also significant political implications concerning not only the balancing of interests of the different groups with a stake in the activities of companies but also the social effects of contestable accounting choices, including the economic consequences for wealth distribution, security of employment, and so on, as well as the level of public confidence in the corporate sector itself.

From time to time, the regulation of company financial reporting comes under intense public scrutiny, particularly when financial scandals hit the headlines along with claims that the rules in force have failed to provide proper accountability. But the process of formulating the standards and laws which govern corporate accounting is an ongoing one and not just a reaction to prominent corporate crises, and a variety of institutional frameworks have emerged in Europe to develop the rules and regulations of accounting. This book provides a timely analysis of such regulatory systems in eleven of the European countries which are member states of the EU.

The previous chapters show how the contestable nature of accounting policy-making draws it inevitably into the political arena. Research in accounting is already rich in political analysis and the issues arising have been problematised in a number of different ways. The traditional approach, which may be referred to as institutional analysis, provides an evaluation of the key aspects mentioned above: that is, the procedures adopted in formulating laws and standards and the organisation of the institutions which claim a legitimate authority in this respect. To be precise, institutional studies have been concerned primarily with the organisation of the regulatory system, although more recent research in this vein has addressed the way in which various issues reach the agenda, and how they are discussed and decided (see, for instance, Nobes, 1992; Power, 1992; Walker and Robinson, 1993; Klumpes, 1994).

Table 13.1 The analysis of accounting regulation

Approaches to political science	*Perspectives on political analysis*	*Applications to the study of accounting regulation*
Institutional studies	Evaluation of the rules, procedures and formal organisation of the political system	R. Walker and S. Robinson, 'Competing regulatory agencies with conflicting agendas', *Abacus* (1994)
Normative theory	Deduction of the available options in poltical relations	D. Solomons 'The political implications of accounting and accounting standard setting', *Accounting and Business Resarch* (1983)
Rational choice theory	Explanation of the political choices made by self-interested individuals, and the conditions for collective action	R. Watts and J. Zimmerman, 'Towards a positive theory of the determination of accounting standards', *The Accounting Review* (1978)
Radical political economy	Explanation of the way in which political forces shape the outcomes of the regulatory process, given that power and influence may be distributed disproportionately	D. Cooper and M. Sherer, 'The value of corporate reports: arguments for a political economy of accounting', *Accounting, Organizations and Society* (1984)
Discourse analysis	Structuring of social meaning to understand how political forces impose their ideas	P. Miller and T. O'Leary, 'Accounting and the construction of the governable person', *Accounting, Organizations and Society* (1987)

In addition to institutional studies of accounting regulation, a number of competing theories have been put forward. Normative theory is an attempt to deduce the available options in the form of a conceptual framework of accounting (Solomons, 1983). Rational choice theory attempts to explain the contribution to regulation made by self-interested individuals, and the conditions for their collective action (Watts, 1977; Zimmerman, 1977). Radical political economy examines the political forces which shape regulation when power and influence are wielded disproportionately (Cooper and Sherer, 1984; Tinker, 1984; Bryer, 1995) and discourse analysis provides an understanding of how political forces in conflict impose their ideas through the structuring of social meaning (Miller and O'Leary, 1987; Robson, 1993). Whilst the preceding chapters throw some light on these theoretical perspectives, their main concern is with the institutions and processes of accounting regulation.

THE INSTITUTIONS OF ACCOUNTING REGULATION

In order to provide an overview of the current state of accounting regulation in Europe, the main question we ask is, 'To whom has been entrusted the task of interpreting, preserving and developing accounting regulation in the countries involved?' A brief answer is that the situation appears to be as particular to each country in the European Union as it is elsewhere in Europe (Garrod and McLeay, 1996). In some cases, the legislature remains as the sole source of binding rules. In others, the legal power to issue accounting regulations is devolved to a government ministry or delegated to an agency, with the status of the requirements or recommendations set down by such bodies differing widely. Finally, in certain countries, self-regulating institutions representing accountants and auditors issue their own regulations in the form of standards or opinions, and there also exist active markets in the interpretation of the accounting regulations in force.

This diversity may appear surprising in the light of the lengthy programme of accounting harmonisation that has taken place in Europe over the past 25 years. However, whilst the directives of the EU impose an obligation on each member state to enact harmonised regulations, they usually enable national governments to accommodate local conditions: that is, although the approach to harmonisation relies on the implementation of detailed, standardised measures in all member states, and cooperation between national rule-makers, it also allows for the adaptation of regulatory goals to local preferences with mutual recognition of national solutions in some cases. However, the recognition of such differences between nations in their systems of accounting regulation does not overcome the significant trans-boundary effects which may arise. For instance, it has been suggested that if companies which bear the cost of regulation place pressure on government to reduce disclosure requirements then, once one government succumbs, the pressure on others will be greater and governments may become engaged in a 'race to the bottom' through deregulation. There is, however, a contrasting view which would claim that those companies which are motivated to disclose higher quality information in order to reduce uncertainty about their activities will seek to comply with the more exacting requirements. Whether the 'race' in accounting regulation is to the bottom or to the top is therefore an open question. In its ideal form, supranational regulation – such as that emanating from the European Parliament – has the potential to solve such problems. However, as noted above, the allocation of regulatory powers still remains very much a national concern. Even though the processes of accounting regulation may be converging, the institutional structures remain diverse, being greatly influenced by differing legal traditions.

Regulation by Legislation

A summary of the legislative instruments used in different European countries is given in Table 13.2. These vary considerably and include codified law, statute law, presidential and government decrees, ministerial orders and guidelines and national accounting plans.

At the heart of accounting regulation is commercial law. In seven of the eleven countries, a commercial code sets out in one volume all the laws relating to business, including accounting. These codes trace their origins to the consolidation of law that took place in German states such as Bavaria and Prussia in the eighteenth

Table 13.2 Legislative instruments in accounting

Member state	*Legislative instrument (in English:)*	*Translated from:*
Belgium	Law	*Loi (Wet)*
	Royal Decree	*Arrêté Royal (Koninklijk Besluit)*
Denmark	Law	*Loven*
	Ministerial Order	*Bekendtgørelsen*
France	Commercial Code	*Code de Commerce*
	Edict	*Ordonnance*
	Law	*Loi*
	Decree	*Decret*
	Accounting Plan	*Plan Comptable Général*
	Ministerial Order	*Arrêté*
Germany	Commercial Code	*Handelsgesetzbuch*
Greece	Companies Law	*Νόμος περι Ανωνύμων Εταιρειών*
	Books and Documents Code	*Κώδικυς Βιβλίων και Στοιχείων*
	General Accounting Plan	*Γενικό Λογιοτικό Σχέδιο*
Ireland	Companies Act	–
	Group Accounts Order	–
Italy	Civil Code	*Codice Civile*
	Law	*Legga*
	Legislative Decree	*Decreto Legislativo*
	Law Decree	*Decreto Legge*
	Ministerial Decree	*Decreto Minesteriale*
The Netherlands	Civil Code	*Burgerlijk Wetboek*
	Administrative Decree	*Besluit*
Portugal	Commercial Code	*Código Comercial*
	Law Decree	*Decreto-lei*
	Official Accounting Plan	*Plano Oficial de Contabilidade*
Spain	Commercial Code	*Codigo de Commercio*
	Law	*Ley*
	Royal Decree	*Real Decreto*
	General Accounting Plan	*Plan General de Contabilidad*
	Ministerial Order	*Orden Ministerial*
UK	Companies Act	–

Note: Accounting plans are usually issued not as legislative instruments in their own right but annexed to an enabling decree.

century (Ebbers and McLeay, 1997), and to the French *Code de Commerce* which, although initially a product of the revolution, was issued by Napoleon's Tribunat in 1807. Based on the French model, commercial codes became established in a number of European countries during the nineteenth century, firstly in the Netherlands (the *Wetboek van Koophandel* of 1810), Spain (the *Codigo Commercio* of 1829), and Portugal (the *Código Comercial* of 1888), and also in the newly unified nations of Germany (the *Handelsgesetzbuch* of 1861) and Italy (the *Codice Commerciale* of 1882). In each of these countries, codified law tends to be revised at fairly long intervals, usually by means of a facilitating law enacted by the legislature. In the remaining countries covered by this book (the UK, Ireland, Denmark, Belgium and Greece), parliamentary law is also the main form of legislation which has regulated the activities of companies, but it takes the form of statute law. In this case, the first Acts bearing substantially on company affairs were the 1844 Joint Stock Companies Act in Great Britain (the UK and Ireland), the Danish *Firmaloven* of 1862, the Belgian *Loi sur les Sociétés* of 1873 and Greek Companies Law of 1920.

In four countries, a general accounting plan also exists as a supplement to codified commercial law. The countries involved are France, Spain, Portugal and Greece, and their national accounting plans set out detailed, mandatory regulations governing the accounts to be maintained, the methods to be adopted in recording transactions and valuing assets and liabilities, and the form and content of financial statements. In Germany and Italy, where accounting regulation also takes the form of codified commercial law but where there is no national accounting plan, standardised charts of accounts have been published by professional or industrial associations and are often adopted by companies. In fact, Germany was the first country to introduce a national accounting plan, the *Reichskontenrahmen*. This was introduced in 1937, but was discontinued when the German Reich was dismantled. During the occupation of France, however, a French version was developed from the German model, and this led to the *Plan Comptable Général* (PCG) which was eventually approved in 1947, extended in 1957 and modified again in 1983. The national accounting plans of the other three countries were greatly influenced by the 1957 version of the PCG, giving rise to Spain's *Plan General de Contabilidad* of

1973 (revised in 1990), Portugal's *Plano Oficial de Contabilidade* of 1977 (revised in 1989 and 1991) and Greece's General Accounting Plan of 1980.

The use of decree law is found in a number of countries, the authority to issue a decree sometimes being devolved to the level of a specific government department. Ministerial orders are also employed in the field of accounting regulation. Decree laws and ministerial orders have provided respective governments with the opportunity to issue accounting regulations in greater detail and with greater speed than has been permitted in the case of parliamentary legislation, and also in conjunction with other measures such as fiscal reform. For instance, for many years, France, Italy, Spain, Portugal and Greece saw a series of decrees either granting permission or making it obligatory to revalue the assets in company accounts for tax purposes in accordance with official price indices. Thus decrees and orders have been used to introduce a degree of flexibility into predominantly legal systems of accounting regulation.

The implementation of the Fourth and Seventh directives is interesting in this respect. In only two member states, Germany and the UK, were virtually all of the requirements set out in laws enacted by the legislature, in Germany's *Bilanzrichtliniengesetz* of 1985 and the UK's Companies Acts of 1981 and 1989. In France, Spain and the Netherlands, the principal provisions were enacted by law and the remaining details were filled in by decree, although following a different pattern in each country. In France, the main requirements of the Fourth and Seventh Directives were presented in two laws, on 30 April 1983 and 1 March 1985 respectively, and the details were provided shortly afterwards in each case by decree, on 29 November 1983 and 17 February 1986. In Spain, the commercial code was amended in one major reform, by Law No. 19 of 1989, which was followed by Royal Decree No. 1564 of 1989 with respect to the Fourth Directive and Royal Decree No. 1815 of 1991 regarding the Seventh Directive. In the Netherlands, the main provisions of both directives were enacted through Law No. 663 of 1983 and, in the same year, detailed regulations on formats were contained in Decree No. 665 and on valuation matters in Decree No. 666. In Denmark and Ireland, there was a movement from statute to ministerial order in between the implementation of the two directives: that is, the Fourth Directive was implemented by law in each country (the *Årsregnskabloven* of 1981 and the Companies Act of 1986) whilst the Seventh Directive was implemented by ministerial order (through the *Årsregnskabsbekendtgoerelsen* in Denmark and the Group Accounts Order in Ireland). In the remaining countries (Belgium, Greece, Italy and Portugal), both the main provisions of the directives and the detailed regulations were introduced by decree, either based on previous law which gave the government the necessary authority or subsequently ratified by the legislature.

In spite of the use of more flexible legislative instruments, accounting regulation still appears to fit uneasily with law in a number of countries. This is not surprising if we consider the broader context, as law that is intended to command on the basis of sovereign power has been supplanted progressively by the discipline of institutions which influence conformance with social norms. Indeed, in many walks of life, law can no longer be taken readily as the sole model or code. Thus, in accounting, reliance on a general plan, statute law or commercial codification as the primary source of mandatory rules either has been abandoned or is under threat, even in countries where decrees and orders have been used to provide flexibility. The creation of a new two-tier framework in France and an accounting standardisation commission in Germany reflect the pressure to find alternatives to the use of formal legislative instruments in accounting regulation, although it must be noted that the creation of these new regulatory bodies can also be interpreted as a means of strengthening the authority of law.

Regulation by Delegation, and Self-Regulation

The delegation of accounting regulation to standardisation commissions or standard-setting bodies can be seen as part of the search for regulatory effectiveness, and there also exist private bodies which pursue a policy of self-regulation without necessarily receiving official acknowledgement.

The principal bodies which act as accounting rule-makers in Europe are listed in Table 13.3, along with other details.

Table 13.3 The status of standard-setting bodies

Status	*Member state*	*Institution*	*Form*	*Regulatory instruments*
Legal status following approval by the government	France	Conseil National de la Comptabilité, now in a support role for the Comité de Réglementation Comptable	Public	Avis
	Spain	Instituto de Contabilidad y Auditoría de Cuentas*	Public	Resoluciones
	Portugal	Comissão de Normalização Contabilística	Public	Directrizes Contabilísticas
	Germany	Deutsche Standardisierungsrat	Hybrid	
The law requires compliance	UK	Accounting Standards Board	Hybrid	Financial Reporting Standards
	Greece	ΕθνικόΣυμβού λιο Λογιστικής – National Council of Accounting	Public	Opinions
There is official recognition but not in law	Netherlands	Raad voor de Jaarverslaggeving	Hybrid	Richtlijnen
The only recognition is that the stock exchange requires listed companies to comply	Italy	Commissione per la Statuizione dei Principi Contabili	Private	Principi
	Denmark	Regnskabspanelet†	Private	Regnskabsvejledninger
	Ireland	Accounting Standards Board	Hybrid	Financial Reporting Standards
The audit profession requires compliance, but not endorsed by a public institution	Belgium	Commission des Normes Comptables (Commissie voor Boekhoudkundige Normen)	Public	Bulletins

* In Spain, an independent body (AECA) issues standards.
† A second body, the Regnskabsrådet, is also in existence.

The first standardisation board was established in France in 1947. As a public agency, it is still funded entirely from the state budget. Now known as the *Conseil National de la Comptabilité* (CNC), its recommendations (*avis*) have had legal status but its future is as a body subservient to the new *Comité de Réglementation Comptable*. In three other countries, the development of accounting regulation is also solely in the hands of a public agency. These were established by law in Belgium in 1975, Portugal in 1977 and Greece in 1988. The Belgian *Commissie voor Boekhoudkundige Normen* (CBN) issues its official pronouncements under the title of *Bulletins*, but these have no legal standing. The CBN's main role is in delivering an opinion to government in the process of drawing up law. In Portugal, on the other hand, the *Comissão de Normalização Contabilística* issues regulations with legal status under the title of *Directrizes Contabilísticas*, and the opinions of the Greek National Council of Accounting also have legal backing as compliance with the opinions is required by law. In both Portugal and Greece, as in France and Spain (see below), the existence of a national accounting plan has given rise to an agency to which some power is delegated.

The standardisation process is in the hands of quasi-regulators in two European countries (the Netherlands and the UK), where a standard-setting board is more strongly influenced by the audit profession but where there is also some state involvement. In Spain and Denmark, by contrast, the process of developing accounting rules and regulations is shared between two separate bodies in each country, one being a private institution concerned with professional standards and the other being a public agency charged with the interpretation of the law.

The first British standard-setter was established in 1970 by the professional bodies in England and Wales, Scotland and Ireland. Now the Accounting Standards Board (ASB), governed by a Financial Reporting Council (FRC), the ASB issues Financial Reporting Standards (FRSs) with which UK companies are required to comply. Although the law only requires that companies should provide an explanation if their accounts are not prepared in accordance with applicable accounting standards, the ASB was prescribed as the relevant standard setting body in this respect under a Statutory Instrument in 1990. The UK government now pays about one third of the costs of the ASB, and Ireland has been left in an odd position in this respect as it does not contribute directly to the funding of the ASB although it is involved in its workings. Nevertheless, it is to be noted that Irish company law does not require compliance with FRSs. In the Netherlands, where the forerunner of the *Raad voor de Jaarverslaggeving* (RJ) was set up by the audit profession in 1971, the state also provides financial backing, meeting about two-thirds of the RJ's expenditures. However, no official recognition is given to the RJ's standards, known as *Richtlijnen*.

As mentioned above, in addition to a regulatory strategy whereby the state participates with the private sector in the funding of accounting regulation, an alternative exists in Spain and Denmark where private and public sector bodies operate side by side. In Spain, the state regulatory agency is the *Instituto de Contabilidad y Auditoría de Cuentas* (ICAC). A predecessor was established by law in 1965 with the purpose of updating the standardised national accounting plan. ICAC sets down regulations under the title of *Resoluciones*, which have legal standing. (In fact, ICAC's standing was under dispute until a recent successful appeal, as the superior court of justice in Spain had declared in 1994 that only Parliament and Ministers may issue rules that are binding). With regard to the private association, the *Asociación Española de Contabilidad y Aministración de Empresas* (AECA), this was set up in 1979 by the audit profession to introduce accounting standards and it would appear that a close and productive working relationship has developed between ICAC and AECA. In Denmark, the *Regnskabspanelet* (RP) was created by the audit profession in 1988, although under a different name to begin with. Danish Accounting Standards are approved by the RP, although they are still formally issued by the audit profession's own institute, the FSR. The state-funded *Regnskabsrådet* (RR) was established more recently, apparently because of some public dissatisfaction with the functioning of the RP.

The remaining countries are Germany and Italy. In these countries, the legal process is dominant. Indeed, in Germany, although the audit profession is represented internationally by the *Institut der Wirtschaftsprüfer*, there was no standardisation board nor standard-setting body until 1998 when the *Deutscher Standardisierungsrat* was founded, and the only requirement on companies in preparing their accounts has been that they comply with the law. In Italy, although the *Commissione per la Statuizione dei Principi Contabili* was founded in 1975 by the audit profession and has issued its own recommended principles, it is again the case that the only requirement on an Italian company is that its accounts be prepared in accordance with the law. In Germany and Italy, as in the other countries examined in this book, the final word on whether a company's financial statements comply with the legislation lies with the courts of law.

Courts of Law, and Conflicting Regulations

Legal disputes over accounting issues come before a variety of courts, including administrative courts, civil courts, criminal courts and tribunals. In fact, in the Netherlands, cases are taken to a court that is dedicated to accounting matters, the *Ondernemingskamer*. Elsewhere, the regulatory framework for accounting incorporates other forms of legal review that are specific to accounting issues but quasi-judicial in nature, such as the Committee for the Resolution of Accounting Disputes in Greece and the Financial Reporting Review Panel in the UK. Finally, where law that is derived from European directives is concerned, cases may be resolved in an international court. In this context, a case was passed from the German High Court to the European Court of Justice in 1996 (*Gebrüder von Wettern*), the first case on accounting to reach that level, the issue at stake being the interpretation in German law of the realisation principle established in European law (Ordelheide, 1996).

Clearly, the role of the courts and quasi-judicial bodies referred to above is not only to consider the evidence relating to breaches of the law with a view to its enforcement, but also to disentangle the complex sets of regulations which sometimes are in conflict. Such conflicts in law have not been uncommon, particularly in the context of tax law and accounting law, where companies have sometimes faced the dilemma of choosing between different accounting treatments in the knowledge that either choice may lead to a breach of one or other regulations. In such circumstances, the very basis of accounting policy choice becomes that of minimising potential non-compliance penalties. Generally speaking, however, the influence of tax law on financial reporting has diminished, and with it the need to take heed of the tax regulations when preparing financial accounts. In the meantime, other conflicts between regulations have become apparent. For instance, whilst the Spanish legislature has removed conflict in law by ruling that tax law and company law are mutually independent, there still appear to be inconsistencies between company law and the national accounting plan (with regard to debt redemption premia, for example).

Conflicting regulations can also occur in other circumstances, particularly between law and standards. Apart from inconsistencies in accounting treatments, the conflict in law can arise from differences in the speed with which internationally agreed rules and regulations are implemented. For instance, the ASB's standard for subsidiary undertakings (FRS2) was in conflict initially with the definition of a subsidiary in Irish company law, although not in UK law. As a result, Irish companies were exempted from compliance with FRS2 until relevant legislation had been enacted. This potential for conflict in law and other regulations, both within countries and between countries, is an important consideration in the design of systems of accounting regulation.

Regulating the Regulators

Most of the regulatory bodies discussed above have already been provided, to one extent or another, with legal powers to fulfil their obligations. If they are unrestricted, the powers which regulatory agencies can manipulate are manifold. Indeed, although legal restrictions may prevent an agency from going so far as to waive observance of the law, an agency could readily refrain from exercising its full authority by, for instance, forgoing regulation in exchange for degrees of compliance. This ability to regulate at the border of its authority may be preferred to full legal action (for example, by gaining immediate compliance on essential issues), but a question that arises nevertheless concerns the manner in which the state agencies and other bodies involved in developing Europe's rules and regulations of accounting are themselves controlled.

One way of regulating the regulator is through the exercise of a veto, as in the USA. In the Securities Act of 1934, Congress delegated authority over accounting standards to the Securities and Exchange Commission which in turn delegated the preparation of accounting standards to a series of privately funded organisations, the current one being the Financial Accounting Standards Board. An integral part of the present arrangement is the retention of veto power by the SEC. In Europe, a more cosy arrangement seems to exist in some cases. Nevertheless, with the recent developments in France and Germany, the legislature appears to have retained substantial control over the operations of the delegated agencies. Generally, however, the legitimacy of agency delegation is seen to rest on the assignment of sufficient authority, institutional competence and, last but not least, due process. We turn to this last element in the next section.

DUE PROCESS AND THE ROLE OF SPECIAL INTEREST GROUPS

Rule-making often reflects the influence of special interest groups rather than general preferences. Indeed, rule-makers are more than likely to be receptive to the influence of special interests as the latter possess information on the technical details of the regulation. Whilst, on the one hand, accounting rule-making bodies may endeavour to correct the imbalance between special interest groups and general preferences and to accommodate any strategic behaviour, they are also prone to capture by those whom they are constituted to regulate (Walker, 1987), and their goals become synonymous with the goals of the regulated. That is, a rule-making body tends to seek acceptance from its constituency by adapting its position in its efforts to achieve institutional legitimacy. In these circumstances, it would be rational to accommodate the strongest wishes of the constituency when this enhances the rule-making body's acceptability without impairing its integrity.

Representation on accounting regulatory bodies in Europe tends to vary, but the differences between the various types of delegated agency and standard-setting bodies (see Table 13.3), and the different approaches to lawmaking, make it difficult to provide a direct comparison between countries. Across the countries involved, the representatives include: (i) appointees of government departments, often the Ministries of Justice, Finance and/or Economic Affairs (depending on the mode of delegation), but also those with more specific responsibilities, such as the Ministries for Small Business, or State Holdings, or the national audit office or statistics bureau; (ii) banking authorities and tax authorities, either in their own right or through the relevant government department; (iii) representatives acting on behalf of auditors, accountants, lawyers and tax consultants, generally the associations with legal responsibilities in those areas; (iv) preparers of financial accounts, in the form of employer federations, industry associations, chambers of commerce and associations of financial executives; (v) stock exchanges, financial analysts and associations of banks, insurance companies and pension funds; (vi) associations representing employees, particularly trade unions; and (vii) academic experts. In certain cases, other parties with a narrower remit are also involved, representing utilities, shipping companies, leasing companies, agricultural enterprises, cooperatives and municipal authorities.

In practice, however, most of those who make representations when accounting rules are designed are either companies, professional associations or public accounting firms. Companies tend to lobby for accounting treatments which broaden their abilities to manage figures in the financial statements, such as reported income. Professional associations, on the other hand, seem to lobby for no change to the status quo, and public accounting firms seem to exercise less influence. However, the users of financial information are often absent from this process. One argument is that they are not motivated to contribute to collective action in order to influence financial information as the necessary action is undertaken by others who bear the cost, the benefits being enjoyed by all. Thus, if the users of financial information are free riders, a question central to the political analysis of accounting is therefore ‘Who benefits from accounting regulation?’

The supplier of such information would benefit by avoiding costly contractual arrangements. Even so, the burden of compliance costs may be distributed unevenly, with serious economic consequences. For instance, the costs of complying with accounting regulations may be proportionately higher for small firms than large firms. Another beneficiary is the auditor, whose risks may be reduced or whose fee income may rise. Whoever the beneficiaries are, one response to the imbalances involved is greater democratisation, by allowing national or supranational legislatures and delegated agencies to play a more decisive role in accounting rule-making, the process of rule-making thereby becoming more transparent.

The role of pressure groups can vary considerably from one national context to another. In its purest form, a pluralist society would be characterised by a degree of balance between the forces impacting on regulation, interest groups sometimes achieving their aims and sometimes not doing so. In this case, the regulatory authorities will tend to be highly responsive to pressure from any group. Yet it is also feasible for certain pressure groups to have privileged access and therefore greater influence, a position which can be maintained indefinitely when they are highly resourced. Indeed, a degree of bias can enter into the process whereby certain pressure groups are largely excluded from the rule-making process. At the extreme, when the regulatory authorities are dominated by certain privileged pressure groups, those who are excluded may develop alternative, more radical, forms of political behaviour (see Table 13.4).

The possibility that powerful groups may hijack the regulatory process, or that others may resort to alternative political methods as a result, is not far-fetched. When Spanish regulators refused to authorise price increases in order to absorb losses arising from the peseta depreciation, accounting requirements of the regulated industries in question were relaxed as an expedient, permitting the capitalisation of currency differences on debt used to finance the purchase of assets. Hence, a small group of albeit large companies were able to secure unduly favourable treatment. In a completely different context, and almost a century earlier, the Alberti scandal in Denmark revealed that a Minister of Justice who had continuously blocked legal reforms calling for greater disclosure was himself involved in covering up the systematic mismanagement of a bank in which he was personally involved.

This kind of struggle, between the majority and a privileged minority or between the forces for fuller accountability and those in opposition who rely on the rhetoric of 'competitive disadvantage' and 'burdensome costs of compliance', is still to the fore. In this

Table 13.4 The role of pressure groups

The position of pressure groups	*The position of the regulator*	*The regulatory strategy*
Pressure groups have varying resources but continual conflict between them leads to variation in the winners and losers (Classical pluralism)	The regulatory authorities react to pressure from all groups equally.	Due process is public and all relevant groups are involved
Certain pressure groups have privileged access but there is a role for others (Reformed pluralism)	The regulatory authorities are responsive to all pressure groups which, however, have differential influence	
Elite groups have privileged access but different elites dominate different policy issues (Elitism)	Certain pressure groups maintain a privileged position because they are highly resourced	
The influence of certain pressure groups is limited by structural power (Neo-pluralism)	The regulatory authorities are biased towards powerful pressure groups	
Excluded pressure groups develop alternative forms of political behaviour (Radical democracy)	The regulatory authorities are dominated by privileged groups	The power to draw up binding regulations is delegated to a subset of the regulated

context, a number of other instances that are discussed in detail in this book point to the overt politicisation of the accounting regulatory process at times; for instance; the disagreement between the Dutch parliament and the Minister of Justice with respect to the differing reporting requirements of 'open' and 'closed' companies (see p. 240); the apparent horse trading over the true and fair concept when the threshold figures for exemption were increased during the redrafting of the Seventh Directive (see p. 181); the left:right split in the Danish parliament over the definition of small and medium-sized enterprises (see p. 63); compromise over new insurance legislation in Belgium which led to a new draft in which disclosure requirements were substantially reduced in exchange for tacit agreement to comply with other provisions (see p. 38); and the rise and fall of the tax reconciliation statement in Italy under Berlusconi's government (see p. 222).

Some of these examples of political involvement in accounting regulation belong to an older order. Today, the politics of accounting regulation has much to do with the visibility of the process itself, and the mechanisms on which it relies. For example, in the Netherlands, publication of a pronouncement by the RJ must be backed by a five-sixths majority, with at least one vote from each delegation. This right of veto can be seen as a mechanism that ensures the existence of a search for consensus. Consensus-seeking is also evident, but with a less formalised structure, in the manner in which the Fourth Directive options were implemented in German law. In spite of the apparent domination of the process by the representatives of German industry, the probability that any pressure group might change the legislator's mind was seen to be far higher when more than one party put forward a similar proposal for amendment. In effect, consensus proved to be more important than the absolute power of a single constituency. The search for consensus, however, can also lead to compromise solutions which continue to favour minority positions. The Danish negotiators, for instance, brought the marginal costing principle into the Fourth Directive in such circumstances, thus allowing its continued application in Denmark at the time (in the meantime, standard practice has reverted to absorption costing). On the other hand, mechanisms designed to achieve a degree of consensus and limit compromise are also evident. For instance, consensus is deemed to emerge in the UK's Urgent Issues Task Force when the dissenting parties number no more than two out of 15 (or, more precisely, out of a quorum of 11), the ASB itself working on the basis of a two-thirds majority.

REGULATION OR BARTERING?

The effectiveness of laws and standards relies not only on mechanisms which secure a consensus, but also on those which provide for self-enforcement. In this respect, incentives to comply may be offered or other enforcement strategies may exist, either through law (for instance, disqualification from management) or professional discipline (for instance, withdrawal of a right to practice as an auditor). Enforcement will fail, however, in the face of the kind of regulatory unreasonableness that arises from the imposition of uniform requirements in situations where they do not make sense. For example, this is likely to occur when there are differences in the capacity to comply, or an overinclusiveness of the rules themselves. On the other hand, enforcement becomes redundant when companies avoid the law by complying technically with its requirements whilst still contravening its intentions, as in the case of off balance sheet financing where the regulator's dilemma is that new rules just invite new adaptations.

Although this book stops short of a detailed examination of compliance mechanisms, we can conclude that part of the reason for the regulatory dilemma in accounting is the traditional view of regulation itself: that is, that it is governed by an instrumental rationality whereby the law specifies goals and gives administrative agencies the power they need to work towards those goals. But much law neither commands nor forbids particular actions; instead, it provides a framework for bargaining. Indeed, most regulatory law has long since discarded the vision of pure substantive rationality. It has become a largely symbolic means of legitimising decisions reached through informal agreement as well as a means of integrating potentially disruptive ideas.

Now, bartering is gradually being instilled into the programme of European accounting regulation, allowing substantive regulation to be traded for cooperation in its enforcement. To take up a theme introduced previously in this chapter, the incorporation of bartering rationality into commercial law marks the end of an era when the state was seen as a superior body. The law, and accounting standards, have become flexible points of reference, the company no longer being seen as an object to be altered through the unilateral exercise of power but as a counterpart in this process. Cooperation, negotiation and bargaining are becoming an acceptable way of regulation in the accounting arena in many European countries.

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