

**WHITHER ACCOUNTING AND THE LAW?
A COMPARATIVE ANALYSIS OF THE SOURCES OF ACCOUNTING
AUTHORITY IN THE LIGHT OF INTERNATIONAL DEVELOPMENTS**

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1. Introduction

Accounting determinations generally have more obvious financial, fiscal, and economic implications than they have legal implications. However, lawyers practicing in the corporate and securities areas come into direct contact with accounting determinations in a variety of contexts. For example: (1) financial disclosures and the adequacy thereof; (2) financially based contract provisions such as earn-out provisions in acquisition agreements, restrictive covenants in loan agreements, and buy-out provisions in shareholders agreements; (3) dividend and stock repurchase limitations; and (4) regulations regarding the form and content of financial statements. Because of the variety of situations in which lawyers may be asked to determine the meaning of an accounting term or the application of an accounting principle, they need to be able to turn to a definitive source or set of sources of accounting authority. This is especially true as increasing numbers of corporations become multinational and as business and investment transactions become increasingly international in character.

This article will survey the sources of accounting authority in the United States, France, Germany, the United Kingdom, and Japan [1]. In addition, it will outline certain recent accounting developments in the European Economic Community, the International Accounting Standards Committee, and the United Nations Commission on Transnational Corporations. It then will pose and attempt to answer the following questions. (a) Who should establish internationally applicable accounting principles? (b) What model, if any, should be used? (c) What role can the law play in either developing or implementing these principles?

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2. Survey of sources of accounting authority

2.1. *United States*

The number of sources of accounting authority in the United States is extraordinarily large and is divisible into the following categories: (i) state corporation law; (ii) federal securities laws administered by the Securities and Exchange Commission; (iii) pronouncements of national accountants' organizations; (iv) stock exchange rules; (v) federal, state, and local tax laws; (vi) special industry regulations; and (vii) pronouncements of international accountants' organizations [2].

(i) *State corporation law.* State corporation law naturally varies from state to state and is an important source of accounting authority in only a few limited situations, e.g. where there is a question concerning the availability of "surplus" funds for dividend distribution. In most other situations state corporation law addresses accounting issues in too general a fashion to be of much use to either the accountant or the lawyer [3].

Courts have attempted to apply the state law to situations other than those concerning "surplus" funds for dividends. However, these attempts have largely been unsuccessful and the result has been simply to thicken the shroud of uncertainty which already envelopes the state law in this area [4].

Thus, while state corporation law does provide a set of accounting standards which is useful in a few limited situations, it has not, on the whole, exerted much influence upon accounting or financial reporting.

(ii) *Federal securities laws administered by the Securities and Exchange Commission.* The federal securities laws, administered by the Securities and Exchange Commission (SEC) partially fill the vacuum left by state corporation law. They constitute a principal source of accounting authority for approximately 14,000 of the over two million corporate businesses in the United States [5]. These businesses, called "reporting companies", are of three types: (1) those which are listed on a registered exchange; (2) those which have had a registered public offering; and (3) those which possess at least \$ 1 million in assets and are owned by at least 500 shareholders.

The SEC is broadly authorized to regulate accounting principles and practices [6], the contents of financial statements filed with it [7], and both the qualifications [8] and the practices [9] of the accountants who certify those statements. In practice it makes its presence felt in a variety of ways: (1) accounting regulations [10]; (2) Accounting Series Releases; (3) annual reports to Congress; (4) formal administrative proceedings; (5) consent decrees in injunctive proceedings [11]; (6) informal staff conferences with corporate businesses and/or their auditors; (7) communications between the Chief Accountant and his staff and committees representing national accountants' organizations; (8) speeches made by SEC commissioners and staff (which disclaim official status but are nonetheless given weight

depending upon the speaker); and (9) testimony given before Congress and comments on or requests for legislation.

In its role as final arbiter of accounting principles and practices for reporting companies the SEC itself accords enormous deference to the views expressed by such national accountants' organizations as the Accounting Principles Board (APB) and its successor the Financial Accounting Standards Board (FASB). The SEC's basic position is that "... principles, standards and practices promulgated by the FASB in its Statements and Interpretations will be considered by the Commission as having substantial support, and those contrary to such FASB promulgations will be considered to have no such support" [12]. Thus, direct conflicts between the SEC and national accountants' organizations are kept to a minimum. However, those which do occur are often dramatic and lend insight into the interrelationship between the private and governmental groups which try to influence the development of accounting principles and practices.

One conflict that occurred between the SEC and the APB is a particularly interesting illustration of the interrelationship among factors that affect accounting and the dynamics of the relations between accounting organizations and the SEC. It arose in the area of treatment of investment tax credit and involved the Revenue Act of 1962 [13]. The Act provided that companies that purchased new depreciable assets other than buildings could reduce their income tax liability in the year of purchase by up to 7 percent of the asset cost. This provision quickly became the subject of controversy between those favoring the "flow-through" approach (*i.e.* tax deduction applied against accounting income in the year of the tax benefit) and those favoring the deferral normalization approach (*i.e.* spread of the tax benefit throughout the useful life of the asset). The APB opted for the latter approach. The SEC, however, issued an Accounting Standards Release that accepted either approach. Two years after the issuance of this Release, the APB retreated and approved the use of either approach [14].

Yet another interesting and more recent conflict arose between the SEC and the FASB, this one in the area of accounting requirements for oil and gas producing companies. FASB Statement no. 19 (1977) made mandatory the use of the so-called "successful efforts" method of accounting. Accounting Series Release no. 257 (1978) permitted the use of the FASB method or, in the alternative, the use of a prescribed form of the full cost method. It also indicated that the SEC was considering replacing both methods with one based upon "reserve recognition accounting". The conflict was resolved when the FASB, recognizing that the SEC had sawed off the limb upon which it was sitting, suspended its Statement 19 [15].

(iii) *National accountants' organizations.* The accounting profession in the United States takes an active role in the development of accounting principles and practices. It boasts three major organizations that work both independently of and in conjunction with one another and other sources of accounting authority such as the SEC and the various stock exchanges. Altogether these accounting organizations comprise a widely recognized source of accounting authority for all types of corporate businesses in the United States.

The oldest of these organizations, the American Institute of Certified Public Accountants (Institute), was founded in 1887 but did not begin to reach general agreement on accounting principles until approximately 1915, when it approved a list of accounting terms and definitions [16]. Thereafter, it took various other steps. In 1918 it prepared a pamphlet entitled "Approved Methods for the Preparation of Balance Sheet Statements" [17]. In the 1930s, following the stock market crash, it began a cooperative effort with the New York Stock Exchange, which continues to this day, to improve financial disclosure to shareholders [18]. Later, in 1939, it began to issue formal pronouncements called Accounting Research Bulletins [19].

The Institute's authority derives from the "soundness of its reasoning and the prestige of its members" [20]. Its pronouncements are not laws, but "it is a brave man in the accounting profession who is willing to take on the task of justifying a disregard" of them [21]. Where its authority has been most feared, there have been attempts to prevent it from making pronouncements. In one notable case [22], arising out of the application of ARB no. 44, Appalachian Power Company sought to delay the distribution of a letter the purpose of which was to discredit one of Appalachian's accounting practices. It sought the delay on two grounds: first, that the Institute failed to follow proper procedure in the distribution and, secondly, that because of the Institute's authority in the accounting profession and in the business community, release of its letter would impair Appalachian's credit and limit its growth. The court, in finding for the Institute, affirmed the Institute's authority:

This court may not dictate or control the procedures by which a private organization exercises its honestly held views . . . every professional body accepts a public obligation for unfettered expression of views and loses all right to professional consideration, as well as utility if its views are controlled by other criteria than the intellectual conclusions of the persons acting [23].

The second of the three major accounting bodies in the United States was the Accounting Principles Board (APB). It was founded in 1959 for the purpose of developing a broad framework of accounting principles but never completed its task. The part-time status of its members, disagreements among representatives from the so-called "Big Eight" accounting firms [24], and pressures from clients, Congress, and the SEC contributed to its demise in 1973. Nonetheless, during its existence it did exert a strong influence upon the accounting world. The Institute, for example, declared that departure from APB pronouncements must be disclosed either in the auditor's reports or in the footnotes accompanying the financial statements and must have substantial authoritative support. If such support were absent, it declared, the reports must be qualified [25].

During its short life span, the APB incited considerable controversy in the accounting world. Issuance of its pronouncements concerning two subjects (pooling versus purchase accounting in mergers and the treatment of goodwill), for instance, resulted in a re-examination of procedures by which accounting bodies may issue

pronouncements [26]. This re-examination took place in 1971 and was known as the Study on Establishment of Accounting Principles. Conducted under the supervision of ex-SEC Commissioner Francis M. Wheat, an attorney, it concluded that what was really needed was a full-time, independent board with substantial research and administrative back-up [27].

Accordingly, the third of the major American accounting bodies, the Financial Accounting Standards Board (FASB) was founded in 1972. It is composed of seven full-time members, four of whom are practicing certified public accountants; an advisory council provides it with a full-time research staff.

Thus far, the FASB has issued thirty-six pronouncements, called "Statements", and it has a large number of exposure drafts outstanding. It has made substantial progress on most of the accounting issues it has dealt with but has only very recently reached even a partial conclusion as to the important issue of inflation accounting.

In late 1978 the first definitive fruits of an effort begun in 1973 to develop a conceptual framework for financial accounting and reporting were produced by the FASB [28]. In its Statement of Financial Accounting Concepts no. 1, it asserted that financial reporting should be directed to investors and creditors, that the main focus should be on earnings (although cash flow information is also important), and that objectives of financial reporting change with the economic, political, legal, and social environments [29]. SEC reactions to the activities of the FASB have been favorable, as indicated by such statements as that of SEC Chairman Williams:

[T]he Board has not limited its scope to financial statements, but rather has wisely elected to define its task in terms of financial reporting in general. . . . [J]ust as significantly, the exposure draft reflects the philosophy that financial information is not simply a record of past occurrences, but is equally of value in enabling users to assess the future [30].

While it is evident that national accounting bodies, taken individually or as a group, comprise a broadly based, widely recognized, and highly respected source of accounting authority, the United States Congress has questioned the propriety of the profession's participation in the development of accounting principles and practices. In 1977 and 1978 the SEC was requested to provide a report to Congress about self-regulation in the accounting profession. That report, made in 1978 [31], stated that the profession's self-regulatory program needs improvement but is moving along well enough not to need government interference. A second report, made in July of 1979, stated that the SEC retains its 1978 position [32].

In response to Congressional criticism the Institute established, in 1977, a CPA Firms Division, which consists of an SEC Practice Section for auditing firms whose clients are regulated by the SEC and a Private Practice Section for firms whose clients are privately owned. The heart of the Institute's self-regulatory program is the peer review program for SEC Practice Section members in which each member is to be reviewed by another firm over a three-year cycle. However, the program is

not without problems. European branches of United States accounting firms are fearful that such peer review might expose highly confidential files of non-United States clients.

(iv) *Stock exchange rules.* Though there are several stock exchanges in the United States, the most influential one in the area of accounting has been the New York Stock Exchange (NYSE). As early as the 1930s it joined the American Institute of Certified Public Accountants in a quest for methods to improve financial disclosure to shareholders. It adopted the Institute's proposals for certain general principles of accounting to govern financial statements and, after conducting a survey among its listed companies, determined that such principles are "so generally accepted that they should be followed by all listed companies . . . [and] any departure therefrom should be brought expressly to the attention of shareholders and the Exchange" [33]. Thus was born the familiar expression "generally accepted accounting principles".

For the most part, however, the Exchange has been relatively inactive in its role as a source of accounting authority. Rather, it defers to pronouncements made by accountancy bodies and by the SEC. In fact, while the NYSE Manual does have a section on financial statements, it does not go beyond the requirements that the SEC establishes for reporting companies [34].

(v) *Federal, state, and local tax laws.* The federal Internal Revenue Code is the only body of tax law that applies throughout the United States and so has a greater effect upon the development of accounting principles and practices than either state or local tax laws. Its central requirement is that the method of accounting selected for use by the taxpayer reflect "the consistent application of generally accepted accounting principles" [35]. So long as it does so the Code will regard it "as clearly reflecting income" [36].

In addition to this central requirement, the Code establishes special methods of accounting for tax purposes in such areas as depreciation, investment tax credit, research expenditures, and loss carry-forwards. While these special methods do not generally affect accounting for financial reporting purposes, there are occasional instances in which they do. For example, Sections 46(f) and 167(e) have just this effect in the public utility industry.

(vi) *Special industry regulations.* Special industry regulations are a source of accounting authority for regulated industries, such as public utilities. They are promulgated by both the state and federal governments and affect accounting in the form of uniform systems of accounts. State governments were the first to establish these systems [37] but the federal government entered the scene by means of growing numbers of regulatory agencies. Included among these are the Federal Power Commission and its successor, the Federal Energy Regulatory Commission; the Federal Communications Commission; the Interstate Commerce Commission; and the Civil Aeronautics Board.

Conflicts between these various federal agencies and the states are minimized by provisions such as Section 301(a) of the Federal Power Act, which provides that

compliance with federal law does not relieve companies from their obligation to adhere to state accounting requirements. The courts also act as watchdogs. In *Appalachian Power Co. v. FPC* [38], for example, the court considered the inter-relationship among accounting requirements imposed by the SEC, the Uniform System of Accounts established by the Federal Power Commission, and state utility commissions and financial reporting requirements. It held that:

(1) a corporation can have “only one set of basic corporate books which reflect its actual financial condition”;

(2) utilities subject to FPC jurisdiction must follow its Uniform System of Accounts;

(3) state utility commissions are not thereby precluded from requiring accounts to be stated in a certain way in rate determinations “as long as differing state accounts are subordinated to and do not obscure the presentation of the accounts prescribed by the [FPC]” [39];

(4) companies that are subject to both SEC 1935 Act jurisdiction and FPC jurisdiction must conform to the FPC’s jurisdiction except where otherwise authorized by the SEC.

The relationship between the Uniform System of Accounts and generally accepted accounting principles has been the subject of study by accountancy organizations as well. The FASB, for example, is presently examining the issue. Its predecessor, the APB took the following position:

The financial statements of regulated businesses other than those prepared for filing with the government for regulatory purposes preferably should be based on generally accepted accounting principles (with appropriate recognition of rate-making considerations . . .) rather than on systems of accounts or other accounting requirements of the government [40].

In sum, the development of accounting principles and practices in the United States is characterized by multiple sources of authority. These sources conflict at times but ultimately they work reasonably well together because everyone is given ample opportunity to comment, significant resources are applied by the government, accounting organizations and industries, and accounting issues are litigated occasionally in the courts [41].

2.2. France

The principal source of accounting authority in France is the *Plan Comptable Général (Plan)*. It was drafted by the Ministry of National Economy (now, the Ministry for Economic Affairs) to facilitate national economic planning and is basically a uniform system of accounts. It was, at first, applied only to companies that were owned or subsidized by the national government but has since, by means of various governmental decrees, been applied to all companies [42]. Particular industry needs are met by a fine-tuning of the *Plan* for the given industry [43]. The

Conseil National de la Comptabilité, a body operating under the auspices of the Ministry for Economic Affairs, works with professional committees for each industry to devise guides based upon the *Plan*.

The *Plan* is linked to tax and financial reporting by means of various government decrees. Decree no. 65-968, for example, requires that all business enterprises — except banks, insurance companies, and certain other regulated industries — file their tax returns on printed forms that substantially follow the *Plan*. Decree no. 65-999 requires that financial disclosures to shareholders conform to tax reporting.

Another source of accounting authority is the *Commission des Opérations de Bourse* (COB). This source is the body that administers the securities laws and thus affects mainly those companies that are listed on the Stock Exchange and have made public offerings of their securities. It does not actually promulgate accounting principles but it does control the information given to investors in stock sales, the annual reports issued by listed companies, and investigates company accounts. In addition, it monitors the work of accountants and auditors by exerting its control over their qualifications and practices [44].

With government pre-emption in the area, the accounting profession itself plays merely an advisory role in the development of accounting principles and practices. However, it is active in the area of auditing standards. It participates, for example, in the *Ordre des Experts Comptables et des Comptables Agréés*, the top accounting organization in France which, along with representatives of the Ministry of Justice, the COB, the tax administration, and the Stock Exchange, has published recommendations on a variety of auditing standards.

2.3. Germany

The principal source of accounting determinations in Germany is the 1965 Stock Corporation Act [45]. Part Five of the Act is especially important since it contains a comprehensive description of the financial reporting requirements for corporations, including forms for the balance sheet, profit and loss, and other financial statements. It is not, however, a strict uniform system of accounts. Corporations are permitted to deviate from the statute's forms and classifications if the type of business involved so requires [46].

Essentially, the act requires the use of one specific type of balance sheet and profit and loss account and it provides specific valuation rules [47]. Annual financial statements must “conform to proper accounting principles . . . [,] be clear and well set out and give as true a view of the [company's] financial position and of its operating results as is possible pursuant to the valuations provisions” [48].

Tax law is another important source of accounting authority in Germany. It relies primarily upon a comparison of balance sheets and so valuations of items contained therein are all-important. As a consequence, detailed valuation rules are supplied. Profits shown in the tax accounts in excess of those in the commercial

accounts are not permitted to be distributed and are subject to a higher rate of taxation.

The Commercial Code is yet another source of accounting authority and applies to all business enterprises, not just corporations. It requires that all businesses maintain accounting records in accordance with the principles of proper bookkeeping [49]. It does not, however, define what exactly constitutes "proper bookkeeping" and so is necessarily supplemented by the 1965 Stock Corporation Act and the tax law.

While the German system does not require a uniform system of accounts in the manner of the French *Plan Comptable Général*, many trade associations and industrial federations voluntarily promulgate uniform charts of accounts for their members. Indeed, the Federation of German Industries has gone so far as to provide a comprehensive general uniform plan of accounting, suggested for use by all trade and industry groups that do not have such plans of their own [50]. It may be said, however, that such uniform systems of accounts are a remnant of the 1937 law of Nazi Germany which made the use of uniform accounting mandatory [51]. That law was rescinded and effectively replaced by the less rigid approach of the 1965 Stock Corporation Act.

The accounting profession is a small but elite group represented by the *Institut der Wirtschaftsprüfer (Institut)*. The *Institut* publishes accounting commentary which is highly respected. However, it is not accorded as much deference as its American counterparts. For instance, its recommendation to give some current valuation as supplementary information has had little impact upon financial reporting.

2.4. United Kingdom

The principal source of accounting authority in the United Kingdom is the Companies Acts of 1948, 1967, and 1976. They prescribe the general form and content of the group accounts, balance sheets, profit and loss accounts, director's report, and auditor's report. In addition, they contain provisions related to the powers, qualifications, appointment, and resignation of auditors [52].

The Companies Acts are administered by the Department of Trade and Industry (DTI). Upon receipt of a substantial complaint, this body conducts investigations, appoints inspectors, and brings proceedings on behalf of stockholders [53]. With respect to accounting matters specifically, the DTI has authority to alter or to make additions to already existing financial statement requirements [54] but in so doing may not make them more onerous [55]. It does not promulgate accounting regulations and, absent a claim of malfeasance, does not ordinarily review financial statements or auditor-director reports that have been filed with it. Thus, the DTI in fact exerts relatively little influence upon accounting matters.

The accounting profession in the United Kingdom is the largest in Europe [56] and is organized into numerous bodies [57]. These take an active role in the devel-

opment of accounting principles and practices but are careful always to point out that their pronouncements "are not intended to be a comprehensive code of rigid rules" [58]. Their basic approach is to judge exceptional or borderline cases with regard to "the spirit of accounting standards as well as to their precise terms and to bear in mind the overriding requirement to give a true and fair view" [59].

The first pronouncements were made by the Institute of Chartered Accountants in England and Wales (ICAEW) in 1942, and were called "Recommendations". These were specifically stated to be nonbinding upon ICAEW members and were intended only to be "helpful to members in advising, in appropriate cases, as to what is regarded as the best practice" [60]. After instances of significant disparities among reports of public companies [61] in 1970, the ICAEW, in association with other major accountancy bodies, formed the Accounting Standards Committee (ASC) and began to issue Statements of Standard Accounting Practice (SSAP). These were intended to be more forceful than the Recommendations: "[W]here members act as auditors or reporting accountants the onus will be on them not only to ensure disclosure of significant departures but also, to the extent that their concurrence is stated or implied, to justify them" [62]. More recently, a committee established by the ASC under the chairmanship of Mr. Thomas Watts, a senior partner at Price Waterhouse and Co., concluded that accountants should continue to narrow the choices open to management by providing more definitive accounting principles. However, in keeping with the general approach, the committee conceded that given the self-regulatory nature of the profession, the standards could be established only by consent [63].

Another organization, the Consultative Committee of Accountancy Bodies (CCAB), was established in 1974 by representatives from six accountancy bodies. In 1976 it set up an Auditing Practices Committee but this committee has not yet promulgated any auditing standards. At present the CCAB is addressing itself to independence issues such as shareholdings in clients.

The Stock Exchange is a source of accounting authority for listed companies. These include most of the largest and constitute approximately 1 percent of the companies registered with the DTI [64]. As to these companies, the Exchange sets requirements that are designed to supplement the Companies Acts. For instance, it requires that listed companies furnish stockholders with a semiannual report to supplement the annual report already required by the Companies Acts [65]. It also imposes requirements for greater financial and other information with respect to prospectuses used in the offering of securities to the public [66].

On matters of accounting principles, the Exchange defers completely to the accounting profession's organizations: "The [Exchange] support[s] the accountancy bodies in the formulation of their Accounting Standards. Any significant departure therefrom must be disclosed and explained" [67]. But note that while this statement resembles SEC Release nos. 4 and 150, it must be remembered that, unlike the SEC (but like the New York Stock Exchange), the Exchange does not promulgate detailed regulations such as Regulation S-X and the Accounting Series Releases.

In 1978 there was created a new watchdog for the British securities industry, namely the Council for the Securities Industry (CSI). It is a self-regulatory organization and has a nineteen-member advisory board composed of three laymen plus representatives from most of the important City groups (pension funds, merchant and clearing banks, investment trusts, issuing houses, the Stock Exchange, the British Insurance Association, and the accountancy profession). The day-to-day work is accomplished by a markets committee that operates in conjunction with the quotations department of the Stock Exchange. The Take-over Panel continues as before, but under the umbrella of the CSI. At present the CSI is considering whether it will take any official interest in the matter of accounting principles [68].

Tax law has little effect upon accounting in the United Kingdom. Although profits for tax purposes are determined by reference to accounts prepared in accordance with recognized accounting principles, there are a number of adjustments required or permitted under the tax laws, for example in the area of rates of depreciation.

2.5. Japan

Accounting on the Western pattern was introduced into Japan in the nineteenth century but was not given real impetus until 1948, when United States occupation forces insisted on the passage of the Securities and Exchange Law (SEL) [69]. This law is based upon the securities laws of the United States and grants administrative authority to the Minister of Finance. Prior to enactment of the SEL, the Commercial Code (Code) [70] was the only law regulating the issuance of securities. It focused primarily upon the protection of creditors and granted administrative authority to the Minister of Justice. At present, both the SEL and the Code govern the promulgation of accounting regulations.

There is considerable interplay between these two sources of accounting authority. For instance, the Code's requirement that "fair and just accounting practices" be taken into consideration in the interpretation of its accounting provisions refers to the Business Accounting Principles upon which the Finance Ministry bases its Financial Statements Regulation [71]. In addition, inconsistencies in regulations issued by each source are generally reconciled by amendments [72].

The SEL and the Code also play roles in the area of auditing matters. Under the SEL, reporting companies must have their financial statements audited by independent (*i.e.* non-employee, officer or director) certified public accountants [73]. The Code requires all corporations with paid-in capital of Y 500 million or more to be audited by independent certified public accountants [74]. It requires all other corporations to have at least one statutory auditor to audit the business report, the financial statements, and certain other documents submitted to the shareholders. If stated capital exceeds Y 100 million, the auditor must also audit the directors in the performance of their duties [75]. The statutory auditor is to be elected by the shareholders and need not be a professional accountant. However, he may not be an

employee, officer, or director of the company concerned [76].

Substantial development of auditing standards occurred in the 1960s, spurred on by a scandal during 1964–1965. In those years a number of corporations, including the large Sanyo Steel Company, went bankrupt or were liquidated. Investigation showed that false financial statements had been issued by Sanyo and a number of other companies and that auditing had been lax at best [77]. Consequently the Ministry of Finance tightened standards for reviewing registration statements and periodic reports [78]. The SEL revised its regulations so as to provide that, in addition to revocation or suspension for a false audit (whether by reason of intent or mistake), an auditor may also be liable, in some cases, for damages [79]. In addition, the Certified Public Accountants Law of 1948 was amended (a) to establish the Japan CPA Association with compulsory membership and self-regulatory powers and (b) to permit the formation of auditing corporations [80].

Audit results take the form of an audit report which outlines the scope of the financial statements and gives the auditor's opinion as to whether the financial statements fairly represent the results of operations and the financial condition of the corporation. It must state whether the financials are in accord with business accounting principles, whether they are consistent with reporting in prior years, and whether they are in accord with the Ministry of Finance Regulations [81].

The Ministry of Finance requires reporting companies to provide consolidated financial statements and to include in such statements the operating results of subsidiary companies with those of their parents. A drastic change in accounting practice in Japan, this requirement is designed to end the long-standing practice by Japanese companies of "window dressing" the parent company's financial results by pushing losses down into subsidiaries whose financial results were not reported [82]. However, affected companies, like their counterparts elsewhere, are presently exploring devices to avoid the result sought by the Ministry. For example, they are attempting to avoid consolidation by means of reducing their holdings in subsidiaries to below the 50 percent level [83].

Another source of accounting authority is the Business Accounting Deliberation Council (BADC). It is organized under the Ministry of Finance [84] and is responsible for promulgating accounting principles. It does so by issuing so-called Financial Accounting Standards for Business Enterprises (FASBE). These are then enacted into law by the Ministry of Finance.

Generally speaking, the Corporation Tax Law, the Special Taxation Measures Law, and their related regulations address questions concerning tax deductions and specify the methods that must be used in accounting for certain transactions in order to qualify for deductions. Most Japanese companies tend to follow these tax accounting methods in their financial statements [85]. It has been noted, however, that in a number of situations, this use of tax accounting (*e.g.* for special reserves under the Special Taxation Measures Law), does not result in a fair presentation [86].

3. Outline of source proposals

With the completion of the survey of sources of accounting authority it is appropriate to outline recent proposals advanced by the major international bodies concerned with issues related to accounting authority.

3.1. European Economic Community

The European Economic Community (EEC) is a source of accounting authority for each of its member states [87]. All safeguards instituted for the benefit of shareholders, employees, creditors, and other third parties must be equivalent in each of the member states.

Recently, the EEC issued its so-called "Fourth Directive" [88] which deals comprehensively with the form, content, and scope of company financial statements and with methods of valuation [89].

Generally, the Directive takes the German–French approach of prescribing the format of reports and the use of certain accounting principles, thereby considerably reducing the freedom of management and auditors to determine the way in which the financial statements are presented. On the other hand, the Directive also takes the United Kingdom approach of providing that, in exceptional circumstances, departures from the Directive will be permitted if these are necessary for the presentation of a "true and fair view" of the company's financial position and results of operations.

The Directive is designed to be implemented through legislation in each member state to the extent of any inconsistencies with the existing national law.

3.2. International Accounting Standards Committee

The International Accounting Standards Committee (IASC) was founded in June 1973 by representatives of professional accounting bodies in Australia, Canada, France, Germany, Japan, Mexico, the Netherlands, the United Kingdom and Ireland, and the United States. At present it has representatives from more than fifty-three nations. Its main objectives have been to "formulate and publish, in the public interest, standards to be observed in the presentation of audited accounts and financial statements and to promote their worldwide acceptance and observance" [90]. Thus far, it has promulgated twelve so-called international accounting standards [91].

The legal impact of IASC's Standards varies from country to country according to the actions at a national level of those countries whose accountancy organizations are IASC members. Some have deferred adoption until such time as the standards have gained international acceptance. Others deem themselves barred from adoption by already existing national statutes. Still others, desirous of adoption of the standards, are unable to force compliance with them because their

national accountancy organizations lack disciplinary power over members [92].

In the United Kingdom the various accountancy bodies support the use of these standards in three ways: (1) by means of assuring that accounts satisfy the standards, (2) by disclosing noncompliance, and (3) by assuring that action is taken against auditors who do not comply with the foregoing procedures [93]. While IASC's Standards do not override the provisions of either the Companies Acts or the Statements of Standard Accounting Practice (SSAP) promulgated by the United Kingdom professional bodies, auditors are required to disclose nonconformity with IASC Standards even when the standards conflict with the Companies Acts or SSAP [94].

In the United States adoption of these standards is made difficult by the fact that AICPA, the United States member of IASC, does not itself set accounting standards, but rather has delegated its authority to do so to FASB. FASB is not an IASC member and thus far has chosen not to adopt the IASC's international standards [95].

The International Federation of Accountants (IFAC), created in 1977 by representatives from more than fifty nations, complements the work of IASC in that its main purpose is to "initiate and guide efforts to achieve international technical, ethical and educational guidelines for the accounting profession". Its establishing agreement recognizes, in fact, that the objectives of the two organizations are "interdependent" and that the "closest relationship" should be maintained between them [96].

Exclusively within Europe there operates yet another accounting organization, the *Union Européenne des Experts Comptables Economiques et Financières* (UEC). This organization is active as to all aspects of the accounting profession in Europe and works toward coordinating the various activities of the European accounting profession. It has issued a number of draft "statements" intended to be persuasive, not mandatory, in nature. In addition, it has conducted a comparative study of professional education and has created both an Auditing Statements Board and a Technical Committee. It is not to be confused with the *Group d'Etudes des Experts Comptables de la CEE*, whose task it is to comment upon EEC draft directives that affect the accounting profession.

3.3. United Nations Commission on Transnational Corporations

In 1975 the United Nations Commission on Transnational Corporations formed a so-called Expert Group on International Standards of Accounting and Reporting. This group recommended the establishment of "international standards of accounting and reporting" [97] and implementation of these standards by means of intergovernmental agreement. Under such an agreement each government would commit itself to taking legislative action to mandate the standards for both transnational corporations domiciled in its country and national companies that are part of any transnational group, whether incorporated in that country or elsewhere [98].

The Group's specific recommendations may be summarized as follows.

(1) Transnational companies should prepare general purpose reports on the enterprise as a whole (*i.e.* consolidated) and member companies of the group, including the parent company, should prepare separate reports.

(2) Certain items of both financial and nonfinancial information should be reported, not only in the aggregate but in accordance with country and line of business.

(3) Nonfinancial reports should be required in the areas of labor and employment, production, investment programs, organizational structure, and environmental measures.

(4) Special reports to government and other special international groups should contain much information which would be of use on a broader basis, but the confidentiality of some of this information *vis-à-vis* the general public must be protected.

(5) In the interest of fair treatment for the transnationals, the international standards should apply to national companies not affiliated with a supranational company.

(6) The minimum size criteria suggested for applicability of the international standards are:

(a) for the enterprise as a whole:

(i) total assets over \$ 100 million (U.S. dollars),

(ii) net sales over \$ 100 million (U.S. dollars),

(iii) average number of employees, over 2500 during the period;

(b) for individual companies at the national level:

(i) assets over \$ 10 million (U.S. dollars),

(ii) sales over \$ 20 million (U.S. dollars) [99].

4. Analysis

The internationalization of accounting principles and practices is a slow, deliberate process. Accountancy organizations move cautiously and openly, adhering to notions of due process. Similarly, IASC and the United Nations solicit input from all interested parties and take action only upon consultation with and cooperation from national accountancy organizations (as in the case of IASC) or national governments (as in the case of the United Nations). Lawyers work to educate accountancy bodies and governments about potential legal ramifications of given accounting principles and practices, and challenge, when necessary, the implementation of given principles or practices. Thus, on the whole, due process has not been lacking.

Insofar as the corporate or securities practitioner is concerned the process of internationalization is not nearly so important as the resultant principles and practices. Clarity and authority are paramount for they determine the degree of con-

fidence and reliability with which the practitioner will draft contracts and advise clients. The source of accounting authority need not necessarily be unitary; multiple jurisdictions work equally well so long as the practitioner can definitively determine the proper authority for a given situation.

Various points of view exist with respect to how much uniformity is possible or desirable. The European Economic Community advocates the creation of a completely unified business environment involving the harmonization of corporate law and tax law and the creation of a Community-wide capital market. IASC advocates the setting of minimum standards, these standards to be those on which there is already universal agreement. Of course, as confidence in the process of internationalization grows, IASC will be more willing to go beyond already widely adopted standards; then the task will be to select the best from among competing approaches. Conflicts with particular national laws and policies will then have to be dealt with as they arise. But this is all to rush matters, as this latter stage will have to await a solid record of achievement and such time as the promulgating body will be accepted as a leading authority.

With this introduction, it is possible now to address the questions posed at the outset of this article.

4.1. Who should establish internationally applicable accounting standards?

The proposals set forth by the United Nations Commission are interesting and substantial. However, I do not believe that they will work because they depend for their implementation upon intergovernmental treaty. Accounting is a rapidly changing field and governments simply operate too slowly in response to these changes to make action (*i.e.* governmental treaty) on their part timely and really effective. Rather, a different mechanism is necessary.

In my view, the most promising means of steady progress in this area is the IFAC supported work of IASC. National governments must be encouraged to accept IASC standards and incorporate them automatically into domestic law and practice. The United States, among others, has been lagging in this respect. Even the AICPA has not yet agreed fully to recognize IASC standards [100]. Certainly governments may attempt to persuade or even to order their country's representatives in IASC to promote a particular point of view, but once that body has acted the countries represented in the group should accept and adopt the new standard.

4.2. What model, if any, should be used?

The worldwide trend in accounting is toward more uniformity and less freedom for management and auditors to select from among several alternative accounting treatments. One end of the spectrum is represented by France, which is, of course, the leading proponent of uniformity with its *Plan Comptable* and with taxation, financial, and economic reporting all based on essentially the same figures. Of the

other countries surveyed, Germany is probably closest to France in this regard although its uniformity tends to derive less from statute and more from the voluntary adherence of many enterprises to uniform charts of account promulgated by industry associations.

At the other end of the spectrum is England, which takes the most flexible approach both from a statutory viewpoint and from the point of view of the pronouncements of the accountancy bodies. Nevertheless, the trend in England is toward greater uniformity, because of a combination of EEC imposed accounting requirements and the influence of the United States experience (whose influence is strong in part because of the close ties among the large accounting firms that serve companies in both countries). On the other hand, the United Kingdom accountant still puts great emphasis on the "true and fair view" concept and less on the promulgation and application of inflexible standards or rules.

Japan is somewhat difficult to classify, in part because an accounting profession in the Western sense was not established until after the Second World War. Moreover, Japan first began requiring consolidated statements from reporting companies as recently as 1977. On the other hand, the accounting standards promulgated by BADC, which is the closest equivalent to the FASB in the United States, are given the force of law by the Ministry of Finance. Accordingly, Japan probably belongs in the spectrum somewhere between Germany and the United Kingdom.

The United States is best placed in the same part of the spectrum as Japan. On the one hand, it has the FASB which establishes accounting principles and is recognized by the SEC, with occasional exceptions, as a source for so-called generally accepted accounting principles. It also has various tax laws which, while they generally follow accounting principles (although often spelling out their requirements in greater detail), explicitly depart from these in several important respects such as asset depreciation. The majority of United States companies prepare their books on a tax basis since few state laws require the filing of audited financial reports. State corporation law largely ignores accounting principles in favor of a few relatively generalized terms necessary to regulate the few financial areas with which state corporation law concerns itself (*i.e.* dividends and insolvency). On the other hand the United States has regulated industries that are subject to uniform systems of account by order of federal and/or state regulatory bodies. These uniform systems of account are comparable in detail to the French *Plan Comptable* or the German charts of account promulgated by industry associations.

The trend toward accounting uniformity is a strong and growing one worldwide. National differences of a political, historical, economic, and even sociological nature doubtless account in part for the differences of approach. It is tempting, especially for the author who has some familiarity with the United States uniform system of accounts for utilities, to consider that the trend toward uniformity is a good thing and that the accounting profession ought to press for national and even international uniformity along the French model. However, I find some strong arguments which incline me in the other direction.

First, even in an industry as homogeneous as the utility industry, uniformity has not been a panacea. There are still areas of flexibility where perhaps none should exist and, more important, areas of rigidity which give results that are misleading. Secondly, in the United States, and to a lesser extent in the United Kingdom and Germany, the accounting profession is quite familiar not only with the concepts of uniform systems of account but with their application. Yet, there seems to be no clamor for the universal adoption of such systems. Moreover, the United Kingdom and the United States have by far the largest reservoirs of professional accounting talent and if established methods such as uniform systems of account were the solution, we would have heard about them before this. A skeptic might claim that it would be against the profession's best interest to promote uniformity since its role would thereby become less important. Experience with regulated industries in the United States does not tend to bear out this theory and it presumes a kind of self-interest that the profession has not manifested in other areas.

In sum, the worldwide trend toward certainty and uniformity is a good one, but it will, and probably should, stop short, except for those countries such as France that prefer that path, of near absolute uniformity.

4.3. What role can the law play in developing or implementing internationally applicable accounting principles?

If accounting standards are, at least to the extent of those that are universally recognized, going to become international, it is important that each country represented in the standard setting body adopt legislation or regulations that will ensure automatic adoption of such standards. Such legislation or regulation is equally necessary whether the international organ promulgating such standards is political, professional or a combination of the two.

To the extent that accounting issues are raised in a legal context in France (and I am informed that this is a relatively rare occurrence), a court is unlikely to be perplexed as to where to look for answers since the *Plan Comptable* and the various industry refinements are uniform and rigid. In the United States or the United Kingdom a court faced with an accounting question, e.g. the meaning of the term "earnings" in a contract, might consult state and federal statutes, SEC regulations and professional pronouncements (GAAP) but might well not feel bound by any of them. Indeed, one court in the United States found auditors criminally liable in a situation where concededly the accounts were maintained in a manner consistent with GAAP [101].

It would seem a case of the tail wagging the elephant for the United States to embrace the uniform system of accounts approach merely to avoid an uncertain result in the relatively infrequent court case. However, what may well be worth considering on a federal level is a statute that more clearly delineates the sources of accounting determinations. While the drafting of such a statute would be a substan-

tial challenge, even the intellectual exercise of the attempt might help to clarify the presently somewhat unclear legal situation [102].

5. Conclusion

As the New York Times reported recently [103], the “task of devising common accounting rules for companies throughout the world would rank high on no one’s agenda of urgent global issues”. Nevertheless, recent developments in the area of international accounting provide strong evidence that accounting may be about to take steps to catch up with the developments in international trade and the internationalization of the capital markets. That trend should be encouraged. The efforts of IASC should be given the greatest consideration and, ideally, should be accepted at a national level, by the explicit acceptance, preferably statutory, of its international standards.

The movement toward uniformity evident at both the international and national level should be encouraged but with a recognition that complete uniformity is probably both unattainable and not generally desirable.

The legal profession should take cognizance of these trends and should be sensitive to the need to clarify the legal status and application of accounting standards.

Notes

[1] This article is an outgrowth of the author's participation in the seminars of the International Faculty for Corporate and Capital Market law. Special thanks are in order to the following members of the International Faculty who reviewed the portions of drafts of this article relative to their own countries: Paul L. Davies, United Kingdom; Friedrich Kübler, Federal Republic of Germany; Noyes E. Leech, United States; Marie-Claude Robert, France; and Misao Tatsuta, Japan.

Three other friends also reviewed the article and contributed most helpful comments: J. Kenneth Hickman, a partner of Arthur Andersen and Co., New York; David Solomons, Arthur Young Professor of Accounting at the Wharton School of the University of Pennsylvania; and L. Harold Levinson, Professor at School of Law, Vanderbilt University.

However, the views expressed and the errata, if any, are strictly those of the author.

[2] Through the present time, such influence as these groups wield in the United States has been felt by means of incorporation into the so-called generally accepted accounting principles. Therefore, they will not be discussed separately in section 2.1 of this article. For a more general discussion of the worldwide influence of these groups see section 3.2, *infra*.

[3] State corporation laws generally have not imposed a requirement that corporations furnish shareholders with financial statements. See, *Changes in the Model Business Corporation Act – Amendments to Require Sending Financial Statements to Shareholders*, 33 Bus. Law. 931 (Jan. 1978). And insofar as they address accounting issues at all they do so in a crude fashion in the financial provisions concerning dividends, stock repurchases and dissolution. See, e.g., Model Bus. Corp. Act Ann. 2d § 45 (West Supp. 1973).

See generally, Manning, *A Concise Textbook on Legal Capital* (Foundation Press, 1977); Hackney, *The Financial Provisions of the Model Business Corporation Act*, 70 Harv. L. Rev. 1357 (1957); Gibson, *Surplus, So What? The Model Act Modernized*, 17 Bus. Law. 476 (1962).

[4] E.g., *Kern v. Chicago and E. Illinois R.R. Co.*, 6 Ill. App. 3d 247, 285 N.E. 2d 501 (1972); *Cintas v. Am. Car and Foundry Co.*, 131 N.J. Eq. 419, 25 A.2d 418 (1942). See Clark, *The Duties of the Corporate Debtor to its Creditors*, 90 Harv. L. Rev. 489 (1977); Hackney, *Accounting for Mergers and Acquisitions Under the New Jersey Business Corporation Act*, 23 Rutgers L. Rev. 689 (1973).

[5] SEC 1978 Annual Rep.

[6] 15 U.S.C. § 77s(a) (1976) empowers the SEC to prescribe "the items or details to be shown in the balance sheet and earning statement and the methods to be followed in the preparation of accounts, in the appraisal or valuation of assets and liabilities, in the determination of depreciation and depletion, in the differentiation of recurring and nonrecurring income, in the differentiation of investment and operating income . . ."; 15 U.S.C. § 78c(b) (1976) empowers the SEC to "define technical, trade, accounting, and other terms used in this chapter, consistently with the provisions and purposes of this chapter".

[7] 15 U.S.C. §§ 77s(a), 77aa [Schedule A], 78m, 79e, 79n, 80a (1976).

[8] 15 U.S.C. § 77aa [Schedule A, items 25 to 26] (1976) (balance sheets and profit and loss statements must be "certified by an independent public or certified accountant"); 17 C.F.R. § 210.2-01 (1978) (SEC defines "independent").

[9] 17 C.F.R. § 201 (1979) [Rules of Practice] ("The Commission may deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found by the Commission . . . (i) not to possess the requisite qualifications to represent others, or (ii) to be lacking in character or integrity or to have engaged in unethical or improper professional conduct, or (iii) to have wilfully violated, or wilfully aided and abetted the violation of the Federal securities laws . . . , or the rules and regulations thereunder."). See *Touche Ross and Co. v. SEC*, F.2d 2d Cir., [1979 Current Volume] Fed. Sec. L. Rep. (CCH) ¶ 96854 (court upholds SEC authority to discipline professionals who appear before it).

[10] 17 C.F.R. § 210 [Regulation S-X] (1979).

[11] *E.g.*, In the Matter of Laventhol, Krekstein, Horwath and Horwarth, SEC Accounting Series Release no. 144, [1977] 5 Fed. Sec. L. Rep. (CCH) ¶ 72166 (May 23, 1973); In the Matter of Peat, Marwick, Mitchell and Co., SEC Accounting Series Release no. 173 [1977] 6 Fed. Sec. L. Rep. (CCH) ¶ 72195 (July 2, 1975); In the Matter of S.D. Leidesdorf and Co., SEC Accounting Series Release no. 209, [1977] 6 Fed. Sec. L. Rep. (CCH) ¶ 72231 (Feb. 16, 1977).

[12] SEC Accounting Series Release no. 150 [1979] 5 Fed. Sec. L. Rep. (CCH) ¶ 72172 (Dec. 20, 1973) [Statement of Policy on the Establishment and Improvement of Accounting Principles and Standards].

[13] Pub. L. no. 87-834, § 2a, 76 Stat. 962 (amending I.R.C. § § 38, 46 to 48) (Oct. 16, 1962).

[14] APB Opinion no. 4 (March 1964) (amending APB Opinion no. 2, Dec. 1962).

[15] FASB Statement no. 25 (1979).

Recently, in response to Congressional pressure, the SEC further narrowed the accounting options for oil and gas producing companies. *See* SEC Accounting Series Release no. 253, [1978] 6 Fed. Sec. L. Rep. (CCH) ¶ 72275 (Aug. 31, 1978); SEC Accounting Series Release no. 258, [1979] 6 Fed. Sec. L. Rep. (CCH) ¶ 72280 (Dec. 19, 1978); SEC Accounting Series Release no. 261, [1979] 6 Fed. Sec. L. Rep. (CCH) ¶ 72283 (Feb. 23, 1979).

[16] Zeff, Forging Accounting Principles in Five Countries (1972) at 113.

[17] *Id.* at 114-15, 118.

[18] *Id.* at 119.

[19] *Id.* at 137.

[20] *Institute Research Bulletins*, J. of Accountancy (Feb. 1945) at 90.

[21] *Id.*

[22] *Appalachian Power Co. v. Am. Inst. of Certified Pub. Accountants*, 268 F.2d 844 (2d Cir. 1959), *cert. denied*, 361 U.S. 887 (1959).

[23] *Id.* at 845.

[24] The "Big Eight" are the eight largest auditing and accounting firms in the United States: Arthur Andersen and Co.; Arthur Young and Co.; Coopers and Lybrand; Deloitte Haskins and Sells; Ernst and Whinney; Peat Marwick Mitchell and Co.; Price Waterhouse and Co.; and Touche Ross and Co.

[25] APB Opinion no. 6 (Oct. 1965) [Status of Accounting Research Bulletins], Appendix A (Oct. 1964) [Special Bulletin Disclosure of Departures from Opinions of Accounting Principles Board].

[26] Zeff, *op. cit. supra* n. 16 at 212-16; Hackney, *op. cit. supra* n. 4.

[27] Report of the Study Group on Establishment of Accounting Principles, American Institute of Certified Public Accountants, *Establishing Financial Accounting Standards* (March 29, 1972).

[28] [1978] 481 Sec. Reg. & L. Rep. (BNA) § D-2 (Dec. 6, 1978) [FASB Issues Statement on Objectives of Financial Accounting and Reporting].

[29] *Cf.* Report of the Study Group on Objectives of Financial Statements, American Institute of Certified Public Accountants, *The Objectives of Financial Statements* (1973). (The study group concluded that financial statements should (i) emphasize information about transactions and other events that significantly affect enterprise earning power or changes therein, be written in terms of actual or prospective cash impact, and facilitate comparisons, (ii) report both facts and interpretations of transactions and other events, (iii) assist in the assessment of the uncertainties with respect to the amount and timing of cash receipts and disbursements, and (iv) report on series of transactions and other events, including value changes, in terms of earnings cycles.)

[30] Speech by SEC Chairman Williams at The Practising Law Institute, *The SEC Speaks in 1979* (March 2, 1979).

[31] [1978] 461 Sec. Reg. & L. Rep. (BNA) § F-1 (July 12, 1978) [SEC report, The Accounting Profession and the Commission's Oversight Role]. (In response to the question of who should establish and improve accounting standards, the private sector or the public sector, the Commission stated:

the initiative . . . belongs in the private sector, subject to Commission oversight, because of . . . [the private sector's] greater resources, its expertise, its ability to detect emerging accounting problems at an earlier stage and because its standards can be applicable to all companies whether or not publicly owned.

[32] [1979] 510 Sec. Reg. & L. Rep. (BNA) § D-1 (July 4, 1979).

[33] Letter from J.M.B. Hoxsey, Executive Assistant, Committee on Stock List, to the Governing Committee, dated October 24, 1933. *Audits of Corporate Accounts, 1932-1934*, New York American Institute of Accountants (1934). While this statement is usually regarded as the first recorded use of the term "generally accepted" in relation to accounting principles, the Institute's 1936 revision of the "Verification of Financial Statements" pamphlet (under the new title "Examination of Financial Statements") is probably the first official use of the term by the Institute.

[34] NYSE Manual, § A-4,

[35] 26 C.F.R. § 1.446-1(a) (2) (1979) [Methods of Accounting].

[36] *Id.*

[37] Price, Walker and Spacek, *Accounting Uniformity in the Regulated Industries*, 30 *Law and Contemp. Prob.* 824 (1965).

[38] 328 F.2d 237 (4th Cir. 1964), *cert. denied*, 379 U.S. 829 (1964) (Plaintiff sought to set aside a Federal Power Commission order requiring it to install and maintain, as an integral part of its basic corporate books, certain accounts related to the effect of deferred tax accounting and to use these accounts in its published financial statements, including those issued to stockholders.)

[39] Section 13(b) of the Securities and Exchange Act of 1934, 15 U.S.C. § 78m(b) (1976) prohibits the SEC from prescribing accounting requirements for any company that are inconsistent with those prescribed for that company by any other federal agency, except to the extent that the SEC determines that the public interest or the protection of investors so requires.

[40] *Accounting and Auditing Problems*, 114 *J. of Accountancy* 67 (Dec. 1962).

[41] Simon, *Accounting and the Law: A Collection of Essays* (Rutgers, 1965); Custer, *The Court's Concepts of Accounting Principles as Revealed by Court Decisions* (Unpublished doctoral thesis, University of Alabama, 1971).

Accounting issues in the United States are litigated in two contexts: (i) interpretation of accounting terms or principles in specific commercial situations, e.g. dividends, surplus, shareholder agreements and buy-out agreements, solvency, and (ii) civil liability of accountants, especially *vis-à-vis* adherence to generally accepted accounting principles, and adherence to auditing standards. Cases in the first category contribute very little to the development of generally accepted accounting principles. Indeed, in those cases, the courts often demonstrate scant reverence for generally accepted accounting principles. In contrast, cases in the second category contribute greatly to galvanizing the accounting profession into a search for greater certainty in accounting principles in order to reduce liability exposure.

[42] Deloitte, Haskins and Sells, *The Fourth Directive Company Accounts*, 34 (London, 1978).

The Law of Dec. 28, 1959 requires the progressive application of the *Plan*.

[43] The Decree of April 13, 1962 sets forth conditions under which committees may be established to adapt the *Plan* to the needs of particular industries. It provides that these com-

mittees will draft particularized versions of the *Plan* and that the Government will, in turn, approve, publish and make these versions mandatory. More than fifty such versions have been approved. See Price Waterhouse, *Doing Business in France*, 68–69 (Sept. 1975) (hereinafter cited as PW France).

[44] Decree of Aug. 12, 1961, art. 67; Decree of Dec. 7, 1976; Ordinance of Sept. 28, 1967, art. 5. See also Chaput, *The Practice of the COB's Powers of Inquiry Toward Companies and Statutory Auditors 5* (paper presented at the French Seminar of the International Faculty for Corporate and Capital Market Law, July 1977); Pontavice, *Originalities of the Laws Governing Company Auditors in France* 8–10 (paper presented at the French seminar, see above, July 1977).

[45] [1965] *Aktiengesetz* §§ 149–159 (amended July 1, 1976) (hereinafter cited as AktG).

[46] *Id.* §§ 151, 157.

[47] *Id.* §§ 149–59; Beeny, *European Financial Reporting: 1 West Germany* 13 (1975).

[48] AktG, § 149 para. 1.

[49] [1974] *Handelsgesetzbuch* § § 38–44 (hereinafter cited as HGB).

[50] Beeny, *op. cit. supra* n. 47, at 15; Mueller, *International Experience with Uniform Accounting*, 30 *Law and Contemp. Prob.* 850, 863–64 (1965).

[51] [1937] AktG § § 129–34.

[52] The Companies Act of 1948 extended the provisions on accounting reports that were contained in the Companies Acts of 1908 and 1929. The Companies Act of 1967 required more detailed disclosure in the financial statements and report of the directors; it also eliminated the exemption for private companies (companies having fifty shareholders or less and unable to offer securities to the public) from the requirement of filing financial statements with the Registrar of Companies for public inspection. The Companies Act of 1976 shortened the time that may elapse between the end of a company's financial year and the filing of the financials, introduced the concept of accounting reference periods, and made certain changes in the provisions relating to the qualifications, appointment, resignation and power of auditors.

[53] Fraser, *Administrative Powers of Investigation into Companies*, 34 *Mod. L. Rev.* 260 (1971).

[54] Companies Act of 1948 § 451(1).

[55] *Id.* § 454(3).

[56] Lafferty, *Under Fire on Many Fronts*, *Financial Times*, June 30, 1977, at 1, col. 1.

[57] *E.g.*, Institute of Chartered Accountants in England and Wales (ICAEW); Institute of Chartered Accountants of Scotland; Ireland Association of Certified Accountants; Chartered Institute of Public and Finance Accountancy; Institute of Cost and Management Accountants.

[58] ICAEW, *Statements of Standard Accounting Practice* 1, paras. 3 to 6 (rev. 1973).

[59] *Id.*

[60] This is part of a typical introductory paragraph, taken from Council of ICAEW, *Recommendations on Accounting Principles*.

[61] Benston, *Accounting Standards in the United States and the United Kingdom: Their Nature, Causes and Consequences*, 28 *Vand. L. Rev.* 235, 245 (1975).

[62] *Supra* n. 58. There are now 16 SSAPs, the latest of which is the controversial one on current cost accounting (SSAP 16).

[63] *Economist*, Sept. 30, 1978, at 78.

[64] Department of Trade Annual Report (1971).

[65] Admission of Securities to Listing, *Listing Agreement – Companies of the Stock Exchange*, para. 9.

[66] *Id.* Schedule II.

[67] Exchange Rule c.3 at 49, para. G (1974).

[68] *Economist*, March 11, 1978, at 109; Council for the Securities Industry, *Report on the*

year to March 31, 1979, paras. 62–63. More recently, a City panel similar to the Takeover Panel has been tentatively agreed upon. See *Financial Times Survey (Accountancy)*, May 13, 1980, at III (Enforcement of Accounting Standards).

[69] *Shōkentōrihikihō*, Law no. 25 of 1948 (amended 1971) (hereinafter cited as SEL).

[70] *Shōhō*, Law no. 48 of 1899 (amended 1974) (hereinafter cited as Comm. Code).

[71] Tatsuta, *Securities Regulation in Japan*, 60 n. 55 (1970).

[72] *Id.* at 59.

[73] SEL art. 193–2, para. 1.

[74] Price Waterhouse, *Doing Business in Japan* 35 (1975) (hereinafter cited as PW Japan); Japan Securities Research Institute, *Securities Market in Japan 1977*, 130 (1977) (hereinafter cited as *Securities Market*).

[75] Tatsuta, *op. cit. supra* n. 71, at 59–60.

[76] Comm. Code arts. 170 para. 1, 183, 274–78, 281–82 para. 1; PW Japan, *op. cit. supra* n. 74, at 35.

[77] Tatsuta, *op. cit. supra* n. 71, at 57–58.

[78] Ministry of Finance Release (*Zōsho*) no. 1654, May 30, 1966; Message, Sept. 30, 1965, *Shōji Hōmu Kenkyū Ū* (no. 360) 63 (1965).

[79] *Securities Market, op. cit. supra* n. 74, at 130.

[80] *Kōninkaikeishihō*, Law no. 103 of 1948, arts. 34-2 to 34-22; Misawa, *Securities Regulation in Japan*, 6 Vand. J. Transnat'l L. 447 (1973). See Tatsuta, *op. cit. supra* n. 71, at 59.

[81] Certain words used to describe reports made by corporations have distinct meanings. "Financial statement" (*zaimushohijō*) refers to the accounting documents required to be filed as part of a registration statement or periodic report. "Business report" (*eigyō hōkokusho*) refers to one of the corporate reports subject to shareholders' approval but free of any regulation governing its content; generally it is equivalent to the literary part of a U.S. corporation's annual report, announcing recent company activities and achievements and containing an address by the company president. "Corporate report" (*keisanshoru*) refers to the documents enumerated in article 281 of the Comm. Code: inventory sheet, balance sheet, income statement, business report, and surplus appropriation plan. All of these, except the inventory sheet must be approved by shareholders.

[82] An example of such "window dressing" is Tokyo Shibaura Electric Co., one of Japan's multinational giants. It reported earnings of \$ 50 million on sales of \$ 3.4 billion for the year ended March 31, 1977, on a parent-only basis. If it consolidated the results of 37 subsidiaries with the parent, Toshiba would show net income of only \$ 18 million even though total sales would amount to \$ 5.3 billion.

[83] *Japan's Accounting Shake-Up*, Bus. Wk., April 25, 1977 at 112, 114. (A loophole in the law allows the parent to exclude minority-owned companies from their consolidated financial statements.)

[84] Members of BADC serve on a part-time basis and represent academia, industry, government, and the stock exchange.

[85] PW Japan, *op. cit. supra* n. 74, at 40–41.

[86] *Id.* at 40.

[87] The member states of the EEC are: Belgium, Denmark, France, Great Britain, Ireland, Italy, West Germany, the Netherlands, and Luxembourg. On May 28, 1979 representatives of the member states and Greece signed a treaty under which Greece will, subject to ratification by the legislature of each member state, become a member of the EEC, effective January 1, 1981. Negotiations have begun concerning the applications of Spain and Portugal for membership in the EEC.

[88] 21 O. J. Eur. Comm. (no. L. 222) 11 (Aug. 14, 1978).

[89] For a comprehensive analysis of the Fourth Directive and its effect on member countries, see Deloitte, Haskins and Sells, *op. cit. supra* n. 42.

[90] Mueller and Walker, *The Coming of Age of Transnational Financial Reporting*, 142 J. of Accountancy 67, July 1976, at 71–72. See McDougall, *Munich – A Place for Decisions*, The Accountant, June 30, 1977, at 744; Benston, *The Story of International Accounting Standards*, Accountancy, July 1976, at 34, 36–39.

[91] [1979] 4 Professional Standards (CCH) International Accounting Standards §§ 9000–9012. The Standards adopted thus far are:

	Effective date
IAS 1 Disclosure of Accounting Policies	1/1/75
IAS 2 Valuation and Presentation of Inventories in the Context of the Historical Cost System	1/1/76
IAS 3 Consolidated Financial Statements	1/1/76
IAS 4 Depreciation Accounting	1/1/77
IAS 5 Information to be Disclosed in Financial Statements	1/1/77
IAS 6 Accounting Response to Changing Prices	1/1/78
IAS 7 Statement of Changes in Financial Position	1/1/79
IAS 8 Unusual and Prior Period Items and Changes in Accounting Policies	1/1/79
IAS 9 Accounting for Research and Development Activities	1/1/80
IAS 10 Contingencies and Events Occurring After the Balance Sheet Date	1/1/80
IAS 11 Accounting for Construction Contracts	1/1/80
IAS 12 Accounting for Taxes or Income	1/1/80

[92] Benston, *op. cit. supra* n. 90, at 39.

[93] See Benston, *op. cit. supra* n. 61.

[94] [1979] 4 Professional Standards (CCH) ¶ 9000.08.

[95] *Id.* at 11102.

[96] [1977] 424 Sec. Reg. & L. Rep. (BNA) D-3 (Oct. 19, 1977) [International Accountants' Federation Formed, Study Group Disbanded] (IFAC replaced the eleven-nation International Coordinated Committee for the Accounting Profession, which recommended the formation of the new group); 144 J. of Accountancy, Nov. 1977 at 36–38.

[97] U.N. Int'l Stds. of Acctg and Reptg. for Transnat'l Corps. (1977) at 6.

[98] *Id.* at 11–12.

[99] *Id.* at 30, 43–44, 47.

[100] *Id.* at 7.

[101] *U.S. v. Simon*, 425 F.2d 796 (2d Cir. 1969), *cert. denied*, 397 U.S. 7006 (1970). In that case the appellate court affirmed the conviction of three accountants who conspired to knowingly draw and certify a false and misleading corporate financial statement. It quoted the lower court: "Proof of compliance with generally accepted standards was evidence which may be very persuasive but not necessarily conclusive that [one] acted in good faith, and that the facts as certified were not materially false or misleading."

[102] See Fogelson, *The Impact of Changes in Accounting Principles on Restrictive Covenants in Credit Agreements and Indentures*, 33 Bus. Law. 769 (Jan. 1978).

[103] New York Times, June 4, 1980 at D2.

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