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**International accounting harmonisation - a comparison of Spain, Sweden and Austria**

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## **Austria**

### **Abstract**

Despite attempts to secure harmonisation of accounting practice, significant variations in accounting rules and practice continue to arise in European countries, variations which give rise to compliance costs for multinational companies.

Firstly, this paper considers the relevance of international accounting harmonisation for European business. It then proceeds to examine accounting regulation in three countries: Spain, Sweden and Austria, highlighting the key regulatory issues of the 'true and fair' view requirement and the link between taxation and accounting. The three countries are selected because of the interesting contrasts which they provide; these contrasts are examined in detail in the paper.

The work is based upon a series of interviews carried out with leading accounting practitioners in the three countries during 1996-97.

The paper concludes that there are significant obstacles to accounting harmonisation in Europe and that there is potential for continuing diversity of national accounting practice.

## Introduction:

Despite the effects of governments, through the European Union (EU), and the accounting profession, through the International Accounting Standards Committee (IASB), substantial variations in accounting rules and practice continue to arise between different European Countries. These variations give rise to both financing and compliance costs for European multinationals. In this paper we report on our discussions with leading accountants in Spain, Sweden, and Austria on the implementation of the EU 4<sup>th</sup> and 7<sup>th</sup> Company Law Directives on accounting harmonisation in their countries.

Specifically we:

1. Briefly survey the relevance of international accounting harmonisation for European business, and the work of two bodies, the EU and IASB, pursuing this objective:
2. Compare the rules of the government and the accounting profession in accounting regulation in each of the three countries.
3. Analyse the response of each country for the requirement of accounts to give a ‘true and fair view’ that lies at the heart of the EU 4<sup>th</sup> directive on accounting harmonisation.
4. Consider how each country has adapted the traditional tax-accounting link with the light of EU harmonisation.

## The pursuit of harmonisation

Multi-national business has two main reasons to seek international accounting harmonisation:

1. The problems of analysing accounts from different countries increase finance costs in international capital markets. Choi and Levich (1990, 1991) report on a study of international investors. In response to the question 'Does accounting diversity affect your capital market decisions', 9 replied yes, and 7, no.
2. The cost of an accounting system in a multinational is increased both by the cost of designing, and running different accounting systems in different countries, and the cost of adjusting accounts from different countries to the accounting system of the country of the holding company for consolidation purposes. Cecchini (1988) reports on a survey of European multinational companies showing that different national accounting systems caused between 10% and 30% of the total accounting costs.

Both these factors hold back the ideal of building a comprehensive and effective free market in Europe. A third point of interest to the European Union (EU) is to avoid any individual member state setting low standards of accounting disclosure so as to attract registration of companies attached to secrecy, at the expense of other EU members. Other parties with a particular interest in achieving international accounting harmonisation are:

- 1 “The Big 6” leading international accounting firms, who can achieve substantial savings on costs of recruitment, training and staff development.

2. Developing countries, who by adopting internationally agreed accounting standards save the cost of devising these at the national level.

There is substantial evidence of international diversity in accounting regulation and practice at both the European level (see for example Simmonds & Azieres, 1989) and the International level (see for examples Radebaugh and Gray, 1993, The Economist 1992)

The European Union has pursued harmonisation through three directives on company law:

1. In 1978 the fourth directive laid down requirements for individual company accounts.
2. In 1983 the seventh directive laid down requirements for group accounts.
3. In 1984 the eighth directive addressed the issue of audit requirements.

Van Hulle (1991) summarises the content of the EU 4th Directive:

"The directive itself is a combination of rigidity and flexibility. There is rigidity in: the mandatory layouts for the balance sheet and profit and loss account; the valuation rules and notably the limited possibility to depart from the historical cost principle; the minimum content of the notes and the annual report; and in the audit and disclosure requirements. There is flexibility in: the true and fair override; the many options both for member states and for companies; the fact that the provisions of the directive are minimum requirements; and the possibility to derogate from certain provisions in exceptional cases provided that disclosures are made in the notes on the accounts"  
(p.25)

The significance of the True and Fair View concept is explored in more detail below. In the context of the European Union its role has been, along with the range of options, to introduce an Anglo-Saxon dimension into a directive which would otherwise have had a strong 'continental European' orientation.

Van der Tas (1988) makes two distinctions between types of accounting harmonisation.

- 1) Formal harmonisation is harmonisation of the provisions concerning financial reporting. Material harmonisation is harmonisation of financial reporting practice itself. Other authorities refer to 'formal' harmonisation as 'de jure' and 'material' harmonisation as 'de facto'.
- 2) Disclosure harmonisation is concerned with the extent of information disclosure. Measurement harmonisation is concerned with the nature of the information disclosed.

Macharzina (1988) observes of the 4th Directive that:

"there is much leeway as regards adoption of accounting, and, in particular, measurement methods".

Given the EU has achieved a higher level of disclosure than measurement harmonisation, there is a danger that European accounts will appear similar while having hidden measurement differences.

Montagna (1986) argues:

"The result is a set of weak regulations. Disclosure remains general and vague. There are many rules but they produce little meaningful information .....one requirement that would greatly strengthen the accountability of the international capital markets to investors and the public, the disclosure of secret reserves, is missing. As the managing partner of a Big Nine Zurich office said, we will always have harmonisation in areas that are not important" (p. 118).

Blake and Amat (1994) offer an analysis of the obstacles to the EU accounting harmonisation at four levels, as summarised in table 1.

1. The EU itself has failed to produce directives that provide for a comprehensive scheme of accounting harmonisation. Major areas of controversy have been ignored; thus the EU directives give no guidance on foreign currency translation, deferred taxation, or accounting for lease commitments. In other areas individual countries may choose from a range of options; an example is the permitted range of formats.

2. At the stage of national legislation some countries have interpreted the directives in line with national accounting traditions. To give two illustrations:

- The German draft law introducing the EC fourth directive offered the comment on the 'true and fair view' requirement: 'In spite of the pretentious formulation it is supposed that for practice there will be no principal changes' (Busse von Colbe, 1984, p.123 ).
- In the UK, the minister responsible for implementing the fourth directive announced in parliament that the UK government was 'at pains to impose the minimum change necessary in actual accounting practice' (cited in McBarnet & Whelan, 1992, p99).

3. National accounting professions have, on occasion, interpreted national legislation implementing the EU fourth directive in a conflicting national tradition. Thus while the fourth directive prescribes that all assets with a finite useful life should be depreciated, a UK standard, SSAP 19, prescribed annual revaluation instead of depreciation for investment properties.

4. At the individual company level there may be failure to comply with the spirit of the rules. As an example, in Germany some 90% of companies fail to file their published accounts (see van Hulle, 1993, pp390-1).

**Table 1**

**Obstacles to Accounting Harmonisation in the European Community**

Level	Obstacles to Harmonisation
European Commission	Unresolved issues. Choice of options.  Ambiguous prescriptions.
National legislation	Adapted to national tradition. Failure to implement.
National accounting profession	Interpretation of national legislation against the spirit of EU directives
Individual business	Non compliance with rules.

The failure of European Union harmonisation is not only apparent at the 'formal' level of the rules, but also at the 'material' level of actual accounting practice. Table 2 shows, in descending order, the degree of material harmonisation achieved by eight European countries across nine areas of measurement practice. Three of the four most harmonised areas in practice are not even covered by EU directives.



**Table 2**

**Extent of harmonisation achieved between 8 EU countries in descending order**

- 1 Translation of the Balance Sheet
- 2 Treatment of translation differences
- 3 Inventory valuation
- 4 Translation of the income statement
- 5 Depreciation method
- 6 Research and development
- 7 Fixed Asset Valuation
- 8 Goodwill
- 9 Inventory Costing Method

Source: Herrmann & Thomas, 1995, p264

Professional accounting bodies have gathered together to form the International Accounting Standards Committee (IASC).

The IASC is run by a board of up to 17 members, having 13 countries nominated by the International Federation of Accountants (IFAC), and up to 4 co-opted organisations with an interest in financial reporting. Countries on the IASC board until 31 December 1997 are Australia, Canada, France, Germany, India, Japan, Malaysia, Mexico, the Netherlands, Nordic Federation, South Africa, the UK, and the USA. There are two co-opted organisations, the International Co-ordinating Committee of Financial Analysts Associations and the Federation of Swiss Industrial Holding Companies (Cairns, 1995). The board meets three times a year, being responsible for the approval of all exposure drafts and standards as well as the general management of IASC. The

board is supported by an advisory council to promote both financing and the use of International Accounting Standards and by a consultation group of parties with an interest in accounting. The IASC constitution defines its objectives:-

"To formulate and publish in the public interest accounting standards to be observed in the presentation of financial statements and to promote their world-wide acceptance and observance. To work generally for the improvement and harmonisation of regulations, accounting standards and procedures relating to the presentation of financial statements" (taken from Cairns, 1995, p 1667).

Since 1973 IASC has issued over 30 standards.

Enforcement of IAS's poses a major challenge. Nobes (1995) points out that IASC can only seek to enforce accounting standards through its member bodies, not by its own authority. In countries such as France and Germany professional accounting bodies have little influence over the setting of accounting rules by the government and governmental bodies, and so can only promote IAS's by persuasion. By contrast in Canada, where accounting standards are issued by the accounting profession, and enforced by law, it is easy to promote IAS's. Cairns (1989) reports that only 4 of the countries on the IASC board set their own national standards. In the UK the accounting profession ceased to control the national process for accounting standards in 1990. It is interesting to note that:

"From 1993, larger gaps between UK and IASC standards have opened up" (Nobes, 1995, p 84).

Nobes goes on to observe:

"One tell-tale sign of the problems of enforcement is the gradual weakening of the commitments required from member bodies. At one stage, members were required to use their best endeavours

to ensure that companies who broke international standards would disclose this fact. Now the IASC preface calls for companies that observe the standards to disclose this fact."

The acceptance of international standards by professional bodies who have no control over their own national standards has been described as 'a symbolic act at best' (McComb, 1982, p 48). Even where a national accounting professional body issues its own accounting standards, as Benson (1976) observes:

"Some accounting bodies do not have the power of discipline over their members, and cannot therefore impose compliance with either national or international Standards" (p 39).

An alternative route to extending the influence of International Accounting standards arises from the prospect that the International Organisation of Securities' Organisations will give wholehearted backing:

"IOSCO's acceptance of the IAS's, if ultimately permitted by the individual securities commissions, would enable international companies that conform to (or reconcile to) the IASC's rules to engage in multinational securities offerings without complying fully with domestic accounting rules and regulations. Multinational companies would realise significant cost savings if they do not have to restate their financial statements to conform to each country's rules when registering a securities offering" (Wyatt & Yospe, 1993, p 84).

To summarise, there are two bodies driving for accounting harmonisation in Europe. The effectiveness of IASC depends on the influence of the national accounting profession. The effectiveness of the European Union depends on a consistent application of the true and fair view. Harmonisation can be held back by national tax considerations- We now, therefore, turn to a review of each of these issues in each of our three countries.

## Sources of Authority

In 1829 the first Spanish Commercial Code was enacted, including detailed instructions on bookkeeping for business and being strongly influenced by the French Napoleonic Code of 1807. The accounting requirements of this code were concerned purely with internal bookkeeping arrangements, and:

“did not include valuation methods or internal reporting, since at that time the accounts were considered to be a business secret, knowledge of which was restricted to the owner of the business and, in the event of litigation, to the judge” (Gonzalo & Gallizo, 1992, p 74).

The code has subsequently been amended in 1885, 1973, and 1989. Only as recently as 1973 was any regulation put forward applying to the balance sheet and income statement of companies in general, although certain industries had been subject to accounting regulation earlier, the first case applying to banks in 1922. The Plan General de Contabilidad (PGC - general accounting plan) of 1973 followed closely the example of the French plan of 1957. Giner Inchausti (1991) analyses the two key features of this plan as:

- 1 A strong emphasis on conservatism to protect the interests of creditors.
- 2 A binding link with fiscal regulations.

To summarise, historically the regulation of accounting in Spain has been through control of the bookkeeping system rather than the financial statements. We have observed that if Spanish accountants are asked to explain an accounting rule, their reply will refer to the entries through the double entry system rather than the impact on the financial statements. Only as recently as 1973 do we find accounting regulation for companies in general that deals with the financial statements. This regulation was tax based and aimed primarily at creditor protection.

As Rivera & Socia's Salva' (1995) observe:

"The real formulation of Spanish accounting principles is a phenomenon of recent vintage, forced upon Spain by the need to adopt the EU directives to the Spanish circumstances" (p 92).

Following Spain joining the European Union in 1986 the EU directives on auditing and accounting have been implemented in an auditing law in 1988, a new company law of 1989, and a new PGC in 1990.

In 1976 responsibility for formulating and adapting the PGC was entrusted to the 'Instituto de Planificación Contable' (IPC) - the Accounting Planning Institute. For twelve years this body, an autonomous administrative agency under the Ministry of Economy and Finance, produced both supplements to the main PGC and sectoral plans for industries, where particular accounting problems arise. In 1988 IPC was replaced by a new 'Instituto de Contabilidad y Auditoria' de Cuentas' (ICAC) - the Institute for accounting and the auditing of accounts. As the name implies, this body is responsible both for the role in accounting regulation formerly served by IPC and for the oversight of auditing. In particular ICAC is responsible for the Registro Oficial de Auditores de Cuentas (ROAC) - the official register of auditors of accounts.

The two main independent professional bodies for auditors in Spain are:

- a) The Instituto de Censores Jurados de Cuentas (ICJCE), founded in 1943, is the longest established body of its kind, representing Spain at IASC.
- b) The Registro de Economistas Auditores (REA), a branch of the Spanish Institute of Economists, was founded in 1982.

Both these bodies formulate auditing standards, subject to review by ICAC.

Alongside these professional bodies for auditors exists a voluntary body, the Asociación Española de Contabilidad y Administración de Empresas (AECA), founded in 1979. Members include academics, practitioners in businesses, private practice, and government, audit firms, and companies. Currently AECA has over 4000 individual and 500 corporate members. AECA committees produce recommendations in a range of areas including accounting regulation, company valuation, management accounting, and organisational issues.

Lainez (1994) pays tribute to the success of AECA in the field of accounting regulation:

"In summary, AECA has by its own efforts introduced the dynamism which accounting regulation has required here in Spain. It has achieved this, on the one hand., by promoting and directly influencing changes in legislative regulation .... On the other hand, the documents issued by AECA cover themes which have not been dealt with in the legislative regulation or, alternatively, have only been treated in an incomplete way" (p 80).

To summarise, AECA has both had a strong impact on the formulation of the PGC and produces influential, albeit voluntary, recommendations on areas not covered by legislation. Cañibano (1992, p 95) reports on a survey by AECA which found that 90% of auditors consider that clients should follow AECA recommendations.

Sweden is unusual in having three accounting regulatory bodies:

1. There is a professional body for authorised public accountants, the Foreningen Auktoriserade Revisorer (FAR), founded in 1923. During the mid- 1960's FAR set up a committee to issue accounting recommendations, and this committee continued its work until 1989.

2. A governmental body under the Ministry of Justice, Bokforingsnamanden (BEN), the Accounting Standards Board, was set up in 1976. Most BEN recommendations are on the detailed application of the internal accounting records. There have also been occasional recommendations on external financial reporting issues, the most notable being on foreign currency translation (Jonsson & Marten 1995).
  
3. In 1989 FAR and BFN joined together with the federation of Swedish industries to support a new body, Redovisningsrade (RR), the Financial Reporting Council. RR issues standards for public companies listed on the Stock Exchange. Since 1989 both FAR and BEN have not issued new recommendations on Financial Reporting, but their old recommendations remain in force.

The Accounting Act requires companies to follow 'God Redovisnings Sed' (GRS), Good Accounting Practice. Practitioners we spoke to referred to this as 'Swedish GAAP', on implicit comparison with the US requirement that companies follow 'Generally Accepted Accounting Principles'. In fact, there are substantial differences between the US concept of 'GAAP', which draws on a hierarchy of official recommendations headed up by the standards issued by the Financial Accounting Standards Board (FASB) (see Sunter 1991) and GRS in Sweden. 'GRS' in Sweden arises when two conditions are met:

- 1) A practice is specified by one of the three bodies discussed above.
- 2) A representative sample of leading companies follow the official recommendation.

Thus to achieve the status of 'GRS' in Sweden an accounting recommendation must both come from an authoritative body and be accepted by a number of companies. Accounting regulators

cannot, as in the US or UK, impose a standard against the views of the business community. An interesting aspect of this system is that recommendations of RR, designed for listed companies, will, if accepted, become 'GRS', and therefore apply to all companies.

Another important difference between 'GRS' in Sweden and 'GAAP' in the USA is that Sweden has a substantial body of accounting and tax law, all of which ranks above GRS (Westermarck 1989).

Overall, practitioners we spoke to felt that the Swedish legislation had implemented the EU directives in a very narrow and prescriptive way, following the German approach. They would have preferred the government to allow the full range of options and discretion permitted in the directives, as they felt had been the case in Denmark. They saw the most important influences on Swedish accountants as, in order., the International Accounting Standards Committee, the USA, and the UK. Indeed, one practitioner observed that he read all documentation from the UK Accounting Standards Board and took this as guidance on areas not covered by accounting recommendations in Sweden.

Thus the implementation of the EU directives in Sweden, with its emphasis on a prescriptive tax-driven accounting system in the German tradition, was a disappointment to practitioners. To illustrate this with some quotes from practitioners on this implementation:

“Quoted companies would prefer Anglo-Saxon solutions rather than the approach offered by the Fourth Directive”.

"The European Union has pushed Swedish accounting towards a German approach which is a pity and old fashioned in a number of ways".

"The Swedish government overreacted to the demands of the EU".



"A retrograde step".

"A step back from our move towards International Accounting Standards".

"A step back towards an extreme prudent view".

It is striking that Swedish accounting practitioners, committed to international accounting harmonisation, have found application of the European Union directives on accounting harmonisation such a negative experience.

The first accounting law in Austria was enacted in 1768, the Holkedret, which required all merchants to keep accounts (Novotny & Gruder, 1993). Subsequent accounting laws include the 1863 General Commercial Law (*Allgemeines Handelsgesetzbuch*) which was drawn up by delegates of all of the states of the German confederation, and the German Commercial Law (*Deutsche Handelsgesetzbuch* - dHGB) which was introduced into Austrian law after the 1938 Anschluss. Even after the Austrian State Treaty of 1955 the German legal influence persisted unabated; the Austrian Companies Act (*Osterreichisches Aktengesetz*) of 1965 was based upon the German equivalent of 1937.

More recently, Austrian accounting law has changed substantially in order to bring it into line with EU requirements. Although Austria applied formally to join the European Community only in 1989 the main provisions of the harmonising law were enacted in 1990, via the Accounting Law (*Rechnunglegungsgesetz* - RLG), and so Austria started on the road to harmonisation of accounting law some time before it actually joined the EU. Austria was undoubtedly helped in this by the existence of German law which it adopted with few amendments.

A further harmonising law is being enacted in Austria during 1997, and this will complete the legal process of harmonisation. These changes in the law have meant radical changes to accounting. Several of our interviewees referred to the poor information content of accounts prior to the new

laws; for example, there used to be no figure for turnover in the profit and loss account and the gross profit figure which was disclosed was not comparable from one company to another. Another significant change relates to group accounting, which was introduced in Austria in 1994. The result of all the recent changes is that Austrian accounts now bear a much closer resemblance to those produced elsewhere in Europe, but the process of harmonisation has required a very rapid evolution of thinking and practice in accounting, the effects of which will take many years to assimilate. Austrian accountants have not been accustomed to preparing accounts which have a high information content, or which are expected to provide decision-useful information to a wide range of users.

There are two main accounting bodies in Austria; the Chamber of Public Accountants and the Institute of Austrian Certified Accountants. All qualified accountants are members of the Chamber, which represents the profession and acts on behalf of its members. Some 80-90% of accountants are also members of the Institute (Wagenhofer, 1996) which is responsible for technical matters. The period of training and education for the full auditor (*Wirtschaftsprüfer*) qualification is long and arduous, as in Germany. There is a lower level qualification (*Steuerberater*) which is an intermediate step between university level qualification and *Wirtschaftsprüfer*. Holders of this intermediate qualification may practise as accountants but are not permitted to audit. The two professional organisations produce opinions and guidelines on accounting and auditing issues; these are not standards because they are not, strictly speaking, mandatory, but they do have considerable persuasive influence.

The most important objective of Austrian accounting is, and has been historically, the protection of creditors, which has led to a very conservative tradition of accounting. A second and much more recently established objective, the provision of information, has been given impetus by two factors: firstly, a series of highly publicised bankruptcies in the 1980s, and secondly, the introduction of harmonising legislation. An example of the alteration in emphasis is the introduction of group accounting via the RLG 1990 which has its main objective the provision of information.

In Austria sole traders and partnerships are a legal form of business entity and come within the scope of the Commercial Code which requires all forms of legal entity, both incorporated and unincorporated, to keep good accounting records and to prepare accounts. There are two important concepts underlying current Austrian accounting: the "true and fair view" and "good accounting practice" (*Grundsatz ordnungsmässiger Buchführung*).

GoB, good accounting principles, are implemented by reference to several sources including the Commercial Code, accounting literature, the courts and from day to day practice (Wagenhofer, 1996). Apart from the general requirement that accounts should be prepared in accordance with GoB there are general concepts set out in the law: for example, clarity, consistency, up to dateness, going concern, valuation of assets and liabilities individually, and prudence. Other concepts derive from accounting literature for example, the accruals concept and materiality. However, GoB are dynamic principles; although some elements of the principles are established in law and accounting literature, they tend to develop over time through commercial practice combined with prescription in law. Our interviews indicated that these principles are recognised and agreed upon by accountants, without necessarily being expressly enshrined in regulation: for example: *"Naturally, there are books about it, and there are lectures on it at the University, but in practice it's in your head"*.

There is an interesting contrast between our three countries. Spain has experienced a major change in the thrust of national accounting regulation driven by a voluntary association of practitioners. In Sweden practitioners have not achieved implementation of the EU directives in the spirit they would prefer. In Austria, practitioners have less influence both on legislation and through accounting recommendations. Table 3 summarises some key aspects.

**Table 3**

	<b>Spain</b>	<b>Sweden</b>	<b>Austria</b>
<b>Regulation</b>	High, both on legislative and through own recommendations	Low on legislation, High through own recommendations	Low
<b>Spirit in which EU directive is implemented</b>	Anglo-American bias	Continental European bias	Continental European bias
<b>Accountants view of how EU directives have been implemented.</b>	Satisfied	Disappointed	Satisfied

The true and fair view

The EU 4th Directive requires:

- 1) That company accounts should present a true and fair view (TFV).
- 2) That where compliance with specific legal requirements does not, in itself, result in the provision of a true and fair view then additional information must be given in the accounts to achieve that end.
- 3) In 'exceptional cases' companies should not comply with specific accounting rules where this is necessary, in order to provide a true and fair view. This is referred to as the TFV 'override'.

Spain has incorporated all three of these requirements in its company law. In Sweden and Austria only the first two have been adopted; neither country has accepted the TFV override.

The term 'true and fair view' first appears in legislation in the UK Companies Act of 1947. It has never been defined in either UK or European law, and a range of meanings can be attached to it. Thus, one study concluded "True and fair is what you make it." (Chastrey 1975 p92). Higson and Blake (1993) identify four distinct, and sometimes conflicting, elements in the term:

- 1) It appears that originally accountants lobbied for the term 'true and fair' to replace the previous term 'true and correct', on the grounds that the latter term implied an unachievable degree of precision. Thus the term was seen as a relaxation of the accountant's duty.
- 2) Conversely, the term has been seen as adding to the accountant's duty in that accounts must not only present the literal truth but also comply with the spirit of the law to give a 'fair' view. As Benson (1989) argues: "In effect substance took precedence over form". (p45)
- 3) 'Fairness' has also been taken to imply that accounts should be free from bias, giving as objective a picture as possible.
- 4) Another aspect of the term is that it has been regarded as giving authority to official pronouncements from the accounting profession, such as the Financial Reporting Standards (FRS's), and Statements of Standard Accounting Practice (SSAP's) issued in the UK.

When the UK joined the European Union in 1973, a first draft of a directive on company accounts had already been formulated. This followed the French and German tradition of rigid and detailed

rules on accounting procedures and disclosures. UK accountants lobbied successfully for both the TFV requirement and a range of options to be brought into revised drafts. Together these changes allowed the UK to retain its traditional flexibility in accounting approaches. One leading UK auditor summed up the spirit of the UK profession with the observation "we seem to have managed to stitch the rest of Europe up under true and fair now" (Higson & Blake 1993,p113).

The Spanish practitioners we spoke to were agreed in welcoming the 'true and fair view' requirement, which translates into Spanish as 'imagen fiel' - 'faithful picture', -an adoption of the French official translation 'image fidele'. Some use of the TFV override appears to be made in Spain. Navarro Gomollon (1995) reports that in a sample of 49 unqualified audit reports, two refer to use of the override. In a survey of 150 company accounts Ernst & Young (1995) give four examples of use of the override. We put two examples of possible cases for use of the override to Spanish auditors:

- 1) The deduction of the unamortised discount on a deep discounted debenture from the nominal value of the debenture rather than showing it as an asset, the latter being the treatment in the Spanish PGC. We chose this as an example of use of the override which we had seen in a Spanish company's accounts, and therefore, saw as a defensible use of the override.
- 2) An 'in substance defeasance of debt' transaction, whereby a company had bought government securities and placed them in an irrevocable trust to cover the payments of interest and principal on a loan. The PGC, applying the 'no set off' rules of the fourth directive, would require both the liability and the assets to be shown in the accounts. We asked whether the alternative treatment, of removing both the liability and the related assets from the Balance Sheet, could be justified by the override. We chose this as an extreme case, where use of the override has only been tentatively suggested as a possibility (see Walton 1985).

Auditors were evenly divided as to whether they would agree with use of the override in the first case, and unanimous in rejecting the second case. To summarise, Spanish auditors seem to welcome the principle of the true and fair view but to be cautious in use of the override.

In Sweden, TFV has been translated as 'rattvisande bild', a term which interviewees were agreed in translating as 'a fair view'. The translation has not given rise to controversy. Sweden has not adopted the TFV override.

Practitioners we spoke to were divided on the issue as to whether they would wish to see such an override provision in the law. On the one hand those in favour argued:

- 1) An override would help companies wishing to override some particularly inflexible aspects of accounting law. An example cited is that some ten companies currently show listed investments at market price, a practice that will not be allowed under strict historic cost rules in the new Act.
- 2) An override would also help companies comply with International Accounting Standards. An example is that the law does not permit foreign exchange translation gains to be taken as profit.
- 3) The override would be useful as a tool against creative accounting. The example of some 'creative' sale and leaseback deals on real estate was mentioned.
- 4) As the Accounting Act becomes older, new circumstances not envisaged in the Act may arise that make an override useful. An example is the complexity of some new financial instruments.

Against this, some practitioners saw the concept of an override provision as alien to the Swedish tradition, while extra disclosure should be an adequate solution. Two practitioners felt that ambiguity in application of an override could give rise to conflict between client and auditor.

In Austria, an early translation of a true and fair view appeared in the Public Corporations Act (*Aktiengesetz* -AKtG), the forerunner of the current Commercial Code, and the RLG 1990. The AKtG translated "a true and fair view" as "*ein möglichst sicherer Einblick*" which translates back into English as "a surest possible insight". This translation was criticised for enabling a tradition of interpretation to be established (Novotny 1992). In addition the work "*sicher*" implied caution and suggested that values were uncertain and indeterminable in the future. (Altenburger, 1989, quoted by Loidl, 1994). The translation of a true and fair view introduced in the Commercial Code by the RLG of 1990 and currently used in Austria, is "*ein möglichst getreues Bild*" which translates literally as "a truest possible picture".

One interviewee, commenting on the close relationship between German and Austrian accounting law, illustrated the point with the example of the RLG 1990; when this Act was written the law makers simply took the German Financial Reporting Act almost word for word leaving out only those sections relating to shipping law which, as Austria no longer had a coast line, were not relevant. It is noteworthy, however, that these two closely linked accounting communities translated "true and fair view" differently. In Germany the translation is "*ein den tatsächlichen Verhältnissen entsprechendes Bild*" (s 264 *Deutsches Handelsgesetzbuch* - dHGB). This translates literally back into English as "a picture according to the facts". This translation was not taken into Austrian law because it was felt that there would be a danger of misunderstanding, and that the principles and the law cannot mirror the facts (Nowotny 1992). Practitioners, when asked why there were different translations for "true and fair view" in Austria and Germany, supported this explanation. One interviewee opined that the Austrian "*ein möglichst getreues Bild*" is more in line with the French "*fidele*" and that it reflects the meaning of "true and fair view" better than the German translation. The same practitioner also had the impression that the German



accounting community is not happy with their translation. Another practitioner pointed out that the use of the word "facts" in the German translation was too strong:

*“Möglichst getreu” is better because the framework of valuation principles which we have means that you cannot present a picture which corresponds with the actual circumstances...”*

An opinion expressed by another practitioner was that the Austrian translation in contrast to the German translation introduces the concept of materiality. It is worth noting too, that there have been no cases in the Austrian courts which test out the significance of "ein möglichst getreues Bild", and so in all instances, the matter is to some extent one of personal interpretation. However, it is significant that the issue of translation has been given so much thought in a country where commercial law is usually adopted without significant change in Germany.

Although it would appear that there is a linguistic difference between the German and the Austrian translations of "true and fair view", in terms of its understanding in the law there appears to be no difference between the two interpretations of the expression. The two translations are recognised by practitioners and in the literature as being comparable. Neither Austrian nor German law has adopted the true and fair view override which permits the detailed provisions of the law to be set aside in order to enable the financial statements to present a true and fair view, even though this override is specifically part of the Directive. German and therefore Austrian law follows the Roman law approach whereby a specific rule takes precedence over a general rule and so, if there is a conflict between a specific legal principle and the general principle of "true and fair view" then a business entity must not depart from the specific rule. However, if the entity is a limited company details of the conflict must be given in the notes to the financial statements (Wagenhofer, 1996). None of our interviewees regarded the absence of the override provision as a problem in Austrian accounting, and indeed would not welcome its introduction:

*"...if you have an exact provision you don't need any in-depth discussions with the client. I hate these discussions. I like to say to the client: 'here is the law: you must follow it'. If you ask five*

*people what 'true and fair view' is, you get five different answers".*

The contrast between the three countries in regard to the true and fair view is summarised in table 4:

- 1) Austria is the one country to have had problems in finding an appropriate translation, rejecting the precedent established in Germany.
- 2) Only Spain has accepted the override.
- 3) Auditors in Sweden see the override as a help in opposing creative accounting whereas, in Austria it is seen as a hindrance. In Spain, auditors are cautious in their willingness to use the override.

**Table 4**

	Spain	Sweden	Austria
Problems in finding a translation for true and fair view?	NO	NO	YES
Override enacted?	YES	NO	NO
Auditors' attitude to override?	Used only in moderation	Would use for a range of issues	Opposed

## The tax-accounting link

A feature of continental European accounting systems has been a strong link between accounting and tax rules. The leading country in this respect has been Germany where the 'Massgeblich Keitsprinzip', translated as the 'principle of bindingness' (Nobes 1989 p8-9) or the 'principle of congruency' (Haller 1992) applies. Under this principle:

- 1) Generally Accepted Accounting Principles as laid down in Commercial Law apply to the published accounts and, unless they conflict with explicit tax regulation, also form the basis for taxation.
- 2) In some cases tax regulations offer opportunities to reduce taxable income compared to the provisions of commercial law. These tax benefits may only be enjoyed if the same accounting treatment is followed in the published accounts.

Taken together, these two factors lend to a binding link between tax and accounting rules. The link is only broken when an expense for tax purposes is computed as a lower amount than for accounting purposes. With the notable exception of pension costs, the German tax system is generally liberal with tax allowable expenses, so that this position rarely arises.

In the US and the UK there are many areas where the accounting treatment determines the tax position, and the consequence can sometimes be an unconventional accounting approach being taken in order to minimise the tax liability. (see Slepian 1985 for a striking example in the USA). However, in some areas tax and accounting rules differ. An important example is the depreciation of fixed assets, based on arbitrarily determined write off periods for tax purposes, but based on an assessment of actual useful lives in the published accounts. Where such a case arises an estimate of how much taxation arising from differences in the past will become payable when those differences reverse in the future has to be made. This estimate is known as 'deferred taxation'. It is only a significant issue in those countries such as the Netherlands, the UK, and the USA, where

substantial differences between tax and accounting rules arise.

Historically, in Spain the link between tax and accounting rules has been a tight one, but the legislation of 1989 implementing the EU directives broke that link. Thus, referring to the pre-1989 period, Gonzalo and Gallizo (1992) observe:

"commercial law was not a major source of accounting standards, and this meant that tax regulations were the main driving force for bookkeeping and its regulation by specific rules" (p 76).

Similarly, it was observed:

"tax law establishes channels through which accountancy must run, so that it is fiscal data" (Cea 1988 p30 - our translation).

During the 1980's, the private accounting body AECA, as discussed above, published a number of accounting recommendations. Two of the accountants we interviewed observed that a major reason for this was to break away from the traditional dominance of tax rules over accounting practice in Spain. The explicit breaking of the link in 1989 indicates the success of AECA in persuading the government to support this view. As Labatut (1993) explains:

"The anglo-saxon approach of separating and considering independently, accounting and tax principles is now firmly established" (p 208 - our translation).

As a consequence, it has become necessary to include a deferred taxation provision in Spanish company accounts.

While the legal obligation to link tax and accounting practice has gone, in some areas companies have chosen not to take advantage of the change. For example, in practice most companies still use the tax allowable depreciation figure in their published accounts.

Traditionally, Sweden has had a binding link between tax and accounting rules, similar to that in Germany. The link was first asserted in the Municipal Income Tax Act of 1928 and the Accounting Act of 1929. The adoption of a German approach was not surprising, given that the first professors of accounting in Sweden were either German or German educated. (Hearlin & Peterssohn 1992). The link continued in the Companies Act of 1975 and the Accounting Act of 1976. The Accounting Act of 1995, which implements the EU fourth and seventh directives, continues with the link.

The leading practitioners we spoke to in Sweden all regretted this position, but suggested that practitioners serving small clients might have a different view. We asked each of them to summarise the arguments for and against the link, and identified the following arguments in favour:

- 1) The separation of the tax and financial accounts will increase costs, a particular concern for small companies.
- 2) It is convenient for the tax authorities to base their assessments on audited figures.
- 3) It is seen as equitable that where the Government gives special tax allowances, thereby forgoing tax revenues, then the same reduction should apply to accounting profits so that shareholders similarly forego the potential for dividend payments.
- 4) Since accounting rules are traditionally based on prudence, reducing reported profit, it is good for business if tax rules are influenced by accounting rules.
- 5) Breaking the tax-accounting link would involve Swedish companies in the complex exercise of computing a deferred taxation provision.

Arguments against the link are:

- 1) It is an obstacle to good accounting practice. To minimise taxation companies aim to report a level of profit just high enough to support the dividend they wish to pay, so they compute income and expenditure in such a way as to arrive at that figure for both tax and accounting purposes. Expenditure that is tax allowable will tend to be overstated, and any expenditure that is not tax allowable will tend to be understated.
- 2) The tax-accounting link is an obstacle to the application of International Accounting standards in Sweden.
- 3) The tax accounting link creates difficulties in explaining Swedish accounts in other countries, particularly the USA and the UK.
- 4) Special government tax incentives have a particularly distorting effect on the accounts.

Swedish accountants have sought to mitigate the effects of the tax accounting link in two ways. From the mid-1970's onwards it has become normal practice to present the income statement in two stages. The first stage involves computation of a figure of operating profit based on accounting conventions and ignoring tax rules. At the second stage the difference between the 'accounting' and 'tax' measure for each item of income and expenditure is shown as an 'appropriation', so that the bottom line is the taxable profit figure. The accumulated 'appropriations' are shown as 'untaxed reserves' in the balance sheet, between liabilities and the shareholders' equity. The effect is that both operating profit and balance sheet figures for assets and liabilities are shown on an accounting basis, independent of tax rules.

RR's first standard, on group accounts takes advantage of the fact that the consolidated accounts of a group of companies do not represent a taxable legal entity, so that the tax accounting link is not obligatory. Accordingly, Swedish consolidated accounts are now prepared in accordance with

accounting, not tax, principles, and with deferred taxation shown, while the individual company accounts continue to be prepared with separate identification of tax driven 'appropriations' and 'untaxed reserves'.

Austria follows Germany in applying a strong tax accounting link. Practitioners identified some problems with this:

- 1) The information content of accounts suffers, because of the overriding tax influence.
- 2) International Accounting Standards cannot be applied where these conflict with tax rules.
- 3) Accounts prepared on this basis are not comparable with those prepared in the Anglo-American tradition.

Overall, practitioners themselves did not feel strongly about problems with the link, unlike those we talked to in Sweden. However, in interviews two reasons for believing that the tax-accounting link will weaken were put forward:

- 1) In a number of areas tax allowances are not generous in Austria. As an example, for tax purposes a vehicle is depreciated over 8 years but an accountant will prefer to use a more realistic life of 4 to 5 years in the published accounts. The difference gives rise to a deferred tax asset.
- 2) One practitioner pointed out that the tax authorities wish to increase the tax yield from the Corporate sector and would like to break the traditional tax accounting link so as not to be bound by traditional accounting conservatism in profit measurement.

In Table 5 we show how for 3 countries, plus the UK, the relationship between tax and accounting depreciation varies. We distinguish between the 'de jure' position, as to what the rules say should be done, and the 'de facto' position as to what companies actually do:

- 1) In the UK tax and accounting depreciation are separate both 'de jure' and 'de facto'.
- 2) In Spain the rules stipulate that tax and accounting depreciation are separate issues, but in practice companies choose to compute both on the same basis.
- 3) In Sweden the rules require that tax and accounting depreciation be on the same basis, but in practice accountants have found ingenious formulations to separate the two.
- 4) In Austria, tax and accounting depreciation have traditionally been linked both 'de jure' and 'de facto'. However, there is now some move away from this position where accountants wish to depreciate assets more rapidly than the tax rules permit.

Is depreciation for accounting purposes different to depreciation for accounting purposes?

**Table 5**

		<b>DE JURE</b>	
		<b>YES</b>	<b>NO</b>
<b>DE FACTO</b>	<b>YES</b>	UK	SWEDEN
	<b>NO</b>	SPAIN	AUSTRIA



## Conclusion

International accounting harmonisation would bring major benefits to international business, particularly within the European Union. Obstacles to the work of the bodies promoting this harmonisation include:

- 1) Differences in the regulatory framework in each country limits the influence of the accounting profession in supporting IASC.
- 2) The 'true and fair view', the fundamental principle on which EU harmonisation is built, varies in its interpretation.
- 3) A binding tax-accounting link ties accounting practice to national tax rules rather than international norms.

We have seen major differences between the three countries we have visited in each of these respects and in the spirit in which EU directives have been applied. Overall, our study indicates the potential for continuing diversity of national accounting practice.

To summarise, following legislation to implement the EU accounting directives Spain, Sweden, and Austria, are in three very different positions on the law and practice relating to the tax accounting link. In Spain, the accounting community have lobbied effectively to break the link, but in practice companies have not taken up the opportunities this affords in full. In Sweden, the accounting profession have failed to achieve a change in the law on the link, but have produced two ingenious accounting devices to circumvent it. In Austria, the link continues, but may be broken because the tax authorities themselves find it a constraint.

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