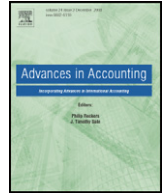




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## Continental European accounting model and accounting modernization in Germany

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### ABSTRACT

Classification techniques based on one or few dimensions are widely used in research studies and textbooks to explain and predict the development of accounting systems internationally. However, their usefulness in international accounting has been limited in today's globalized world. For example, in the context of the EU, IFRS are required for consolidated accounting, while national accounting systems continue to be the dominant system for unconsolidated accounting in many countries. Using Germany as a case study, the objective of this paper is to examine whether Germany can still be classified within the Continental European model of accounting following the Act to Modernize Accounting Law (*Bilanzrechts-modernisierungsgesetz* – BilMoG), which was promulgated on May 29, 2009. This Act introduced some major reforms to the German Commercial Code (*Handelsgesetzbuch* – HGB), such as removing the close connection to tax rules and introducing new recognition and valuation regulations, which changed traditional principles of orderly accounting (*Grundsätze ordnungsmäßiger Buchführung*). As a result, the current German approach of financial reporting separates Germany from the traditional Continental European model of accounting and moves it somewhere on a spectrum between the traditional Continental European model of accounting and the Anglo-American model of accounting.

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### 1. Introduction

Some of the earliest writings in international accounting attempt to classify national systems of accounting primarily to organize data, describe and compare different accounting systems, understand why and how national accounting systems differ, and explain and predict future developments (Choi & Meek, 2008, p. 34; Nobes & Parker, 2010, p. 59). Research attempting to classify accounting systems has taken two main approaches, namely, extrinsic classification and intrinsic classification. Extrinsic classifications utilize a methodology that is based on factors that are hypothesized to influence the nature and practice of accounting such as culture (Gray, 1988), economic makeup (Mueller, 1968), and regulatory style (Puxty, Willmott, Cooper, & Lowe, 1987). These approaches classify accounting systems based on one or more such factors. Alternatively, intrinsic classifications are based on financial reporting practices that are analyzed in order to identify groups of accounting systems. A number of environmental factors are then

used to explain those groups (for example, da Costa, Bourgeois, & Lawson, 1978; d'Arcy, 2001; Douppnik & Salter, 1993; Nair & Frank, 1980; Nobes, 1983).

A common feature of both classification approaches is the notion that the development of similarities and differences of accounting systems is largely a function of environmental factors such as economic and legal systems, financing systems, and culture. However, the number of factors that influence accounting development and their individual importance vary greatly in existing taxonomies such as that of Nobes (1983, 1998), Douppnik and Salter (1995), and Gray (1988). This suggests that the relationship between a single factor and the contribution it actually makes to the type and amount of accounting information provided is not clear. It also suggests that it would be too simplistic to explain differences and similarities in financial reporting in terms of one or few identified environmental factors.

A dominant taxonomy in international accounting is Nobes (1998) classification, which divides accounting systems into two classes labeled Class A and Class B. These two classes are commonly known as the Anglo-American model of accounting and Continental European model of accounting, respectively. Nobes suggests that major differences between these two classes are attributed to one main variable, namely the financing system, and considers Germany as a clear example of a country that would be expected to have the Continental European model of accounting. In light of recent legislative changes in German accounting rules, namely the BilMoG, the objective of this

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paper is to examine whether Germany can still be classified within the Continental European model of accounting. By focusing upon Nobes (1998), we argue that comparative accounting research can be further enhanced by developing new taxonomies that are capable of examining the accounting environment of a country holistically instead of focusing on few selected factors.

We focus upon the taxonomy proposed by Nobes (1998) for a number of reasons. First, this model is a revised version of a previous model (Nobes, 1983, 1992) that has been described as being precise in defining the object being classified, providing a hierarchy, and not containing data errors (Roberts, 1995). Second, it has been recently updated (Nobes, 2008) while other taxonomies have remained unchanged since their development (for example, Gray, 1988). Third, it maintains a dominant position in international accounting research and education. This is evident in the large number of studies that adopt this taxonomy such as Rahman, Yammesri, and Perera (2010), Alexander and Eberhartinger (2009), Sellhorn and Gornik-Tomaszewski (2006), Delvaillie, Ebbers, and Saccon (2005), Hope (2004), Tarca (2004), Schultz and Lopez (2001), Alexander and Archer (2000), Nobes and Roberts (2000), Flower (1997), and Douppnik and Salter (1993). Finally, Nobes' classification is a prominent topic in current textbooks on international accounting in which classifications are usually adopted as introduction and basis for further discussion (for example, Nobes & Parker, 2010, chapter 3; Douppnik & Perera, 2009, chapter 2; Choi & Meek, 2008, chapter 2; Radebaugh, Gray, & Black, 2006, chapter 2).

Focusing on the changes that have taken place in Germany, we provide evidence to show that Nobes' classification may not be as valid to Germany. German accounting practices changed fundamentally as a result of the BilMoG, which was promulgated in the Federal Gazette (*Bundesanzeiger*) on May 19, 2009.<sup>3</sup> These changes, for example, partially eliminate the relation between tax law and commercial law, and include accounting practices similar to IFRS, such as the recognition of internally generated intangible fixed assets and the application of fair value measurements for financial instruments. However, the factors that were used in Nobes' classification to explain accounting practices remain relatively unchanged. The current accounting education often promotes redundant and misleading information about the German accounting environment by uncritically relying on simplistic taxonomies for the classification of accounting systems. In Germany, as in many other European countries, IFRS are only required for consolidated financial statements of capital market orientated companies, and therefore, two accounting systems are used with the HGB as the dominant accounting system.

This study is based on the data collected through interviews with key individuals and an online focus group with representatives of groups that are affected by changes in the accounting environment. Additionally, we introduce the reader to German language literature such as that related to the BilMoG.

## 2. Implications of regulatory changes on financing system in Germany

Nobes (1998) proposes to divide accounting systems into two classes labeled Class A and Class B, which are better known in international accounting textbooks as the Anglo-American model of accounting and Continental European model of accounting, respectively (for example, Douppnik & Perera, 2009, pp. 37–45; Gernon & Meek, 2001, pp. 8–11). Nobes suggests that major differences between these classes are attributed to the characteristics of the financing system, more specifically, to the existence of a strong equity financing market with large numbers of outside shareholders. His model assumes that a strong equity-outsider market would lead to Class A and a weak equity-outsider market

would lead to Class B accounting system. Importantly, Nobes (2003, 2008) proposes that the two-group classification based on the financing system has predictive power even in the IFRS era. The argument is that for some purposes, many countries retain national accounting systems that are noticeably different from IFRS. For example, large German groups were using IFRS or US rules for consolidated financial statements, which did not affect the local accounting rules for individual accounting.

Nobes applied two measures to distinguish between the types of financing system. These measures are domestic equity market capitalization divided by gross domestic product (GDP) and domestic listed companies per million of population, as highlighted in Table 1.

Interpreting his 1995 data, Nobes considers Germany as a clear example of a country that would be expected to have the Continental European model of accounting and the US and the UK as clear examples of the Anglo-American model of accounting. Importantly, Table 1 clearly shows that the distances of these two measures did not change significantly between Germany and both the UK and the US since Nobes' original classification. Hellmann, Perera, and Patel (2010) recently examined the German accounting environment and provided additional evidence that the main institutional features are still corresponding with the proposed Continental European model. This has an important implication on Nobes' model because if Germany's accounting practices moved from Class B to Class A in recent years despite an unchanged financing system, Nobes' model would no longer be able to explain and predict accounting practices in Germany.

Since Nobes' original classification, several regulatory changes took place. However, the major pre-BilMoG regulatory changes in Germany did not directly affect the fundamental German accounting principles themselves. This is reflected in the Capital Raising Act 1998 (*Kapitalaufnahmeerleichterungsgesetz*), Governance Act 1998 (*Gesetz zur Kontrolle und Transparenz im Unternehmensbereich*), Qualifying Partnership Act 2000 (*Kapitalgesellschaften- und Co.-Richtlinien-Gesetz*), Transparency Act 2002 (*Transparenz- und Publizitätsgesetz*), Financial Reporting Control Act 2004 (*Bilanzkontrollgesetz*), and Accounting Law Reform Act 2004 (*Bilanzrechtsreformgesetz*).

In the early 1990s, an increasing number of German companies expecting to raise finance in overseas stock exchanges started to prepare consolidated financial statements in compliance with internationally accepted accounting standards (Ordelheide, 2001, p. 1369). However, legislation at the time did not allow for the preparation of consolidated financial statements only according to IFRS or US-GAAP, and companies at that time had to prepare such statements in addition to HGB financial statements or had to prepare one set of statements which allegedly complied simultaneously with HGB and IFRS/ US-GAAP. The Capital Raising Act 1998 opened the German accounting environment to Anglo-American accounting ideas by allowing groups of companies with listed shares the option of

**Table 1**  
Equity market measures.

Country	Domestic market capitalization/GDP			Domestic listed companies per million of population		
	1995	2002	2009	1995	2002	2009
UK	1.22	1.16	1.29	35.8	40.5	35.2
The Netherlands	0.85	0.92	0.68	14.0	11.1	7.30
Sweden	0.70	0.72	1.06	25.3	31.2	35.8
Belgium	0.37	0.51	0.56	14.1	13.8	15.4
France	0.33	0.66	0.74	7.80	13.0	15.0
Spain	0.33	0.68	0.89	9.20	72.3	74.70
Germany	0.23	0.34	0.39	8.30	8.70	7.30
Italy	0.19	0.39	0.15	4.40	5.20	4.80
United States	0.93	1.07	1.06	28.80	19.80	14.30

Source: World Bank (2010).

<sup>3</sup> Appendix A provides a glossary of the German terms, their translations and abbreviations used.

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