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Contextual issues of the convergence of International Financial Reporting Standards: The case of Germany

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ABSTRACT

The objective of this paper, using Germany as a case study, is to show that accounting as the language of business is deeply embedded in a country's social, political and economic environment and that these contextual factors cannot be ignored in the process of convergence. Specifically, by invoking the accounting ecology framework and interviewing selected stakeholders, this study critically examines the unique features of accounting in Germany and raises issues related to the adoption of IFRS. The findings of this study provide evidence of the importance of considering the contextual influences in successful adoption of IFRS in a country.

1. Introduction

Accounting as the language of business is practiced differently within varying historical, political, economic and social environments. However, largely because of the development of global capital markets and the growth of multinational enterprises, a call for a uniform set of international accounting standards emerged in professional and academic accounting debates in the 1980s (Choi & Meek, 2008; European Parliament, 2002; Flower, 1998; Hopwood, 1994; Parker, 1983; Taylor, 1987; Whittington, 2000, 286; Doupnik & Perera, 2009, 70). A number of supranational accounting institutions, such as the International Accounting Standards Board (IASB), the International Organization of Securities Commissions, and the International Federation of Accountants were also created mainly for this purpose. The IASB has been responsible for developing a set of so-called 'high-quality' financial reporting standards, known as International Financial Reporting Standards (IFRS) (Tweedie, 2007). During the last few years there has been a significant increase in the number of countries adopting IFRS as national standards (Whittington, 2008). A recent survey found that over one hundred countries permit or require IFRS to be used for financial reporting. Among them are not only industrialized countries such as Germany, France and Italy but also developing countries such as Egypt, Bangladesh and Bolivia (Wild, 2009). This has supported the argument that there is a global trend of convergence towards IFRS.

IFRS reflect the Anglo-American accounting model that in broad sense refers to the accounting system prevalent in the English-speaking countries such as the United States, the United Kingdom, Canada, Australia, and New Zealand (Doupnik & Perera, 2009, 37). This model focuses on investor orientation, fair value accounting and extensive use of accountants' professional judgment (Haller & Walton, 2003, 28). The promotion of IFRS by the IASB indicates an implicit assumption that Anglo-American accounting values, practices and principles are superior and equally applicable to all countries (Ball, 2006; Hoarau, 1995; Perry & Noelke, 2006).

However, it has been argued that differences in, for example, legal systems, taxation, sources of finance, inflation, political ties, and culture may cause diversity in accounting practices among countries, and it may hinder the adoption of a single set of accounting standards worldwide (Doupnik & Salter, 1995; Evans, 2004; Jaggi & Low, 2000; Nobes, 1998; Patel, Harrison, & McKinnon, 2002; Richardson, 2007; Salter & Doupnik, 1992; Schultz & Lopez, 2001). For example, in 1993, when the German multinational company *Daimler-Benz AG* reconciled its financial statements to US-GAAP in order to list on the New York Stock Exchange, it reported a profit of 615 million German *Deutsche Mark* under German accounting law but a loss of 1839 million German *Deutsche Mark* under US-GAAP (Doupnik & Perera, 2009, 60). Moreover, several studies have provided evidence that IFRS are applied inconsistently across countries and cultures, especially if countries have accounting environments which are different to that in Anglo-American countries where IFRS were developed (Doupnik & Richter, 2003, 2004; Psaros & Trotman, 2004). Germany is a classic example of such a country, which is often included in the Continental European accounting model as distinct from the Anglo-American model of accounting (Nobes, 1998; Nobes & Parker, 2008, 61; Doupnik & Perera, 2009, 44). However, several steps have been taken in Germany to encourage companies to adopt IFRS. For example, since 2007, all listed companies in Germany are required to apply IFRS for

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their consolidated financial statements without exception[1]. The German government also incorporated the permission of the EU to extend the application of IFRS for consolidated financial statements of non-listed companies. The culmination of these steps is the issuance in May 2009 of the Act to Modernize Accounting Law (*Bilanzrechtsmodernisierungsgesetz*; henceforth, BilMoG) (for details see Hellmann, Perera, & Patel, 2009).

Using the accounting ecology framework developed by Gernon and Wallace (1995), this paper provides a rigorous and systematic analysis of the main features of Germany's accounting environment. In addition, the paper examines potential issues associated with convergence in Germany by interviewing selected key stakeholders, such as accounting academics, professional auditors, and persons affiliated with the German Accounting Standards Board (GASB), the German Financial Reporting Enforcement Panel (GFREP), and the German Federal Ministry of Justice. The main objective of this paper is to show that accounting as the language of business is deeply embedded in a country's social, political and economic environment and that the influence of these contextual factors cannot be ignored in the process of convergence.

2. Research methods

2.1. Case study approach

The purpose of this study is to provide an understanding of the context in which accounting operates in Germany. To analyze the context of a contemporary phenomenon, the case study method is considered to be most appropriate (Yin, 2003, 13). Germany has been selected for this study for two main reasons. Firstly, Germany is often included in the Continental European model as distinct from Anglo-American model of accounting (Nobes, 1998; Nobes & Parker, 2008, 61; Doupnik & Perera, 2009, 44). The German accounting model with its distinctive features such as creditor protection (*Gläubigerschutz*), principles of orderly accounting (*Grundsätze ordnungsmäßiger Buchführung*), authoritative principle (*Maßgeblichkeitsprinzip*) as well as the complementary institutional environment evolved over a long period of time. Since 1861, Germany has had a uniform accounting law, the General German Commercial Code of 1861 (*Allgemeines Deutsches Handelsgesetzbuch 1861*), followed by the Stock Corporation Act in 1870. Both acts were amalgamated with the German Commercial Code (*Handelsgesetzbuch*; henceforth, HGB) in 1897 which emphasizes the German method of creditor protection and prudence in its conservative measurement approaches and a high degree of statutory control (Eierle, 2005).

Secondly, the IASB is dominated by members of accountancy bodies with an Anglo-American accounting background (Street, 2002; Kirsch, 2006, 375). The initial board members were from Australia, Canada, France, Germany, Japan, South Africa, Switzerland (with one member each), United Kingdom (four members), and the United States (three members) (IASB, 2001). From these countries, only France, Germany, Switzerland and Japan represent the Continental European accounting model. Consequently, 10 of the 14 members of the board had an Anglo-American accounting background and they would have influenced the conceptual basis of IFRS.

2.2. Theoretical framework

This paper uses the framework developed by Gernon and Wallace (1995) to provide a holistic analysis of the accounting environment in Germany. They describe the environment in which accounting operates by using the term ‘accounting ecology’, which is defined as follows:

> A national accounting ecology is a multidimensional system in which no one factor occupies a predominant position. Such a synthesis would emphasize the interrelationships of the environmental factors which influence and are influenced by accounting and would focus on the importance of perceptual as well as non-cultural factors such as population and land area (p.59).

The concept of accounting ecology encompasses the following five separate but interacting slices:

1. The societal slice of the accounting environment refers to structural, cultural and demographic elements within a society that may affect the demand for financial accounting services.
2. The organizational slice refers to events and/or trends bearing on rationalizations in the choice and design of accounting systems such as organizational size, technology, complexity, and human and capital resources.
3. The professional slice refers to events and/or trends bearing on the determination of roles and relationships in the accounting profession such as education, training, registration, and professional ethics and culture.
4. The individual slice refers to accounting policy choices made by individuals and covers the total setting in which individuals lobby standard setters and use accounting numbers to their respective advantages.
5. The accounting slice refers to accounting practices, rules and/or trends that affect or are affected by the other slices of the environment. Specifically, it includes the disclosure and measurement requirements and practices, and types and frequency of accounting reports (Gernon & Wallace, 1995).

The appropriateness of the accounting ecology framework to examine the accounting environment of a country has been shown by Perera and Baydoun (2007) who provide insights into the accounting environment of Indonesia.

2.3. Data collection

Data were collected from multiple sources including one-on-one interviews, and a survey of academic literature and publicly available documents such as press releases. It is suggested that this use of multiple sources, known as data triangulation, helps to improve the reliability of the data collected and to capture a comprehensive picture of the accounting environment in a country (Yin, 2003, 98). Interviews of stakeholder groups were conducted in Germany in June 2008 and follow-up interviews in November 2008. Interviewees included seven German accounting professors, one professional auditor, one member of the GASB, one member of the GFREP, and one member of the German Federal Ministry of Justice. These eleven individuals were selected because of their expertise both in the field of accounting in Germany and its contemporary environment, and in international accounting. The interviews were semi-structured and followed an interview guide, which served as a checklist for ensuring that all relevant issues were covered. Interviews lasted from 30 min to 2 h and were carried out in German to overcome possible language barriers. They were all digitally recorded, with permission, and fully transcribed for analysis. The interviewees had the opportunity to check the accuracy of transcribed version of interview data, which are subsequently translated into English by the first author who is fluent both in German and in English.

2.4. Data analysis

Interview data were analyzed using the iterative process of transcription, coding, and interpretation based on the accounting ecology framework. A detailed reading of all transcripts led to the

[1] In November 2007, the U.S. SEC decided to remove the requirement that foreign companies using IFRS reconcile their financial statements to U.S. GAAP.