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Financial accounting and reporting in Germany: A case study on German accounting tradition and experiences with the IFRS adoption

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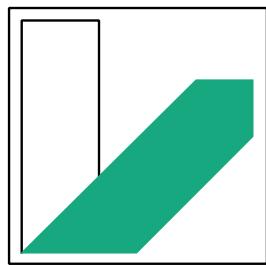
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**UNIVERSITÄT
BAYREUTH**

**Bayreuther Arbeitspapiere zu
Finanzierung, Rechnungslegung und Steuern**

Bayreuth Working Papers on
Finance, Accounting and Taxation
(FAcT-Papers)

No. 2013-01

**Financial Accounting and Reporting in Germany:
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Experiences with the IFRS Adoption**

Rolf Uwe Fülbier, Malte Klein
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AAA Financial Accounting Standards Committee

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Abstract: Financial accounting is rooted in national thoughts, traditions and institutional settings. As a consequence, accounting has developed heterogeneously over time and fulfilled contracting purposes in divergent national environments. Against this background, we argue that the ongoing process of accounting internationalization and imposed harmonization carries with it the danger of deforming country-specific balancing factors in the accounting systems, especially when the national environment for economic and contractual activities is not harmonized at all. In contrast to more evolutionary integration and adjustment processes of the past where spillover effects have always existed, the rapidity of the current process and coercive nature increases country-specific frictions. To support our argument and to substantiate the interplay of accounting as a contractual device and country-specific characteristics, we provide an in-depth case study of one country, Germany. We illustrate how the traditional German commercial law accounting system has evolved over time to meet specific contractual needs. We demonstrate how the current process of globalization and accounting internationalization has been attended by increasing frictions and challenges, especially on the contractual and regulatory level. We finally investigate the consequences on the German standard setting system, which also includes the changing role of German accounting research.

Zusammenfassung: Als standardisierte Kommunikation zwischen Unternehmensbeteiligten wurzelt Rechnungslegung stets auch in nationalen Traditionen, Konzepten und institutionellen Rahmenbedingungen. Insofern verwundert es nicht, dass sich Rechnungslegung weltweit heterogen entwickelt hat und unter unterschiedlichen nationalen Bedingungen unterschiedlichen Zwecken folgt. Dabei birgt die seit Jahren zu beobachtende Internationalisierung und oktroyierte Harmonisierung der Rechnungslegung die Gefahr, landesspezifische (Ausgleichs-)Faktoren in der Rechnungslegung zu nivellieren, obwohl sonstige Rahmenbedingungen unternehmerischer Aktivität keineswegs harmonisiert sind. Im Gegensatz zu den eher evolutischen Integrations- und Anpassungsprozessen der Vergangenheit, in denen Einflüsse anderer Systeme durchaus erkennbar waren, dürften die Schnelligkeit und der regulatorische Zwangscharakter des gegenwärtigen Prozesses landesspezifische Friktionen erzeugen. Um diese Argumentation zu untermauern und um das komplexe Zusammenspiel von Rechnungslegung als Vertragskoordinationsinstrument mit landesspezifischen Rahmenbedingungen zu verdeutlichen, wird eine detaillierte Fallstudie präsentiert, die auf ein einziges Land, Deutschland, zielt. Darin wird aufgezeigt wie sich handelsrechtliche, deutsche Bilanzierungstradition vor dem Hintergrund spezifischer Koordinationsbedürfnisse historisch entwickelt hat. Untersucht werden zudem die Friktionen und Herausforderungen auf unternehmensvertraglicher wie auch regulatorischer Ebene, die durch den gegenwärtigen Internationalisierungsprozess in der Rechnungslegung ausgelöst werden. Die Untersuchung schließt die dahingehenden Konsequenzen für das System der deutschen Rechnungslegungsregulierung und für die Rechnungslegungsforschung mit ein

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with the IFRS Adoption

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*Case Study Reports on the National Systems for the
Regulation of Financial Accounting and Reporting*

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1 Introduction

The ongoing process of accounting internationalization has always been attended by one crucial question: How much uniformity is required in financial reporting on globalized capital markets and how much accounting diversity is still necessary to reflect divergent contractual and regulatory settings on a firm- and country-level? Accounting fulfills a specific role in firm governance system and has evolved over time to meet the information needs and claims of the firm contract partners. Therefore, accounting is driven by the complex interplay with environmental and institutional conditions, especially within the regulatory infrastructure where the firm operates. This interplay builds on the notion that accounting information serves to provide coordination in a firm's nexus of contractual relationships (e.g., Coase 1990, Biondi 2007), a purpose that goes beyond merely supplying valuation-oriented information.

To control the efficient use of firm resources, contract partners from the outside (principal) in particular have the incentive to monitor management (agent) action, to link contractual claims directly or indirectly to financial accounting information and to analyze the firm's compliance with its contractual obligations (e.g., Bushman and Smith 2003). Although accounting research is not able to identify in detail the precise characteristics of an accounting system with a pure contracting orientation (AAA FASC 2006 for a literature review), it has already analytically separated the contracting and valuation objective and documented that appropriate information for contracting purposes is not necessarily qualified for valuation and vice-versa (Gjesdal 1981 with respect to stewardship and owner-management relationships, more recently Christensen and Demski 2003; Christensen et al. 2005; much earlier on more qualitative grounds, e.g. Littleton 1961, and, for an overview, Biondi 2013; first empirical evidence is provided by Gassen 2009; Fülbier and Gassen 2010).

Accounting being embedded in the firm environment has at least two consequences. First, there is no homogeneous contracting accounting objective due to firm-level differences and characteristics. A contracting focus of one firm does not necessarily conform to the contracting focus of another. Differences in financial accounting information arise because of differences in the incentive-structure and relative importance of contractual partners, and in the informational and regulatory infrastructure. Second, the national specific types of legal regulatory settings and other country-specific manifestations create heterogeneity, especially in a cross-country context. Within one country, only firm specific differences remain which are even more reduced in more homogeneous settings, e.g. within one industry or one legal form. Against this background, it may be hypothesized that national accounting systems reflect the particular contracting situation of the preparing firms in one country. From the per-

spective of evolutionary stability, they represent the efficient outcome of a long alignment process where accounting needs and accounting regulation interact with the country-specific environment. Spillover effects from other countries are also possible in this perspective. They represent the evolutionary adoption of foreign accounting elements that qualify as either compatible with the institutional setting or triggering factors for an evolutionary adjustment of the institutional setting.

Against this background, we argue that the ongoing and, from the historical perspective, rapid process of accounting internationalization and imposed harmonization comes along with the danger of distorting country-specific balancing factors in the accounting systems – especially when the national environment for economic and contractual activities is not harmonized at all. This argument refers to the contracting dimension of financial accounting where dependence on the contractual and regulatory setting is obvious. To support our argument and to substantiate the interplay of accounting as a contractual device and country-specific characteristic, we provide an in-depth case study of one country, Germany. We illustrate how the traditional German commercial law accounting system has evolved over time to meet specific contractual needs. We also demonstrate how the current process of globalization and accounting internationalization has been attended by increasing frictions and challenges, especially on the contractual and regulatory level. We finally investigate the consequences on the German standard setting system, which also includes the changing role of German accounting research.

Our paper contributes to existing studies about accounting traditions in single countries (compilations, e.g. by Previts et al. 2010; Biondi and Zambon 2013), especially about Germany (e.g., Forrester 1977; Baetge et al. 1995; Busse von Colbe 1996; Küpper and Mattessich 2005; Ballwieser 2010; Busse von Colbe and Fülbier 2013). Due to its partly historical elaboration, we also contribute to the accounting history literature about the European code law area, especially with regard to accounting principles and system development (e.g., Richard 2005; Vogeler 2005). In contrast to these studies, we concentrate on the dependence of one national accounting tradition on contractual and regulatory settings in this country and expose the respective impact of accounting internationalization. Against this background, we touch on the literature on economic consequences of harmonization and IFRS adoption effects in general (e.g., Goeltz 1991; Márquez-Ramos 2011) and with respect to specific regions or countries (e.g., Qingliang 1994; Boross et al. 1995; Laínez et al. 1999; Kikuya 2001; Ernstberger and Vogler 2008; Callao et al. 2009). Moreover, we contribute to literature in the fields of governance research and international finance, which investigate the accounting de-

pendence of governance and other regulatory factors (e.g., La Porta et al. 1997, 1998; Leuz et al. 2003, Kaufmann et al. 2009). Even literature about the cultural impact on accounting and accounting behavior is partly addressed (e.g., Gray 1988; with regard to IFRS e.g., Doupnik and Richter 2004; Nobes 2006; Kvaal and Nobes 2010; Heidhues and Patel 2011).

The remainder is organized as follows. First, we analyze the evolution of the German accounting tradition and expose the German specific contracting orientation of commercial law accounting (section 2). Then, we illustrate the challenge of accounting internationalization during the last two decades and identify some of the incremental frictions (section 3). Finally, we enlarge our analysis and investigate some material consequences on the German standard setting system, which also includes the changing role of German accounting research (section 4). A fifth section concludes.

2 Evolution of the German accounting tradition

2.1 Early developments and manifestation of a German accounting tradition

In terms of keeping organized recordings of economic transactions, the evolution of a German accounting tradition can be traced back to at least the early 14th century. The oldest extant book of accounts was opened by the merchant Hermann Wittenborg of Lübeck in 1329 and carried on by his son Johann until 1360 (Penndorf 1913). The Wittenborgs' records, like other contemporary account books, merely contain unsystematic, single entries of lending and trading transactions (Mollwo 1901) and resemble more a notebook than the outcome of systematical bookkeeping (Brown 1968).

At the dawn of the 16th century, mercantile accounting practice substantially advanced with the expanding international activities of German trading families, particularly the Fuggers of Augsburg, who adopted double-entry bookkeeping techniques that had evolved earlier in the commercial centers of Northern and Central Italy (Ricker 1967). In 1518, Matthäus Schwarz, who had become chief bookkeeper of Jacob Fugger only two years earlier, authored the first manuscript on the art of bookkeeping entitled “Dreyerley Buchhalten” (“Threefold bookkeeping”, Weitenauer 1931 with a reprint), a treatise which appears to be both descriptive and instructive (Yamey 1967). Given the numerous locations of the Fuggers' activities' throughout Europe, it is not surprising that Schwarz' illustrations particularly focus the purpose of bookkeeping to maintain control over an internationally active enterprise through gathering financial information (Kellenbenz 1971).

The birth of comprehensive legal accounting requirements in Europe goes back to the enactment of the French *Ordonnance de Commerce* of Louis XIV in 1673, accompanied by the commentary on good merchant behavior “*Le Parfait Negociant*” (1675, facsimile 1993) of the law’s scholar and expert Jacques Savary, an advisor of Finance Minister Colbert. The *Ordonnance*, often referred to as the “*Code Savary*”, legally required all merchants to keep an orderly journal and to biennially prepare an inventory (i.e. balance sheet) of their commercial assets, receivables and debts (Title III, Article VIII). Accounting records were mandated to be disclosed in case of bankruptcy; otherwise, the bankrupt tradesman was accused of intentional fraud (Title XI, Article 11). While the *Ordonnance* did not contain valuation rules, Savary’s commentary perceived accounting as being dynamic in its ability to measure performance as well as static in its aptitude in revealing pending bankruptcy. Hence it proposed valuation of assets and liabilities either at cost or their value of sale (Richard 2005; Savary 1675, 1993).

The *Code Savary* has essentially influenced commercial legislation that followed. It was not only incorporated into the French *Code de Commerce* of 1807, which spread throughout the Napoleonic Empire at the beginning of the 19th century (Walton 1993), but also served as a model for the “*Allgemeines Landrecht für Preussische Staaten*” (General Law for Prussian States) of 1794 (Ballwieser 2010; Schröer 1993; Barth 1953). The Prussian Law similarly required orderly bookkeeping (Part II, Title 8, §§ 566–607) but only provided for a balance sheet in case of bankruptcy (Part II, Title 20, § 1468). To govern mutual claims of shareholders, hence reflecting an early contracting role, it referred to an inventory with current assets valued through the “lower of cost or market” rule and fixed assets to be depreciated (Part II, Title 8, §§ 642–646).

The further evolution of accounting regulation is closely related to the political restoration of the European landscape after the Congress of Vienna in 1814/15. Following the formation of the “*Deutscher Bund*” (German Union) in 1815 and the “*Deutscher Zollverein*” (German Customs Union) in 1833, the German National Assembly called for the draft on a unitary commercial law, which was enacted as “*Allgemeines Deutsches Handelsgesetzbuch*” (ADHGB; General German Commercial Code) in 1861 and became commercial law of the German Reich in 1871. It was accompanied by a comprehensive law on stock corporations (Aktiengesellschaft, AG) and limited joint-stock partnerships (Kommanditgesellschaft auf Aktien, KGaA), issued in 1870. Around that time a legal book-tax-conformity emerged (section 2.4). According to the ADHGB, all commercial businesses were to draw up an inventory and a balance sheet at the end of each fiscal year (Article 29). Contrasting the Prussian principle, Article 31 stated that all assets shall be recognized at their “current” value at the time the

inventory/balance sheet is drawn (“nach dem Werte (...), welcher ihnen zur Zeit der Aufnahme beizulegen ist.”). As clarified by Barth (1953), “current” value – we might now say “fair” value – was solely intended as a ceiling to prevent arbitrary valuation of assets. However, it was commonly mistaken for a compulsory valuation principle. Intentional misuse of that principle led to the downfall of numerous German stock corporations between 1870 and 1873 (“Gründerkrise”) that had not been legally obliged to build up sufficient capital reserve funds until then (Schröer 1993 in more detail).

Interpretation of Article 31 was later clarified by the Reich’s Supreme Court of Commerce. The Court’s decision of December the 3rd, 1873 clarified that application of Article 31 had to follow the core principle of objectivity. Hence, the current value should reflect a general trade, i.e. market price of goods at the time the balance sheet is drawn. This decision highlighted a static accounting theory with the balance sheet primarily serving to determine a firm’s net asset position, i.e. its ability to meet obligations (“Schuldendeckungsfähigkeit”), while profit or loss was to be derived subsequently from the periodical difference in net assets. The static perception was advocated by Simon (1886), but later on challenged by Eugen Schmalenbach’s dynamic accounting theory (Schmalenbach 1919), which triggered a scholarly debate on the general purpose and content of financial statements in the 1920s and 1930s (Busse von Colbe and Fülbier 2013; Hommel and Schmitz 2013 in more detail). Schmalenbach particularly highlights the crucial role of accounting in determining business income to the firm, a purpose primarily intended to serve stewardship purposes.

Due to the “Gründerkrise”, that early form of fair value accounting was widely opposed in the following years (Barth 1953). To strengthen stock corporations’ funding and prevent distribution of unrealized profits, the Stock Corporation Law was substantially reformed in 1884. Regarding valuation, Article 185a established cost of acquisition or production as the highest attributable value of assets and required depreciation of noncurrent assets. However, valuation at cost was not mandated for other legal forms, such as limited liability companies (“Gesellschaft mit beschränkter Haftung”, GmbH), a legal form that had been originally codified in 1892. In 1897, the ADHGB was superseded with only minor changes by the new German Code of Commercial Law (“Handelsgesetzbuch”, HGB), which became effective along with a revised Civil Law on the 1st of January, 1900. For the first time, the HGB referred to the “Grundsätze ordnungsmäßiger Buchführung” (GoB, Generally accepted principles on proper bookkeeping), a leading set of accounting principles that has been in force ever since.

2.2 Major regulatory steps in the 20th century

In the 20th century, accounting regulation was substantially formed by legislative reactions to the Great Depression which culminated in the issue of an emergency decree on the stock corporation law in 1931 (“Aktienrechtsnotverordnung”). The decree stipulated a general layout for both balance sheet and statement of profit or loss (§ 261 a–c HGB 1931) as well as stricter disclosure requirements to provide a true and fair view on a firm’s financial position and performance (§ 260 b (2) HGB 1931). Most important, it henceforth demanded a stock corporation’s annual accounts to be audited (§ 262 a (1) HGB 1931), motivated by several cases of accounting fraud in large German companies (Busse von Colbe 1996).

The Stock Corporation Law was comprehensively amended in 1937 and, due to its increased complexity, separated from the HGB, which still retained general requirements (obligation to orderly bookkeeping, preparation of inventory and financial statements). Serving to maintain creditor protection, the new “Aktiengesetz” (AktG 1937) particularly emphasized the demand for (nominal) financial capital maintenance and codified German key accounting principles that still apply today. Specifically, it not only stipulated fixed assets to be strictly valued at amortized cost (§ 133 no. 1 and 2 AktG 1937, “Anschaffungs-/Herstellungskostenprinzip”) and current assets through the “lower of cost or market” rule (§ 133 no. 3 AktG 1937, “Niederstwertprinzip” which strongly reflects accounting conservatism), but also prohibited capitalization of start-up costs (§ 133 no. 4 AktG 1937) and internally generated goodwill (§ 133 no. 5 AktG 1937). Rules on the layout of balance sheet and statement of profit or loss (§§ 131, 132 AktG 1937) were largely inherited from the emergency decree, but accompanied by stricter disclosure requirements.

In the years after World War II, accounting legislation remained closely linked to the stock corporation law. It was only marginally amended in 1959 by mandating the profit or loss statement to be prepared in vertical form (§ 132 (1), (3) AktG 1959), but changed substantially with an extensive reform in 1965. The “Aktiengesetz” of 1965 incorporated two substantial innovations. Firstly, it introduced the so-called “Fixwertprinzip” (fixed value principle), i.e. rules regarding the valuation of assets below historical cost (§§ 154–156 AktG 1965), to limit the buildup of hidden reserves (Busse von Colbe 1996). Moreover, for the first time, preparation of group accounts was required (§§ 329–338 AktG 1965), yet with only domestic subsidiaries to be included (§ 329 (2) s. 1 AktG 1965). In that point, legislature had followed an earlier rule imposed by the allied forces in 1950, which demanded consolidated financial statements for German mining and metallurgy firms that had been voluntarily adopted by other industries as well (Busse von Colbe et al. 2010). Following the requirements of

the AktG 1965, preparation of group accounts became a prevalent subject in the German accounting literature henceforth (Ballwieser 2010; Busse von Colbe and Fülbier 2013).

In 1969, the obligation to publicly disclose financial statements was extended to legal forms other than stock corporations or joint-stock partnerships in the Disclosure Law (“Publizitätsgesetz”). The law was motivated by the crisis of the Krupp group, a non-incorporated steel firm that had suffered severe losses in 1966 (Busse von Colbe 1996). Until then, even large non-incorporated firms were required to prepare but not to disclose financial statements (on the German characteristic of disclosure secrecy see Heidhues and Patel 2008 in more detail). Public disclosure was and still is not essential in a contractual setting. Here, proper accounting rules exist but concentrate on the preparation of specific accounting figures, especially on the distributable and taxable income. The Krupp crisis revealed that restricted disclosure, especially for a limited number of owners and fiscal authorities, may disadvantage other contract partners such as suppliers or other creditors not having the contractual right and power to demand bilateral information. Additional accounting requirements for particular industries, such as the financial and insurance sector, followed (Ballwieser 2010 for an overview). Legal accounting requirements remained scattered across both commercial and corporate law.

2.3 European harmonization

The German Code of Commercial law underwent its most fundamental revision in 1985, when the ECC’s fourth (Accounting Directive of July 1978), seventh (Directive on consolidated accounts of June 1983) and eighth directive (Audit Directive of April 1984) were transformed into German federal law by the “Bilanzrichtliniengesetz” (BiRiLiG, Accounting Directives Act) of December 19th, 1985. Pursuing the integration of the member states’ business activities, EC legislation had aimed for a harmonization of accounting regulation throughout the European Union to acquire better comparability of financial statements. Interestingly, the fourth directive contained about 40 member state options, of which the German legislature adapted only a few to preserve traditional German accounting characteristics, especially those regarding valuation.

The BiRiLiG substantially changed the scope of the Commercial Code. As the fourth directive generally concerned incorporated firms, accounting regulation was necessarily extended to German limited liability companies (GmbH). Beyond that, it was even uniformly extended to non-incorporated firms, i.e. sole proprietorships and partnerships. Consequently, previously scattered regulation was re-unified and condensed in the Third Book of the Com-

mercial Code (§§ 238–339 HGB). The reform brought several innovations, such as the obligation to prepare a management report (§§ 289, 315 HGB), the mandatory recognition of pension obligations (Art. 28 EGHGB) and, more generally, a further emphasis of “true and fair view” as the leading purpose of accounting (§ 238 HGB). Moreover, the BiRiLiG had opened the German Commercial Code to particular Anglo-American accounting elements concerning group accounting. Most strikingly, the HGB now required the preparation of worldwide consolidated statements (§ 294 (1) HGB), valuation of investments in associates (§§ 311, 312 HGB) at equity and proportionate consolidation of joint-ventures (§ 310 HGB). It similarly highlighted the “true and fair view” principle for consolidated financial statements as well (§ 297 (2) HGB). The German Commercial Code was further amended by several specific ECC’s directives with a more limited impact. However, despite its fundamental reform in 1985 and other European harmonization steps, it has retained its conservative key accounting principles that had historically evolved.

2.4 Contracting objective and commercial law accounting as main German characteristics

German accounting tradition has evolved over centuries to meet the contractual requirements of firms’ stakeholders. In this historical context, at least four fundamental characteristics have shaped the German business environment and substantially influenced accounting and reporting regulation:

1. The minor role of (equity) capital markets and the dominance of debt financing through “house banks”.
2. The prevalence of small and medium sized entities, largely family-governed.
3. Book-tax-conformity due to a strong link between financial accounting taxation, apart from other legal uses of accounting information regarding profit distribution, capital maintenance and insolvency.
4. A stronger stakeholder orientation, particularly towards employees, due to the German corporate governance model.

We will outline these characteristics in more detail below.

2.4.1 Minor role of equity capital markets

Given the encompassing contribution of bank lending to the growth of the German economy since the beginning of industrialization, Germany is generally characterized as a

typical bank-based economy, grounded on a strong universal banking sector. It is interesting to note that the German equity capital market used to be highly developed in the early 20th century (Nowak 2001) but failed to regain its initial importance after World War II when Germany's economic restoration primarily relied on debt and internal financing while capital market activity remained weak (e.g., Büschgen 1979). Compared to archetypical market-based systems, (organized) equity capital markets seem to play nothing but a minor role even today: Between 1991 and 2010 average market capitalization of listed German stock corporations amounted to not more than 40.7 % of the German GDP, which appears inconsiderable compared to 117.9 % in the US or 132.0 % in the UK (Data provided by The World Bank). Moreover, in the same period, German corporations had on average raised more external funds through bank loans than through shares or other securities (Deutsche Bundesbank, Monthly Report January 2012). In doing so, German companies, particularly small and medium-sized ones, often tend to bond with not more than one bank, their so-called "Hausbank," on a long-term basis.

With respect to the dominance of bank lending and the subordinate role of a German equity capital market, it is not surprising that accounting requirements generally remained to be regulated in corporate and commercial law. As pointed out in 2.2, we find Germany's regulatory reaction to the Great Depression, rooted in the "Aktienrechtsnotverordnung" of 1931 and later also influenced by the AktG of 1937, primarily having aimed to prevent stock corporations and, closely connected banks, from bankruptcy by financial capital maintenance through determination of a conservative business income figure limiting dividend distribution (Baetge et al. 1995; Moxter 2007). Eventually German accounting regulation primarily evolved to mitigate creditor-related agency conflicts, which have driven accounting rules into a more conservative direction ever since. The latter is characterized by an explicit focus on the general reliability of accounting information and, above all, the core principle of creditor protection (e.g., Leffson 1987; Moxter 2003, 2007), e.g. through a consequent historical cost approach (§§ 253, 255 HGB) and a strict realization principle (§ 252 HGB). However, the principle of conservatism and prudence is much older and has substantially shaped the understanding of fair business behavior throughout Continental Europe for centuries (section 2.1).

The historical evolution of creditor-oriented accounting requirements suggests that, unlike capital investor-oriented accounting systems, German accounting regulation did not necessarily evolve to provide for an increase in capital market efficiency, e.g. through detailed disclosures or a drift towards relevance-oriented valuation. In fact, mature securities regulation did not emerge until the 1990s when the globalization of capital markets, EU harmoniza-

tion and stricter equity requirements for listed German companies (the “global players”) arose. German securities regulation even today still refers to commercial law when the preparation of financial statements is concerned (e.g., §§ 175, 176 AktG, §§ 37v, 37y WpHG). Yet we find that the aforementioned, conservative accounting principles have been deliberately broken by the Accounting Law Modernization Act of 2009, which selectively incorporated information- and valuation-oriented elements of international accounting standards into the Commercial Code (e.g. option to recognize self-made intangible assets, roughly following IAS 38 – Intangible Assets). There was, however, an attempt to leave the general contracting orientation, especially regarding the limitation of dividend distribution, unaffected. We refer to the German struggle to preserve the contracting purpose of accounting in more detail in section 3.3.

2.4.2 Dominance of small and medium-sized entities

As of 2010, according to the Federal Statistical Office’s business register statistic, 99.3 % of about 3.6 million total German businesses are rated as small and medium-sized entities, based on the EC’s SME-definition (less than 250 employees and less than 50 million EUR annual sales). Even for incorporated firms (around 632,000), the ratio still amounts to 98.8 %. In the same year the “Mittelstand” employed 54.6 % of all German employees and generated 35.8 % of total sales in Germany (IfM 2010).

While the dominance of small and medium-sized entities does not exclusively apply to Germany but numerous economies worldwide, it is yet apt to further highlight the contractual orientation of accounting information in the specific German setting. SMEs are not only smaller on average but, above all, usually not publicly listed. Hence SME-related accounting rules are predominantly expected to comply with preparers’ cost restraints and consequent cost-benefit considerations as there is no need to provide valuation-oriented information to equity investors. That rationale is frequently brought in to justify less complex SME-accounting conventions and has substantially shaped Germany’s cautious position in the general debate on the IFRS for SMEs (e.g., BDI and E&Y 2005; DIHK and PwC 2005; Haller and Eierle 2007; von Keitz et al. 2007; Sian and Roberts 2006, 2008 for overviews about international SME studies). Moreover, small and medium-sized entities are often characterized by a far closer relationship, if not identity, of ownership and management, which mitigates owner-manager agency conflicts (Berle and Means 1932; Jensen and Meckling 1976; Fama and Jensen 1983). Debt-related agency conflicts may have a much greater impact on SMEs, since they are not publicly listed and particularly depend on traditional bank financing (e.g.,

Statistisches Bundesamt 2011; Kaserer et al. 2011). In addition, a major part of German SMEs is family governed (e.g., Klein 2000), which may further emphasize a more conservative orientation of accounting: Striving to preserve themselves across generations, family firms tend to pursue a more sustainable management philosophy which alleviates the demand for continuously providing valuation-oriented accounting information. However, this notion could be stylized. More complex ownership structures, access to organized capital markets and the separation of ownership and control often change the objective of accounting and increase the pressure to provide information allowing outside owners to price their assets more efficiently (Fülbier and Gassen 2010).

2.4.3 Book-tax-conformity and other legal consequences of accounting information

The debt related focus of German accounting is traditionally complemented by its tax-orientation. Since the introduction of a legal book-tax-conformity (authoritative principle, “Maßgeblichkeit”) in Saxony 1874 (also in Bremen 1874, Prussia 1891; Schneider 2001 for a more detailed historical overview), accounting figures have been determined to reduce taxable income. This incentive corresponds with the debt-related contracting orientation by the determination of a conservative and distributable profit figure. It also strengthens the demand for reliable accounting figures due to possible legal disputes with tax authorities. The demand for reliability seems in line with accounting research arguing that contracting information should be “hard” and “difficult for people to disagree” and should, therefore, help to settle conflicts within the firm (Ijiri 1975, 36; also Biondi 2011) for the purpose of governing and enforcing firm contracts (e.g., Leuz 1996; Bushman and Smith 2003 for the prominence of reliability under the contracting perspective). Gjesdal (1981) suggests that soft information is less valuable in contractual (stewardship) settings. Although accounting research is able to analytically separate the contracting (stewardship) and valuation demand (Gjesdal 1981; also Christensen and Demski 2003; Christensen et al. 2005) the consequences for setting accounting standards remain unclear.

In addition to the book-tax-conformity, a range of legal consequences is attached to German accounting figures, albeit to single financial statements exclusively (e.g., Sellhorn and Gornik-Tomaszewski 2006). These comprise rules for minimum and maximum dividend distribution in corporate law (§ 58 (2) and § 150 AktG) and the identification of bankruptcy in insolvency law (§§ 17–19 InsO), which further emphasizes the contractual objectives of German accounting regulation.

2.4.4 Strong stakeholder orientation

The aforementioned business characteristics are complemented by a strong stakeholder orientation. German (business) culture is considered to be characterized by more “collectivism” (e.g., Hofstede 1980¹), especially with respect to employees. We find support for that notion in the historically evolved, broad regulation on the participation of employees in supervisory boards (e.g., Act on co-determination in coal and steel industry 1951, Co-determination Act 1976, One third participation Act 2004, which superseded the Work council constitution Act 1952) and a pronounced employment protection (Employment Protection Act 1951, rev. 1969). Based on the general view that there is a cultural impact on accounting (e.g., Gray 1989), the strong role of employees, among other firm contract partners, in Germany supports a more stakeholder-oriented accounting approach (e.g., Kern 1975) which also corresponds to the debt- and tax-related focus described above. Against this background, a predominantly capital market-oriented accounting doctrine, solely focusing on the demands of equity investors, has not emerged in German financial accounting. This especially applies to private SMEs and family firms, but has even applied to listed firms for a long time as well. In consequence, we find German accounting regulation in commercial and corporate law to have necessarily developed in a strong contraction orientation, whereas a valuation objective similar to US-GAAP or IFRS could not arise. Nevertheless, information- and valuation-oriented accounting elements have been implemented in German accounting regulation, a long time without interfering with contracting objectives (section 3.3 in more detail).

We note that accounting research still has difficulties in providing clear empirical evidence on different accounting objectives, such as contracting and valuation leading to different accounting outcome (e.g., Bushman et al. 2006; O’Connell 2006; Banker et al. 2009; Drymiotes and Hemmer 2011). However, we have exposed some German specific characteristics which have evolved (and proven successfully) over centuries under a German specific contracting environment. We assume that accounting rules and accounting behavior interact and reflect the specific regulatory infrastructure and the specific cultural and socioeconomic environment of German firms.

¹ Interesting to note that another cultural value dimension by Hofstede (1980), the uncertainty avoidance leads in Germany to high values and may additionally explain the (in this context also cultural driven) conservatism in traditional German accounting.

3 Challenge of internationalization

3.1 IAS/IFRS demand on globalized capital markets

In the early 1990s, some listed German global players such as Daimler Benz AG, BASF AG or Bayer AG claimed to be an “insider in the triad,” i.e. to be present on the markets in Europe, North America and Southeast Asia with production, distribution and financing activities (Liener 1992, the former CFO of Daimler Benz). One consequence was the cross-border-listing of German firms on international stock exchanges. In 1993 Daimler Benz was the first German company listed with its ADRs at the New York Stock Exchange (NYSE) and, therefore, required to reconcile consolidated equity and net income figures from HGB to US-GAAP (Bruns 1998). A couple of large listed DAX-firms followed, e.g. Deutsche Telekom in 1996, E.On 1997, SAP 1998, Allianz 2000, BASF 2000, Deutsche Bank 2001, Siemens 2001 and Bayer 2002. However, with only 22 cross-listings until 2002 (Pellens et al. 2004), the absolute number remained low. Moreover, a wave of delistings, especially after Sarbanes Oxley 2002, reduced the current number of German NYSE listings to less than a dozen (as of July 2012), which documents the unfavorable cost-benefit considerations of German firms with respect to the unfamiliar and permanently increasing administrative burden and litigation risks of US securities regulations.

Another group of listed German firms tried to show a higher level of transparency to their shareholders without taking a US-listing into consideration. Driven by the rising shareholder value orientation in the 1990s, these firms perceived International Accounting Standards (IAS) as more informative and voluntarily switched to IAS in their consolidated financial statements. Puma (1993), Bayer, Heidelberger Cement and Schering (1994) were early examples. Still required to prepare consolidated accounts according to HGB, they prepared a “dual” set of financial statements, which met the requirements of HGB and IAS simultaneously. Taken together, international accounting of German firms in the 1990s was characterized by two reporting strategies: 1) the preparation of HGB consolidated financial statements with reconciliation by few US cross-listed companies (parallel accounting), and 2) dual accounting under both HGB and IAS of a few more companies (Pellens 1997). Survey research on the attitude of German managers by that time exposes an increasing willingness to accept far-reaching changes towards internationally accepted rules, assuming a higher information value (Glaum 2000).

However, the starting position in the early 1990s was characterized by a skeptical view of German managers on IAS and US-GAAP, which were supposed to negatively affect capital

markets and encourage short-term thinking (Glaum and Mandler 1996). Prior empirical research could not prove that notion wrong. For example, Harris et al. (1994, 207) suggest that German earnings “are not as garbled as is often perceived”, based on the fact that they are significantly associated with stock price levels/returns. In addition, the explanatory power of earnings for stock market returns in Germany resembles that in the U.S. Furthermore, the vast majority of German firms, i.e. the dominant SME-sector, were not affected by IAS or US-GAAP and continued to prepare single and consolidated financial statements according to HGB, most likely due to dominant contracting considerations. On the other hand, empirical research documents significant economic benefits, i.e. a decrease in information asymmetry, for German firms that voluntarily committed to increased levels of disclosure under the aforementioned reporting strategies (e.g., Leuz and Verrecchia 2000).

After intensive lobbying of German IAS- and US-GAAP-preparers, two important acts were codified in 1998: The German Capital Raising Facilitation Act (“Kapitalaufnahmeverleichterungsgesetz”, KapAEG) and the Corporate Sector Supervision and Transparency Act (“Gesetz zur Kontrolle und Transparenz im Unternehmensbereich”, KonTraG). The KonTraG added a cash flow statement, an owner’s equity statement and segment reporting to the consolidated financial statements of publicly traded firms. It also provided the legal basis for a private German standard setting body (section 4.1), an innovation in the German code law tradition. The KapAEG introduced a de-facto-option to prepare consolidated financial statements according to IAS, US-GAAP or HGB for listed German companies if they were cross-border listed. In other words, IAS- and US-GAAP preparers were relieved of the HGB requirements for consolidation matters. In the following years the number of IAS- and US-GAAP-adopters increased. In 2001 around 36 % of German firms listed in the German stock exchange’s Prime Standard followed IAS and around 29 % US-GAAP (Zwirner 2010). It is interesting to note that already in 1997 the German stock exchange required, according to the private listing agreements for the newly established “new market” segment, IAS or US-GAAP figures to be prepared on a quarterly basis (d’Arcy and Leuz 2000). Neither IAS or US-GAAP accounting nor quarterly financial reporting was required so far by German or European law. It was more the pressure of increasing globalized capital markets and the sheer belief in some elements of the Anglo-American securities regulation philosophy which affected stock exchanges and issuers both in Germany and in the rest of Europe.

3.2 European directive 1606/2002 and implementation in Germany

Due to heterogeneous member state regulations with regard to accounting internationalization within the EU in the late 1990s, European Regulation 1606 was codified in 2002 (Regulation (EC) No. 1606/2002 of the European Parliament and the council of 19 July 2002 on the application of international accounting standards). According to this regulation and in order to standardize the regulations for publicly traded firms on the consolidated financial statement level, all publicly traded companies governed by the law of an EU member state have been required to prepare their consolidated accounts in conformity with IFRS for each financial year since 2005 (Art. 4). Moreover, the regulation has established member state options for the consolidated accounts of non-publicly traded companies and all single financial statements (Art. 5). Here, it is up to the member states to permit or require the IFRS adoption.

In contrast to EU directives, EU regulations have direct binding effect, in this particular case for the publicly traded companies concerned. As EU regulation must be entirely, immediately and uniformly enforced throughout the European territories, no transformation into national law was necessary. Only the member state options required a legal national response. For that purpose, in Germany the Accounting Law Reform Act (“Bilanzrechtsreformgesetz”, BilReG) was codified in 2004. It transformed the member state options into company options. Thereafter, for consolidation purpose, listed corporate groups have been required to apply IFRS, while other companies still *can* apply HGB or switch to IFRS (§ 315a (3) HGB). However, the German regulator restricted the option for single financial statements. Here, the HGB remains mandatory, especially due to the bundle of legal and fiscal consequences connected to single financial statements. (A second set of) IFRS accounts are allowed only for disclosure purposes (§ 325 (2a) HGB) (Haller and Eierle 2004).

3.3 German struggle to preserve contracting purposes alongside the capital markets

The IFRS application in Germany and Europe in the last two decades reflects the rise of a valuation-oriented, i.e. capital market-oriented, accounting and reporting philosophy. Given the heterogeneous institutional setting of the firms affected, this step is debatable. Empirical cross-country studies document significant differences in the economic consequences of IFRS accounting on firm and country level (e.g., Daske et al. 2008), though valuation is the primary focus. Culture seems to have an impact as well (e.g., Nobes 2006). Aside capital markets and on the single financial statement level, the more pronounced contractual considerations are likely to increase these differences (e.g., Coppens and Peek 2005; Burgstahler et al. 2006; Peek et al. 2010; Fülbier and Gassen 2010). As the particular business characteristics suggest

(section 2.4), in Germany contracting demands are of utmost relevance. And even if the IASB claims for disconnection of specific regulatory matters (e.g., IFRS for SMEs P.11) it cannot avoid misuse of IFRS. The global IFRS dominance may influence national regulators or contract partners either to use IFRS in a pure contractual setting (e.g. the EU (2001) initiative to use IFRS as a “starting point” for a common consolidated tax base for listed EU companies) or to adjust national accounting systems which originally have contracting purposes (e.g. the BilMoG reform in Germany elaborated below).

The process of internationalization of German accounting practice and regulation has mainly affected consolidated financial statements. The German regulator endeavored to preserve the HGB commercial law accounting tradition on the single financial statement level in the 1990s (KapAEG and KonTraG 1998) as well as in response to the EU regulation 1606/2002 with BilReG 2004 (Haller and Eierle 2004). This also applied to the Deutsche Börse when stock exchange listings agreements for several indices required the adoption of non-German accounting systems. Even the preparers and their managers feared negative consequences if German accounting was adapted to non-German standards (Glaum and Mandler 1996) and confined their voluntary IAS/US-GAAP adoption in the 1990s to consolidated accounts. Their single financial statements remained with the HGB. Again, single financial statements have been the major base for contracting consequences in Germany and, therefore, safeguarded against valuation oriented accounting systems. Thus, all German firms without exception have had the continuing ability to satisfy their contractual (private or legal) needs with single financial statement data.

Statistics on consolidated accounts do not support an all-encompassing adoption of IFRS either. On the one hand, approximately 1,000 publicly listed German companies, mainly parent companies, prepare consolidated IFRS accounts. Therefore, thousands of subsidiaries are affected by internal group guidelines which require IFRS accounting, also on the subsidiary level for consolidation purposes. This group of mandatory preparers is complemented by private firms that may voluntarily adopt IFRS in their consolidated financial statements. Although the probability of the respective IFRS adoption increases with size, legal form (corporations) and internationality of business activities (von Keitz et al. 2007), the vast majority of private firms does not prepare consolidated or single financial statements (Eierle and Haller 2010) according to IFRS. The option to disclose additional IFRS single financial statements next to the already required HGB statements has no significant effect on accounting practice (Küting et al. 2011).

However, we do find that accounting legislation has moderately moved the German HGB towards international benchmarks since the late 1990s². The KonTraG 1998 for example, required publicly traded firms to add a cash flow statement, an owner's equity statement and a segment report to their consolidated financial statements. Due to a wider scope of further regulatory steps (esp. by the "Transparenz- und Publizitätsgesetz" 2002, TransPuG and the BilReG 2004), all consolidated financial statements according to HGB comprise these basic financial statements regardless of their public or private nature. In addition, further disclosure requirements on notes and management reporting were enacted for single financial statements as well.

The regulatory focus on disclosure matters and consolidated financial accounts intended to moderately internationalize the HGB was abandoned in 2009. The Accounting Law Modernization Act of 2009 ("Bilanzrechtsmodernisierungsgesetz", BilMoG) marked a fundamental reform of HGB accounting which changed, among other things, material recognition and measurement rules and touched the foundations of German accounting principles. For example, the strict ban on recognizing self-made intangibles was changed into an option to recognize intangibles in their development phase if certain conditions are met (§ 248 (2) HGB), a procedure quite similar to IAS 38 – Intangible Assets. Furthermore, the aforementioned, untouchable historical cost principle as well as the strict realization principle connected to the transaction accomplishment and the transfer of risks and obligations (Leffson 1987; Moxter 2007), were diluted by a fair value measurement of trading securities required for the financial industry (§ 340e (3) HGB). These changes affect both single and consolidated financial statements according to HGB. The contracting consequences are unclear so far, but distortions can be assumed. Some of these changes were banned from tax accounting due to newly introduced tax rules which forbid the new HGB procedure (e.g., the recognition of development expenditures, § 5 (2) EStG). Some others were transferred into tax accounting and have, since then, direct consequences on taxation (e.g., the restricted fair value measurement, § 6 (1) 2b) EStG). Consequences for dividend distribution are also possible. Two fields modified by the BilMoG reform, deferred tax assets and recognized self-made intangibles, are both subject to a payout block (§ 268 (8) HGB). However, other BilMoG changes with clear income effects but without dividend payment constraint remain. Therefore, accounting rules which have been

² Our analysis sticks to the German specifics, although regulatory consequences in other countries and even on an international level can be observed. The latter for example, comprises the link between IFRS consolidated accounts, yet on a modified basis, and supervisory standards of Basel II applying to the financial sector.

originally developed to increase capital market efficiency (valuation objective) find their way into pure contractual accounting.

The BilMoG 2009 was one big commercial law accounting reform to strengthen the German regulation position with regard to the European discussion about a wider scope of IFRS and IFRS for SMEs. The latter was newly introduced by the IASB in 2009 and has been discussed on the European level as an alternative accounting system for private firms. Germany, exhibiting a strong private firm sector, strongly lobbied against a pending implementation of the IFRS for SMEs in Europe (e.g., see the German comment letter activity on EU level; EU 2010). Similar movements occurred in France, the UK and even the US. The motive is understandable: The IFRS for SMEs transfers the questionable idea of valuation oriented general purpose financial statements to private firms (Fülbier and Gassen 2010). Although private firms, acting alongside globalized capital markets, are embedded in an even more heterogeneous institutional setting, the IFRS for SMEs tend to make private firm accounting uniform and, more implicitly, to anchor the conceptual base on valuation grounds. IFRS for SMEs may be simpler than the full IFRS but remain conceptually similar. On the one hand, the conceptual orientation is laid out more or less identically in both systems (see also Bertoni and de Rosa 2010) and the IASB seems to believe that concepts and pervasive principles shall not differ between IFRS for SMEs and full IFRS³. On the other hand, the IASB refers to contracting (stewardship) in the IFRS for SMEs with a clear subordinating character (IFRS for SMEs, 2.3) and, unsurprisingly, emphasizes the distinction between general purpose accounting and the specific accounting often identified as primarily relevant for the SME setting: “SMEs often produce financial statements only for the use of owner-managers or only for the use of tax authorities or other governmental authorities. Financial statements produced solely for those purposes are not necessarily general purpose financial statements” (IFRS for SMEs, P12; see also Son et al. 2006).

Against this background, the BilMoG is an attempt to move the HGB closer to international valuation benchmarks aimed at increasing international and especially European acceptance in order to prevent the general application of the IFRS (for SMEs) system and to protect the HGB based contracting accounting tradition. It is nothing else than a balancing act between more valuation and – that’s the hope – not less contracting. This balancing act is also reflected in the explanatory memorandum of BilMoG, which declares that the “approved and time-tested HGB should be developed further to an alternative that shall be durable and adequate relative to international standards, but more cost-efficient and more simple, while main-

³ Interesting to note that – according to the IASB – an exclusive conceptual IFRS for SMEs approach „would be costly and time-consuming and ultimately futile“ (IFRS for SMEs BC97).

taining the fundamental principles of HGB: HGB financial statements shall remain the basis for profit distribution and tax accounting; HGB accounting principles shall remain unaffected” (Deutscher Bundestag 2008, Preamble A., translated by the authors). Currently, it seems too early to assess this balancing intention. Time and later ex-post research will reveal the economic costs and benefits of its implementation. Moreover, the regulatory development is still in progress: The IFRS for SMEs is in discussion on EU level and the European directives are under revision.

4 Code law oriented standard-setting system in Germany

4.1 Public regulator and private standard-setting body GASB

In opening German accounting tradition to the Anglo-American regulation philosophy, the KonTraG of 1998 has pioneered another distinct non-code law element; that is, a private standard setting body. Legally based on § 342 HGB, such a body was formed in September 1998 as German Accounting Standards Board (GASB; “Deutscher Standardisierungsrat”, DSR), GASB), governed by the Accounting Standards Committee of Germany (ASCG; “Deutsches Rechnungslegungs Standards Committee e.V.”, DRSC). However, in contrast to its common-law counterparts, the GASB has not come with any genuine standard-setting competence. Apart from providing advisory service to the Federal Ministry of Justice (FMJ) in legal matters regarding accounting regulation and the representation of German interests in international standard-setting bodies, it is only empowered to develop recommendations on the application of German generally accepted principles on proper group accounting (§ 342 (1) HGB). In that context, GASB’s activities in the first years merely comprised transcription of particular IAS/IFRS-rules into “German Accounting Standards” (GAS; “Deutsche Rechnungslegungsstandards”, DRS) to provide guidance on the accounting novelties that had come with the KonTraG (e.g., cash-flow statement). Later on, interpretations of specific HGB-requirements (esp. Management Report) were added. The scope of the GAS was not restricted to public firms, and thus transferred valuation oriented elements to the accounting practice of private firms under HGB as well. However, GAS are not legally binding in a strict sense (as indicated by the wording of § 342 (2) HGB) and due to their sole focus on group accounts, in fact irrelevant for single statement purposes.

Following the IAS-regulation 1606/2002, the GASB’s focus shifted on the interpretation of IFRS and representation of German interests, above all those of the German global enterprises, in the IASB’s due process. In the years to follow, the standard setter’s public sup-

port and funding slowly began to fade, as it was increasingly perceived to struggle with proper representation of the overall heterogeneous German interests, especially those of private firms. Eventually the ASCG resigned from its function as German standard-settings governing body at the end of 2010 to allow for a general reorientation. It was substantially reformed and reenacted one year later with two distinct functions represented by corresponding expert committees (Fig. 1).

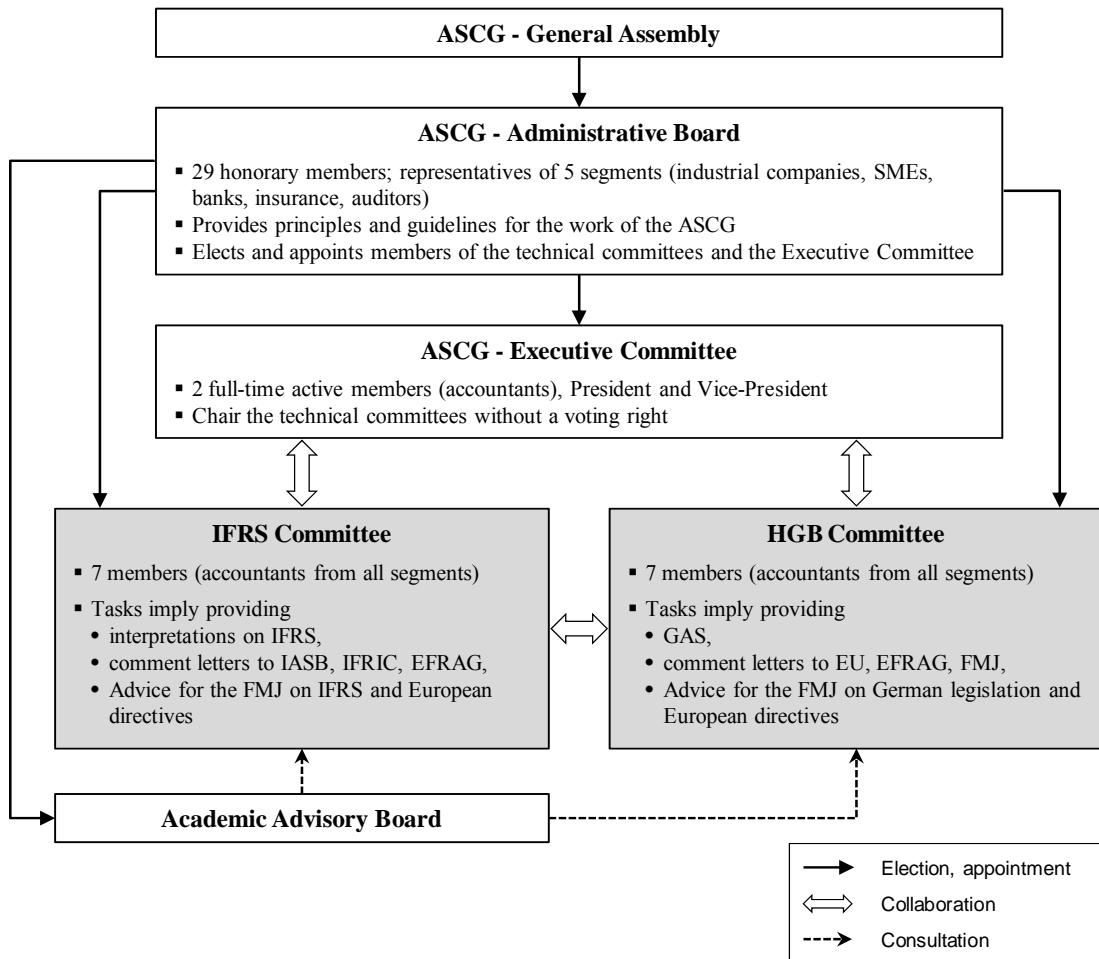


Figure 1: Organizational chart of the ASCG

Source: Adapted from DRSC 2012a. For the sake of simplicity, organizational chart elements for “Staff” and “Nomination Committee” were dropped.

The expert committees comprise a particular HGB-Committee, closely linked to the FMJ, to provide particular expertise on the (national) accounting regulation of private entities, i.e. acting in the specific German contracting setting of accounting. Secondly, an (strengthened) IFRS-Committee guide on the interpretation of IFRS and to interact with both IASB on

an international and EFRAG on a European level (DRSC 2012b) was enacted. However, both tasks do not imply a standard setting in the common-law sense.

4.2 Standard setting impact of stakeholder groups

Accounting regulation in Germany is set as statute law by the parliamentary system under the aegis of the FMJ, henceforth accompanied by the professional expertise of the ASCG (see above). Yet, parliamentary legislation is not exclusively subject to the major political forces but shaped by particular lobbying groups as well. Given the multilateral function of accounting for contracting purposes, these groups reflect a wide range of stakeholders, including, as summarized by Ballwieser (2010), industrial and trade associations (i.e. preparers), the banking community, auditors, and accounting academics who are involved in the legislative process. Accounting regulation is also in code law countries like Germany the result of a political process – in this particular respect comparable to a common law oriented due process organized by private standard setters. Academic research has been able to identify the impact of distinct lobbies on accounting regulation, but evidence for the strictly legal setting of Germany remains scarce. McLeay et al. (2000) examine the impact of constituencies' lobbying by industry (preparers), auditors and academics on legislature's decisions during the conversion of the ECC's fourth directive in Germany. They find preparers to have exerted the greatest influence on the decisions of German legislature, while academics had only limited impact. Further tests reveal that the industry's influence crucially depends on joint agreement with at least another lobby group.

Due to the aforementioned strong position of private firms and SMEs in Germany, these firms have a strong influence on the legislation process, not only due to effective lobbying of their organizations such as Bund Deutscher Industrie (BDI) and Deutscher Industrie- und Handelskammertag (DIHK), but also due to the awareness of their pivotal economic position by parliamentarians of almost all parties. This applies to bigger family firms, their pioneering entrepreneurs and their organizations as well. It can be assumed that accounting regulation has always been reviewed for its consequences for the SME-, family- and private firm-sector. This is very much in contrast to the Anglo-American sphere where public firms and the finance industry are more powerful, also with regard to accounting standard setting. In times of globalization and accounting harmonization, the German specifics are dramatically challenged. The SME-, family- and private firm-sector has suffered a significant decrease in influence on the European and international level.

4.3 Deductive legalistic accounting research under pressure of internationalization

German accounting tradition and the respective accounting environment also influenced German accounting research. This tradition emerged at the beginning of the 20th century when several business schools were established in the German language area (Küpper and Mattessich 2005; Busse von Colbe and Fülbier 2013). At the beginning, studies on general accounting purposes and objectives (accounting theories, “Bilanztheorien”; see Hommel and Schmitz 2013 for an overview) by researchers such as Simon, Schär, Nicklisch, Schmalenbach or Schmidt received considerable international attention (e.g., Forrester 1978; Mattessich, 1986, 1995; Clarke and Dean, 1986; Graves et al., 1989). This also applies to the U.S. where some papers of (and about) Schmalenbach (1933; also Quire 1937, 1965) and Schmidt (1930, 1931) were published and scholars such as Hatfield, Littleton, Sweeney and others were aware of German research (Zeff 1976; Zeff 2000; Biondi 2013). After World War II, a more jurisprudential methodology emerged when German researchers focused on the interpretation of indefinite details in the vague HGB accounting legislation (deduced from superior accounting objectives also under consideration of microeconomic efficiency) instead of developing new accounting theories or conducting empirical research. In contrast, for example, to the U.S. “normative deductivists” (AAA 1977 with regard to researchers such as Chambers or Sterling) the German deductivism was held in higher esteem at least till the late 1990s.

The rise of positive and empirical approaches in the U.S. since the 1960s (“mainstream” according to Chua 1986) further highlights the different character of German financial accounting research. It can be explained, similar to the accounting tradition itself, by the institutional specifics, first and foremost, the code law tradition in Continental Europe and the principles-based regulation in Germany, which necessitate interpretations also on an academic level. German accounting academics substantially influenced the accounting commentaries renowned in code law countries, a stream of literature having been scarcely added to by legal scholars. With respect to the interplay of accounting academia and legislation, Moxter (e.g., 2007, with further references) finds German jurisdiction having substantially drawn from scholarly tenets. In doing so, jurisdiction, more precisely the Federal Court of Finance, had not only incorporated elements of the traditional accounting theories until the 1960s, but constantly attempted to provide legal guidance in a principles-based system with reference to accounting literature. Also Moxter himself, one of the major protagonists of post World War II accounting research in Germany, has been intensively cited in the respective Court opinions (Groh 1994).

Moreover, accounting academics have participated in the legislative process through publications and contributions to the hearings of government and parliament, (Busse von Colbe 1992) although other groups, especially preparers and auditors, seem to be more influential (McLeay et al. 2000). The strong contracting role of German accounting, i.e. legal consequences such as taxation, profit distribution and insolvency being directly linked to single financial statements, have also increased the significance of this academic field, e.g. by participating in judicial proceedings as a scientific expert. Furthermore, the dominance of SMEs and the prevalence of debt financing rather seem to oppose a capital market-oriented, empirical research approach. First, there was no extensive supply of (standardized) accounting data due to *de facto* non-existent disclosure requirements outside capital markets (that changed in 2007, when an electronic business register was introduced in Germany). Secondly, given the minor role of equity capital markets, respective economic consequences appeared irrelevant for a long time. Thirdly, the HGB did and still does not exclusively focus on capital markets but a wider range of contracting objectives. Taken together, these arguments may explain the rise of capital market-oriented empirical research, when international accounting (IAS/IFRS or US-GAAP) had been introduced in Germany in the 1990s (Fülbier and Weller 2011)⁴.

The U.S. driven positive-empirical turn in the 1960s and 1970s had, at first, only a modest impact on German research. Back then, quantitative-empirical research was conducted only sporadically, generally less focused on capital markets, using smaller data-sets and less elaborated statistical models (Coenenberg and Haller 1993 for an overview). With the rise of international accounting in the 1990s, a number of comprehensive system-descriptions, -analyses and -comparisons were published (e.g., Ballwieser 1995; Ordelheide and KPMG 1995; Wagenhofer 1996; Pellens 1997). Driven by the traditional deductive orientation of German research, further literature aimed at analyzing the frameworks and basic principles as well as identifying potential inconsistencies between rules and principles. In addition, a more sophisticated capital market-oriented empirical research evolved, which concentrated on differences between accounting systems, especially IAS/IFRS, US-GAAP and HGB, in the beginning (esp. Harris et al. 1994; Leuz et al. 1998; Leuz 2003; Glaum and Street 2003; Glaum et al. 2004; Ernstberger and Vogler 2008; see also Sellhorn and Gornik-Tomaszewski 2006), but extended to all internationally relevant research questions (e.g. Daske and Gebhardt 2006; Gassen and Sellhorn 2006; Gassen et al. 2006; Daske et al. 2008; Goncharov et al. 2009; Ernstberger et al. 2012; Brüggemann, Hitz and Sellhorn 2013) later on.

⁴ The specific German research approach may further stem from institutional differences in university systems (Busse von Colbe and Fülbier 2013 in more detail).

By increasingly addressing matters of international (mainstream) research, that strand of literature has gained better access to international journals compared to legalistic-deductive, normative research, which seems to reflect a purely domestic matter (Busse von Colbe and Fülbier 2013). In the last few years, German accounting scholars have more and more become part of the international community, its congresses and leading journals. This is not restricted to empirical research, but also applies to other internationally accepted fields such as analytical modeling, behavioral accounting, critical and epistemological research, and accounting history. Moreover, an increasing unease with international rules and procedures has been identified by, but not limited to, the legalistic-deductive group. Their critique comprises, among other things, the theoretical foundations of IFRS in general or in the context of specific accounting problems (e.g., Wüstemann and Kierzek 2005), the rules versus principles debate (e.g., Wüstemann and Wüstemann 2010), the high complexity of IFRS (FREP 2011), the minor role of contracting/stewardship (e.g., Gassen 2009), the fair value measurement in general, in the contractual environment and in the financial crisis (e.g., Zimmermann and Werner 2006; Hitz 2007; Laux and Leuz 2009, 2010; Schmidt 2009; Gassen and Schwedler 2010), the privately organized standard setting (e.g., Schmidt 2002; Königsgruber 2010) and last but not least the possible IFRS for SMEs application in the EU (e.g., Eierle and Haller 2009, 2010; Fülbier and Gassen 2010).

In a nutshell, the challenge of internationalization of accounting research went hand in hand with the rise of international accounting in Germany. A delayed, yet substantial increase in empirical accounting research in the last few years has shaken the foundations and reputation of the traditional deductive-legalistic research approach. It furthermore introduced the “publish or perish” game and neglected the academic examination of HGB accounting – after all still the dominant system in German accounting practice – with unknown consequences so far. However, even the empirical approaches seem to reflect some German peculiarities, e.g., that research questions are still more applied, publications still more comprehensive (and monographic) and topics more connected to practical problems.

5 Summary

Financial accounting fulfills more than mere valuation purposes, as it plays a specific role in the firm governance system and has evolved over time to meet the accounting demands of various contractual partners and institutional stakeholders of the firm. As a consequence, accounting is on the one hand driven by the complex interplay with the institutional and regulatory infrastructure on the firm- and country-level. On the other hand, country-specific (na-

tional) accounting systems have evolved over time and reflect the specific contracting situation of the preparing firms in that country. Against this background, we argue that the ongoing process of accounting internationalization and imposed harmonization bears the risk of distorting country-specific balancing factors in the accounting systems, especially when the national environment for economic and contractual activities is not harmonized at all.

To support our argument and to substantiate the interplay of accounting as contractual device and country-specific characteristics, we have provided an in-depth case study of Germany. We illustrated how the traditional German commercial law accounting system has evolved over time to meet specific contractual needs and how the current process of globalization and accounting internationalization has been attended by increasing frictions and challenges, especially on the contractual and regulatory level in this country. We have finally investigated the consequences for the German standard setting system, which also includes the changing role of German accounting research. Our findings contribute especially to the ongoing debate about possible and not only economic consequences of accounting harmonization and IFRS adoption with respect to specific regions or countries.

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