Chapter 7

Accounting as the Documentary Proof of Good Corporate Governance*

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7.1 Handling the ‘Invisible’

According to Friedrich Carl von Savigny, the corporation is a mere fiction of law.¹ As a separate legal person the corporation (company) is ‘invisible, intangible, and existing only in contemplation of law’ (John C. Marshall).² That is the case worldwide. No one ever has seen, for example, the ‘DaimlerChrysler AG’, the ‘BHP Billiton Corp.’ or the ‘Vodafone plc’. Thus, corporate governance and the law associated with corporate governance deal with an ‘artificial being’. So, how can we deal with something ‘invisible’?

Accounting gives us the necessary and only instrument to do so: by means of the financial statements, stating in numbers and words the corporation’s assets, liabilities and performance, a picture of the corporation evolves. Such a picture is fundamentally the subject of company law and capital markets law, and it also embraces the governance of the corporation. That makes accounting the documentary proof of good corporate governance.

In this chapter we highlight basic aspects of accounting as the documentary proof of some aspects of corporate governance. Our main focus is on Germany, a country which operates within the European Community and the international legal environment. Obviously, in corporate accounting the ‘German task’ is to a large extent determined internationally, according to the evolution of accounting. We commence our discussion by having a deeper look at a key question of corporate governance: What is accounting all about?

* For the reader’s convenience, we have included English translations of some of the European provisions – see Appendix, “English Translations of Some European Provisions” for Purposes of Chapter 7” at 257–273.


² In Dartmouth College v Woodward, 4 Wheat. 518, 636 (1819) = 17 U.S. 518, 636 (1819).
7.2 Accounting Law

7.2.1 Accountability

Accounting is simply a means of reporting about ‘other people’s money’! This phrase, well known as the title of Louis D Brandeis’ book from 1914 about misuses of corporations and markets, is still at the core of today’s corporate governance standards. Since ancient times accounting has been the figurative expression of accountability. ‘Account’ (from Latin *accomp[u]tare*) means to give a counting, a reckoning of something (e.g. money). In German such an action is called *Rechnenschaft geben* or *Rechnung legen* (to make account). The noun is *Rechnungslegung* (accounting) synonymous with ‘financial reporting’, from Old French *raport* and Latin *reportare*.

It should be noted at the outset that it is those responsible for directing and managing the business of the corporation who are collectively responsible for the financial statements (accounts) of a corporation. The proposed amendment of the European Accounting Directives explicitly states:

> Member States [like Germany] shall ensure that the members of the administrative, management and supervisory bodies of the company are collectively responsible towards the company for ensuring that the annual accounts and the annual report are drawn up and published in accordance with the requirements of this Directive [(EEC) 78/660, rsp. (EEC) 83/349].

As explained in Chapters 3 and 4, Germany adheres to a two-tier board system for public companies (*Aktiengesellschaften*): a supervisory board (*Aufsichtsrat*) and a

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4 Louis D Brandeis, *Other People’s Money and How to Use it* (Stokes, New York 1914).