Transformation of Role Models: Germany, the UK and the US

This chapter sketches developments in the financial reporting systems of Germany, the UK and the US, all of which will be discussed in greater detail in Part II. These three national configurations have been selected for different reasons. All three systems traditionally display diverging goals, functions and institutional set-ups in financial reporting, which are contrasted throughout the following chapters. The US regulation focuses exclusively on listed companies, is founded on strict enforcement and provides detailed rules. The UK system has a long-standing tradition of mainly societal (community) accounting governance by the accounting profession. It focuses on capital markets, which is similar to the US system, but has a broader scope and emphasizes professional judgement instead of detailed rules. Finally, traditional German accounting concentrated more on creditor protection and on using accounting for problem-solving within firms while capital markets played a subordinate role; the system is also highly influenced by jurisdiction. The British and German systems stand for two extremes in the European spectrum of accounting systems that spans between the so-called Continental European (Germany) and Anglo-Saxon approach to accounting. This necessarily rough distinction differentiates mainly between a predominant role of equity financing (Anglo-Saxon) and of bank financing (Continental) in funding companies and has remained dominant for almost three decades in comparative accounting research (Flower 2004; Nobes 1983; 2003; Nobes and Parker 2004).

In fact, the three national configurations represent three different paths of accountancy with diverse formative institutional developments. In particular, the institutionalized role of the state in accounting differs, and there is substantial variation in the importance and function of enforcement in the respective nation states.
2.1 UK accounting: Diversity, professions and ‘fair presentation’

Financial reporting looks back on a long-standing tradition in the UK. Between the 16th and the 19th century, Britain was leading the evolution of accounting. British literature rightly claims the emergence of the ‘accounting profession’ as one of their nation’s contribution to accountancy (Flower 2004). The tradition of a strong profession, which regulates many accounting and financial reporting issues out of its own initiative, has spread not only into many parts of the Commonwealth but, for example, also to the Netherlands and the US. At the same time, this initiative from the societal actors sets Britain apart from the Continental European model.

Privately organized societies and institutes of accountants shaped the British accounting system from the 1850s by admitting and educating their members. The state applied a *laissez-faire* approach until the beginning of the 20th century and rarely interfered in the financial reporting of most commercial and industrial companies (Parker 1990).¹ Not the state but societal arrangements – mainly the accounting profession – provided the rules for preparing financial reports: in the absence of legal stipulations, the professional bodies of the accounting profession issued guiding principles for their members to promote a ‘true and fair view’ in their professional judgement. These could vary from one professional body to another (Walton 1993).

Companies Acts passed successively from 1844 did not contain any rules concerning the format or content of financial statements (Roberts *et al.* 2005). The first notable involvement of the state occurred in 1907, when company law introduced mandatory disclosures of audited balance sheets. Before, disclosure was minimal, legal rules for recognition and measurement did not exist, and auditing as an enforcement mechanism was mandatory only for a small number of companies. Generally, ‘... the company was seen as a private arrangement involving shareholders and directors, and secrecy in business matters was regarded as a virtue’ (Roberts *et al.* 2005).

State interference was augmented when the important Companies Act 1948 outlined more specific rules on disclosure. Next to the balance sheet, profit and loss accounts were to be disclosed and consolidated accounts had to be published. The Act demanded from firms a true and fair view (fair presentation) according to the demands of skilled addressees, especially investors (Flower 2004; Walton 1993). It also introduced some concrete yet basic accounting rules, such as the